08/28/2007

Back to Basics Part II - Getting a Great Home Mortgage

You’ve seen the mortgage news headlines – “Foreclosures on the Rise,” “Mortgage Rates Jump Up,” “Credit Dries Up for Home Buyers,” “Dozens of Mortgage Lenders Shut Their Doors.” All of this drama can make getting a mortgage loan in today’s market seem very scary, if not impossible. Fortunately, the truth is that there are plenty of stable lenders and loans out there. If you are considering buying a home in the near future, you would be wise to first educate yourself about the mortgage basics in order to maneuver into a great loan in a not-so-great market.

The first part of this article series discussed the importance of knowing and improving your credit score. This article focuses on the next step, which is deciding how much of down payment to provide.

The Down Payment

The traditional down payment amount was 20 percent of the home purchase price. The proliferation of unconventional loans has made it possible for borrowers today to obtain “zero down” terms. Because of the subprime mortgage troubles however, no-down payment loans may be unavailable to all but those with the best credit and you should be prepared to make some sort of down payment.

If you can swing it, making a 20 percent down payment might be a great decision. First, making a 20 percent down payment will allow you to avoid paying private mortgage insurance or PMI. If you buy a home with anything less than 20 percent down you will be required to pay PMI, an insurance policy that guarantees your lender will be reimbursed for any losses should you default and go into foreclosure. It typically adds up to several hundred dollars per year. You will be able to discontinue those payments once you earn 20 to 22 percent equity in your home, but avoiding them altogether may be more cost effective. If you must pay PMI, there is a bright side this year. PMI is tax deductible in 2007, and there is the possibility of the deduction becoming permanent.

If you do not have a full 20 percent to contribute, the larger the down payment you can make, the lower your monthly payment will be and the bigger the loan you can qualify for. If you have only 3 to 5 percent saved up, you may need to consider going with a government-sponsored FHA or VA loan.

Your down payment can come from many different sources. Of course you can save up yourself, but often and especially in today’s market, you can negotiate with the seller to make your down payment through some sort of down payment gifting program. You can also ask relatives for help with your down payment; many first-time home owners do! If you are really desperate for more funds, you can raid your 401k retirement plan or Roth IRA, if you have them.

A final consideration is how much you will have to pay for closing costs and other fees. You may need to subtract those charges from your savings for a down payment.