



### Step 3:

## Working with a Lender

A mortgage lender is a financial institution that explains your financing options, reviews or underwrites your income and credit documentation, and approves your mortgage loan so you can purchase a home. Lenders work with you to ensure that you've completed all the required paperwork and evaluate your credit history and financial health to determine whether you qualify for a loan and for what amount. Lenders provide explanations for the different options based on your qualifications. These options include interest rates, loan terms, and other loan details. When it's time to purchase a home, your lender will ensure that you have the money to make the purchase. Let's go over what you'll want to know before talking with a mortgage lender.

#### **This step covers:**

**Pre-qualification vs. pre-approval**

**Shopping for a lender**

**Basic types of loans**

**Conventional mortgages**

**Mortgage terms to know**



# Pre-qualification vs. pre-approval

## You'll learn:

**What a mortgage pre-qualification is**

**How a mortgage pre-qualification is different from a pre-approval**

**The benefits of getting pre-approved**

You'll hear the terms mortgage pre-qualification and pre-approval used quite a bit on your homebuying journey. These terms may sound similar, and they are often used interchangeably, but they can have significant differences.

## Pre-qualification

Getting pre-qualified provides you with an idea of how much you may borrow. The process is often quick and free. You'll speak to a **lender** who will collect information about your income and assets, which can be done verbally or through an online form without providing any supporting documentation. The lender will normally consider this information along with your **credit report** and provide an estimate of the approved loan amount that you'll likely receive. Keep in mind that pre-qualification is an estimate. You'll be required to submit documentation of your income and assets to your lender in order to apply for the actual loan approval. Pre-qualification can, however, provide a realistic idea of the price tags you might consider when you begin your home search. It can also be viewed favorably when you submit a contract to purchase a home but not to the same degree as pre-approval.

### Lender:

An organization or person that lends money with the expectation that it will be repaid, generally with interest.

### Credit Report:

A credit report is a statement that has information about your credit activity and current credit situation such as loan-paying history and the status of your credit accounts.

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## Pre-approval

Pre-approval lets the lender inform you as to whether you've been approved for a specific loan amount and, as with pre-qualification, it can be done before you've chosen a home. In essence it's a stronger commitment from the lender. When you get pre-approved for a mortgage, you will provide your lender with documents that prove your income and other personal financial records. The lender will do a more in-depth review of your credit history and financial standing. Pre-approval typically takes a bit longer.

## Benefits of pre-approval

Since pre-approval is a thorough evaluation of your financial health and history, it's a bigger step in the homebuying process. The lender will review your income and asset documentation and tell you more accurately whether you qualify for a mortgage. The lender will likely share other details like how much they'll lend you, the potential **interest rate**, and even an estimate of monthly payments. Additionally, pre-approval may help you when looking for a real estate agent or making an offer. It shows that not only are you serious about buying a home but also that you're financially qualified to do so.

### Interest Rate:

A percentage of a sum borrowed that is charged by a lender or merchant for letting you use its money. A bank or credit union may also pay you an interest rate if you deposit money in certain types of accounts.

# Shopping for a lender

## You'll learn:

About different types of mortgage lenders

Why it's important to speak to more than one lender

What to consider when choosing a lender

Finding the right lender can make a big difference in your ability to get the best mortgage and loan terms that meet your needs, so shop around before deciding on one. If you don't know where to begin this process, start by asking for referrals from family and friends, your real estate agent, or your local bank. It's also helpful to search online for trusted lenders and read their reviews. Here are a few tips to help you to confidently choose a lender.

## Finding a lender

Many types of lenders can help your homebuying experience. Choosing one type of lender over another comes down to your needs and what you're looking for in a lender.

## Finding a lender you can work with



### Online Lead Service

Online sites like LendingTree.com and Bankrate.com display information about multiple lenders and brokers in one place.



### Mortgage Broker

Mortgage brokers work independently from the financial institutions that lend money. This approach allows them to work with multiple lenders who can help you to find a variety of rates and loan products.



### Financial Institution

Consider speaking with a representative at your bank or credit union. Most major and local banks offer mortgage products and sometimes offer their current customers preferred rates or discounts.



### Non-Bank Mortgage Lender

If your bank or credit union doesn't offer mortgage products, or it doesn't offer a mortgage product that fits your needs, a non-bank mortgage lender is an option since many companies specialize in only home financing.

## Why it's important to shop around

This could be the largest financial investment you'll make, so be sure to shop around and speak with a few lenders to find the best fit for your situation. You can start by searching for mortgage rates online. Then, reach out to the lenders that interest you to obtain a few quotes. You'll want to compare costs and decide which ones meet your financial needs. Remember, while the interest rate you'll pay is a big factor, it shouldn't be the only factor.

## Consider the following when choosing a lender:

- ① Different types of loan options
- ② Annual Percentage Rate (APR)
- ③ Closing costs and other fees
- ④ Quality of customer service
- ⑤ How they communicate the status of your loan application (online vs. over the phone)
- ⑥ Whether they will service your loan once it is closed, or sell it to another institution

## Questions to ask a lender

When talking to different lenders, it's a good idea to have questions prepared so you can make comparisons. Here are some questions you can ask to get a good sense about whether they're the right lender for you:

### 1. How do you prefer to communicate with clients—email, text, phone calls or in person?

If it's easier for you to write everything down and read answers to questions, consider working with a lender who prefers email. Or, if you prefer to talk through things, you may choose a lender who prefers phone calls or meeting in person. While this is different for everyone, establishing and understanding a method for communicating can make the mortgage process easier to manage.

### 2. How long are your turnaround times on pre-approval, appraisal and closing?

During the homebuying process, time is of the essence. If pre-approval takes up a lot of time, this could delay looking at homes. If the appraisal has a long turnaround time, this can delay the purchase of the home and your closing date. It's important not to rush, but it's also important that a lender doesn't become a roadblock.

### 3. What fees will I be responsible for at closing?

These fees are extremely important to know upfront as you'll need to ensure that you've saved enough to cover the costs. It's also an important factor when choosing a lender as fees may vary.

### 4. Will you waive any of these fees or roll them into my mortgage?

Again, this may determine what is owed upfront, your monthly payment amount and the mortgage lender you choose.

### 5. What are the down payment requirements?

You'll want to know these requirements ahead of time so you can prepare. Also, these conditions may influence the lender you choose, especially if one lender has requirements that you can't meet.

## 6. Do you offer eClosings?

An eClosing allows you to sign some or all of the closing documents electronically, reducing the amount of paperwork that must be signed at closing. In some cases, the closing and/or notarization requirement can be fulfilled digitally, so you don't need to travel to attend an in-person closing.

To help you in the process of finding a lender, [use this guide](#) to keep track of lenders you talk to and jot down notes.

# Basic types of loans

## You'll learn:

**The difference between fixed and adjustable-rate mortgages**  
**The risks of interest-only mortgages**  
**If you might be served best by a government-guaranteed mortgage**

While several mortgage products come with different or unique features, most loans fall under a few standard types. It is important to understand these differences, especially when determining the right mortgage product for your needs since they will affect your current and long-term payments.

## Fixed-rate mortgages

A **fixed-rate mortgage** offers a consistent interest rate for the entire life of the loan, which means that your total monthly payment of principal and interest will remain the same over time. If you plan to stay for a long time in the home you're buying, or want a consistent mortgage payment amount, a fixed-rate mortgage is usually the way to go. Fixed-rate mortgages are available for various durations—e.g., 10, 15, 20, or 30 years. Loans with longer terms usually have a lower monthly payment, but a higher overall repayment amount, because you're paying interest on the amount borrowed over a longer period of time.

## Adjustable-rate mortgages

If you get an **adjustable-rate mortgage (ARM)**, the interest rate can change—and most likely will—over the life of your loan. Depending on your loan terms, your interest rate could remain unchanged for the first

### **Fixed-Rate Mortgage (FRM):**

A mortgage loan in which the interest rate remains the same for the life of the loan.

### **Adjustable Rate Mortgage (ARM):**

A mortgage loan with an interest rate that can change at any time, usually in response to the market or Treasury Bill rates. These types of loans usually start off with a lower interest rate comparable to a fixed-rate mortgage.

adjustment date, such as 3, 5, or 7 years. Then it could change as often as every six months throughout the rest of the 30-year period. While an adjustable-rate mortgage may start off with a lower interest rate, it could increase, which can increase your payments. Borrowers may choose to go with an ARM when they don't plan on staying in a home long term, or if they expect their incomes to increase in the next few years.

## Interest-only mortgages

An interest-only mortgage has an initial period of time at which your payments only cover the cost of interest, and they don't go toward the principal amount. Usually, this can mean that your payments are smaller in the beginning, and then at the end of the interest-only period, they increase significantly to include both interest and principal payments. Some may even require a **balloon payment** for the entire balance. Interest-only mortgages are less common, and they can add risk because borrowers need to be prepared for the higher payments after the interest-only period ends. In addition, you will not be building any **equity** during the interest-only period because you will not be paying down the principal amount you owe.

## Government-guaranteed mortgages

If you have income restrictions, currently serve in the military, or are a military veteran, the **Federal Housing Administration** and **Department of Veterans Affairs** offer loans with unique benefits and additional flexibilities around credit and income guidelines that could help you purchase a home. Usually, you will have a lower **down payment** and qualifying guidelines that are more flexible. Make sure to let your lender know if you think you qualify for this loan type.

# Conventional mortgages

### You'll learn:

**Why you may not need a 20% down payment**

**How you can make a fixer-upper work for you**

**Why manufactured homes might be an affordable option**

### **Balloon Payment:**

A balloon payment is a larger-than-usual one-time payment at the end of the loan term. If you have a mortgage with a balloon payment, your payments may be lower in the years before the balloon payment comes due, but you could owe a big amount at the end of the loan.

### **Equity:**

Ownership interest in a property. This is the difference between the home's market value and the outstanding balance of the mortgage loan (as well as any other liens on the property).

### **Federal Housing Administration (FHA):**

Provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories. FHA insures mortgages on single-family, multifamily, and manufactured homes and hospitals. It is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception in 1934.

### **Department of Veterans Affairs (VA):**

The Department of Veterans Affairs runs programs benefiting veterans and members of their families. It offers education opportunities and rehabilitation services and provides compensation payments for disabilities or death related to military service, home loan guaranties, pensions, burials, and health care that includes the services of nursing homes, clinics, and medical centers.

### **Down Payment:**

The amount of cash a borrower may need to pay in order to buy a piece of property; equal to the purchase price minus the amount of any mortgage loans used to finance the purchase.

Whether you have limited cash savings for a down payment, want to buy a fixer-upper, or decide that a **manufactured home** is the way to go, some conventional **mortgage** products can apply to these situations. Here are a few conventional mortgage products that can help you make homeownership a reality.

## Low down payment loans

A common misconception claims that your down payment needs to be 20% of the purchase price of the home. For example, if your home costs \$85,000, you need to have \$17,000 for the purchase. That's simply not true. Depending on the type of mortgage and your lender, your down payment can be as low as 3% of the home's purchase price. In this case, instead of \$17,000 down on an \$85,000 house, your down payment could be as low as \$2,550.

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## Loans for fixer-uppers

If you find a home you love, but it needs some renovation work or repairs, the costs might seem overwhelming. When you have a loan option that lets you combine the purchase price of a home with those other costs, you can consider more options.

## Manufactured housing loans

Today's manufactured homes are quite a bit different than those of the past. They can also become a more affordable option than a traditional, site-built house. If a manufactured home is right for you, a few mortgage loan products can help.

### **Manufactured Home (MH):**

A dwelling of at least 400 square feet and at least 12 feet wide, constructed to the "HUD Code" for manufactured housing, that is built on a permanent chassis, installed on a permanent foundation system, and titled as real estate.

### **Mortgage:**

A legal document that pledges property to the mortgage company as security for the repayment of the loan. The term is also used to refer to the loan itself.

# Mortgage terms to know

**You'll learn:**

**Why it's important to understand your annual percentage rate (APR)**  
**How points can reduce your interest rate**  
**What's included in your monthly mortgage payment**

Many mortgage-related terms may be confusing, especially as you start talking to lenders. Knowing some of these terms ahead of time can make you feel more at ease throughout the process, more confident asking questions, and more comfortable comparing options.

## Annual percentage rate

An **annual percentage rate (APR)** is an even “bigger picture” view of the total cost of borrowing money and can be useful when comparing mortgages that look similar. It reflects many, but not all, of your costs as an annualized rate. It can include the interest rate, points, mortgage broker fees, and closing costs, as well as other fees you may pay for the loan. Since these costs are included in your APR, your APR is typically higher than your interest rate. Two lenders could be charging the same interest rate, but the lender that is charging more for other fees will have the higher APR. That’s why it’s always important when comparing lenders to look at the APRs quoted and not just the interest rate.

## Points

Points come in two forms: origination points and **discount points**. Origination points are applied toward costs that lenders incur for processing, **underwriting**, and approving your loan. These points can be a percentage of the loan amount or be a flat fee. Keep in mind, if you include your **closing costs** in your loan, you will be paying interest on those costs over the life of the loan. On the other hand, mortgage discount points are purchased to lower the mortgage interest rate. The cost of a point is usually calculated in relation to your loan amount; typically, one point equals 1% of your loan amount. For example, if your mortgage amount is going to be \$125,000, then one point would equal \$1,250. If you are considering applying points to your loan, be sure to talk to your lender to determine if it is the right approach.

## Loan amortization

Amortizing a loan means paying it off in regular installments over a period of time. With each installment, a percentage of that amount goes toward paying off your **principal** and the rest toward interest. Your lender will most likely create an amortization schedule that shows how much of each payment goes toward the principal and how much goes toward interest. Typically, more goes toward interest in the beginning, with less money going toward the principal. Then, eventually, more of your payment will go toward paying off the principal and less toward interest.

### Annual Percentage Rate (APR):

The APR includes the interest rate as well as other fees that will be included over the life of the loan (closing costs, fees, etc.) and shows your total annual cost of borrowing. As a result, the APR is higher than the simple interest of the mortgage. That’s why it’s always important when comparing lenders to look at the APRs quoted and not just the interest rate.

### Discount Point:

Amount payable to the lending institution by the borrower or seller to increase the lender’s effective yield. It may represent a payment for services rendered in issuing a loan or additional interest to the lender payable in advance. One point is equal to 1 percent of the loan.

### Underwriting:

In mortgage banking, the analysis of the risk involved in making a mortgage loan to determine whether the risk is acceptable to the lender. Underwriting involves the evaluation of the property as outlined in the appraisal report and of the borrower’s ability and willingness to repay the loan.

### Closing Costs:

Various fees required to conclude a real estate transaction.

### Principal:

The amount a person borrows from a lender (also referred to as “amount financed”).

## Private mortgage insurance

If your down payment is less than 20% of the **home purchase price**, you may need to get mortgage insurance. **Mortgage insurance** protects the lender in case you stop paying your home loan, and it's typically paid along with your monthly mortgage payment. If you fail to make payments, even with mortgage insurance, your **credit score** could suffer, and you could lose your home to **foreclosure**. While it's an additional cost, it may help you get a mortgage with a lower down payment. Depending on the terms of your loan and mortgage insurance, some loans allow you to cancel the insurance once you've reached 20% equity, which could mean extra savings down the line.

**While it's an additional cost, it may help you get a mortgage with a lower down payment.**

## Mortgage payment

Your monthly mortgage payment is typically made up of four components: principal, interest, taxes, and insurance. The principal is the money you borrowed, or the amount financed. The interest is what the lender charges you to borrow the money used to purchase the home. Taxes are what you pay in **property taxes** to your local city/municipality and sometimes county. Insurance is what you pay to insure your home from damages, such as fire or natural disasters. For conventional loans, depending on your loan terms, if you put less than 20% down, then Private Mortgage Insurance (PMI) will also be included in your monthly payment until you reach the 20% equity threshold.

### Your monthly mortgage payment includes:



**Principal**



**Interest**



**Taxes**



**Insurance**

### Home Purchase Price:

The final selling price of a home.

### Mortgage Insurance (MI):

Insurance that protects the mortgage company against losses caused by a homeowner's default on a mortgage loan. Mortgage insurance (or MI) typically is required if the homeowner's down payment is less than 20% of the purchase price.

### Credit Score:

A credit score predicts how likely you are to pay back a loan on time. Companies use a mathematical formula—called a scoring model—to create your credit score from the information in your credit report. There are different scoring models, so you do not have just one credit score. Your scores depend on your credit history, the type of loan product, and even the day when it was calculated.

### Foreclosure:

The legal process by which a property may be sold and the proceeds of the sale applied to the mortgage debt. A foreclosure occurs when the loan becomes delinquent because payments have not been made or when the homeowner is in default for a reason other than the failure to make timely mortgage payments.

### Property Taxes:

The amount individuals pay to their local city/municipality and sometimes county, based on the value of their property.

Many lenders help borrowers set up a separate **escrow** account to pay for estimated taxes and insurance. This alleviates borrowers from having to remember to pay their real estate taxes and homeowner insurance premiums. Since the amount is estimated, borrowers may be billed if there is a shortage. This amount will normally adjust through the life of the loan.

**Escrow:**

An account (held by the mortgage company or mortgage servicing company) whereby a homeowner pays money toward taxes and insurance of a home.