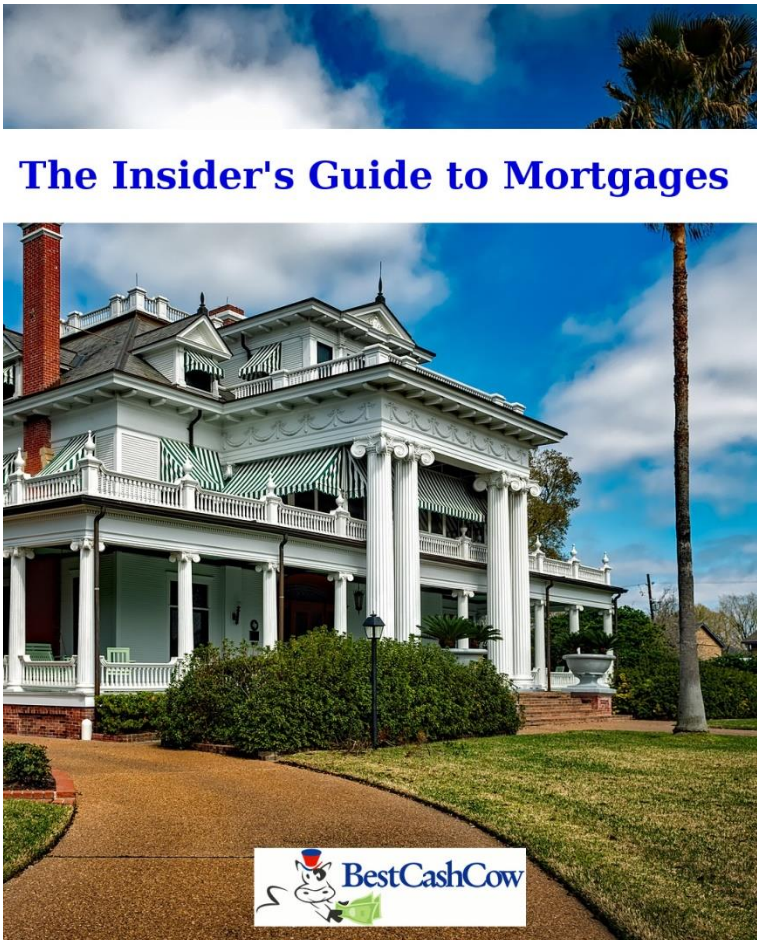
The Insider's Guide to Mortgages



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Mortgages can be incredibly intimidating. With multiple options and regulations, there is a lot of information to process and many choose to go the easy route by doing whatever program their local bank is advertising. This is how many homeowners find themselves locked into a mortgage that they can't afford with terms they don't understand. For most people, buying a home will be the greatest fiscal investment of a lifetime. BestCashCow.com wants to make sure that you are empowered to make that investment by offering knowledge and advice to guide your decision.

How do mortgages work?

A mortgage, by simple definition, is a loan for the purpose of buying a home. A borrower is charged an interest rate for the length of the time it takes them to pay back the loan. The interest rate on a mortgage is dependent on multiple guidelines and factors and can be different for everyone depending on their personal situation and the national economics at the time the loan originates.

Regulators

As with most aspects of finances, there are governmental guidelines and regulations that determine who is eligible to get a mortgage and what kind of interest rate they will pay. These regulations are set by two entities: the Federal National Mortgage Associate and the Federal Home Loan Mortgage Corporation, known as Fannie Mae (FNMA) and Freddie Mac (FHLMC) respectively. While you will never directly deal with Fannie or Freddie, your ability to be approved for a mortgage will depend on their guidelines so it's a good idea to have some familiarity with them.

Interest Rates

It's important to remember the importance of a low interest rate. Your rate will determine how much you spend in interest over the next 10 to 30 years of your life. Even a difference of an eighth of a point could make the difference of multiple thousands of dollars in the end. There are many sources online that can offer a detailed look at today's current mortgage rates. We recommend BestCashCow's mortgage comparison tool that offers updated pricing by the minute since rates can change throughout the day. Monitor rates daily as you get closer to your home purchase to catch rates at the lowest point.

While Fannie and Freddie essentially determine the average interest rate, your rate could change based on the state you are in, loan amount, down payment, and credit score. Make sure that you have this information and that it's accurate to the best of your knowledge when you are comparing rates since your rate can change dramatically if you are looking at the wrong state or a different FICO tier. You can also see rates generally shift over time based on inflation, a change in the Federal Funds Rate, or a national news event.

Rates between lenders can vary pretty significantly. Rates represent risk for the lender. The higher the rate, the more risk that loan represents for the lender. There is also a difference in rates caused by whoever is funding the loan. A mortgage broker, for example, can pull rates from multiple lenders and find the best rate, while a direct lender or bank can only look at what their current offer is. You should check with at least three lenders to find the best rate since each lender could have a different risk factor or pricing model.

"Make sure the comparison between lenders is apples to apples. Is the lock period the same? Third party costs comparable? Are there origination fees or credits?," recommends Colin Treend, Senior Vice President of Marketing, Cardinal Financial Company.

If you are having trouble comparing the individual interest rates and fees for each lender, look at the APR, or Annual Percentage Rate! APR is a tool for borrowers to compare all packages through one number and represents the actual annual cost for a loan including all additional fees. The interest rate does not take into account fees or points on a loan.

If you plan to stay in the home for a while, it might benefit you to pay additional discount points in order to drive the interest rate lower. Not to be confused with origination points that you will pay as a part of your closing fees, a discount point is prepaid interest on your loan. If the rate that your lender can offer you is higher than you want, you can choose to pay almost any number of points up front, which can lower your interest rate over the life of your loan. If you don't plan to stay in the home for a longer period, it may not be worth the upfront cost so make sure to run through the full scenario before deciding. Paying one point is equal to one percent of the loan amount.

Example:

Katie is looking at a thirty-year mortgage of $235,000 with a rate of 4.75%. Her monthly payment will be $1,225. If she pays one point, or an upfront fee of $2,350, her rate will drop to 4.625% which will drop her monthly payment to $1,207, a savings of $18 a month. If she plans to stay in the home for a little longer than 10 years, she will save overall by paying the discount points.

If your goal is to pay the least amount possible upfront, ask your lender about a rolling your fees into negative points, or a rebate. You will in turn get a higher interest rate, but will have a lesser cost upfront.

Loan Amount Limits

For the large majority of counties in the United States, any loan amount less than $417,000 is determined to be a traditional conforming loan. However there are around 230 counties in the United States where $417,000 is simply not enough to buy a home, so you need a higher loan limit. These super-conforming loans can be found in Los Angeles, New York City, Washington D.C., Denver, Boston, San Francisco, and more. For these areas, the conforming limit can go up to $625,500 allowing borrowers more opportunity to buy a home. If you live in Hawaii, the limit is closer to $650,000 or $700,000 depending on your county. If you think that you live in a higher cost area, check with your lender on your county loan limits.

You may find that the home that you want is much higher than even the super-confirming loan limits. In these cases, you will need to look for a jumbo mortgage, or any loan amount over the confirming limits for your county. Obviously, because there is more risk for the lender to take on a loan for such a high amount, there are more regulations surrounding jumbo loans:

- Your credit score needs to be much higher than average (typically over 700)
- You are likely to make a down payment of 30%
- You have the same regulations with your debt-to-income ratio so you need to have the income or assets to support the home purchase

Debt-to-income ratio

There are two different ratios that your lender will run for you during the application process: the front-end ratio will tell you how much of your monthly income will go towards your mortgage and other housing costs (like your homeowners association fees, insurance, taxes) while the back-end ratio will show how much of your monthly income is going toward debt payments. A standard guideline is that your front-end ratio should not be greater than 28% of your household income and your back-end ratio should not be greater than 36% of your household income. While you may be able to find loan programs that allow more flexibility on these ratios, it’s inadvisable to stretch your budget much farther. Keep in mind that these ratios do not include additional expenses like cable, Internet, or even your taxes so a realistic ratio should be much lower than the standard.

Example:

Kayla has a monthly household income (before taxes/ gross income) of $4,000. She pays $600 per month on her student loans. Her potential housing expenses are $1,200 per month.

To calculate her front-end ratio, she would divide her housing expenses by her monthly income, and then multiple that figure by 100.

[$1,200 (housing expenses) / $4,000 (monthly income)] x 100= ***30%***

To calculate her back-end ratio, she would divide her monthly debt payments by her monthly income, and then multiple that figure by 100.

[$600 (debt payment) / $4,000 (monthly income)] x 100= ***15%***

For this example, while the back-end ratio is a reasonable 15%, the front-end ratio is 2% higher than the maximum, which may make it difficult to be approved. Kayla should try to find additional funds for a down payment or look at longer-term mortgages in order to lower the monthly payment.

If your debt ratio is too high, it may be a sign that you should look at a less expensive home or possibly wait to purchase a home until you have paid off more debt. Lenders have these standards in place to keep homebuyers from getting in over their heads.

A non-occupant cosigner could help you qualify for a mortgage or get a better rate because they can add to your income or assets. A cosigner is not added to the home title and has no legal rights to the property, but he or she signs onto the mortgage. As a cosigner, their assets and income will be added to yours lowering your debt-to-income ratios and making your mortgage offer more appealing and less risky to lenders. If your problem is a low credit score however, they probably can't help much because lenders typically only look at the lower of the two scores. A cosigner though could help someone without a credit score or a very short credit history. You should keep in mind that if you default on the loan, your cosigner's credit would be impacted as well. This could cause a rift in relationship. For this reason, borrowers typically look to family to act as cosigners first. If you get a friend to act as your cosigner instead, you may also have to provide some sort of documentation to explain who they are, how long you have known them, and why they would want to help you. This requirement will depend on the lender.

It's also important to note that the loan amount that your lender qualifies you for may be more than you should actually spend on a home. When you go through the application process, a lender is not looking at your lifestyle expenses or taking into account the amount you need for HOA fees, additional gas or electricity expenses, or home improvements. Make sure that you look at your personal budget as well and feel comfortable with the monthly payments including all of these factors before you make an offer. You don't want to get into a situation where half of your income is going towards your housing; that expense is untenable and usually a sign of a pending foreclosure.

"Your eyes are bigger than your wallet, in most cases, and it's easy to justify a stretch budget. Resist the stretch," recommends Treend.

Why is credit history important?

Getting approved for a mortgage basically boils down to whether or not the lender can trust that you will pay back the loan. The easiest way for lenders to judge your worthiness is to check your credit score. A credit score places a numeric value on a consumer that represents the amount of risk he or she represents. A higher score means that the consumer is more likely to pay his or her bills and can be trusted borrowing a higher amount on a loan. A lower score shows that the consumer probably cannot handle borrowing a larger amount and represents a higher level of risk. As such, a credit score is built through systematic debt accumulation and repayment.

In order to get the best possible interest rate, you should strive for a high credit score. A higher credit score gives you more options in terms of what lender you choose, what loan programs you can qualify for, and allows you more flexibility when it comes to lenders regulations.

There are four basic ideas to building or maintaining a good credit score:

1. Make your payments on time
2. Keep your balance low
3. Only apply for a new credit account if you need it
4. Regularly monitor your credit report for fraud

The more established scoring classification is FICO, which was established by Fair Issac Co. in 1956 (today the company goes simply by FICO). Your FICO is calculated by a few different factors in your credit history, all having varying amounts of importance or weight on your credit score:

Payment History: 35%

Payment History will have the biggest impact on your credit score as this category looks at your overall ability to make payments in full and on time. A pattern of late payments or missing payments can quickly drag down your score.

Amounts Owed: 30%

Keeping your overall debt amount low can also greatly improve your score. In fact, a revolving history of paying off your credit card at the end of each month will probably be your fastest way of improving your credit score.

Length of Credit History: 15%

This statistic will look at the age of your oldest debt, your most recent debt, and an average age of every debt or loan that you currently have on your credit report. Ideally, your credit history should show that you have been building good credit for six to twelve months. It's important to remember that closed accounts are shown on your credit report for up to seven years. Also, opening several new credit accounts before applying for a mortgage in an attempt to raise your score could actually impact your score negatively since it will lower your overall credit age.

New Credit: 10%

This category will look at how often you open new credit accounts. If you open new credit accounts often, you could be seen as a risky investment so think twice before you sign up for every department store credit card.

Types of Credit Used: 10%

Having multiple lines of credit, such as having a credit card on top of an auto loan and a student loan, can help your score. It's good to show diversity.

To find out your credit score, you should request a credit report from the three credit bureaus: Experian, Equifax, and Transunion. Your credit report contains all of your debt-related financial information for the past seven to ten years: a list of every credit account (credit card, student loan, auto loan, mortgage, etc.), every inquiry made to find out your credit score, all public records such as a bankruptcy or foreclosure, and of course your personal information like your name and social security number. You are entitled to a free copy of your report each year. Each bureau will score your credit slightly differently, so you should always check all three reports. Your lender will use the lowest of the three scores when judging your risk factor. If you find that your score is lower than you expect, check for any inaccuracies and start the journey of credit repair.

The minimum credit score required to get a mortgage can vary for every lender. For most, lenders will look at a score of 620 as the minimum for a conventional loan provided that the borrower has a suitable down payment and a low debt-to-income ratio. For non-conventional or government loans (like an FHA loan or VA loan), lenders can go lower, but your goal should be to keep your score as high as possible in order to get the best interest rate. A high score, such as a score above 700, will greatly improve your ability to be approved, especially if you are struggling to save a down payment or still have a lot of debt.

Most lenders use the following tiers to judge your credit score:

Excellent: 740 FICO +

Very Good: 720 – 739 FICO

Good: 700 – 719 FICO

Above Average: 680 – 699 FICO

Average: 660 – 679 FICO

Fair: 640 – 659 FICO

Needs Improvement: 620 – 639 FICO

Poor: Lower than 620

If your credit is less than perfect, it’s still possible for you to get a mortgage. There are multiple loan programs that you can apply for, but you may end up with a higher interest rate because lenders will consider you a riskier investment.

Some people choose to take a different approach to credit by paying off all loans and closing all debt accounts, thereby removing all of the necessary factors that would build or diminish your score. In this way, your credit score could technically disappear. If you choose to do this, there are some opportunities to still get a mortgage, but it will be much harder than the traditional path.

The trickiest part will be to find a lender willing to work with you. Traditional mortgages require much less effort on the part of the lender so many choose to not do any kind of alternative mortgages. For mortgages without a credit score to prove the borrowers history, underwriters, the individuals who ultimately judge your level of risk, have to manually research through 12 to 24 months of alternative history records showing that the borrower can be trusted to pay back their loan. These alternative records can be rent payment history, utility bills, tuition payments, etc. This takes a significant amount of time on the side of the underwriter, so borrowers should make sure to be pre-approved before they start looking for homes. If you are having trouble finding a lender, try looking to local credit unions or lenders specializing in loans with no credit score.

A very common misconception in mortgage lending is that everyone listed on the title of the home is required to be a co-borrower on the mortgage. To the relief of many spouses', a mortgage only needs to be signed by one party provided that the person is able to qualify alone, while the home title can be deeded to multiple people. It could be more beneficial to include both co-borrowers if both incomes are needed to show that the household expenses or debt will not exceed the debt-to-income ratio limits, but it could also be beneficial to only list one person on the mortgage if the other person has a significantly lower credit score. If two credit scores are presented to a lender, they do not look at an average of the two scores, which is the common belief, but the lower of the two scores.

Example:

Ryan and Ashley got married last year. They are looking to buy a home with a monthly payment around $1,000. Ryan makes $5,000 a month, has a credit score of 780, and pays $680 a month on his student loans. Ashley makes $2,000 a month, has a credit score of 540, and pays $150 a month on her auto loan. Because Ryan has the suitable income to cover their expected mortgage and debt-to-income ratio, it makes more sense for Ryan to sign the mortgage in his name only but add Ashley to the home title. Adding Ashley to the mortgage would mean that they would have to pay a higher rate due to her lower credit score.

What are my options?

Loan Programs

The decision on what type of mortgage you will choose from could have a significant impact on your future and finances. To keep it simple, let's look at the two main choices:

- In a fixed-rate mortgage, the interest rate that you agree to pay at the beginning of the mortgage will be the same interest rate that you will pay until you pay off the house. The rate is "fixed", or will not change. With this loan, you know exactly what you will pay month to month and have a better sense of stability. This is the more popular route for homebuyers.
- With an Adjustable Rate Mortgage, or ARM, rates are traditionally lower to start, but after an initial period they will adjust based on the economic state at that time and can adjust every year thereafter. This means that the rates can fluctuate up or down rather dramatically.

So, why would you go with an ARM, where you could end up with a significantly higher and more unpredictable interest rate? While ARMs are definitely more complex, they are more flexible than a fixed rate and can offer the homebuyer a unique opportunity that is not available with the rigid fixed-rate mortgage. ARMs start with a lower rate than a fixed-rate mortgage, which means you could have a lower monthly payment and be able to afford a bigger home. You also can enjoy a lower rate later into the loan term if interest rates drop. With a fixed-rate mortgage, you would have to refinance in order to take advantage of a lower rate environment.

Ed Powell of GoodMortgage.com adds, "Very few folks hold on to their loans or their individual homes for more than 7 years so I would say folks should be looking [more] at 5 and 7 year ARMs."

The hybrid ARM is the most popular option when you look at adjustable rates mortgages. The hybrid allows a longer fixed initial period (three years, five years, seven years, or ten years depending on what your lender offers). This option is ideal for buyers who know that they will be moving or those who expect a large pay increase before the fixed period is over. However, the risk is that the borrower can't sell the house or plans and circumstances change leaving the borrower with a loan that could adjust to a higher rate.

First Time Buyer Programs

If it's your first time buying a home, there are multiple programs available to help get you into a home. These programs can offer lower down payment requirements or flexibility in terms of credit score. Tell your lender if this is your first home purchase.

If you are having a hard time getting approved for a conventional loan, FHA might be a good option for you. FHA, or Federal Housing

Administration, loans are backed by the U.S. Department of Housing and Urban Development, making lenders more comfortable accepting a loan from someone who has less than perfect credit and a lower-than-average down payment. This is especially helpful for first-time homebuyers. As you would expect, an FHA mortgage traditionally has more fees and the interest rates are higher.

A VA loan is available to all veterans, service members, and surviving military spouses and has a myriad of benefits. The biggest benefit is that you can be approved to buy a home without a down payment and without paying mortgage insurance. While it's a more complicated loan to be approved for and rates are traditionally higher, a VA loan is a great benefit to help past and present military personnel to get into a home.

Terms

After you decide what type of mortgage program you want, you will also need to determine what length, or term, is best for you. The biggest factors to think about when choosing a loan term will be your budget and the interest rate. The shorter your term, the more you will pay on a monthly basis but you will pay off your loan significantly faster saving you thousands of dollars in the long run. The longer your term, the lower your monthly payment but you will end up paying more in interest over the life of the loan.

The term that you choose is also partially based on what your lender offers. The two most popular choices are a thirty-year or a fifteen-year term, but lenders are becoming more and more flexible for borrowers looking for a specific term.

If you choose an ARM, you also have to think about what your initial fixed period will be and how often your rate can adjust thereafter. While the overall ARM length is traditionally 30 years, the initial period where rates are fixed is usually just a small portion. A 5/1 ARM, for example, has an initial fixed rate period of five years and then adjusts everyone one year thereafter. Other popular ARM products are the 3/1 ARM, 7/1 ARM, and 10/1 ARM where the fixed rate period lasts three years, seven years, and ten years respectively. This is also where ARMs can be extremely flexible because you can choose longer or shorter terms for the fixed period, overall length of the mortgage, and even the timing between adjustments.

Property Types

Your options can also change depending on the type of property you plan to purchase. If you plan to purchase a condo, for example, you may incur a different interest rate than if you were to purchase a single family home. You could also see a higher interest rate or find it more difficult to be approved for a second home, vacation home, or investment property because they are considered non-conforming properties and are not covered by Fannie Mae or Freddie Mac. You may also have trouble finding a lender that is willing to offer a loan for mobile homes, or manufactured housing, since those property types are not worth as much if you default on your loans.

How much money do I need?

Down Payment

Most people find that the biggest struggle to get a mortgage is saving up the down payment, which is the collateral amount that you can pay upfront to the bank when you close on your home. The bigger the down payment, the better chance you have to get approved for a low rate on a loan. A general rule of thumb is to have at least 20% of the home's value for the down payment, leaving the necessary loan amount at a maximum of 80% of the price of the home; this ratio of loan amount to the property value is called the loan-to-value ratio (or LTV). For example, if you are purchasing a home for $200,000, then you should be prepared to make a down payment of $40,000. If you are looking at purchasing a home in a higher cost area (Los Angeles, New York, San Francisco, etc.), having a down payment of 20% can be especially hard to save up considering that you could easily need a down payment of $100,000 or more for a $500,000 home. Buyers should also be aware that a jumbo loan could require you to have a minimum down payment of 30%.

If you don't quite have the full down payment, it is still very possible for you to be approved as long as you have a minimum of 3% to offer, the minimum down payment for a Fannie Mae loan. Buyers should be aware that lower down payment programs typically come with Private Mortgage Insurance, or PMI. PMI protects the lender in case the home loan ends in a foreclosure since there are additional risks involved. You are required to pay PMI as an additional fee added into your monthly payment until you have paid off at least 20% of the home value. The PMI fee can vary based on your loan criteria but is usually 1.5% or less of the original loan value per year.

It's typically not a good idea to use your entire savings for the down payment. Many home buyers want to put down as much as possible in order to get the biggest home possible or to pay their home off faster. However, if you are forced to use all of your savings for the down payment in order to get the home, you may not be protected in case of an emergency, which significantly increases your risk of having to declare bankruptcy or foreclosure. Make sure that you set aside a healthy emergency fund to cover for any unforeseen issues as well as a separate fund to cover other costs associated with the home purchase such as closing costs, third party fees, moving expenses, new appliances, or repairs that need to be done before you can move in.

"Guidelines generally require 6 months cash reserves; I would say first time home buyers are better off with at least one full year of reserves," recommends Powell.

Veterans have the option of a V.A. Loan that has the added benefit of no down payment required. Farmers and some qualified individuals living in rural areas can also find no down payment loans from the Department of Agriculture.

Closing Costs

Closing costs are the fees charged to cover the cost of the final real estate transaction and are to be paid on the day of closing. They can vary state to state, but generally average between 3-6% of the loan amount.

“Most first time home buyers only focus on the down payment, when in reality, title is where a majority of the closing costs come from and that is not covered by the down payment,” said Geony Rucker, a loan officer at CapWest Mortgage.

Make sure that you know about every closing cost and have the payment in hand when you close or you could face delays in moving into your home. Within three days of submitting your mortgage application, your lender is required to give you a formal Loan Estimate. This should be a three-page document and will contain a detailed list of all closing costs and associated services. Closing costs can include a credit report fee, attorney fees, an appraisal fee, taxes, plus more depending on your state and county.

This Loan Estimate should be compared to the Closing Disclosure that you receive three days before you close to make sure that the details of the loan match. Catching a mistake could save you time and money at the closing. You also may find that certain closing services are flexible allowing you to find other, cheaper companies to perform them. As you get closer to finalizing your home purchase, every little bit of savings can help.

Another option if you don’t want to pay closing costs is to ask the seller to cover closing costs as a condition of sale. Some buyers also may be able to wrap the closing costs into their loan to save on the immediate out of pocket expense. You could also save some money on the prepaid interest by closing at the end of the month rather than the beginning, since you are required to prepay all interest for the remainder of month in which you close. You may be able to save on title insurance through a re-issue rate, or carrying on with the current owner's title insurance if they purchased the home in the past ten years. In a refinance, you may be able to waive the appraisal completely if your home has been recently appraised.

How do I choose a lender?

Finding a good lender has a huge impact of your mortgage experience. There isn't a definitive rule for to choose the best lender, but it depends more on what you want as borrower. If you have gotten a mortgage before and are familiar with the experience, you may want a lender who will be very simple, manage the paperwork, and call you if there are any problems. If this is your first mortgage and don't feel confident to make a decision on your own, you may need someone more involved that can guide you through the process. There are both types of lenders out there, you just have to find them.

Your local or home bank is typically the first stop when you are looking for a mortgage. Though you may receive some kind of relationship discount for opening a mortgage with the same bank that holds your checking account, you may end up spending much more than that in interest over the life of your loan because you didn't spend the time doing research.

"I really think consumers should talk to multiple lenders to get an understanding about what options they have, which company, and loan officer will be the best fit for their needs," says Powell.

Your loan officer can be your best resource in deciding what mortgage offer is best for you. He or she will identify issues early, find additional options, and can guide you through the process. That being said, you should also make sure that you understand all of the options and terms of your mortgage. Don't assume that your loan officer is choosing the best option for you and sign a contract that you don't fully understand. For most, a mortgage is the single biggest financial decision of your life. A loan officer doesn't understand all of the aspects of your life.

When you are comparing different offers, look at the overall cost of your mortgage, with fees, interest, and principal included, in order to find who is offering the lowest deal. If you feel like the loan officer is not being honest, ask for full transparency about how the commission structure works. If he or she is unwilling to answer, that may be a sign that you are about to be overcharged.

What questions to ask a loan officer

The best way to determine if a lender is trustworthy is to have an honest conversation about your finances and ask questions.

"You'll have to be working with them for the next 45 days, so the more questions you ask up front, the better you'll be able to feel out how knowledgeable they are and how hard they'll be willing to work for you," said Geony Rucker, a loan officer at CapWest Mortgage. "When a lender chooses to go above and beyond what is required of them, that is the lender you want to choose."

Here are other questions that you should ask a potential lender:

1. What are your minimum requirements for credit score, loan amount, loan-to-value, debt-to-income ratio, etc.?

   The minimums can vary lender to lender.

2. How do you prefer to communicate with borrowers? How long does it typically take for you to respond to questions?

   Their preference should coincide with your preference. A lender that prefers phone calls and in-person meetings may not be the best option for someone who can't take time away from work. Some borrowers may need a lender that can be available after hours, on weekends, or via text and email to answer questions.

3. How long does it typically take for you to take a borrower from application to closing?

   This can be an extremely important question if you need a fast closing in order to get the house you want.

4. What fees will I be responsible for at closing?

   Origination and third-party fees can also vary by lender. You should also ask if the fees can be wrapped into the loan or if they will be required up front.

5. Are you licensed in my state?

   Mortgage brokers are typically only licensed in a few states, so if you are looking to get a mortgage because you are moving to another state, make sure that you are contacting a company that can help you. There is nothing worse than going through the preapproval process only to discover that you called a lender who is not licensed in your state.

6. Do you have an online platform where I can track my mortgage application?

   With today's technology driven culture, many mortgage companies can offer an app or online platform that allows you to submit documents and track your application status all the way to approval. These platforms can be incredibly helpful to make sure that you aren't missing any required documents, respond to any issues immediately, and monitor your application process.

Lender Recommendations

Online reviews and recommendations from family and friends can also be extremely helpful, but make sure that you are getting a full picture. If online reviews don't contain any negative feedback, they probably can't be trusted. Also, be wary of recommendations from your real estate agent. Some agents make reliable recommendations, but there are a few that make a deal with a specific lender to share clients, so it may be a recommendation based more on incentives for the real estate agent rather than an honest effort to get you the best lender.

The great news is that you are not tied to a specific lender. If you are pre-approved with a specific lender and then find a better rate or a better lender elsewhere, you are under no obligation to stay with your original lender until the contract is signed.

What is the application process like?

Prequalified and Preapproved

Step one in your mortgage application process is to get prequalified with a lender. You provide a lender the details of your income, debt, credit score, and assets and the lender will in return give you a calculated estimate of what you can actually afford. This is usually done at no cost to you and offers a professional opinion before you get too far in the home search process.

If you want to go a step further, getting preapproved for a mortgage will be an added bonus for home sellers giving you an advantage over other buyers when you finally make an offer. In a preapproval, the lender will go through the process of income verification with your employer, run your credit history, confirm your overall net worth, and you walk away with a verified letter from your lender to show home sellers that you can qualify for the home loan. Home sellers like preapproved buyers because there is a better chance the sale won't fall through later due to a mistaken credit score or bad debt. Because this process is more in depth, preapproval usually requires a small fee, but it's often refunded at the home closing.

"A preapproval can give you a little extra leverage when making an offer on a home," said Tachiana Bumbalough, Demand Generation Manager at First Internet Bank.

If a home seller is presented with two offers, it is not uncommon for them to accept a preapproved, lower offer because there is less risk for something to fall through at closing.

You aren't required to stick with the same lender that you were preapproved with, so you can use the preapproval process as a test drive of the actual loan application. Once you've meet with several lenders, gather all of your necessary documents and submit them to the lender. They will take it from there.

Locking a Rate

Once you have an accepted offer on a property, you need to lock in your rate as soon as possible. Once you have found a lender and you think the rate is low enough, request the lender to lock your rate. This means that you will start the application process with that lender thereby placing a hold on that particular rate and point scenario. If rates go up before you close, it doesn't matter because your rate is locked and will not change.

You will need to determine a rate lock period in which you agree that the loan will close. This could affect the interest rate a bit as well. Lock periods can vary from 10 to 60 days. Generally a lower lock period means a lower rate bump, however it may not be realistic for you to close in 10 or 30 days depending on your state regulations. Ask your lender for advice on how long your rate lock period should be.

At the end of your rate lock period, your goal is to have your loan closed and the keys to your new home. Through no one's fault however, there could be delays in paperwork, getting an appraisal, or, a necessary repair in the home. If you are nearing the end of your rate lock period and it looks like you won't be closed in time, check with your lender on an extension. Sometimes your lender will extend your lock period with a small fee.

Loan Documentation

The Uniform Residential Loan Application, or form 1003, is the standard form for mortgage loan applications and requires a two-year job history, a list of all assets (property, retirement accounts, savings, life insurance, and investments), and all of your debts (student loans, car loans, credit cards, etc.). Knowing all of this information ahead of time can be a big time-saver when you are meeting with a lender.

Most homebuyers can easily tell a loan officer what their annual or monthly income looks like, but for those who are self-employed or work multiple jobs, this may be harder to document. Those who are self-employed or have their own business may be required to submit the last one to two years of federal tax returns, profit and loss statements, and possibly a business license. If you are a traditional employee that receives W-2 statements, you should supply your lender with the last one to two years' worth of W-2s and the most recent pay stub as proof of income. You should always include all of your income including bonuses, overtime, second jobs, commissions, child support, alimony, and additional benefits.

Online Applications

It’s an exciting time for mortgages as traditional avenues for finding a home loan are being overtaken by the highways of online media. Of course there will always be the traditional loan officer/ borrower relationship, but the relationships are now being built over email and text rather than face-to-face interaction. There are now many banks that are fully online. It’s become commonplace to not meet your lender in person until closing.

Many lenders utilize technology to offer online applications that buyers can fill out at home on their own time. This can be a huge asset to someone who works long hours or needs more time to gather all of his or her documentation. Online applications are completely safe and usually are protected through multiple firewalls since you have to share your social security number. Many online lenders even have a support staff available 24-7 through chat services so that you can ask questions if you get stuck.

Closing

Mortgages can be tricky and complex, but there are so many options that almost everyone can find something to fit their lifestyle and budget. When you are trying to find the right fit for you, look at your budget, think about your future plans, and decide what option is best for you.

Finding the best loan for you doesn't have to be intimidating. Be prepared by doing your research, comparing mortgage rates and options online using comparison tools, and meeting with several mortgage lenders.