

## **Work Samples Series**

### **The Assignment:**

MarshComm was asked to write a series of consumer-focused articles to be used by RBC Mortgage loan officers for placement, in their name, in local publications or used with prospects and clients as direct-marketing pieces.

The articles provide useful advice and information to consumers as a means to position the loan officers as industry experts and, as such, to help increase their business.

The series focused on providing detailed information and background on mortgage products and services to help consumers understand their options and make the right choice for them.

## **How to Choose the Best Mortgage for You**

Understanding your array of options, and answering questions about your financial goals and expectations, are the keys

So you've decided to buy a home. And you've done your homework – calculated how much you can afford; checked your credit report/score; gathered your necessary documents; chosen your lending professional; and gotten prequalified or preapproved. But you still can't decide what type of mortgage is best for you. You're not alone.

Deciding on the financing for the single biggest purchase you'll ever make is often the most wrenching step in the mortgage process. The array of mortgage products available today is extensive. But by better understanding your range of options, and by answering a few questions about your financial goals and expectations, you can choose the mortgage best-suited to your needs.

### **A Review of the Typical Options**

A quick review of the typical available loan types, and the benefits of each, is a great place to begin.

The industry standard remains the 30-year fixed-rate mortgage. With a 30-year fixed, your payments are spread over 30 years, and your interest rate and payments are fixed – they remain the same – every month for the entire term. Your payments are lower than they would be with a shorter term loan, but you pay thousands of dollars more in interest over the period of your loan. The good news is that mortgage interest is 100 percent tax-deductible.

In recent years, the 15-year fixed-rate mortgage has become more popular. In exchange for higher monthly payments, borrowers pay a lower interest rate than with a 30-year loan (typically, a quarter to a half point lower). However, because the interest portion of your monthly payment is lower, so too is your tax deduction. The major advantages of a 15-year fixed is that you save thousands of dollars in interest costs over the life of the loan and pay off your mortgage in half the time of a 30-year loan.

An adjustable-rate mortgage (ARM) is a short-term loan (typically seven years or less) that offers significantly lower interest rates than standard fixed-rate loans. Because the rate “adjusts,” or changes periodically, based on a standard financial index, there is a certain amount of risk involved. However, most ARMs have caps on how much an interest rate may increase. Generally, if you plan to live in the house you’re buying for less than seven years, and you want to keep your payment to a minimum, you’re better off with an ARM.

You must also consider the points attached to the loan. Points are the fees paid on a mortgage loan; one point is equal to 1 percent of the loan amount. For example, three points on a \$100,000 loan would be \$3,000. Points typically are paid out-of-pocket at closing by the buyer. As with annual mortgage interest, though, for most home purchases (not including refinancings, which are handled differently) points are totally deductible in the year they are paid. And in most cases, you’ll qualify for this deduction even if the seller pays the points. Check with an attorney or tax accountant to discuss your specific circumstances.

## **New Options Gaining in Popularity**

Joining the mix of options in recent years are a number of high loan-to-value (LTV) – low- or no-down payment – loans. First, lenders began offering mortgages for up to 95 percent of a home’s value, leaving only a 5 percent down payment. Then came the 97 percent LTV mortgage. Now, qualified borrowers can get a mortgage for 100 percent of the value of their home – or even more, if they want to finance the closing costs as well.

However, these low- and no-down payment mortgages come with a somewhat higher interest rate than the loans available to those who can put down between 10 and 20 percent. But, again, mortgage interest is fully tax-deductible, so that might not be a big concern.

More important, though, is that anyone who puts down less than 20 percent must pay private mortgage insurance (PMI), which is required by lenders to protect them in the event of a default on the loan. PMI typically adds a 0.5 to 0.75 percent premium to your interest rate. For example, on a \$100,000 mortgage, PMI would tack on an extra \$42 to \$63 per month in costs. Only after you have built 20 percent equity in your home can you cancel PMI.

The most popular recent addition to the mortgage mix – especially in the current low-rate environment for refinancings – is the no-fee loan. With a no-fee loan, the lender pays most or all of the fees for the borrower – saving thousands of dollars in up-front, out-of-pocket costs – but the borrower must pay a higher interest rate (typically between .25 percent and .5 percent) on the loan.

## **Answering Some Critical Questions**

Now that you’ve reviewed the options, it’s time to ask yourself a few questions to help you narrow your focus to the mortgage that most closely matches your needs.

### **1. How long do I plan to stay in this home?**

If you plan to stay in your new home less than seven years, you might try to match an adjustable-rate mortgage to the length of time you’ll be in the home. For example, ARMs are available in 1-year, 3-year, 5-year or 7-year loans – at significantly lower interest rates than

fixed-rate loans. There is also a 7-year balloon mortgage, so-called because at the end of the seven-year term, a “balloon” payment for the remainder of what you owe on the house comes due.

If you will be in your home longer than seven years, you’re probably a better candidate for a 15-, 20-, or 30-year fixed-rate mortgage (yes, there is a 20-year fixed, though it’s not exceedingly popular).

## **2. How much money do I have for a down payment?**

As we mentioned earlier, lack of money for a down payment is no longer an obstacle to homeownership. Nowadays, qualified borrowers can finance 100 percent or more of the purchase price, but you’ll pay a higher interest rate for a high-LTV loan. As a general rule, though, you should put down as much as you can afford, for a couple of reasons. First, if you’re able to put down 20 percent, you can avoid the much-reviled PMI. Second, whatever you put down is instant equity in your home and, even if it’s not quite 20 percent, it will allow you to reach that critical 20 percent threshold sooner – and cancel PMI sooner.

## **3. When do I want to finish paying off my mortgage?**

Some homebuyers, especially younger, first-timers, often don’t give this question much thought. But homebuyers in later stages of life – with kids nearing college age; themselves edging toward retirement or considering buying a vacation home – may have numerous reasons for wanting to pay off their mortgage sooner.

Most people who want to cut the term of their mortgage simply opt for a 15-year fixed over the traditional 30-year fixed. In doing so, you can get an interest rate of .25 to .5 percent lower and save thousands of dollars in interest over the term of your loan. But you will face a higher monthly payment – and a lower annual tax deduction.

For many, though, the 30-year fixed is still the gold standard.

## **4. How well do I tolerate risk?**

This question goes to the heart of whether an ARM is the right type of mortgage for you. If you’re comfortable with risk and can flow with market changes, an ARM may be right up your alley.

However, even if you know you'll only be living in your home for seven years or less, if you're not comfortable facing the prospect of fluctuating interest rates – and a fluctuating monthly mortgage payment – you may be better suited for a fixed-rate loan.

Be true to yourself on this one.

**5. What's more important to me: A lower payment or building equity?**

If you're intent on rapidly accumulating equity in your home, a 20-year – or even better, a 15-year – fixed-rate mortgage is the way to go. More of each payment goes to the principal of the loan, thus building your equity.

If keeping your monthly payment low is your goal, then a 30-year fixed, or an ARM of any term (in a low interest-rate environment), would accomplish this.

**6. What is the current interest-rate environment, and where are rates headed?**

This isn't so much a question to answer yourself, but a topic to follow in the news leading up to getting your mortgage. Keeping abreast of rates could help you decide whether to lock in a longer term fixed-rate loan (if it appears that rates are about to rise) or instead go with a short-term ARM (if it looks like rates are fairly steady or might fall even more).

Fortunately, the current rate environment presents an almost “no lose” situation for any type of mortgage you choose. Mortgage rates have fallen steadily through the summer from already historically low levels – reaching a 35-year low in August. According to Freddie Mac, the national average rate for the standard 30-year-fixed mortgage was 6.27 percent for the week of August 22; for the 15-year fixed, the national average rate was 5.71 percent.

In short, from a cost perspective, there's no better time to get a mortgage than now. Whether you lock in a fixed-rate loan or go with an ARM – even if rates rise or fall a few tenths of a point – you will have gotten a better deal than at any time in a generation. You just can't beat that.

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