

Financing Overview

To purchase residential real estate, borrowers typically take out loans. Most loans are fully amortized, meaning that they are paid off in equal monthly installments that reduce the principal over time. The process by which borrowers are considered for loans and, if qualified, receive them is called underwriting. Underwriters consider the quality, quantity and durability of an applicant's income and his or her net worth, credit, debt and source of funds. Borrowers qualify for most loans on the basis of two ratios: the total housing expense to income ratio and the total debt service ratio. The three most common types of loans are conventional loans, FHA loans and VA loans.

Conventional loans are those loans that are neither guaranteed nor insured by the federal government. Conventional loans are categorized by whether they conform to FNMA ("Fannie Mae") guidelines for secondary market sale or not. These latter are called non-conforming or jumbo loans. Most conventional loans are fully amortized loans. They generally have a 28%/36% (total housing expense/ total debt service) ratio requirement, but lenders can set these ratios higher for subprime borrowers. The Fannie Mae underwriting guidelines are designed to decrease the risk of default by increasing the lending restrictions on high LTV loans and to make conventional loans uniform and comparable for sale on the secondary market.

FHA loans are insured by the Federal Housing Authority, which Congress created as part of the U.S. Department of Housing and Urban Development (HUD). The FHA program was designed to encourage homeownership and anyone who is either a U.S. citizen or holds a valid U.S. green card may apply. The cost of the FHA insured loan is the Mortgage Insurance Premium, consisting of a one-time up-front fee of 2.25% of the loan amount and an annual MIP payment that varies in accordance with the length of the loan term. The FHA sets certain limits on the loans that it insures, including a stipulated maximum loan limit, down payment requirements and income qualifications. Borrowers are required to have at least a 3% investment in the property they are purchasing and may not have a total housing expense to income ratio in excess of 29% or a total debt service ratio in excess of 41%.

VA loans are loans guaranteed by the Veterans Administration and the federal government. They are only for veterans of foreign wars, current servicemen and women and a select group of others. The VA reimburses lenders up to \$60,000 in the event of a veteran borrower's default. The cost of this guarantee is a one-time funding fee, which varies inversely as a function of the borrower's down payment. The VA sets limits on allowable closing costs and requires that sellers pay the amount of any overages at closing. It also requires that properties be appraised by the Administration and receive a Certificate of Reasonable

Value. Any amount of the appraisal value that exceeds the sale price must be paid as a down payment. VA loans are fully assumable, but only by borrowers who meet all the VA eligibility requirements.

In addition to the three most common types of loans, VA, FHA and conventional fixed-rate loans, there are several other loan payment plans available. One important loan type of this sort is the Adjustable Rate Mortgage or ARM. ARM's have an initial interest rate generally below conventional rate loans that is adjusted periodically on the basis of the fluctuation of some economic indicator, an index, stipulated in the loan to which the lender adds a percent called the margin. ARM's typically have either a rate cap or a payment cap for either the adjustment period or the term of the loan, or both. Other loan payment plans are often variations on the conventional loan and can have increased payments over time like a Graduated Payment Mortgage or a Temporary Buydown; an increasing interest rate, as with a Growth Equity Mortgage; or a decreased rate, as with a Permanent Buydown.

The formal process by which ownership of real property passes from seller to buyer is known as closing. The loan and purchase process is governed by several government acts, including the Real Estate Settlement Procedures Act (RESPA), the Federal Fair Credit Reporting Act and the Equal Credit Opportunity Act (ECOA). A real estate professional must be familiar with the provisions of these acts in order to avoid violating the law.

Closing costs are many and varied. They include lender's fees and fees unassociated with the lender and run between 2.5 and 4 percent of the total amount financed. Fees must be paid to lawyers, couriers, homeowners' associations, insurers, inspectors, appraisers and a myriad of others. Lenders typically charge a loan origination fee for originating a loan, a mortgage broker fee for processing, a credit report fee for obtaining a credit report, a tax service fee to ensure that a property's taxes are current and other fees from services in the course of closing.

To learn more about the lending solution that would work best for you, please contact Stephanie Lawrence with Village Real Estate Services at (615) 554-3745 or by e-mail at Steph@NestingInNashville.com