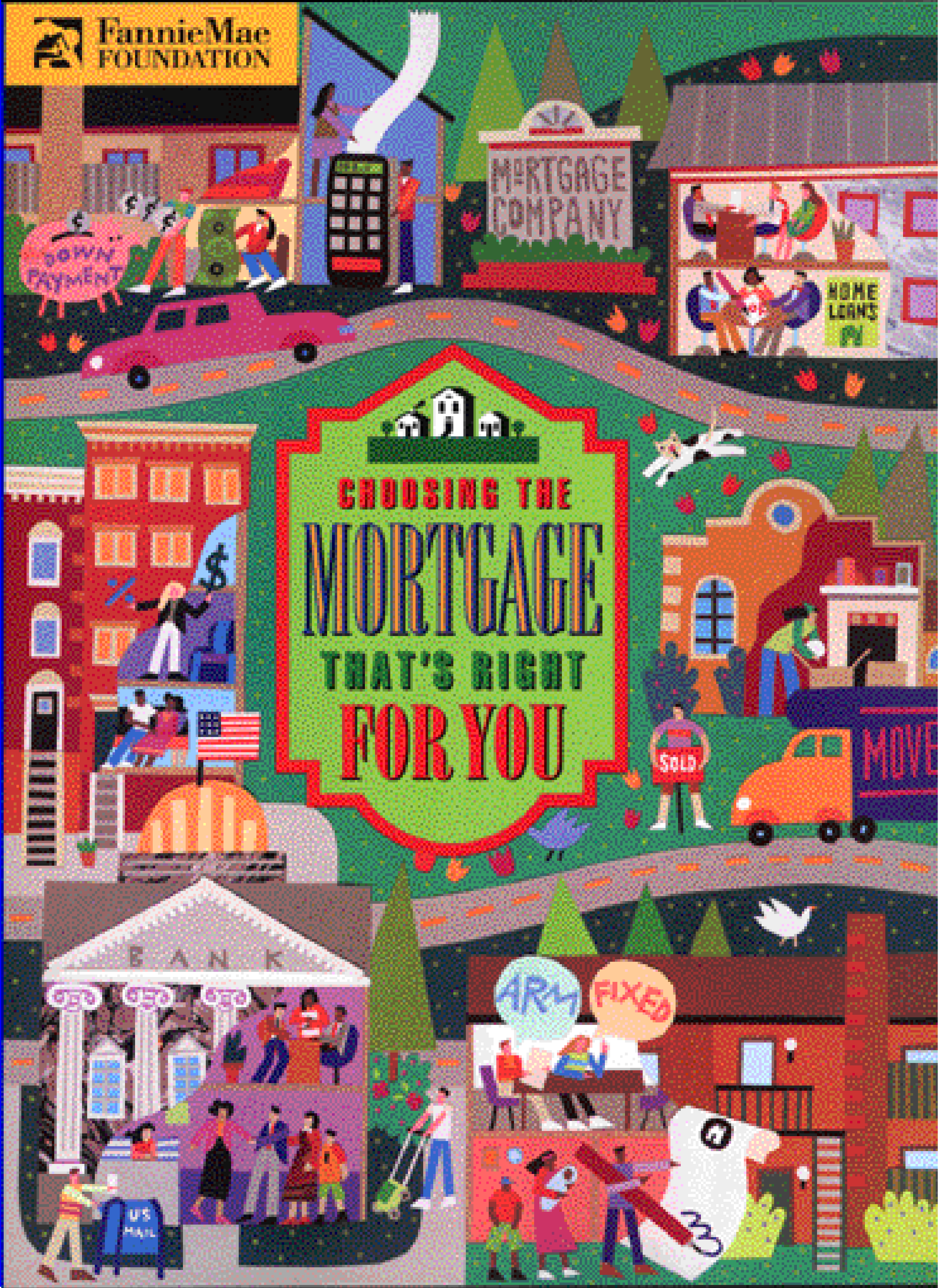
Fannie Mae FOUNDATION

CHOOSING THE MORTGAGE THAT'S RIGHT FOR YOU



How the Fannie Mae Foundation can help.

If you're like most Americans, owning your own home is a major part of the American dream. The Fannie Mae Foundation wants to help you understand the steps you have to follow to reach that dream. Homeownership is a big responsibility, one that you will need to accept for many years to come. It's worth the effort, and the Fannie Mae Foundation can help.

You may not be familiar with us. We were formed and funded by Fannie Mae, which is a private company chartered by Congress to provide funds to local lenders for home mortgages in communities all across America.

The Fannie Mae Foundation is a nonprofit organization. Among other activities, the Foundation provides information useful to Americans who want to buy a home. We know that the whole process of getting a mortgage can be confusing, so an important service we provide is information such as this guide. We hope this objective information will help you get started on the path to homeownership.

How this guide can help you shop for a mortgage.

So you want to buy a home. Millions of people in America do so every year. Like them, you want to be careful in finding the right mortgage to make your dream a reality.

How big a loan can you get? How will the type of mortgage you get determine how much house you can afford? Which mortgage is best for your budget? Your future?

When you finish reading this guide, you will have answers to these questions and several more. It is important that you know this information, so you will be prepared for some of the questions a lender will ask when you actually apply for a mortgage loan. It is also important to know this information so you can get an idea about how expensive a home you can afford before you go shopping. In short, we want to help you move to your new home without costly mortgage surprises or disappointments.

This guide is written for people who are ready to buy a home. This means that you have a history of paying your bills on time, a job history that indicates continued employment, and the ability to handle debt. If you are not sure you are ready to buy a home, you may wish to receive the first guide in our home buyer education series, *Opening the Door to a Home of Your Own.* It is available by simply calling 1-800-688-HOME.

If you are ready to buy a home, it doesn't necessarily mean you are prepared to shop for a mortgage. Being a smart mortgage shopper requires some special vocabulary and a bit of work. On the next few pages, you will find definitions, charts, and exercises that should make it easier to find the best mortgage for you.

This guide takes you through the shopping process in three steps. In Step I, you will find out what a mortgage is and how to calculate your buying power. In Step II, you will learn about different types of mortgages. In Step III, you will find out where to shop for a mortgage and how to compare mortgage terms. Because there is a lot of information here, you may want to read it in more than one sitting. Please refer to the Mortgage Comparison Shopping Chart at the end of this guide when you actually start calling lenders to compare mortgages.

While shopping for a mortgage is more complicated than shopping for a new car or a major appliance, having this information before you start will help. As with any major purchase, you can get your best value by knowing what questions to ask. So let's get started.

What is your buying power?

One easy way to find out how much you can afford is to get prequalified by a mortgage lender. Many lenders will be happy to tell you how large a mortgage they might offer you. At the prequalification stage, you do not need to obligate yourself by paying an application fee and actually applying for the mortgage. However, keep in mind that lender prequalifications are only "ballpark" ranges of your buying power and don't obligate the lender to approve your loan. Only you can decide how much you feel comfortable borrowing – and what type of mortgage is best for you. This guide will help you do that.

You may have heard that if you can pay rent and have cash for a down payment, you can afford to buy. You may have also heard that most individuals or families can afford to borrow up to two and one-half times their gross annual household income (income before any deductions are made for taxes, etc.). Following this rule of thumb, a couple with a combined annual income of $30,000 should be able to borrow up to $75,000.

Like other rules of thumb, this one is handy, easy to calculate, and can give you a ballpark guess of how large a mortgage you can afford. But, because it is so simple, it doesn't take into account many other pieces of information that help determine whether you'll feel comfortable with this financial obligation.

So before you start calling or visiting lenders, let's examine what actually goes into a mortgage payment and some key factors that lenders will use to determine how much house you can afford. Let's start by getting a better understanding of just what a mortgage is.

What is a mortgage loan?

A mortgage requires you to pledge your home as the lender's security for repayment of your loan. The lender agrees to hold the title to your property (or in some states, to hold a lien on your title) until you have paid back your loan plus interest. If you do not repay your mortgage loan, the lender has the right to take possession of your house and sell it in order to satisfy the mortgage debt.

PRINCIPAL AND INTEREST. All mortgages have two features in common. The first feature is the mortgage principal, which is the actual amount of money you borrow. So, if you take out a $70,000 mortgage your mortgage principal is $70,000.

The second feature is the mortgage interest, which is the money you pay for use of the money you borrow. How much interest you pay over the life of your loan depends on a number of factors – which you will learn about shortly. The interest you pay on your mortgage can be deducted from your taxes, which is one of the many benefits of homeownership.

AMORTIZATION. Over time, you will repay your mortgage gradually through regular, monthly payments of principal and interest. The amounts of these payments are calculated to let you own your home debt-free at the end of a fixed period of time. During the first few years, most of your payments will be applied toward the interest you owe. During the final years of your loan, your payment amounts will be applied almost exclusively to the remaining principal. This type of repayment method is called amortization.

When you sell your home, you will be required to pay back any remaining principal balance due on your mortgage loan to your lender.

Four factors that affect your mortgage payments.

If you're shopping for a home, you know that the price of a house is determined by location, size, special features (such as a garage, a deck, an extra bathroom), and overall market conditions. However – before you fall in love with your new dream home – learn the four factors that may be the key to whether or not you can afford that house of your dreams. They are:

- the size of your down payment,
- the amount of your mortgage,
- your mortgage interest rate, and
- the repayment term of the mortgage loan you choose.

A change in any one of these four factors will influence how much house you can afford. Let's examine each of these four factors in detail, so you can get a good grasp of your buying power. After answering the four buying power question that follow, you should be ready to start shopping for a mortgage knowing how much you can pay each month.

Buying Power Question 1

How large a down payment can you afford?

Your down payment will reduce the amount you'll need to borrow. So, the more cash you put down, the smaller the size of your loan. And the smaller your mortgage payments will be.

Lenders often view mortgages with larger down payments as more secure because you have more of your own money invested in the property.

Saving enough money for the down payment is usually the hardest part of getting ready to buy a home, especially if you're a first-time buyer. It often takes many years to do.

Five Percent Down Payments Are Possible. In the past, mortgage lenders expected home buyers to make a down payment amounting to at least 20 percent of the purchase price of the home. Today, however, lenders recognize that 20 percent of the sales price is a tremendous amount of cash for most buyers, particularly first-time buyers. So, now, most lenders will offer you mortgage loans with as little as 5 percent down. Some may even offer 3 percent down.

Putting less than 20 percent down often means you will be required to purchase private mortgage insurance. Private mortgage insurance protects the lending institution in case you fail to make payments on your mortgage. Its cost will be added to your monthly mortgage payments and to your closing costs. This insurance helps you buy your home years sooner than you ordinarily would have been able to because you don't have to save a 20 percent down payment.

Some types of mortgages for which you put less than 20 percent down do not require private mortgage insurance. These include loans insured by the federal government such as an FHA loan or a

VA loan. Your state may also offer special mortages for low- and moderate-income home buyers that use state-sponsored mortgage insurance programs.

Consider Upcoming Expenses and Closing Costs in Your Down Payment Decision.

How much money do you feel comfortable applying to your down payment? Before you decide, you'll need to consider moving expenses, home decorating costs, and any needed upcoming "big ticket" items (such as replacing a car). You don't want to move into your dream house with all your savings depleted.

In many cases, your lender will want you to have two months of mortgage payments saved up as cash reserves when you apply for your mortgage.

You also will need to consider closing costs. The closing (or in some parts of the country, settlement) is the final step where ownership of the home is transferred to you. The purpose of the closing is to make sure the property is ready and able to be transferred to you from the seller. Items to be paid at closing vary from state to state and may include transfer and recordation taxes, title insurance, site survey fee, attorney fees, loan discount points, and document preparation fees. After you have applied for a loan, your lender is required to provide you with a good faith estimate of closing costs. Because you probably have not yet applied for a loan, you need to "ballpark" what your closing costs might be. One easy way to do that is to call a real estate agent and ask what closing costs run for houses in your area. Usually, closing costs are expressed as a percentage of the loan amount and typically run from 3 percent to 6 percent of your mortgage loan amount. Sometimes, you can negotiate with the seller of a property to pay some of your closing costs.

So, How Much Money Do You Have Saved for a Down Payment? You may have more than you know. Use the Down Payment Calculator Work Sheet below to prepare a list of all your present assets. (Your mortgage lender will also request this list when you apply for your loan.)

DOWN PAYMENT CALCULATOR WORK SHEET			
ASSETS AVAILABLE FOR DOWN PAYMENT		**UPCOMING NEW HOME EXPENSES**	
Savings Account		Moving Expenses	
Checking Account		New Home Repairs	
Cash Value of Life Insurance		Home Decorating	
Proceeds from Sale of Current Home, if Applicable		Major Appliance Purchases	
Gift from Relative *		Estimated Closing Costs at Settlement (usually 3 – 6% of your loan amount)	
Other Assets That Can Be Sold to Obtain Funds		Other Major Purchases in Next Six Months Unrelated to New Home (car, etc.)	
A. Total Liquid Assets Available	**$**	**B. Cash Needs for Next Six Months in New Home ****	**$**
A. – B. = Total Down Payment Available: $			

* Some mortgages put a limit on how large a gift you can use for your down payment. Check with your lender to determine exact amounts and appropriate forms to complete.

** Remember, lenders may require you to have two months of mortgage payments in reserve when you go to closing. Be sure to consider this in your cash needs for the next six months.

With a maximum down payment in mind, you now can figure out the next factor that will affect your monthly mortgage payments – the amount you borrow.

How large a monthly mortgage payment can you afford?

Your actual mortgage payments will depend in large part on the amount you borrow – your mortgage principal. Your income and your debts are the most important factors for determining how large a mortgage you will be able to get. If you are buying a house with someone else (spouse, parent, adult child, partner/companion, friend, brother, sister, etc.), you should consider your co-purchaser's earnings and existing debts as well. If you apply for a loan with somebody else, you and your co-borrower are both legally responsible for repayment of the mortgage.

LENDERS USE TWO GUIDELINES TO DETERMINE THE AMOUNT OF MONEY THEY WILL LEND. The first guideline says that a household should spend no more than 28 percent of its gross monthly income (income before taxes) on monthly housing expenses. Monthly housing expenses include mortgage principal and interest, hazard insurance, real estate taxes, and private mortgage insurance (if applicable). Lenders do not include monthly utility bills in your monthly housing expense ratio.

The second guideline says that monthly housing expenses and other long-term debts combined generally should not be more than 36 percent of total monthly income. That means that your monthly mortgage principal and interest payments, real estate taxes, hazard insurance, car loan, credit card payments, and other long-term debts combined generally may not exceed 36 percent of your gross monthly income.

These ratios (28 percent of total income for housing expenses and 36 percent for total debt) are flexible guidelines. If you have a consistent record of paying rent that is very close in amount to your proposed monthly mortgage payments or you make a large down payment, you may be able to use somewhat higher ratios. What's more, some lenders offer special loan programs for lower-

and moderate-income home buyers that allow as much as 33 percent of their gross monthly income to be used toward housing expenses and 38 percent for total debt.

However, to be conservative, let's calculate your allowable housing expense at 28 percent of income and your allowable total debt expenses at 36 percent of income. So, how much can you spend? It's easy to get an idea by completing the exercises below.

CALCULATE YOUR MONTHLY INCOME. First, you'll want to calculate the total gross (before-tax) monthly income for you and your co-borrower, if you have one. Be sure you include all the income your household receives on a regular basis, indicating any monies received under each item listed.

GROSS MONTHLY INCOME WORK SHEET

ITEM	BORROWER	CO-BORROWER	TOTAL
Base Employment Income			
Part-Time/Second Job Income			
Overtime*			
Bonuses*			
Commissions*			
Dividends/Interest			
Alimony/Child Support			
Unemployment Compensation			
Pension/Social Security Benefits			
Public Assistance/Food Stamps			
Veterans Benefits			
Other Income			
		Total Gross Monthly Income	$

* If your overtime, bonuses, or commissions do not fall into 12 equal monthly payments, be sure to divide them so as to spread this income over 12 months. You will need a two-year history of receipts for this income to count.

After you know your gross monthly income, multiply it by 28 percent to get your maximum allowable housing expense.

1. Your Total Gross Monthly Income $ ____________
2. Multiply by 28 Percent x .28
3. Equals Your Maximum Allowable Monthly Housing Expense $ ____________

Calculate Your Long-Term Debt. Next, you'll need to consider the long-term debt that your household owes. Any installment or revolving debts (such as credit card and store accounts) that will take more than ten months to pay off are considered long-term debts and should be included. Other debts may include car payments, student loans, alimony, or child support payments. Total your existing monthly payments on long-term household debts below. Be sure to disclose all the long-term debts of each co-borrower.

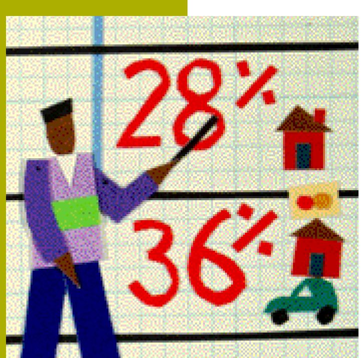
LONG-TERM MONTHLY HOUSEHOLD DEBTS WORK SHEET	
ALLOWABLE MONTHLY HOUSING EXPENSE	
1. Fill in Amount You Calculated in #3 Above	$
LONG-TERM MONTHLY DEBT* (Please enter the minimum monthly payment required on each of your outstanding debts)	
2. Installment and Revolving Debts (for example, credit card and store accounts)	$
3. Car Loan	
4. Student Loan	
5. Existing Real Estate Loans (if you are not selling the property)	
6. Alimony/Child Support	
7. Other Long-Term Monthly Debts (including loan from relative, loan against insurance policy)	
Add all the debts (1–7) above to calculate your total monthly debt payments:	$
* Note: Ongoing monthly living expenses you pay for in cash such as utility payments; grocery bills; entertainment expenses; and health, life, medical, and car insurance are not considered long-term debts for mortgage loan qualifying purposes.	

Is the amount of the monthly debt payments you just calculated more or less than what a lender will allow? That's easy to find out. To calculate your maximum monthly allowable debt, com–plete this exercise:

1.	Your Total Gross Monthly Income	$______________
2.	Multiply by 36 Percent	x .36
3.	Equals Your Maximum Allowable Combined Housing and Monthly Debt	$______________

You can easily see if the actual long-term debt you have is more or less than the 36 percent amount you are allowed. Simply compare your sum total in the Long-Term Monthly Household Debts Work Sheet on page 11 to the 36 percentage figure you just calculated. If your long-term monthly debt is greater than 36 percent of your monthly income, you may have to pay off some debts before applying for a mortgage loan.

Double-Check Your Figures. Now that you've calculated your income and debt ratios, let's double-check your figures. Your monthly housing expense (including mortgage principal and interest, property taxes, hazard insurance, and, if applicable, mortgage insurance) should total no more than 28 percent of your gross monthly income. Your total long-term monthly debt (including your housing expenses and all other debt) should total no more than 36 percent of your gross monthly income. Check the figures you calculated against the chart on page 13. As you review these figures, remember that your allowable monthly payment amounts are flexible and can be increased somewhat depending on your situation.



ALLOWABLE MONTHLY HOUSING EXPENSE AND MONTHLY DEBT BASED ON YOUR INCOME		
GROSS ANNUAL INCOME	ALLOWABLE MONTHLY HOUSING EXPENSE	ALLOWABLE LONG-TERM MONTHLY DEBT
$20,000	$467	$600
25,000	583	750
30,000	700	900
35,000	817	1,050
40,000	933	1,200
45,000	1,050	1,350
50,000	1,167	1,500
55,000	1,283	1,650
60,000	1,400	1,800
65,000	1,517	1,950
70,000	1,633	2,010
75,000	1,750	2,250
80,000	1,867	2,400
85,000	1,983	2,550
90,000	2,100	2,700
95,000	2,217	2,850
100,000	2,333	3,000
130,000	3,033	3,900

This chart shows about how high your monthly housing expenses and your long-term monthly debt can be based on your income. “Allowable monthly housing expense” includes mortgage principal and interest, property taxes, hazard insurance, and, if applicable, mortgage insurance.

Buying Power Question 3

How low an interest rate can you expect?

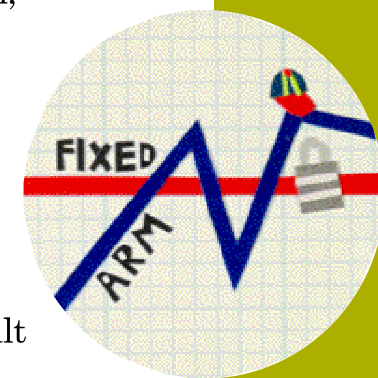
If you've ever shopped for a credit card or a car loan, you know that getting the best interest rate is a very important part of your shopping decision. The same is true when you shop for a mortgage.

As with any other loan, the lower your interest rate, the lower your monthly payments. Or, another way to look at it is the lower the interest rate, the more buying power you'll have. With lower rates, you can borrow more money for approximately the same monthly payment. Here are some points to keep in mind when you compare interest rates among loans:

Shorter Term Loans Offer Lower Intersest Rates. Keep in mind that each type of mortgage loan may carry a different interest rate. As a general rule, the shorter the term of the loan, the lower the interest rate you will pay. So, a 15-year fixed-rate mortgage usually has a lower interest rate than a 30-year fixed-rate mortgage.

A Fixed Versus an Adjustable Interest Rate. Also keep in mind that you can choose a mortgage with an interest rate that is fixed for the entire term of the loan or an interest rate that adjusts during the loan term. A fixed-rate loan gives you the security of knowing that your interest rate will never change during the entire term of the loan. An adjustable-rate mortgage loan (called an ARM) has an interest rate that will vary during the life of the loan, with the possibility of both increases and decreases to the interest rate and consequently to your mortgage payment.

An ARM frequently offers a lower initial interest rate than a fixed-rate mortgage. However, when comparing interest rates between ARM's and fixed-rate mortgages, you need to know the adjustable-rate mortgage's interest rate caps. There is a cap or limit for how much the interest rate can increase over the life of the loan, and a cap for how much the interest rate can increase at each adjustment date. These caps tell you the maximum interest rate you could be required to pay during each adjustment period and over the life of the loan.



PAYING DISCOUNT "POINTS" CAN LOWER YOUR INTEREST RATE. In the special vocabulary of mortgage lending, "points" is a difficult term for many home buyers to understand. "Points" are often used to describe a type of fee lenders charge. (The full term to describe this fee is "discount points." Simply put, a point is a unit of measure that means 1 percent of the loan amount. So, if you take out a $100,000 loan, one point equals $1,000. If you take out a $50,000 loan, one point equals $500. Discount points represent additional money you can pay to the lender at closing. In return, the lender will provide you a lower interest rate on your loan.

For example, you are shopping for a 30-year mortgage loan. A lender quotes you an interest rate for a 30-year, $50,000 mortgage at 7 1/2 percent with no discount points. If you like that rate, you can choose not pay any discount points at closing and pay 7 1/2 percent interest. If you want to pay less interest, ask the lender to quote you an interest rate with you paying one, two, or three discount points. Usually, for each point you pay for a 30-year loan, your interest rate is reduced by 1/8 (or .125) of a percentage point.

So, if you pay one discount point at closing on a $50,000 loan ($500), you could lower your interest rate from 7 1/2 percent to 7 3/8 percent. If you pay two discount points ($1,000 on a $50,000 loan), you could lower your interest rate from 7 1/2 percent to 7 1/4 percent. If you pay three discount points ($1,500 on a $50,000 loan), you could lower your interest rate from 7 1/2 percent to 7 1/8 percent. Remember, these are just examples. For a true comparison, you need to call lenders. When you call lenders to shop rates, it is important to compare the same combination of interest rates and points quoted by each lender. A good example to help you compare rates is to ask lenders for quotes for a loan with no discount points. You can often get a better idea of what the basic interest rate is at zero discount points. Then, you can ask to see how the interest rate is reduced for each additional discount point you pay.

How do you decide if you want to pay more discount points and a lower interest rate, or fewer discount points and a higher interest rate? First, you should know that you can sometimes negotiate with the seller of a property to pay some of the points on your loan. Second, keep in mind that the discount points you pay are tax deductible. Third, realize that you will need more cash at closing if you decide to pay points. And finally, remember that you have to pay for your points all at once, whereas you only pay interest on your loan as long as you have your house. So if you will be living in your house for only a short period of time, you may decide it is preferable not to pay points.

Interest Rate Lock-Ins. While you shop for a loan, interest rates can change frequently. So it's important to ask if the mortgage lender will offer you a rate lock-in. This can guarantee you a specified interest rate, provided the loan is closed within a set period of time. When you apply for your mortgage, you should have a good idea of when you want to close on your house. If your lock-in period expires before you go to closing, your lender is not obligated to give you the same interest rate you had locked in earlier. So, it is important to lock in for a period that will cover the time until your expected closing date. Locking in a quoted rate when rates are rising may save you thousands of dollars in interest over the life of the loan. If the rates are falling, it may be best to wait until the last possible moment before locking in.

Annual Percentage Rate (APR). This percentage figure includes interest plus points and closing costs and spreads them over the life of the loan. The APR gives your "effective rate of interest" and must be disclosed to you according to federal truth-in-lending laws.

How to Calculate Loan Payments at Different Interest Rates. The following table should help you calculate the principal and interest charges you can expect for a wide range of interest rates and loan amounts.

To use this table, find the loan rate on the left side and the term of the loan at the top. At the intersection is the monthly payment for a loan of $1,000 at the given rate and term. Multiply this figure by the number of thousands of dollars you're thinking of borrowing to calculate the monthly payment for your loan. (For example, for a 30-year fixed-rate loan of $70,000 with a 7.5 percent interest rate, multiplying $7.00 times 70 gives you a monthly payment of $490.)

MONTHLY LOAN PAYMENT TABLE
EQUAL MONTHLY PAYMENTS TO AMORTIZE $1,000

INTEREST RATE	15 YEARS	20 YEARS	30 YEARS
5.0%	$ 7.91	$ 6.60	$ 5.37
5.5%	8.18	6.88	5.68
6.0%	8.44	7.17	6.00
6.5%	8.72	7.46	6.33
7.0%	8.99	7.76	6.66
7.5%	9.28	8.06	7.00
8.0%	9.56	8.37	7.34
8.5%	9.85	8.69	7.69
9.0%	10.15	9.00	8.05
9.5%	10.45	9.33	8.41
10.0%	10.75	9.66	8.78
10.5%	11.06	9.99	9.15
11.0%	11.37	10.33	9.53
11.5%	11.69	10.67	9.91

The table shows how much you'll pay monthly (principal and interest) for every $1,000 you borrow. Taxes and insurance payments are not included in these monthly payments.

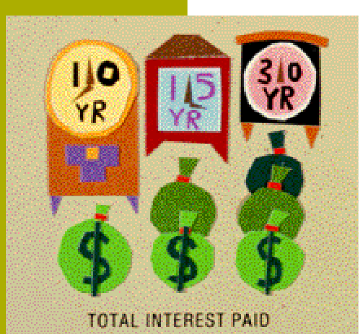
BUYING POWER QUESTION 4

How short a repayment term can you handle?

The most popular mortgage – the 30-year fixed-rate loan – gives you a full 30-year repayment schedule. If you make every monthly payment as scheduled (without prepayments or missed payments), you will own your home debt-free 30 years from the day your first mortgage payment is due.

Thirty years sounds like a long time – and it is! But by extending payments over 30 years, you keep your monthly housing costs low. If you can afford higher monthly payments, you can select a mortgage repayment schedule that is shorter: there are 20-year, 15-year, and even 10-year fixed-rate mortgages available from most mortgage lenders.

Shorter Repayment Period Means You Will Owe Less Interest. The length of your mortgage repayment period will directly impact your monthly mortgage payments. For the same mortgage principal amount, you will find that the shorter the repayment period, the higher your monthly payment will be, but the total interest you pay over the life of the loan will be less. On the other hand, the longer your repayment period, the lower your monthly payment will be, but the total interest you'll pay over the life of the loan will be more. To see how the length of a repayment period affects both your monthly payments and the total interest you pay over the life of the loan, consider the chart on page 19. It shows the total lifetime interest payments on a $100,000 loan with a 7.5 percent interest rate. You can easily see how much more total interest you pay when you stretch your payments out over a longer period of time. As you can see, selecting a loan term involves striking a balance between how low you want your monthly mortgage payments to be versus how quickly you want and can afford to own your home debt-free.

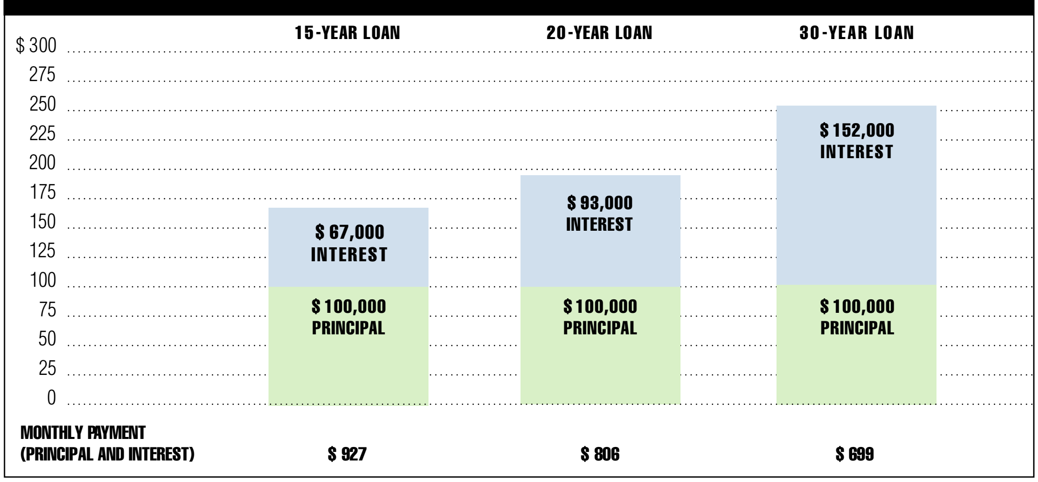


More Frequent Payments Can Make Your Final Pay-Off Date Arrive Sooner. In addition to the original term of your mortgage, your payment schedule can affect how quickly your loan gets repaid. Most loans require you to make one payment a month, or 12 payments a year.

However, you almost always have the option to make additional principal payments that will shorten the amount of time it takes to fully repay your mortgage loan. In fact, most lenders have a place on the payment card marked “additional principal payments.” If you make just one extra monthly payment each year, you would pay off your mortgage years ahead of schedule and save a considerable amount in interest payments.

If you want to set up a more frequent payment schedule when you apply for a mortgage, you should know that some lenders offer biweekly payment plans that require a payment every other week, or 26, sometimes 27, payments a year. You may find that making payments more often is a better match with your paycheck. It will also save you a considerable amount of interest over the life of the loan and help you pay off your mortgage much faster.

TOTAL INTEREST PAID (AT 7.5%) OVER LIFE OF $100,000 LOAN



■ *Total Interest Paid Over Life of Loan* □ *Principal Amount: $100,000*

Now, how much can you afford?

If you've done the exercises in this guide, you now know how much you can afford to spend on monthly mortgage payments (28 percent of your gross monthly income). You also know whether your present debts and projected housing costs are within a comfortable range (36 percent of gross monthly income).

You've compared your monthly housing allowance to the monthly loan payments for the mortgage amount you are thinking of borrowing. You've been able to do this by using the Monthly Loan Payment Table on page 17, which helps you see how large a mortgage loan you can afford.

You've looked at your available assets and considered how much money you'll need to put aside for closing, moving, and settling-in costs. How much of the remainder of these savings are you willing to spend on your down payment? Once you've made this decision, you can add your expected down payment to the maximum mortgage loan amount for which you hope to qualify. The total should be the maximum price you can comfortably afford to pay for a home.

Once you know that maximum price, it's time to start shopping for the mortgage loan that's right for you. Let's move on to Step II of this guide – Selecting A Mortgage That Is Right For You.

There are dozens of different types of mortgage products available. When shopping for a home, take the time to shop for the type of mortgage that will best suit your lifestyle and your financial needs.

How do you choose the right mortgage?

There is a wide selection of mortgages available in today's mar ket, and you should narrow the field by considering your particular situation. Your choice of mortgage will be influenced by questions such as

- How many years do you expect to live in your new home?
- How important is it to be free of mortgage debt before facing your children's college bills or planning for your own retirement?
- How comfortable are you with the certainty of a fixed mortgage payment versus a payment that can change over time?

Advantages of fixed-rate mortgages.

If you expect to live in your home for many years, the interest rate of your loan may be your primary consideration. You may want a fixed-rate mortgage that will ensure that your interest rate will remain the same for as long as you have your loan. If you decide that you like the stable, predictable payments of a fixed-rate loan, then you must choose form variety of repayment terms – 15, 20, and 30 years are the most common. Here are some points to compare about various fixed-rate loans:

A 30-YEAR FIXED-RATE MORTGAGE is the easiest fixed-rate loan to qualify for. Its longer term gives you the best chance to keep monthly mortgage payments low and use the extra cash for other purposes.

A 20-YEAR FIXED RATE MORTGAGE amortizes principal and interest over a 20-year period, 10 years sooner than the traditional 30-year mortgage. If offers you the opportunity to own your home debt-free much more quickly. Yet, the monthly payment is only somewhat higher than the 30-year mortgage loan.

A 15-YEAR FIXED-RATE MORTGAGE offers a lower interest rate than a 30-year or 20-year mortgage and will save you a significant amount of interest over the life of the loan. You will build up equity in your home quickly, which can allow you to move to a more expensive home sooner. If you're nearing retirement, this shorter-term mortgage allows you to own your home sooner. The benefits of a 15-year mortgage come with a price – your monthly mortgage payment will be considerably higher than for the 30-year mortgage.

Advantages of adjustable-rate mortgages (ARMs).

If you're confident that your income will increase steadily over the years, or if you plan to move in a few years and aren't concerned with potential rate increases, then you may want to consider an ARM. ARMs feature an interest rate that moves up and down as market conditions change. Although an ARM usually offers a lower initial interest rate, your mortgage payments change periodically (usually once or twice a year). Interest rate changes typically are subject to two caps, one for each adjustment period and one for the life of your loan. For example, a typical ARM that adjusts annually may have a per adjustment cap of 2 percent and a lifetime cap of 6 percent.

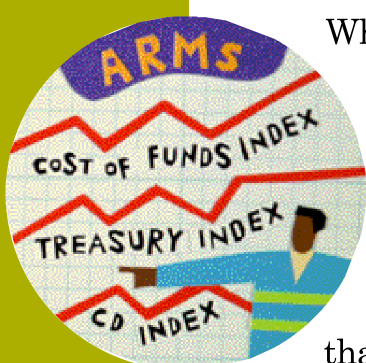
Because ARMs offer lower initial interest rates, initial monthly payments will be lower, so you may be able to qualify for a larger mortgage amount. However, you will likely be required to come up with more than a 5 percent down payment (usually at least 10 percent). Of course, if interest rates go down, your payment will decrease as well. Some ARMs offer you the chance to convert to a fixed-rate loan (for a fee) within a certain period of time.

The interest changes on an adjustable-rate mortgage are always tied to a financial index. A financial index is a readily publishable rate – for example, the financial index for many credit cards is the prime rate. The three most popular types of ARMs are:

Treasury-Indexed ARMs, indexed to six-month, one-year, or three-year Treasury bills or securities. Depending on which of these three indexes you choose, your interest rate will adjust once every six months, once each year, or once every three years.

CD-Indexed ARMs, which adjust to a Certificate of Deposit (CD) index. Rate adjustments typically occur every six months, with a per adjustment cap of 1 percent and a lifetime cap of 6 percent.

Cost of Funds-Indexed ARMs, indexed to the actual costs a particular group of lending institutions pays to borrow money. Lenders using this index can adjust mortgage rates monthly, every six months or annually. The most popular index of this type is the Cost of Funds Index for the 11th Federal Home Loan Bank District of San Francisco.



When comparing ARMs that have different indexes, you should look at how the index has performed recently. Some indexes are widely published in newspapers, making them easy to track. Mortgage lenders are required to provide you with information on how to track the index and to provide a 15-year history of the index they use. Remember, though, that past performance cannot predict future performance of the index or the direction your interest rate may go.

Other types of ARMs.

ARMs With an Initial Fixed Period. You may wish to look into a special type of adjustable-rate mortgage that doesn't adjust your interest rate until several years after you take out the loan. These loans offer you several years of fixed payments before there is an interest rate change. You can get a three-, five-, seven-, or ten-year fixed period ARM. This means your interest rate would be the same for the first three, five, seven, or ten years and then, at the end of your chosen fixed-rate period, your interest rate would adjust every year. This type of adjustable-rate mortgage protects you against rapid interest rate increases in the early years of your loan.

ARMs That Adjust Only Once. You can also choose an ARM that adjusts just one time. The first adjustment would happen at five or at seven years. After that initial adjustment, the mortgage maintains a fixed rate for the remaining 23 or 25 years of a 30-year mortgage term. This type of ARM, sometimes called a "two-step," provides the benefit of initial low rates with the stability of longer term financing.

Balloon mortgages.

Balloon loans offer lower interest rates for shorter term financing, usually five, seven, or ten years. At the end of this term, they require financing or paying off the outstanding balance with a lump-sum payment. Balloon mortgages may be suitable if you plan to sell or refinance your home within a few years and want a fixed, low monthly payment. The advantage they offer is an interest rate that is lower than fully amortizing fixed-rate mortgages. For example, your initial interest rate may be 6.5 percent and you would pay the rate for the first five, seven, or ten years (depending on the term of your balloon loan). Then, your entire outstanding loan balance would be due to the lender or you might have to pay a fee to refinance your loan at the prevailing interest rate. However, ask about all the conditions for a refinance option at the end of the balloon term. With some balloon mortgages, the lender doesn't guarantee to extend the loan past the balloon date. If you don't feel you will be able to meet all the refinance conditions or think the balloon term may be up before you are ready to move, this type of loan may not be appropriate for you.

Other types of mortgages to consider.

SPECIAL LOAN PROGRAMS. Special loan programs often exist to help first-time buyers. With some of these programs, you may be able to accept a gift from a relative or to borrow a portion of the money you will need for the down payment and closing costs from a local nonprofit organization or government agency. With others, you may be able to get a grant or other funds that you will not have to repay and can use to cover some of these costs. If you don't qualify for a mortgage based on some of the traditional underwriting factors described earlier, you may want to find lenders who offer special mortgage loans like these. These loans allow you to use a greater percentage of your income toward monthly housing expenses and will not require you to have two months of cash in reserve at closing. If you don't have a traditional credit history, you can show you have a good credit history using your rent and utility receipts.

GOVERNMENT-INSURED LOANS. You may want to consider the mortgage plans offered by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), or the Rural Housing Service (RHS). Properties purchased under these programs must meet certain minimum standards and possible loan limits. FHA-insured loans offer very low down payments (3 to 5 percent). VA-guaranteed mortgages with no down payment are available to qualified veterans. You must get a certificate of eligibility from the Department of Veterans Affairs for a VA loan. The guaranteed rural housing program offered by the RHS is for people who meet certain income requirements and wish to buy a home in a rural area. This government-guaranteed loan requires no down payment.

You may shop for a mortgage loan at mortgage companies, savings and loan associations, commercial banks, and credit unions.

Where do you look for a mortgage loan?

Mortgage loans are available from a number of sources, including:

- mortgage companies,
- savings and loan associations,
- commercial banks,
- federal credit unions, and
- other financial institutions.

These financial institutions can be found in the Yellow Pages under “mortgages.” The real estate section of your local newspaper often includes comparative mortgage rate charts and may even offer a mortgage rate hotline that can be very helpful in your search. You may also use popular search engines on the World Wide Web to locate mortgage lenders and current interest rates. Your real estate agent will also know about local mortgage lenders and the mortgage products they offer.

How do you compare loan terms between lenders?

Plan to contact at least three lending companies by phone or in person to discuss the mortgages they have available. You may also use a computerized search, offered by many real estate firms and mortgage lenders, as a way to quickly see the rates and terms of various mortgage products. Some of these databases are limited to a single lending institution; others include mortgages offered by many firms. Such a computer search should be free or very inexpensive.

Because there are so many variables, you'll need a systematic approach. The following Mortgage Comparison Shopping Chart will help you ask lenders questions about the terms of the mortgages they offer. Use this chart to get the information you need to make an informed decision on which mortgage lender offers the best deal for you.

Remember, some information (especially interest rates) can change daily. So, try to call three lenders on the same day so you can get a true comparison.

Each item on the chart is numbered. If you don't understand a specific item, don't skip that question when talking to a lender. Just look it up in the Checklist of Mortgage Shopping Terms that follows, so you understand what you will be asking.

After you've asked these questions about the same type of mortgage loan offered by three different lending institutions, you can figure out which mortgage lender gives you the best deal. Once you find your best deal, make sure the loan officer will handle your application through to the end and get your deal done. Trust in the company and the loan officer you are dealing with is an important part of your shopping decision, too.

FIXED-RATE MORTGAGE COMPARISON SHOPPING CHART	LENDER 1	LENDER 2	LENDER 3
1. Company name/phone number:			
Loan officer name?			
2. Mortgage type:			
3. Interest rate and points:			
Interest rate quoted on __/__/__ is? (day) (month) (year)			
How many points quoted?			
Annual percentage rate?			
4. Interest rate lock-ins:			
Upon application?			
At approval?			
Lock-in costs?			
Effective how long?			
Lower lock-in if rates drop?			
5. Minimum down payment r equired:			
Without mortgage insurance			
With mortgage insurance			
If mortgage insurance is required:			
Upfront costs?			
Monthly premiums?			
Can it be financed?			
6. Prepayment of principal:			
Is there a penalty?			
Duration of penalty?			
Extra principal payments allowed?			
7. Loan processing time:			
How many days estimated from:			
Application to approval?			
Approval to closing?			
8. Closing costs:			
Application/origination fee			
Credit report fee			
Lender's attorney fee			
Document preparation fee			
Transfer taxes			
Appraisal fee			
Survey fee			
Title search/title insurance			
Any other closing costs quoted?			

CHECKLIST OF FIXED-RATE MORTGAGE SHOPPING TERMS

Note: Each item in this checklist is numerically coded to the Mortgage Comparison Shopping Chart on the previous page. So if you don't understand an item on the chart, this list of terms will help you when asking questions of various mortgage lenders.

1. **Company Name/Phone Number:** Write down the name of the loan officer with whom you speak, so you can get back in touch if you decide to apply for a loan at that financial institution.

2. **Mortgage Type :** Your task will be simpler if you've narrowed your search to the type of mortgage loan you prefer. When comparing mortgages among lenders, compare the same loan among the lenders you call–in other words, a 30-year fixed rate to a 30-year fixed rate, a one-year Treasury ARM to a one-year Treasury ARM, etc.

3. **Interest Rate and Points :** Interest rates change often, even daily. Make sure you record the date of your rate quote. Try to call all lenders on the same day, so you have an accurate comparison. Another way to evaluate rates is by examining the Annual Percentage Rate (APR). It indicates the "effective rate of interest paid" per year. The figure includes points and other closing costs and spreads them over the life of the loan. While the APR provides you with a common point for comparison, it's important to look at the whole product before deciding which mortgage to get. For a fuller discussion of points, see pages 15–16.

4. **Interest Rate Lock-ins:** When a lender agrees to hold the quoted rate for you, this is called a "lock-in." Ask when can the rate be locked in, at the time of application or only upon approval? Will the lender lock in both the interest rate and points? Can you get a written lock-in agreement? How long does the lock-in remain in effect? Is there a charge for locking in a rate? If the rate drops before closing, must you close at your locked-in rate or can you get the lower rate?

5. **Minimum Down Payment Requir ed:** Ask the loan officer what the lowest allowable down payment is – with and without private mortgage insurance. If Private Mortgage Insurance (MI) is required, ask how much it will cost. Find out how much is due upfront at closing and the amount included as monthly premiums. Ask if you can finance the closing cost of mortgage insurance. Also ask how long MI will be required. In some cases, you may be able to cancel the MI when your loan balance drops below 80 percent of the original value of the property or when a new appraisal establishes that your mortgage is 80 percent or less of the new appraised value.

6. **Prepayment of Principal:** Some lenders charge borrowers a prepayment penalty if they pay the loan off early. If you think you may sell your home before the loan is paid off (most mortgages are repaid early) or plan to make principal payments before they are actually due, you need to know if there will be a penalty and for how long it will remain in effect. Some penalties are in effect only for the early years of the loan.

7. **Loan Processing Time:** Loan approvals can take 30 to 60 days or more. Peak business periods, particularly when rates are dropping and many homeowners are refinancing, can affect a lender's response time. Ask each lending institution for its estimate, and see which can promise very short approval times. If interest rates are rising or you have an urgent need to get moved in, these "express" services may be the answer.

8. **Closing Costs:** Closing costs are fees required by the lender at closing and can vary considerably from one financial institution to another. Ask specifically about the application fee, origination fee, points, credit report fee, appraisal fee, survey fee (if required), lender's attorney fee, cost of title search and title insurance, transfer taxes, and document preparation fee.

ADJUSTABLE - RATE MORTGAGE COMPARISON SHOPPING CHART			
	LENDER 1	LENDER 2	LENDER 3
1. FInancial index and mar gin: Treasury, Cost of Funds, Certificate of Deposit, or other? What is the margin over the index used by the lender to calculate the fully indexed rate?			
2. Initial interest rate:			
3. Adjustment inter val: What is the interest adjustment interval (six months, one year, three years, etc.)?			
4. Rate caps: Lifetime interest cap? Periodic interest cap?			
5. Payment caps:			
6. Conversion to fixed-rate loan: When can the loan convert? How is the new converted rate determined? Are there any conditions under which a conversion option will not be offered to me? Is there a conversion fee?			

CHECKLIST OF ADJUSTABLE-RATE MORTGAGE SHOPPING TERMS

If you're shopping for an adjustable-rate mortgage (ARM), ask the additional questions that follow. The most important thing to discover is the maximum amount your payments might increase.

1. **Financial Index and Margin:** The interest rate on an ARM is determined by adding a margin or spread to a specified financial index. This is called the fully indexed rate. Find out both the financial index used (Treasury, Certificate of Deposit, Cost of Funds, etc.) and the margin (that is, how much higher is the ARM rate than the index rate?).

2. **Initial Interest Rate:** Is the initial rate quoted the fully indexed rate or a lower introductory rate, sometimes called a teaser or discount rate? A teaser rate may sound like a bargain today, but it may turn out to cost you more in the long run. This low rate lasts only until the first adjustment. After that, you will be charged the fully indexed rate, at which point your payments may become unmanageable.

3. **Adjustment Interval:** How often can the interest rate be adjusted – every six months, one year, three years, five years? A loan that adjusts its interest rate after six months is called a six-month ARM; after one year, a one-year ARM; etc.

4. **Rate Caps:** Rate caps limit how much your interest rate can move, either up or down. Periodic caps limit the change per adjustment period, and a lifetime cap governs the maximum amount the interest rate can increase or decrease over the life of the loan. For example, you may find a one-year ARM with a 2 percent periodic cap and a 6 percent lifetime cap. If this one-year ARM is originated at 5.75 percent, after the one-year adjustment period it could be adjusted upward to as much as 7.75 percent, or downward to as low as 3.75 percent, depending on the movement of the index. Remember to consider the adjustment interval when comparing rate caps. The one-year ARM just described could reach its lifetime cap of 11.75 percent (original interest rate of 5.75 percent plus lifetime interest rate of 6 percent) in three years if interest rates rose steadily. A three-year ARM would just be making its first adjustment after such a three-year period.

5. **Payment Caps:** Payment caps may appear similar to rate caps, but don't be misled. While they can limit how much your monthly payment increases, they don't restrict the interest rate from going up. Many ARMs with payment caps have no corresponding interest rate caps. As a result, you may end up paying the lender less than the amount of interest you owe each month. If this happens, this unpaid interest is added to your loan balance, and the principal amount you owe increase, rather than decreases with each payment. This is called negative amortization – and generally should be avoided.

6. **Conversion to Fixed-Rate Loan:** Some ARMs let you covert to a fixed-rate mortgage at specified times, typically during the first five years of the loan. Because the convertibility feature is often an added expense (some lenders charge an extra point, for example), find out the exact conversion terms and how much it would cost you to convert your ARM to a fixed-rate loan. You'll want to compare this cost with the cost incurred and the interest rate savings you might gain by refinancing your mortgage to a fixed-rate loan. This will help you decide the relative advantages of each option to determine which is most cost-effective for you.

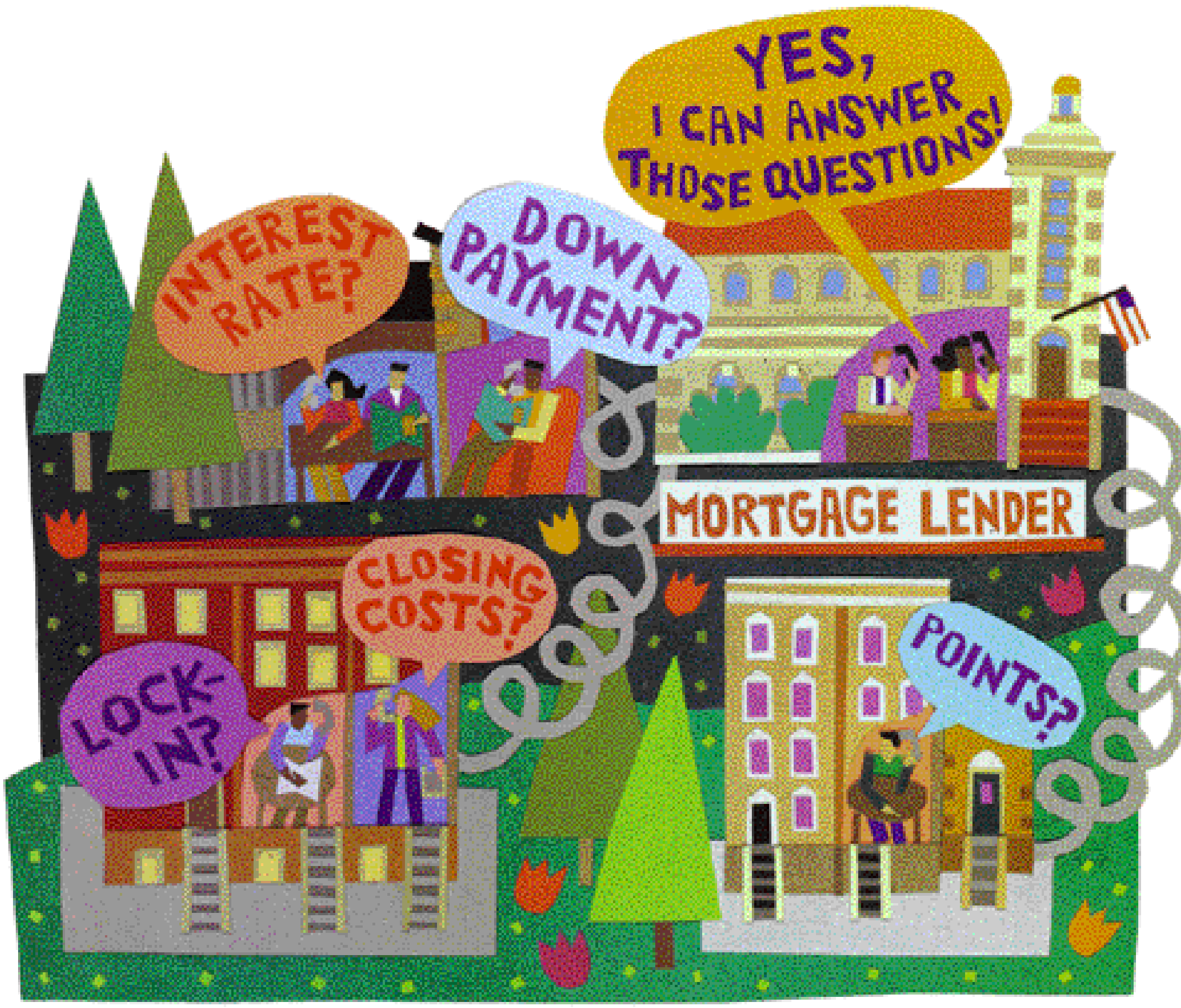
After you've gathered information.

After you've gathered information and talked to several mortgage lending institutions, you'll want to compare the terms and options that look most promising. You may see from filling out the Mortgage Comparison Shopping Chart that one lender is quoting the lowest interest rates, but another

charges less in upfront costs payable at closing. Still, another lender has the most liberal lock-in policy.

Only you know which features address your situation to the best advantage. Once you decide that, you will want to schedule an appointment with a loan officer to start filling out your mortgage application. Feel free to bring this guide along to your appointment in case you want to refer back to any of the information you have read.

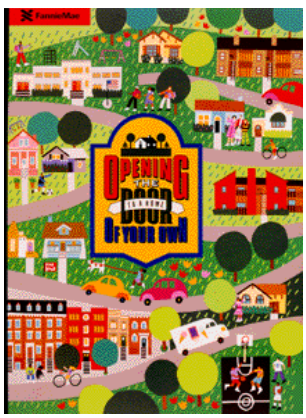
Good luck!



Before deciding on a mortgage lender, you'll want to call several different institutions to compare the terms and options that look most promising. When calling, refer to the Mortgage Comparison Shopping Chart in this guide for a list of questions you may wish to ask.

If you want our other guide, call the Fannie Mae Foundation toll free.

The Fannie Mae Foundation wants to help more Americans better understand what it takes to finance a home and how the mortgage process works. If, after reading this brochure, you are still not sure if now is the right time to get a mortgage, call for *Opening the Door to a Home of Your Own*. It gives you ten questions to ask yourself to determine if you're ready to buy a home. For your free copy, call 1-800-688-HOME.



And if you have friends, relatives, or neighbors whom you would like to help with information on the home-buying process, please tell them to call us at 1-800-688-HOME. We would be happy to send them their own personal copies of *Opening the Door to a Home of Your Own* or *Choosing the Mortgage That's Right for You* – at no cost.

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