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TRUiC Real Estate Silo Writing Portfolio

Contents:

What Is a Conventional Loan?

A conventional loan is a loan that is obtained through a private lender in order to purchase a home.

When buying a home, it's common that buyers cannot pay the full price of the home out-of-pocket. Instead, they pay a small percentage in cash—usually between 5% and 20—and take out a loan known as a mortgage to pay for the remainder. The buyer then repays the loan plus interest over a set amount of time, often 30 years.

Conventional loans typically have a fixed interest rate, meaning once the interest rate is decided when the mortgage is approved, it does not change while the loan is being repaid.

These loans are not funded or guaranteed by the federal government, so lenders often have stricter requirements to help reduce the financial risk to them.

Are Conventional Loans and Conventional Mortgages the Same Thing?

Yes. A conventional loan is a type of mortgage, and the terms "conventional loan" and "conventional mortgage" can be used interchangeably. Conventional loans or mortgages are obtained through a private, non-governmental organization.

Where Can I Get a Conventional Loan?

Conventional loans are available through private lenders like banks, credit unions, and mortgage companies, such as Giniel Financial Group.

They are not available through government agencies. However, some other types of loans are.

Who are Fannie Mae and Freddie Mac?

Fannie Mae is the Federal National Mortgage Association and Freddie Mac is the Federal Home Loan Mortgage Corporation. They are government-sponsored enterprises (GSEs) that can guarantee conforming conventional mortgages.

This means they purchase loans from lenders in the secondary market, paying off the borrower's debt if they cannot pay or stop making payments, also known as defaulting on your loan.

Fannie Mae and Freddie Mac also have established a standard set of requirements for a type of mortgage called “conforming loans.” All conforming loans are conventional loans, but not all conventional loans conform with Fannie Mae and Freddie Mac’s criteria.

Types of Conventional Loans

Conforming Conventional Loans

Conforming conventional loans are standard conventional loans that adhere to regulations, criteria, and limits established by Fannie Mae and Freddie Mac. This includes minimum requirements for down payments and credit scores, maximum debt-to-income ratio, and limits on the total amount of the loan.

Jumbo Loans

Jumbo loans are conventional loans that allow homebuyers to borrow more than the maximum lending limit set for conforming loans. In 2023, the conforming loan limit is $726,200 in most areas.

Jumbo loans require a higher credit score, a larger down payment, and a lower debt-to-income ratio.

Portfolio Loans

Portfolio loans are when lenders keep a conventional in their own portfolio instead of selling it on the secondary market.

Subprime Loans

Subprime loans are conventional loans available for borrowers who don’t meet conforming loan requirements for DTI or credit score.

Amortized Conventional Loans

Amortized conventional loans give homebuyers a set monthly payment for the duration of the loan repayment period.

Adjustable-Rate Mortgages

Adjustable-rate mortgages offer a fixed interest rate for a set period, often 3–10 years, after which your interest rate can vary from year to year.

Why Might I Need a Conventional Loan?

- You cannot pay for your new home in cash, so you need to take out a loan to obtain the funds.
- You do not qualify for or do not want one of the loans offered by a government agency like the FHA, VA, or USDA
- You want flexibility in finding the best financing options for you

Requirements for a Conventional Loan

To get approved for a conventional mortgage loan, you'll have to submit various documents proving your income, assets, employment, and identification along with your application so lenders can check your background and financial information.

Conventional loans have minimum requirements, which vary based on which type of loan you're applying for.

Down Payment

The percentage you're paying upfront and out-of-pocket as a down payment can influence your perceived risk to lenders, the amount of the loan you're applying for, and your mortgage interest rates.

Conventional loans usually require a minimum down payment of 5%, although first-time homebuyers may be able to pay as little as 3% down. Some situations may require a minimum of 10% or 15% down, and 20% has been a more traditional down payment often considered a better long-term investment.

Private Mortgage Insurance (PMI)

If your down payment is less than 20% of the purchase price, you'll have to buy private mortgage insurance (PMI), which protects your lenders in the event that you default—or stop making payments—on your loan.

PMI is typically billed with your monthly mortgage payment, with a price range from around 0.58%–1.86% of the loan amount each year based on your loan type, credit score, and the size of your down payment. PMI can also be paid for upfront with closing costs or by requesting a slightly higher interest rate.

You can stop paying once you reach 20% equity in your home. This is when you have paid 20% of the cost of the home between your down payment and monthly mortgage payments.

Credit Score

Lenders often require a credit score of at least 620 to qualify for a conventional loan.

Some loan types, like FHA loans or subprime loans, are available for homebuyers with lower credit scores.

Debt-to-Income Ratio

Debt-to-income ratio (DTI) divides your total minimum monthly payments on student loans, auto loans, credit cards, and other debts by your gross monthly income to show what percent of your monthly income is spent paying off debt.

Most conventional loans require a maximum DTI of 43%–50%. This means if you spend more than 43% of your monthly income on debt and loan payments, you may not qualify.

A lower DTI of 36% or below, may increase your chances of approval and a lower interest rate.

Loan Limit

The amount of the loan you are requesting can be found by subtracting your down payment from the total purchase price of a home. In 2023, conforming conventional loans cap loan amounts at $726,200. However, areas of the US where homes cost more have a loan limit ranging to a ceiling of $1,089,300.

To see the 2023 conforming loan limit map, visit the Federal Housing Finance Agency website.

Example: What Does a Conventional Loan Look Like?

Imagine you are interested in buying a $400,000 home.

Your credit score is 720 and your DTI ratio is 35%, making you a candidate for a conventional loan.

After reading TRUiC’s down payment guide, you decide a 20% down payment, or $80,000, is best for you. While it’s more money out-of-pocket, it means you’ll pay less on your mortgage each month and save more in the long term.

You are approved for a $320,000 fixed-rate mortgage. With the most common repayment term of 30 years, that means you’ll pay a principal rate of $889 per month before taxes, interest, insurance, and other fees.

Private mortgage insurance, or PMI, can range from around 0.58%–1.86% of the loan amount each year until you reach 20% equity in the home. For a 720 credit score and a $320,000 loan, that's about $2,784 per year or $232 per month. But since your down payment was 20%, you don't have to purchase this insurance. Your monthly rate remains $889.

In early 2023, the average interest rate for a 30-year mortgage was around 6.5%–7%. That means you'd pay around $432,000 in interest over 30 years. This would increase your monthly mortgage payment to around $2,050.

However, your 20% down payment earned you a lower interest rate of 6%, which equals a monthly mortgage rate of $1,920 per month, including both principal and interest.

Additionally, you'll have fees like property taxes and homeowner's insurance, which vary based on your property, location, and other factors. We'll allow $500 for this example, bringing your monthly mortgage payment to a grand total of $2,420.

If you'd gone with a smaller down payment, let's say 6%, you could be paying $3,240 per month.

Pros of Conventional Loans

- Conventional mortgages offer many options in loan types and terms, including fixed and adjustable interest rates.
- You can choose how you want to distribute your money—pay less upfront out-of-pocket but slightly more month-to-month, or more upfront but less month-to-month—by choosing your down payment percentage and the best PMI options for you.
- Jumbo loans are available if you are purchasing a home above conforming loan limits

Cons of Conventional Loans

- There are relatively strict financial requirements. You typically need to have a credit score of at least 620 and a low debt-to-income ratio below 43% to qualify.
- With many other options in existence, including government-backed mortgages for eligible borrowers, conventional loans may not be the best option for you, either in the short term or long term.

Conventional Loans vs. Other Loans

Conventional Loans vs. Conforming Loans

All conforming loans are conventional loans. However not all conventional loans are conforming, such as jumbo and subprime loans.

Conforming loans meet the funding criteria of Fannie Mae and Freddie Mac including minimum down payment and credit score and maximum DTI and loan amount.

Conventional Loans vs. Nonconforming Loans

Nonconforming loans are simply the opposite of conforming loans: mortgages that do not meet criteria created by Fannie Mae and Freddie Mac. They are not always conventional loans.

This includes jumbo loans, FHA loans, VA loans, USDA loans, and anything allowing credit scores below 620, DTI above 50%, down payments below 3%, or loans above the limit of $726,200 – $1,089,300 depending on your location.

With nonconforming loans, it's possible to afford more expensive properties, pay smaller down payments, and get approved with lower credit scores, but your interest rates will likely be higher as these factors make you a bigger risk for lenders.

Conventional Loans vs. FHA Mortgages

While conventional loans are private, FHA mortgages are backed by a government agency, the Federal Housing Authority.

FHA loans are designed for low-to-moderate-income buyers with poor credit and/or limited savings. They offer low down payments and no closing costs.

Other government agencies, such as the Department of Veterans Affairs and the US Department of Agriculture also offer loans to borrowers who qualify, often with a low or no down payment requirement.

For more information about FHA mortgages, visit the Department of Housing and Urban Development website. Click here to learn more about VA home loans or USDA loans.

Conventional Loans vs. DSCR Loans

DSCR loans are mortgages intended for real estate investment, including residential and commercial rental properties.

Unlike conventional loans, DSCR loans aren't based on personal income, and eligibility is determined based on a calculation of how much money you can make on a property versus cost and expenditure.

Conventional Loan Interest Rates

Interest rates for conventional loans vary based on the economy and real estate market.

The type of conventional mortgage you have, the total amount of the loan, the length of the repayment period, whether the interest rate is fixed or adjustable, and the size of your down payment also affect your mortgage's interest rate.

In early 2023, the average interest rate was around 7%.

Conventional Loans Summary

- Conventional loans are a common type of mortgage.
- There are many types of conventional loans, making them very flexible and customizable to your personal needs.
- To qualify for a conventional loan, you typically need to have a credit score of at least 620 and a debt-to-income ratio no higher than 43%. If you don't meet these qualifications, there may still be loans, such as subprime loans and FHA loans, available to you.
- The size of your down payment and the risk you pose to your lender based on your finances are some of the biggest factors in determining your interest rate.
- Check out Giniel Financial Group to get advice or apply for a conventional mortgage.

Down Payment

What is a Down Payment?

DOWN PAYMENT DEFENITION

A down payment is the money a buyer pays upfront when purchasing a good or service. This payment is a percentage of the total purchase price, and the buyer will pay the remainder of the purchase price at a later stage of the process.

Down payments are frequently required in expensive transactions that require you to apply for a loan, such as purchasing a home or car. You may also encounter a version of down payments often called a deposit if you work with a vendor. Down payments may be non-refundable.

One of the most common applications of a down payment is when a homebuyer is using a mortgage. The buyer will pay between 5% and 25% out-of-pocket at the time of closing, then take out a mortgage to pay the remainder of the purchase price.

Real estate investors who take out a DSCR loan to pay for a property will typically be required to pay at least 15% down.

HOW DOWN PAYMENTS WORK

Many home buyers take out a loan called a mortgage to pay for their homes. However, mortgages won't cover 100% of the cost of the home, so buyers are still required to pay for a percentage of the home with their own cash out-of-pocket.

Depending on the amount of and type of mortgage a buyer takes out, down payments can range from 5% to 25% of the total price of the home. For qualifying buyers, mortgages that allow just 0% to 3.5% down payments are available through entities like Veterans Affairs, the Federal Housing Administration, and USDA.

With a Federal Housing Administration loan—designed for homebuyers with low to moderate income and lower credit scores—a required down payment can be as low as 3.5%. Other special financing loans exist

Down payments are due at the time of closing, which is when that money and documents are exchanged to transfer ownership of the home to the buyer.

Earnest money, which is a smaller amount of money paid by the buyer in good faith earlier on in the purchase process, may be applied to your down payment.

If the transaction falls through or is canceled after closing, the down payment may not be refundable.

DOWN PAYMENT EXAMPLE

Let's say Buyer A and Buyer B both want to purchase a different $400,000 home. Both buyers take out a mortgage with a 30-year loan term.

Buyer A's mortgage covers 80% of the total cost of the home. This requires them to pay 20% down, which has been common in the US traditionally.

Buyer B's mortgage covers 94% of the cost of the home. This means Buyer B is required to pay 6% down, which was the average first-time homebuyer down payment in 2021, according to the National Association of Realtors.

At closing, Buyer A will make a down payment of $80,000, while Buyer B will make a down payment of $24,000.

While Buyer A is paying more out-of-pocket upfront, they will owe less money month-to-month and overall to pay back their loan. Not including factors like interest, location of the home, taxes, and insurance, Buyer A's mortgage has a base balance of $320,000, or $889 per month over the 30 years.

Buyer B doesn't have to save up as much cash to pay upfront at once, but their monthly mortgage payments will be higher, with a base balance of $376,000, or $1,045 per month.

When Do I Need to Make a Down Payment?

Down payments are made in the early stages of a transaction.

For home purchases, they are paid during closing.

Since closing follows escrow, the down payment is not the first—nor the last—payment a homebuyer will make. Fees paid prior to the down payment include earnest money, which is held in an escrow account and can be credited to your down payment. Closing costs are often paid at the same time as the down payment.

Why Do Lenders Require A Down Payment?

Lenders require a down payment in order to reduce the financial risk you pose to them.

Not only does making a down payment indicate you have funds available for your mortgage payments, but it also reduces the amount of money they are loaning you by at least 5%.

The larger the percentage of the cost of the home you take on as a down payment, the less of a perceived risk you pose to a mortgage lender. If a lender sees you as less of a risk, they may offer a lower interest rate.

How Much is a Down Payment?

Down payments for home purchases in the US typically range from 5% to 25%.

In some circumstances, 0% to 3.5% down payments may be possible. This range may be available for first-time homebuyers, but is typically related to entities like the VA, FHA, and USDA.

For real estate investors or those not purchasing a property as a primary residence who take out a DSCR loan, the required down payment is often 15% to 25%.

Traditionally, 20% down payments have been seen as ideal. Here are some examples of what a 20% down payment would look like for a range of home prices:

- $35,000 down for a $175,000 home
- $60,000 down for a $300,000 home
- $100,000 down for a $500,000 home
- $150,000 down for a $750,000 home

The recent average first-time homebuyer down payment was 6%. Here are some examples of what a 6% down payment would look like for a range of home prices:

- $10,500 down for a $175,000 home
- $18,000 down for a $300,000 home
- $30,000 down for a $500,000 home
- $45,000 down for a $750,000 home

How Do Down Payments Relate to Mortgages?

Mortgages may finance 75% to 95% of the cost of a home. The buyer is responsible for the remaining percentage out-of-pocket as a down payment.

A larger down payment may reduce your mortgage’s interest rates, while a smaller down payment may increase them.

Larger down payments will also reduce your monthly mortgage payments. Some lenders may not require you to purchase private mortgage insurance (PMI) if your down payment is 20% or more.

With different mortgage types, down payment requirements may be different.

CONVENTIONAL LOAN DOWN PAYMENT REQUIREMENTS

Conventional loan down payment requirements vary based on the buyer's personal situation and the home they are trying to buy.

First-time home buyers, and buyers who do not make more than 80% of their area's median income can often opt to pay 5% down.

Those buying a condo, duplex, or other unit in a multi-family home are often required to pay a down payment of at least 15%, while buyers purchasing a second home are required to put at least 10% down.

DSCR LOANS

DSCR Loans are for investment properties. This includes renters, house flippers, and anyone not intending to use the home—or at least one unit of the property—as a primary residence. Lenders see these properties as a higher risk, so down payment requirements are typically higher than those for conventional loans.

These mortgages typically require a 15% to 25% down payment.

MORTGAGE DOWN PAYMENT REQUIREMENT EXAMPLES

Let's go back to Buyer A and Buyer B, and say both buyers' mortgages are conventional loans, meaning both buyers intend to use the home as a primary residence.

As a reminder, Buyer A is paying 20% down on a $400,000 home, while Buyer B is paying a 6% down payment on a home of the same price.

More likely than not, Buyer A's mortgage lender would have offered them a lower interest rate since they are making a larger down payment. Buyer A's mortgage lender also may not require them to pay a monthly PMI.

Buyer B, on the other hand, will likely be offered an average or higher interest rate and will be required to purchase PMI due to their smaller down payment.

Now, let's say before committing to anything, both buyers decide they do not want to live in the home, but want to renovate it and rent it out.

So, Buyer A and Buyer B both pursue a DSCR loan instead of a conventional loan.

Buyer A will probably not need to make much of an adjustment to how much they were expecting to spend on their down payment, as it is above 15%.

Buyer B, however, will need to start saving up, because they will probably be asked to put down at least $36,000 more than they were expecting to.

After some research, Buyer B decides real estate investment isn't for them. Instead, they want to move forward with their original plan to buy the $400,000 condo as a second home using a conventional loan.

However, Buyer B is still going to have to find that extra $36,000 to go from a $24,000, 6% down payment to a $60,000, 15% down payment, because conventional loans typically require at least 10% down for second homes and at least 15% down for units in multi-family properties. At least their monthly mortgage payments will be a bit less!

Pros of a Large Down Payment

A large down payment, from 20% to 25%, could save you significant money on mortgage payments.

- Lower interest rates
    - Paying more up front makes lenders consider you less of a risk

- Private mortgage insurance (PMI) is not required
    - Lenders may not require this monthly payment if your down payment is 20% or higher

- Lower monthly mortgage payments
    - You owe less money total over the same amount of time

    - For a $400,000 home, Buyer A would pay a base rate of $889 per month for 30 years with a 20% down payment, while Buyer B would pay a base rate of $1,045 per month for 30 years with a 6% down payment

    - This is because Buyer B's mortgage is financing $376,000 of the home, while Buyer A's is financing $320,000

    - Lower interest rates and no PMI means less monthly fees added onto the base rate

Cons of a Large Down Payment

While there are definite perks to a 20%+ down payment, the upfront out-of-pocket cost can be staggering and unattainable for some buyers, especially first-time homebuyers.

- Can be a massive amount of money
    - A 20% down payment on a $400,000 home is $80,000

- This payment is in addition to closing costs, moving fees, renovations, furniture purchases, and other expensive payments homebuyers will be making around the same time as the down payment is due

Pros of a Small Down Payment

Paying tens or even hundreds of thousands of dollars out-of-pocket is not attainable for everyone, making smaller down payments, between 5% and 10%, a great option.

- Less cash up front out-of-pocket
    - A 6% down payment on a $400,000 home is $24,000

- Lower out-of-pocket cost may mean less time saving up, allowing buyers to purchase their home sooner
    - A monthly mortgage, even if it's a bit higher, may be a more realistic payment plan to spread out the impact of the cost

- Allocate the extra money where it's needed
    - The difference between a 20% and 6% down payment on a $400,000 home is $56,000

    - Buying a home often requires expensive and even unforeseen spending, including closing costs, moving fees, renovations, and furniture purchases

    - Or, you can keep the extra $56,000 in your savings for future payments

Cons of a Small Down Payment

While you pay less upfront with a 5% to 10% down payment, you will pay more over time.

- Lenders will see you as a higher risk
  - You will pay higher interest rate
  - You'll have to purchase PMI, which is an additional monthly cost

- Higher starting loan balance
  - Buyer B had to take out a loan that is $56,000 more than Buyer A

- Higher monthly payments & overall mortgage cost
  - With more money to pay off in the same amount of time, higher interest rates, and PMI, buyers who put less down will pay more each month and overall

How Should Real Estate Investors Approach Down Payments?

Real estate investors with a DSCR loan should expect to pay at least 15% down.

If investors are planning to flip or resell a property, they should also keep in mind that the mortgage must be paid off following the sale of the home. Therefore, investors may want to consider a higher down payment in order to take advantage of lower interest rates.

Get More Information and Advice

To learn more about down payments, ask for advice, or get started with real estate investing or a mortgage, contact the Giniel Financial Group.

What Is a Fixed Rate Mortgage?

A fixed rate mortgage allows a predictable and consistent alternative to adjustable and variable interest rates. It guarantees borrowers a set interest rate for the entire term of their mortgage, no matter how the market changes.

A fixed interest rate can be harder to qualify for and it can require larger payments, but borrowers and lenders can create schedules that repay interest before principal.

Fixed Rate Mortgage Definition

Getting a fixed rate mortgage means that you will have the same interest rate for the entire term of your loan. This means borrowers will pay the same amount each month.

This is a much more predictable option than adjustable rate mortgages or variable mortgages, where interest rates change and fluctuates based on market conditions.

If market conditions change and significantly decrease interest rates during the term of the loan, borrowers may be able to refinance and receive a lower rate.

Fixed Rate Mortgage vs. Adjustable Rate Mortgage

In a fixed rate mortgage, interest rates stay the same for the entire loan term. In an adjustable rate mortgage, or ARM loan, interest rates begin at a set low rate, then after several years begin to vary based on market conditions. This means ARM interest rates could remain around the same, become lower, or increase.

Fixed rate mortgages are often chosen by people who want predictability and consistency, and who plan to live in their home long-term.

ARM loans are typically chosen by people who either know they will refinance, won’t live in or own the home for long, or don’t mind the risks of unpredictable interest rates.

How Do Fixed Rate Mortgages Work?

During the mortgage application and approval process, borrowers will decide on a loan term, either 10, 15, 20, or 30 years. This is the number of years loan repayments and interest will be spread out over.

A 30-year fixed rate mortgage is the most common type of home loan.

You'll also be offered an interest rate. If you decide to pursue a fixed rate mortgage, this rate will be what you pay for the entire loan term, no matter how the market changes.

The longer the term, the more interest you pay overall. This is because a shorter term means there are less monthly payments to be made.

Can Monthly Payments Change with a Fixed Rate Mortgage?

The amount of interest a borrower pays will remain the same throughout the entire term of their loan. This means monthly payments will always remain the same.

However, if a borrower's property taxes and home insurance change or are paid out of escrow, the monthly bill could increase. If a borrower's taxes or insurance increase, that additional amount will be added to monthly payments.

Additionally, borrowers can go back to their lenders to refinance their loans if average interest rates and indexes drop significantly.

Costs of Fixed Rate Mortgages

The costs that factor into fixed rate mortgages include the principal amount of the loan and interest. Borrowers must pay back both principal and interest during the term of their loan.

- Principal
  - The principal cost is the amount of the loan a borrower takes out.

    - Often, this is the total cost of the home, minus the down payment.

- Interest
    - Interest is the fee borrowers pay back to investors. It is calculated by and displayed as a percentage of the principal amount of the loan.
    - In early 2023, the national average mortgage interest rate ranged from about 6-7%.

How is Interest Rate Determined?

Interest rate is calculated by lenders and is based on market conditions and the borrower's finances.

Some personal finances that factor into an interest rate offer include:

- Credit score

    The higher a borrower's credit score, the more likely they will be able to pay back their loan, and the less risk they pose to lenders. Therefore, they may be eligible for a lower interest rate.

    Borrowers with a lower credit score may receive a higher interest rate due to the additional risk they pose to lenders.

- Down payment

    The amount the borrower spends on a down payment impacts interest rate in a few ways. One is that a larger down payment—for example 20%—simply reduces the overall principal amount of the loan. It also indicates the borrower has the finances and assets available to pay a large sum of money. Both indicate lower risk to lenders, and can be impactful in bargaining a lower interest rate.

Homebuyers who pay a smaller percentage down—for example 6%—will likely be offered a higher interest rate due to perceived risk and the additional capital the lenders are providing.

- Additional costs

Factors such as closing costs, if you are required to get private mortgage insurance, and the overall size of the loan also factor into interest rate.

Closing costs can sometimes be paid by the bank in return for a higher interest rate. This is known as a “no-cost loan.”

Private mortgage insurance (PMI) is often required when borrowers pay less than 20% down. Both PMI and the overall cost of the loan can affect interest rate based on perceived risk to lenders.

Can Conventional Loans be Fixed Rate?

Fixed interest rates can be applied in both conforming and non-conforming conventional loans.

Conforming conventional loans follow the regulations and requirements set by Fannie Mae and Freddie Mac. Typically, you’ll need a credit score of at least 620 and a maximum debt-to-income ratio of no more than around 43%.

Non-conforming conventional loans do not follow the same restrictions, allowing space for homebuyers who do not meet certain financial requirements, such as with FHA, VA, and USDA loans, or who need a larger mortgage to purchase their home, such as in the case of jumbo loans.

Pros of Fixed Rate Mortgages

- Monthly mortgage payment remains the same throughout the entire term due to a consistent interest rate

- No risk that peaks and valleys of the shifting real estate market will increase your interest rate
- Flexible and customizable amortization schedules allow borrowers and lenders to decide the best ways to pay off the loan, often repaying interest before principal

Cons of Fixed Rate Mortgages

- Their interest rates are typically higher than introductory ARM loan rates.
    - However, ARM interest rates do not remain at this introductory rate forever. Once the fixed period ends, the interest rate varies with the market, and it's more likely than not that the interest rate will increase.
- Often more expensive up front due to fees, closing costs, and higher introductory rates
- They are typically more difficult to qualify for since the payments are larger. Very good credit and a large down payment is often required for borrowers to be approved for a fixed rate mortgage and a low interest rate

Types of Fixed Rate Mortgages

Amortized

In mortgages, amortized means to pay off the loan in regular installments with a monthly schedule created by a lender.

In amortized fixed rate mortgages, the monthly payment amounts are consistent. However initially, a higher percentage of that payment is allocated toward paying off interest. With each payment, that ratio gradually leans more and more toward paying off principal. This means toward the end of the term, the buyer is paying off more principal and less interest.

Amortized schedules are the most common type of fixed rate mortgages.

Non-Amortized

Non-amortized fixed rate mortgages—which are relatively uncommon—allow lenders to create a more flexible payment structure. Two popular non-amortized fixed rate structures are balloon payment loans and interest-only loans.

Balloon payments redistribute the borrower's payments so that, depending on how a lender structures it, they pay off interest and/or principal in significantly smaller monthly payments for a set number of years—usually five or seven. Borrowers then pay off the remaining balance of interest and principal in a large lump sum.

Interest-only loans offer borrowers the opportunity to pay off only interest for a set number of years, typically five or ten. After that period, you will begin to pay both interest and principal. This means a borrower’s loan term to pay off principal will be reduced by five or ten years.

Both of these non-amortized mortgages can be done with a fixed interest rate. Their flexibility can allow lenders and borrowers to decide how and when they want to distribute their funds. These loans can be great options for house flippers or people who do not plan to own the home long term.

Fixed Rate Mortgage Examples

30-Year Fixed Amortized vs 15-Year Fixed Amortized Example

Let’s say you are taking out a $320,000 mortgage with a fixed interest rate of 6.5%.

If you choose a **30-year lease term**, at the end of 30 years you will have paid a **total of $728,142 in principal and interest**, or $408,142 in total interest.

This means your **monthly mortgage payment will be $2,022**. Annually, you will spend $24,271 on your mortgage.

If you choose a **15-year term**, you will pay a **total of $501,758 in principal and interest**, or $181,757 in total interest.

Each month, you will pay $2,787 for an annual cost of $33,450.

With a longer lease term, you are ultimately paying more interest. However, you will pay significantly less each month.

Balloon Payment vs Interest-Only Example

Using the same loan—$320,000 with a fixed interest rate of 6.5%—you decide to look into non-amortized terms.

If you choose a balloon payment with a 5-year repayment term, you will pay **$2,022 each month**. After five years, you will stop making monthly payments and instead pay the remaining balance of both principal and interest in one **lump sum of $301,177**. Overall, you'll have paid $100,912 in interest and **$420,912 in total**.

If you choose an interest-only mortgage with a 5-year interest-only period and a 30-year loan term, you will make **monthly payments of $1,733**. After five years, you will begin to pay both principal and interest with **$2,160 monthly payments** for the remaining 25 years. Overall, you'll have paid $432,199 in interest and **$752,199 in total**.

Is a Fixed Rate Mortgage Right for You?

Fixed rate mortgages are great choices for homebuyers looking for predictability and consistency, and who are looking to own their homes long-term.

If interest rates are low, it's also a great time to consider taking advantage of a fixed rate mortgage.

For homebuyers who plan to own their home for a shorter term or are knowledgeable and comfortable with the risk that comes with adjustable rate mortgages, fixed rate mortgages may not be the best option.

When interest rates are high, ARM loans can seem like a great offer, but borrowers are taking a risk, as there is no guarantee that the market will have improved after the fixed, lower, introductory period is over. Fixed rate mortgages offer stability and predictability, no matter how the market turns.

What Is an Adjustable Rate Mortgage (ARM)?

Adjustable rate mortgages, or ARM loans, offer homebuyers a low, fixed interest rate for three to 10 years, then an interest rate that varies based on market conditions for the remainder of the term. This makes ARM loans a great option for buyers looking to resell the home within the fixed introductory period or who are looking for a short-term way to save money after purchasing their home.

ARM Definition

Adjustable rate mortgages (ARM) are a type of home loan with an interest rate that changes during the term of the loan.

They are often an option for both conforming and non-conforming conventional loans, including FHA, VA, and USDA loans.

ARM loans begin with a period of a fixed introductory interest rate for a set number of years, after which the interest rate can and will fluctuate depending on the real estate market. Typically, there is an annual and lifetime limit on how much interest rates can rise.

These loans are different than fixed rate mortgages—which guarantee the same interest rate for the entirety of the loan term—and variable rate mortgages—which offer interest rates that change based on the state of the market with no fixed introductory period. Because ARM loans are, in a sense, a mix of fixed rate and variable mortgages, they are sometimes referred to as “hybrid mortgages.”

In addition to market conditions, other factors, including your credit score and the size of your down payment, can also factor into determining interest rates.

How ARM Loans Work

ARM loans begin with several years of a fixed, consistent interest rate. Typically, this is either 3, 5, 7, or 10 years. These “introductory” or “teaser” rates are typically much lower than the average interest rate.

During the teaser period, borrowers will pay the same amount of money each month with this lower rate, almost as though they were paying off a fixed rate mortgage.

However, once the period ends, their interest rate can rise, fall, or remain the same. These fluctuations in the interest rate are based on real estate and financial markets as well as the Federal Cost of Funds Index (COFI) and the Constant Maturity Treasury (CMT) Index.

Interest rates for ARM loans are calculated by adding a margin—or the number of percentage points set by a lender based on the lender, loan type, and borrower’s finances—to the number of percentage points in the index.

Just as borrowers and lenders will agree on the number of years of the fixed introductory rate term, they will also negotiate how often the interest rate can and will fluctuate. This is often once a year.

This means that after the introductory period, ARM loan borrowers can expect their monthly mortgage payments to change once a year. Most often, borrowers will pay the same amount each month for 12 months, then they will receive a new rate, pay that rate’s amount consistently for 12 months, and so on.

Typically, there is a cap on how much a borrower’s rate can rise annually and over the term of the loan once the introductory period ends.

ARM loan terms are displayed as a fraction, placing the number of years of the fixed introductory rate over the adjustment frequency of the variable rate. For example, a 5/1 ARM offers five years of a fixed rate, after which the interest rate adjusts once a year. A 10/1 ARM, on the other hand, would offer 10 years of a fixed rate, which would also be followed by annual adjustments.

Some components of adjustable rate mortgages are consistent throughout the loan repayment term, or fixed, while others can move, change, or adjust throughout the term. Let's break down the components of ARM loans in more detail:

Fixed Components of Adjustable Rate Mortgages

- Margin
    - In ARM loans, this is the fixed number of percentage points that lenders add to the COFI or CMT index to calculate a borrower's interest rate during the adjustment period
    - The margin is calculated in part using the borrower's financial information including credit score and the amount they contributed to the down payment of a home, and can vary depending on the lender and loan type.

- Adjustment caps
    - Adjustment caps limit how much interest rates can increase after the introductory period of an ARM loan. Specific limits of these caps can change based on the ARM program chosen by the borrower and lender.
    - The initial adjustment cap or first payment adjustment cap is the maximum number of percentage points that a rate can increase after the introductory period ends.
    - The subsequent adjustment cap establishes a limit on how much an interest rate can increase in future adjustment periods. Usually, this is 2%, meaning interest rates can increase a maximum of two percentage points each adjustment period.
    - The lifetime adjustment cap limits the amount an interest rate can increase in total over the entire loan repayment term. Usually, this is 5%, meaning the most an interest rate can increase from the initial rate is five percentage points.

- Subsequent adjustment period

- This establishes how often a borrower’s interest rate is adjusted, or how many months or years are between each adjustment. Often, the subsequent adjustment period is once a year.

Adjusted Components

- Initial rate
  - Also known as the “introductory” or “teaser” rate, this is a lower, fixed rate offered for a set, temporary period of time at the beginning of an ARM loan. After that period, typically 3, 5, 7, or 10 years, the rate will move away from the initial rate and change based on market conditions.
- Index
  - Indexes, such as COFI or the CMT index, analyze financial and real estate market conditions to establish benchmark or baseline interest rates. The index rates change and are updated regularly.
  - These baseline rates are added to the margin calculated by lenders to determine a borrower’s interest rate.
  - In an ARM loan, new index rates are applied to the margin rates at each adjustment period to create the borrower’s new interest rate.

Adjustable Rate Mortgage Example

Let’s say you are a homebuyer purchasing a $400,000 property. In order to take advantage of lower rates, no private mortgage insurance, and lower monthly payments, you make a 20% down payment. This means you must take out a $320,000 mortgage. You are interested in pursuing an adjustable rate mortgage.

Your lender offers you a 30-year 5/1 ARM loan with an introductory rate of 5.75%. This means that during the first five years of your 30-year loan, you will pay just 5.75% interest. After five years, your interest rate will be adjusted based on indexes and market conditions once a year.

In early 2023, average 30-year fixed interest rates ranged from around 6.5% to 7%, so this is a great deal, at least for the first five years.

For the first five years, you will pay just $1,867 per month.

Comparatively, a 6.75% fixed rate mortgage would cost you closer to $2,400 per month.

After five years, your interest rate can be adjusted once a year. If the interest rate stays around the same as in early 2023, you can expect around a 1% adjustment. If the interest rate is capped at a maximum of 10.75%, five percentage points higher than the introductory rate, you can expect a maximum monthly payment for any given year following the introductory period of $2,803.

Overall, depending on market conditions, you could pay up to $930,274 total in principal and interest, or up to $610,274 in interest alone. If the markets allow for a lower interest rate, it's possible you could pay significantly less than this.

In contrast, for the 6.75% fixed rate mortgage, you are guaranteed to pay approximately $747,597 in principal and interest total, or $427,597 in interest alone.

Types of Adjustable Rate Mortgages

There are three different kinds of ARM loans.

Hybrid Adjustable Rate Mortgage

Hybrid ARM loans are the standard and most common type of ARM. These loans offer a fixed interest rate for a certain period of time, often 3, 5, 7, or 10 years. Once that period has ended, the interest rate begins to vary based on market conditions at a set interval, often annually.

A common hybrid ARM loan is a 5/1 ARM, which means the fixed period is five years, after which the interest rate changes annually.

Interest-Only Adjustable Rate Mortgage

An interest-only ARM, or I-O ARM, sets an amount of time during which borrowers only repay interest. This means borrowers pay a smaller amount and do not pay off any of the principal balance of the loan throughout this period. Most commonly this period is between three and 10 years.

Once that period ends, the borrower’s monthly payments increase, as principal payments are added for the remainder of the term.

While I-O ARMs allow several years of significantly smaller monthly payments, once the interest-only period ends borrowers will pay significantly more. The longer the interest-only period, the more the borrower’s subsequent monthly payments will be in order for the loan to be repaid by the end of the term.

Payment-Option Adjustable Rate Mortgage

A payment-option ARM offers borrowers more options and flexibility on how to repay their loan and how much they will repay each month.

Borrowers have the opportunity to repay both interest and principal, just interest, just principal, or a minimum payment each month. The minimum payment is lower than the cost of monthly interest.

While payment-option ARMs allow borrowers to pay less per month and customize their payments to their needs or preferences, it can also put borrowers at risk of compiling debt or defaulting, since the entire loan must be repaid by the end of the term.

Adjustable-Rate Mortgages vs. Fixed-Rate Mortgages

While ARM loan interest rates only remain fixed for up to 10 years, fixed rate mortgage interest rates remain fixed for the entire term of the loan. As a result, fixed rate mortgages are more predictable than ARM loans.

ARM loans often offer a much lower introductory rate than fixed rate mortgages. However, when the fixed period for an ARM loan ends, there is a chance it can reach the same height or exceed the rate of a fixed rate mortgage.

Borrowers may find it easier to qualify for ARM loans, since the lower introductory costs pose less of a risk to lenders.

Due to the low rates of the introductory period, ARM loans are a great option for borrowers who are looking to purchase a home they will not own long-term. The predictability of fixed rate mortgages makes them a great option for borrowers who hope to own their home for more than 10 years.

Pros of Adjustable-Rate Mortgages

- Low interest rates allow significantly lower monthly payments than fixed rate mortgages during introductory periods, and in the event that average interest rates drop.

- Allows the opportunity to save money or recover from large payments made during the purchase of the home, such as the down payment, closing costs, and furniture

- A great option for short-term homebuyers, such as house flippers or those looking for a starter home. ARM loans are also a good option for risk-takers who are educated on and interested in navigating the fluctuating real estate and financial markets.

- There is no need to refinance, since your loan will automatically adjust based on the index at the time of readjustment

Cons of Adjustable-Rate Mortgages

- Since your rate will change many times throughout the loan term, ARM loans are much less predictable than fixed rate mortgages
- There is a chance interest rates could rise significantly, causing monthly payments to increase and affect or exceed your monthly budget
- ARM loans are complicated and can require more research, a higher level of understanding of mortgages and financial markets, and closer reading of the fine print than fixed rate mortgages might
- Some lenders may require higher down payments and higher minimum credit scores in order for a borrower to qualify for an ARM loan

Should I Get an Adjustable-Rate Mortgage?

Adjustable rate mortgages are an excellent option for borrowers who expect to resell the home they are purchasing—or who plan to make additional payments to repay the entire loan—before the fixed introductory period of the ARM loan ends. This includes house flippers and buyers who are looking for a starter or shorter-term home.

ARM loans are also good options when interest rates are high, since introductory offers tend to be lower than the average fixed rate.

Since there is a period of lower monthly payments, ARM loans also offer an opportunity to save money or spend less for several years immediately following the purchase of a home. This can allow borrowers to recover from fees such as down payments and free up money for other purchases such as furniture and moving expenses.

For borrowers looking for predictability and/or a long-term home, adjustable rate mortgages may not be the best option.

What Is a DSCR Loan?

A DSCR loan is a mortgage for real estate investors seeking to purchase a property they will rent out. They are not funded, backed, or guaranteed by a government agency of government-sponsored enterprise (GSE) like Fannie Mae and Freddie Mac.

DSCR stands for Debt-Service Coverage Ratio, which is a value comparing the potential rental income to the costs you will need to pay on it.

Since it is intended for property rental businesses, you can apply as an LLC or an individual. Borrowing through your LLC protects your personal assets and finances, as the LLC is a separate entity from you. If there are multiple members of your LLC, it also provides an opportunity to pool your funds for the high down payments, which often have a minimum requirement of 20–25%.

While these loans are often smaller than traditional mortgages, lending limits can be as high as $1 million, $2 million, or even $5 million.

DSCR loan applications do not require homebuyers to provide any personal financial information outside of a credit score. Their interest rates and lender fees can be higher, as lenders consider investment properties a larger risk than properties used as a primary residence. While 30 and 35-year loans are possible, their repayment terms can be shorter, commonly ranging from 15 to 20 years.

Overall, the application process is faster and more straightforward than many other loan types.

Debt-Service Coverage Ratio (DCSR)

DSCR is a value determined by dividing the property's estimated rental income by costs.

The costs are known by the acronym PITIA: principal, interest, taxes, insurance, and association dues.

For commercial or multi-family properties, it is calculated by dividing annual net operating income by the annual PITIA costs.

The ratio calculates estimated cash flow of the rental property to give lenders an indication of the loan borrower's ability to pay back the loan.

A DSCR of 1 is commonly the minimum requirement to receive a loan. This means the costs of running the property will be the same as the rental income.

A DSCR above 1 indicates the property is making a profit. 1.25 is considered good, and 1.5 or above is considered strong. A higher DSCR can provide benefits such as a lower interest rate.

Who are DSCR Loans for?

DSCR loans are intended for real estate investors who are interested in renting out the properties they purchase.

What Kind of Properties Can I Purchase With a DSCR Loan?

- Single-family and multi-family long-term rental residential properties
- Hotels, vacation rentals, and short-term rentals
- Commercial properties, such as office buildings

DSCR loans cannot be used for rural properties, properties under 750 square feet, manufactured housing, and certain unique homes like domes, log cabins, and condotels.

DSCR Loans and LLCs

You can borrow a DSCR loan as an individual or through your LLC. This not only allows an investor to protect their personal assets and other investments, but also allows the members of the LLC to pool their money to fund the higher down payments.

Some lenders have a limit of two LLC owners on the loan and property title.

The ability to close a mortgage in the name of an LLC is a major benefit and unique quality to DSCR loans, as conventional loans can only be taken out by individuals.

Click here to learn more about the benefits of establishing an LLC and how to create an LLC for your rental property business.

DSCR Loan Example

Let’s say you have an LLC that focuses on rental properties.

You are interested in purchasing a $400,000 home you can rent out for $2,750 per month. You’re able to pay 25% down, and therefore would receive a below-average interest rate of 6% on a 30-year loan.

In order to calculate your DSCR for this property, we need to determine your monthly PITIA:

- Principal: $888
- Interest: $910
- Taxes: $275
- Insurance: $100
- Association Dues: $0

Total monthly costs = $2,173

Now, we'll divide the monthly rent by the monthly PITIA to get our DSCR: 1.27.

This is a good DSCR and indicates to lenders that your property will make a profit and you will be able to repay your loan.

You are approved under these terms, and receive a loan of $300,000 at a 6% interest rate to be repaid over 30 years. You will make an out-of-pocket down payment of $100,000.

However, if you rented out that same property for just $2,000 per month, your DSCR would be 0.92, indicating that your costs are higher than your income and you would be losing money on the property. This signals to lenders that you are at a higher risk of defaulting on your loan payments, and they are unlikely to approve you for the mortgage.

If you charged $2,173 per month, you would be breaking even on the property and your DSCR would be 1. This means your costs and income are the same amounts, and you are not making a profit on the property. In fact, if your tenants skip a month of rent or additional costs arise, your costs will be greater than your income and you will be losing money on the property. Lenders will therefore consider you a higher risk of defaulting on your payments and may not approve you for the mortgage. If they do, you will likely have higher interest rates.

DSCR Loans vs Conventional Loans

Conventional loans can technically be used to purchase investment properties, but they are not specifically designed for that purpose. Typically, this is allowed if the borrower uses part of the property, such as one unit of an apartment building, as their primary residence. DSCR loans are designed for rental and investment properties, while conventional loans are designed for homeowners purchasing a primary residence.

This means conventional loans have a detailed application process requiring the borrower's personal financial information and more intense financial requirements.

DSCR, on the other hand, only factor in what is directly related to the rental property in question.

However, DSCR loans have a higher required down payment of 20%—25%, while conventional loans can require as little as 3%–5% down.

DSCR loans can also be smaller than conventional loans.

Since lenders consider investment properties a larger risk, DSCR interest rates can be higher than that of conventional loans. In early 2023, they were an average of around 7.7%, compared to conventional loans' average of around 6.5%.

Conventional loans most commonly have a 30-year repayment term. This is also possible to obtain for a DSCR loan, although 15–20 year terms are more popular. The term of a DSCR loan is influenced by the estimated cash flow of the property and the homebuyer's investment timeline, goals, and intentions.

Using a conventional loan for a rental property may require investors to live in a unit of the property.

DSCR Loans vs FHA and VA Loans

Like conventional loans, FHA and VA loans are intended for homebuyers seeking homes to live in as a primary residence.

These loans are also designed for people with lower income, savings, and/or credit scores, and may be reserved for people who meet specific qualifications, such as military veterans. This means they have lower or no down payments and lower credit score requirements.

FHA multifamily loans require investors to live in a unit of the rental property for at least one year. VA loans also require the borrower to use one unit as a primary residence.

DSCR Loans vs Other Investment Loans

Some other mortgage options for real estate investors include portfolio loans, blanket loans, private loans, and a home equity line of credit (HELOC).

Portfolio and blanket loans are most relevant to investors who own multiple properties. Since they rely on one lender financing or refinancing multiple loans, the terms and requirements vary depending on the lender, investor, and situation.

Private loans are loans from experienced investors. There are highly customized and personalized deals, which may include conditions that award the private lender equity, and therefore profits from the rental income.

A HELOC uses the equity of an existing property as a line of credit for another property. This credit must still be repaid with interest, and interest rates may be higher than that of a conventional loan.

DSCR loans, however, are more straightforward and predictable options that are especially excellent for newer investors and investors with fewer rental properties.

How Do I Apply for a DSCR Loan?

You can apply for DSCR loans through private lenders and mortgage brokers. When you apply, you'll need to provide information about your investment property, estimated rental income, and estimated costs.

Mortgage brokerages like Giniel Financial Group can help you obtain a DSCR loan and begin your real estate investing business.

How Do I Qualify for a DSCR Loan?

Credit Score

If you're applying for a DSCR loan as an individual, you will have to provide your credit score. If you're applying as an LLC, you can use the LLC's credit score.

Depending on the lender, the minimum credit score to qualify for a DSCR loan can range from 640-720.

Significant events like foreclosures, bankruptcies, and past-due payments will also be taken into consideration.

Higher FICO scores can allow lower interest rates.

Down Payment

DSCR loans typically require you to pay at least 20%–25% down payments. Some lenders may allow down payments as low as 15%.

This is significantly higher than many other mortgages, like conventional loans. However, it is comparable to down payments often required when purchasing a second home.

Minimum Property Value

Lenders may have a requirement for the minimum value of a property that qualifies for a DSCR loan. A minimum $150,000 property value is common.

No Personal Finances

Typically, you won't need to submit any personal finances to be evaluated for a DSCR loan, especially if you apply through your LLC. Instead, lenders use rental income compared to cost to evaluate your ability to repay loans.

You or your LLC may be asked to provide some proof of finances, business, or past rental income, especially if you have a low DSCR.

DSCR Calculation

Your debt-service coverage ratio is calculated by dividing the potential rental income by estimated costs.

The higher the number, the more confident a lender is that you will be able to pay them back. A DSCR of 1.25 or higher is ideal.

Pros of DSCR Loans

- DSCR applications are faster and easier to qualify for than conforming conventional loans
- No personal income, like W2s and tax returns, is checked during the application process
- You can have multiple loans and properties simultaneously, making it easy to scale your business and grow your real estate portfolio
- Lending limits are typically higher than conforming conventional loans
- Since the loan is intended for real estate investors, you do not need to use the property or a unit of the property as your primary residence

Cons of DSCR Loans

- Large down payments are required, often 20%–25%
- Interest rates and lender fees can be higher than conventional loans and other mortgages for owner-occupied homes. In early 2023, they were about 1% higher on average.
- DSCR loans tend to be smaller than traditional loans
- You may be asked to provide proof of experience in renting during the application process

DSCR Loans Summary

- DSCR loans are intended for real estate investors who are purchasing properties they will rent out for residential or commercial use.
- DSCR loans do not require personal financial information. Instead, they are evaluated by comparing the rental property’s potential income with its expenditures.
- LLCs and individuals can both apply for DSCR loans
- DSCR loans have larger down payment requirements and may have higher interest rates than conventional loans, but they are faster and simpler to apply for.
- You can obtain multiple DSCR loans and properties at once.
- Check out Giniel Financial Group to obtain a DSCR loan and begin your real estate investing business today.

Tips for First Time Home Buyers & Mistakes to Avoid

Buying a home is no easy feat, especially when it's your first time. There are many mistakes you can make that could jeopardize your chances of being approved for a mortgage, getting low interest rates, and paying less out-of-pocket. But these "don'ts" aren't always clear, so it's easy for first time home buyers to make mistakes.

Here are the top 10 things you should not do between pre-approval and closing on your home.

1. **Don't change your job**

   Mortgage lenders look for risk in their applicants, meaning anything that could make the borrower more likely to not be able to pay the loan, also known as defaulting.

   Financial shifts indicate a lack of stability, and therefore higher risk to the lender. Higher risk means higher interest rates and could prevent you from being approved for a mortgage at all.

   Starting a new job, quitting your job, or becoming self-employed before submitting a loan inquiry are all red flags to lenders that you are a higher-risk borrower.

   Tip for first time home buyers*:*

   Most conventional mortgage lenders require you to be in a job for at least two years in order to be approved for a loan.

   If you have recently started a new job or received a high-paying job offer, you still have a chance of approval if you have a high credit score, low debt-to-income ratio, and healthy savings, assets, and investments.

2. **Don't change banks**

   Lenders' requirement for stability and consistency isn't just limited to your employment history. Your banking history should also demonstrate these qualities.

   Changing where you bank can also put a major pause on your mortgage application paperwork. If you move your bank account after you apply for pre-approval, you'll have to provide new banks statements. Lenders often require at least two months of bank statements demonstrating you have sufficient funds for all out-of-pocket fees, such as the down payment, which they can deem as sourced—meaning they know where the money came from—and seasoned—meaning the money and assets have been in your account for at least 60 days.

Changing bank accounts could not only cause a logistical nightmare, but it could put you at risk of rejection or prevent you from getting the best possible rates.

***Tip for first time home buyers**:*

Demonstrate consistency, stability, financial responsibility, and loyalty by sticking with your bank. You'll need to have held your bank account for at least 60 days before applying for a loan.

The more consistency and long-term financial stability you can show in the form of bank statements, the better your chances.

3. **Don't buy a car**

   Buying a car, truck, or any other form of transportation that you have to finance is a huge "don't."

   For one thing, lenders will see that you are spending a large amount of money while you are also working toward the purchase of a home, which will also require a lot of money out-of-pocket. You will need to be able to prove that you have the cash reserves to pay your down payment and closing costs.

   Additionally, purchasing a car can affect your credit score, especially due to the hard credit inquiry.

   Financing a vehicle also means that you have taken out a loan and are therefore paying off a debt. This will increase your debt-to-income ratio (DTI), which is a major factor for lenders in determining risk and therefore interest rates, down payment requirements, and approval at all.

   DTI divides your monthly payments on loans and credit cards by your gross monthly income to show what percentage of your income is spent paying off debt. Most conventional loan lenders allow a maximum of 43% DTI, while 36% or below is considered good.

   Taking out an auto loan will increase your DTI and reduce your chances of qualifying for a mortgage or getting a lower interest rate.

   ***Tip for first time home buyers**:*

If you just purchased a car, it may be ideal to wait six months to a year to apply for a mortgage to allow your credit score and cash reserves to bounce back.

You may still qualify for a mortgage when you have just purchased a vehicle if you have a very high credit score and the auto loan will not increase your DTI, meaning your new car payments are the same as or less than—and not in addition to—your old car payments.

However, it's best practice to not make any major purchases, including a vehicle, shortly before or during the mortgage application and homebuying process.

4. **Don't make large purchases—such as furniture—on credit**

   Like financing a car, charging big-ticket items to your credit card increases your debt-to-income ratio and now is not the time.

   Even items like furniture, which may make sense to purchase before moving, can be deceptively expensive. Whether you finance furniture or charge it to your credit card, you are creating a similar situation to purchasing a vehicle: increasing your DTI, risking a lower credit score, and spending cash reserves.

   ***Tip for first time home buyers**:*

   Any financing, loans, payment plans, and large credit card purchases will increase your DTI and indicate to lenders that you have a higher risk of defaulting.

   Wait until you have closed on your home to make large purchases, including furniture.

5. **Don't be late on your credit card payments**

   Both being late on credit card payments and charging excessively and indicate a lack of responsibility and money management in the eyes of a lender, especially if you incur additional late fees, increasing your DTI and lowering your credit score.

   Remember, the lender's goal is to determine if you will be able to pay them back in a timely manner. If they aren't confident that you can, they will either create terms to offset their financial risk, such as higher interest rates and private mortgage insurance, or not approve you for the loan.

   ***Tip for first time home buyers**:*

In order to prove to lenders you are a reliable borrower, pay your credit card bills on time and don't charge excessively or make any major purchases. Ideally, you should use 30% or less of your credit limit. These guidelines will also help you improve your credit score, which will improve your chances of approval and lower interest rates.

6. **Don't make large deposits or cash deposits**

   Lenders want the money you'll use for your down payment to be in your bank account for at least two months—what they call "seasoning"—so that the funds don't just appear out of the ether. They also want this money to be traceable to its origin, which they call "sourcing."

   If a large deposit appears in your bank account, and it's inconsistent with your normal banking activity, lenders may be skeptical of the deposit's legitimacy.

   This is because lenders need to ensure you actually have the funds to pay out-of-pocket fees and repay the loan. If you have money deposited into your bank account immediately before applying for a mortgage by someone other than your employer, lenders may wonder if it is money you actually have, or if someone has loaned you the money so it appears you qualify.

   They'll also need to understand if the deposit is a windfall, and how that may factor into the financial risk the lender is taking on.

   They'll need to trace the deposit to its source, such as a personal sale you made. The money being seasoned in your account for at least two months further demonstrates your financial responsibility and the legitimacy of the deposit.

   All cash deposits are required to be documented and sourced. Documentation may include a letter explaining why someone is giving you the money or proof of the value and occurrence of a sale.

   Tip for first time home buyers*:*

   If you need to deposit cash or an unusually large amount of money into your bank account, you should do it at least two months before applying for your mortgage or wait until after your loan has been approved.

   Be sure to keep any documentation proving the source and legitimacy of the funds.

7. **Don't lie or omit information on your loan inquiry**

Leaving out any debts and liabilities or lying about your income is fraud, is illegal, and you have a high chance of being caught and at the very least being rejected or losing your loan.

Beyond that, lying or omitting information will not be helpful to you in the long-term. If you lie about your income in order to be approved for a larger mortgage, you could be setting yourself up to default on a very large debt.

Tip for first time home buyers*:*

Being truthful and thorough on your mortgage application will not only help you avoid legal repercussions, it will also help you avoid long-term consequences such as difficulties or inability to repay the loan.

Taking the time to improve your credit score, build an employment history, and so on are the highly preferable, legal, and responsible option.

8. **Don't co-sign a loan for anyone**

Even if you're not the one making the payments on that loan, the loan is factored into your debt-to-income ratio. The higher your DTI, the lower your chances of being approved and receiving lower interest rates.

Lenders consider co-signing a loan the same as taking out your own loan.

The principle behind this is the same as not buying a vehicle, furniture, or any other major purchase that requires financing or a large amount of credit: opening new credit is not good while you are trying to take out a mortgage and purchase a home because it gives you more debt and makes you a larger financial risk to lenders.

Tip for first time home buyers*:*

Lenders view co-signing a loan and taking out your own loan as the same thing. Any new credit under your name, even if you aren't the one making payments, increases your DTI, therefore indicating you are a bigger financial risk to investors.

If you are applying for a mortgage and attempting to purchase a home, do not make or co-sign any major purchases on credit or take out any loans, including financing.

9. **Don't have inquiries made into your credit**

   Another reason you should not open new credit or make any purchases that require financing, or loans, is because lenders will make a hard inquiry into your credit score.

   A hard inquiry can drop your credit score as many as five points. While this may be a relatively small hit, especially if you have very high credit, it's best to avoid any opportunities for lenders to see you as a risk.

   Soft inquiries, such as you checking your own credit report, will not affect your credit score.

   Tip for first time home buyers*:*

   Opening any new credit that will require a hard credit inquiry should be done no later than six months before you apply for a mortgage, or after you have closed on your home.

10. **Don't spend the money you need to reserve for closing costs**

    Even with a mortgage, purchasing a home can require a lot of surprising out-of-pocket costs. It's a common first time home buyer mistake to not set aside enough money for all of these costs, including the down payment and closing costs.

    Lenders may also want proof that you have seasoned, sourced, and sufficient closing costs set aside in your bank account.

    Tip for first time home buyers*:*

    Be sure that you know what your financial obligation for the closing costs will be and set that money aside in your bank account at least two months before you apply for a mortgage.