Low Rates Better than Tax Break

This article comes from *"The Record"* real estate section by J.W. Elphinstone, The Associated Press.

For those who can qualify, it's one of the best times to get a mortgage. Last week, rates for 30-year fixed-rate loans dropped to 4.56%, the lowest level on record dating back to 1971, Freddie Mac said.

And for some who missed out on the government's home buying tax credit, the rates may more than make up for that lost $8,000.

A tax credit is immediate gratification", said Leonard Baron, a professor finance at San Diego State University, "but long-term, with rates this low, you can get much more value."

But which loan is right for you? The mortgage game has changed since the housing bust and more rules have been and are being added. One factor is for sure now: your credit score should be at least 620 or you'll have a hard time finding a loan. What varies is how much you have for a down payment.

Buyer 1 – You have a 20% down payment and expect to retire in the house.

Take out a 30-year fixed-rate loan, the most popular type of mortgage. The interest rate stays the same over the life of the loan, and right now, that rate is at historical lows.

This loan is for someone interested in stability and security.

Buyer 2 – You have a 20% down payment, but plan to move into another home down the road.

Consider a five, seven or 10-year adjustable-rate loan, which has a fixed rate for a set period and then adjusts higher after that time. These loans carry a lower initial interest rate than the 30-year fixed-rate, so you save money over the fixed-rate period. After the fixed-rate period ends, borrowers typically refinance into another loan to avoid the adjustable rate.

Rates on five-year adjustable-rate mortgages averaged 3.75%. That was the lowest on Freddie Mac's records, which date back to January 2005.

ARMs got a bad rap during the housing bust because most people who took out two or three-year ARMs got caught with an unaffordable payment when their rates reset. They couldn't refinance into a fixed-rate loan because home prices had tanked and credit tightened up.

That risk still exists, but starting in September, lenders will have to evaluate whether borrowers can make payments after the rate reset on adjustable-rate loans backed by Fannie Mae.

Buyer 3 – You have at least a 20% down payment for a house worth more than $729,500.

You need a so-called jumbo loan, which is not backed by Fannie Mae and Freddie Mac. That means any lender who makes a mortgage above that amount will have to keep the loan on its books.

To compensate for that risk, lenders charge higher interest rates than a conventional mortgage. The average rate for a 30-year fixed-rate jumbo loan fell to 5.48%, the lowest level ever in Bankrate.com's survey.

Buyer 4 – You have more than a 20% down payment.

Depending on how much you're putting down, you might consider a 20-year fixed-rate mortgage. Rates are sometimes, but not always, lower than a 30-year fixed-rate by about a quarter-point. However, because the loan term is shorter on the 20-year loan, the monthly payment will be higher than a 30-year mortgage.

For example, the monthly payment for a 20-year fixed-rate loan for $300,000 is $1,898. It's only $1,565 a month if the loan is 30 years. But over the life of the loan, you'll save about $108,000 in interest.

Buyer 5 – You have less than 20% down payment.

Consider a mortgage insured by the Federal Housing Administration or FHA. A borrower needs to put down only 3.5% of the purchase price.

Or, consider a mortgage loan that isn't back by the FHA, which requires only 5% down. However, you will pay mortgage insurance each month, which can add an extra $25 to $50 to your monthly payment depending on your credit score. Private mortgage insurance protects a lender against losses when a borrower defaults. If you have very good credit, this option may be cheaper.

Buyer 6 – You have a gift down payment.

While one in five first-time home buyers used a gift from a relative or friend for a down payment last year, there are some rules to navigate

Gift money can be used for a down payment on a conventional loan only after the borrowers use their own money to make the 5% minimum.

Gift money can pay for closing costs or prepaid expenses like property taxes and insurance that are put into an escrow account.

Banks typically check two months' work of bank statement for unusually odd deposits that could be considered gifts.

However, if the gift was deposited six months before, a bank might not notice.

However, FHA mortgages allow borrowers to use a gift to make the 3.5% minimum down payment. The gift must be documented in writing and the lender may ask for proof of deposit.

Buyer 7 – You don't have a down payment.

Your options are limited. If you are a veteran or the surviving spouse of one, consider a mortgage backed by the Dept. of Veteran Affairs. The loans offer 100% financing without private mortgage insurance at competitive mortgage rates.

If the home you're buying is in a rural area as defined by the US Dept. of Agriculture, you may qualify for a USDA home loan, which offers 100% financing without adding on private mortgage insurance. The USDA aims to help lower-income households get home loans at reasonable rates.