Mortgage Loan Types

Fixed-rate loans

These are the most popular loans because they offer stable, consistent payments throughout the life of the loan. The most common is the 30-year fixed rate.

Adjustable-rate loans

These loans have a variable interest rate that fluctuates according to the financial index they are tied to and the type of adjustable-rate mortgage (ARM) obtained. An adjustable-rate loan is usually capped over the life of the loan and limited to one or two points a year, depending on the loan type.

FHA loans

Government-backed Federal Housing Administration (FHA) loans are designed for first-time or lower income homebuyers. The interest rate for FHA loans is usually less than it would be for conventional loans. FHA loans are available as fixed-rate and adjustable-rate mortgages. The down payment is 3% to 5% of the loan amount. There are limits to the maximum loan amount.

VA loans

These loans are available to veterans of the U.S. Armed Forces and backed by the Department of Veterans Affairs. No down payment is required, the seller must pay points, and Congress controls the maximum loan amounts.

Assumptions

Consider assuming the seller's existing loan and interest rate if the rate on the assumable loan is lower than the prevailing rate for a new loan. By assuming a loan, you take responsibility for paying the mortgage owed by the seller.

Buy-down

If you cannot afford the prevailing interest rate, consider a buy-down mortgage. The buyer can pay extra points to buy down the mortgage for the first few years. Buy-downs are common among new construction homes and first-time homebuyers.

Step loans

These combine the stability of a fixed-rate loan with the lower rates of an ARM. There are two options: 5/25 and 7/23: The interest rate is fixed for the first five or seven years, and then the loan adjusts once into a one-year ARM or a fixed-rate loan. Step loans offer lower interest than the prevailing rate for 30-year fixed-rate mortgages.

Balloon loans

Interest paid during the term of the loan does not fully pay off the mortgage. At the end of the loan term, the homeowner must pay the remaining principal in one lump sum. Balloon loans usually have lower interest rates than fixed-rate loans. Balloon loans are most useful to homebuyers who stay in the home no more than the term of the loan but typically are not a good choice for a first-time homebuyer.

Seller financing

The seller takes on the role of lender and gives the buyer a loan to purchase the property. Generally, the seller owns the property outright and can finance the entire purchase or has significant equity and can "carry back" a second mortgage, which can be used to finance the buyer's down payment.

State veterans program

Many states offer veterans benefits. These benefits may include educational grants and scholarships, special exemptions or discounts on fees and taxes, home loans, veteran's homes, free hunting and fishing privileges, and more. Each state manages its own benefit programs. Be sure to take advantage of the benefits you have earned by linking to your state department of veterans affairs.

BEWARE OF:

Interest-only mortgage

An interest-only mortgage allows you to pay only the interest for a specified number of years. Since there is no payment on the loan principal, a borrower who takes this type of loan is depending on the housing market to increase the value of the home. Most interest-only mortgages have adjustable interest rates, which means the interest rate and monthly payment will change over the term of the loan. The interest-only mortgage payment period is typically between three and 10 years. After that, your monthly payment will increase even if interest rates stay the same, because you must pay back the principal as well as the interest.

80/20 mortgages

An 80/20 mortgage is essentially two mortgage loans that equal the total amount of the purchase price, with the first mortgage being 80% and the second mortgage covering the remaining 20%. The first is typically at the going rate for a conventional mortgage, whereas the second is usually significantly higher.

Subprime lending

Subprime lending, also called "B-Paper," "near-prime," or "second chance" lending, is a general term that refers to the practice of making loans to borrowers who do not qualify for market interest rates because of problems with their credit history.