# Action Plan:

## HOW TO SHOP FOR A MORTGAGE

Before you can buy a house, you will need to shop for—and qualify for—a home loan. A mortgage will likely be the biggest amount you ever borrow, and could take 15 to 30 years to pay back. That makes shopping for the lowest interest rate and fees even more important. A small difference in interest rates could save you hundreds of dollars every month, or thousands of dollars over the life of the loan. But to qualify for the lowest rates, you'll need to prepare yourself financially.

Comparing mortgages can be complicated, but the following steps can help guide you through the process.

1. **Start saving for a down payment.** Even though you may qualify for a loan from the Department of Veterans Affairs that doesn't require a down payment, you'll have more options—and could get a better interest rate—if you can make a down payment of at least 3.5 percent. The more you can put down the better. You'll also need cash to cover your closing costs—fees associated with the purchase, transferring ownership, inspections, insurance and taxes. Start saving well in advance of applying for a loan, so you'll have plenty of options when you're ready to buy a house.

2. **Avoid Paying PMI.** If you can afford to put down 20 percent, you will not have to pay private mortgage insurance (PMI) to pay off the bank if you default on the loan. The premium payments are added to your payment until your equity or ownership of the property equals 20 percent of the borrowed amount.

3. **Improve your credit score.** Having a good score will make a big difference in your interest rate and can save you thousands of dollars over the life of the loan. A few months before you apply for a mortgage, check your credit report at each of the three major credit reporting agencies for errors, pay all of your bills on time and try to keep your credit card balances below 25 percent of your credit limits for at least a month. Get a copy of your credit score when you order your credit reports.

### DIFFICULTY:

MODERATE TO COMPLEX

### WHAT YOU'LL NEED:

- A copy of your credit report and score
- Mortgage information from lenders
- Shopping for a Mortgage worksheet

### RELATED RESOURCES:

- Printable Plan (PDF 711 KB)



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4. **Decide how much house you can afford.** Most lenders generally want your mortgage payment (including the mortgage plus real estate taxes and homeowners insurance) to be no more than 28 percent of your gross monthly income. They also look for all of your debts (including your mortgage, car loan, student loans, credit-card payments and other debts) to be less than 36 percent of your gross income. You can use the Debt Service to Gross Income Ratio Worksheet to help with the calculation. The limits are slightly higher for VA and FHA loans. But even if you can qualify for a large mortgage, you don't need to borrow the maximum amount.

5. **Compare your payments to your Basic Allowance for Housing (BAH).** Calculate the difference between your mortgage payments and your BAH and decide whether you want pay the difference if these two amounts don't match. Also, determine whether you will still be able to afford monthly payments if you leave the military and no longer have a BAH. And don't forget that other costs, such as property taxes, homeowners insurance and repairs, will increase your monthly expenses. Look up BAH levels by zip code.

6. **Plan ahead for a PCS.** If you have to make a PCS move, you will need to decide what to do with the house. You need to plan ahead in case you can't sell it—or if you would have to sell the house at a loss. One possibility is to keep the mortgage payments slightly lower than the BAH so you can try to rent to other servicemembers. This way, you could charge an affordable rent that pays the mortgage and covers other expenses, like repairs or management fees.

7. **Compare rates, fees and terms from several mortgage lenders.**Contact your bank, credit union or other financial institutions to find out about their mortgage rates, loan terms and fees for the loan amount you want. The more details you can provide about your situation, down payment and credit score, the more accurate a rate estimate you will receive. You can also work with a mortgage broker who deals with many different lenders. And be sure to visit VA Home Loans for details on VA assistance and services regarding home ownership.

8. **Understand the interest rate terms.** Mortgages generally fall into two categories—fixed and adjustable. Fixed-rate loans charge the same amount of interest over the life of the loan. Adjustable-rate mortgages (ARMs) generally start at a lower interest rate than fixed-rate loans, but can go up or down over time. Hybrid ARMs let you lock in the initial rate for a number of years. Then the rate adjusts on a specific timetable.



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If you choose an ARM, be sure you understand how long the fixed rate lasts, when the adjustments will start, how often the loan will adjust, what the maximum adjustments will be and whether the adjustments are "capped," or stop when they reach a certain interest rate.

Visit **SaveAndInvest.org** for more tools and tips about Managing Your Money With Confidence.

9 **Compare rates for 15-year and 30-year mortgages.** You might qualify for a lower interest rate with the shorter term mortgage. Your monthly payments will be higher on a shorter term loan, but you will build equity faster and save money on interest rate charges in the long run. See the Shop for a Mortgage Worksheet for help comparing loans.

10 **Pick a lender and get pre-approved.** When you get closer to buying a house, get pre-approved. The lender pre-approves you for a loan after it verifies all of your income information and runs a credit check. The lender then provides you with a letter of commitment for the amount it will let you borrow. You will likely have to pay a fee for this service, but it tells realtors and sellers you are ready to buy. Being pre-approved also makes the final application process much easier. Take the time to search the Nationwide Mortgage Licensing System & Registry (NMLS) database at www.nmlsconsumeraccess.org to verify your mortgage broker is properly licensed.

In the market for a car? See our Shop for a Car Loan Action Plan to avoid running into trouble when buying a car.