

## Conforming Loan Programs

Conforming loan programs are loans not insured directly by the U.S. Department of Housing and Urban Development. These loans normally require a higher down payment than government insured loans but can carry lower interest rates. Conforming loans are different from government loans as they do not require mortgage insurance if a loan to value of 80% is reached at purchase. If a loan to value is lower than 80%, monthly mortgage insurance is needed and calculated based on that loan to value. At time of print (11/2009), the minimum down payment on a conforming loan is 5%.

### Pros:

- Anyone can apply for a Conventional loan.
- Several different loan programs are available.
- Mortgage Insurance is not needed with 20% down payment or more.

### Cons:

- Higher down payment and loan to value is needed to purchase a home.
- Higher loan to value is needed to refinance a loan.

**30 Year Fixed:** a loan where the interest rate has no fluctuation (change) for the term of 30 years. The interest rate is “fixed” for 30 years. This loan should have no pre-payment penalty whatsoever.

### Pros:

- Borrower’s can take advantage of a long term fixed rate of interest with no worry about fluctuation in interest rate.
- If the monthly payment will fit your specific goals, this would be considered the most conservative loan program available.
- Borrowers can budget their principal and interest payments for the 30 year period.

### Cons:

- Other programs with shorter terms such as: 20 and 15 year fixed mortgages may carry a lower interest rate due to shorter fixed term of the mortgage.
- Adjustable Rate Mortgages will also carry lower “start” rates.

**25, 20, 15 and 10 Year Fixed:** This is also a loan where the interest rate has no fluctuation for the specific term of the loan. The interest rate is “fixed” for that specific loan term 25, 20, 15, or 10 years.

### Pros:

- Borrower’s take advantage of a fixed rate of interest for the term of the loan with no possibility of change.
- Borrowers can budget their principal and interest payments for the specific term.
- These loans may carry a lower interest rate than a 30 year fixed.
- These loans will be paid off sooner than a 30 year fixed.

### Cons:

- Other programs may carry lower interest rates due to their shorter term periods, such as Adjustable Rate Mortgages (ARM's).
- Required Principal and Interest payments are higher than a 30 year fixed.

**Adjustable Rate Mortgages:** These loans have shorter terms that may be fixed. After the fixed period they have the possibility to adjust to a lower or higher interest rate - depending on financial markets at the time of adjustment. When the loan adjusts the interest rate will be “capped” at a specific ceiling rate (highest the rate can go) and/or floor rate (lowest the rate can go). These are called the ARM caps. The loan is also tied to a major financial instrument that is used to base the adjustment in interest rate at the time of adjustment. These financial instruments include but are not limited to: The 1 year US Treasury index or The LIBOR (London Interbank Offered Rate). These loans also carry what is called a margin that is added to the specific index to calculate an adjustment. These margins can range from such as 2.0% up to 3.0% depending on the investor (Bank). Note: These loans are usually based on a 30 year amortization (payment) but can be shorter depending on the investor.

**ARM caps:** An example of an ARM's caps would be: **2/6 caps**. Take for example a 1/1 ARM with 2/6 caps. Definition: The first number (2/6) - means that at the scheduled time of interest rate adjustment, the interest rate cannot go higher or lower than the original interest rate by 2%. Definition: The second number (2/6): This means that even if the loan has adjusted more than once and even for several years, the loan interest rate cannot exceed or go below 6% of the original interest rate – for the life of the loan. Note: Some loan programs carry caps that read like: 5/2/5 – the only difference from the above definition is that the first number (5/2/5) shown means that the at the initial (first) interest rate adjustment, the loan can go up (or down) a full 5% compared to the original rate. After that period the loan cannot go up any more or less than 2% per adjustment, and no more than 5% over the life of the loan.

**Margin:** The margin is what the investor uses to add to the specific index to calculate the new adjusted rate. Ex: Say you have a 1/1 ARM tied to the 1 Year Libor with a 2.25% margin. For example, let's say the 1 Year Libor index is at 1.24688 at the time of adjustment. The investor takes that number 1.24688 + (plus) the margin of 2.25% which will equal your new approximate interest rate of – 3.49688%. Depending on what your original (start) rate may have been, this rate will be rounded to the nearest .125% of the rate – up or down and be fixed for the next 12 month period.

**1/1 ARM or 1 year ARM:** this is a loan that is fixed for a 12 month period (1 year) and per loan program guidelines - is set to adjust on the 1 year anniversary of the loan and every 12 month period thereafter. This loan is usually a 30 year loan but can be shorter depending on the investor.

**3/1 ARM or 3 year ARM:** This loan is fixed at the original rate for a 3 year period (3/1) and then will adjust annually (3/1) after that period. This loan payment is usually based on a 30 year loan but can be shorter depending on the investor.

**5/1 ARM or 5 year ARM:** This loan is fixed at its original rate for a 5 year period (5/1) and then adjusts every 1 year (3/1) thereafter. This loan payment can be based on a shorter amortization (payment) after the original 5 year period. This is depending on investor's guidelines. This loan is usually a 30 year loan but can be shorter depending on the investor.

**7/1 ARM or 7 year ARM:** This loan is fixed at its original rate for a 7 year period (7/1) and then adjusts every 1 year (7/1) after. This loan payment can be based on a shorter amortization (payment) after the original 7 year period. This is depending on investor's guidelines. This loan is usually a 30 year loan but can be shorter depending on the investor.

**10/1 ARM or 10 year ARM:** this loan is fixed at its original rate for a 10 year period (10/1) and then adjusts annually (10/1) after that. This loan payment can be based on a shorter amortization (payment) after the original 10 year period – and usually is. It can be based on a 20 year amortization (payment) after the first 10. This is depending on your investor's guidelines. This loan is usually a 30 year loan but can be shorter depending on the investor.

**\*\*Other ARM programs** can have initial “interest only” periods that will reduce the original (start) payment even lower. Check with your lender for details.

**Pros:**

- **Lower original (start) interest rate than a longer term fixed rate mortgage.**
- **Custom years of fixed rate periods are available incrementally – 3, 5, 7 and 10 year periods.**

**Cons:**

- **Not a fixed rate term for the life of the loan.**
- **Loan is adjustable and can move up at adjustment possibly costing more.**
- **Caps on ARM's are not consistent lender to lender.**
- **Borrowers cannot budget for future swings in monthly payment.**

**REAL WORLD: If this house is your “forever house” don't use an ARM! We feel that the only reason you should get an ARM is if you are positive that you will only be in a home for a short period of time. The advantage of an ARM is the lower original (start) rate for sure. Note: Make sure you check the specific ARM rate versus a 30 year fixed at the time of purchase. Do the math and see if it is worth the savings monthly (and possible downside) and fixed term of the ARM. Example: 5/1 ARM, \$200,000.00 loan amount, 30 year term @ 4.5% = P&I payment of \$1013.37 per month. Take the same 30 year fixed @ 5.0% (same loan amount) = P&I payment of \$1073.64 per month. The savings monthly by using the 5/1 ARM is \$60.27 monthly or \$723.24 or \$3616.20 over the 5 year period. Analyze: If you know that you will be in the home for only 5 years, this is an excellent financial decision. If you stay in the home for a period longer than the 5 years, you will face an adjustment either way - up or down in interest rate. If your rate does go up at**

**adjustment, you will then be “giving back” what you saved over the 5 year period...Be sure of your timeframe to use an ARM.**