LEARNING MADE EASY

Mortgage Management

for dummies®
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Choose, manage, and pay off your mortgage

Match your mortgage to your financial goals

Qualify for a mortgage even when money is tight

Eric Tyson, MBA
Bestselling author of *Investing For Dummies*

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Bestselling author of *Property Management Kit For Dummies*

Mortgage Management For Dummies by Eric Tyson and Robert Griswold

Eric and Robert's Top Tips for Borrowers

- *Before* you get a mortgage, be sure you understand your personal financial situation. The amount of money a banker is willing to lend you isn't necessarily the amount you can "afford" to borrow given your financial goals and current situation. See Chapter 1.
- Maximize your chances for getting the mortgage you want the first time you apply by understanding how lenders evaluate your creditworthiness. Don't waste time and money on loans that end up rejected. Most obstacles to mortgage qualification can and should be overcome prior to submitting a loan application. See Chapters 2 and 3.
- Because the ocean of mortgage programs is bordered with reefs of jargon, learn loan lingo before you begin your mortgage-shopping voyage. This will enable you to hook the best loan and avoid being taken in by loan sharks. See Chapter 4 and Appendix C, the Glossary.
- To select the best type of fixed-rate or adjustable-rate mortgage for your situation, clarify two important issues. How long do you expect to keep the loan? How much financial risk are you able to accept? See Chapter 5.
- Special situation loans — such as a home equity loan or 80-10-10 financing — could be just what you need. However, some "special" loans, such as 100 percent loans and balloon loans, can be toxic. See Chapter 6.
- Whether you do it yourself or hire a mortgage broker to shop for you, canvas a variety of lenders when seeking the best mortgage. Be sure to shop not only for a low-cost loan but also for lenders that provide a high level of service. See Chapter 7.
- Investigate when shopping for a mortgage on the Internet. Be cautious. You may save time and money. Or you could end up with aggravation and a worse loan. See Chapter 8.
- Compare various lenders' mortgage programs and understand the myriad costs and features associated with each loan. To help you keep score and do a fair comparison, we provide helpful worksheets. See Chapter 9.
- Just as you must prepare a compelling résumé as the first step to securing a job you want, craft a positive, truthful mortgage application as a key to getting the loan you want. See Chapter 10.
- After you get a mortgage to purchase a home, stay informed about interest rates, because a drop in rates could provide a money-saving opportunity.

Refinancing — that is, obtaining a new mortgage to replace an existing one — can save you big money. Assess how long it will take you to recoup your out-of-pocket refinance costs. See Chapter 11.

- You may benefit from paying off your mortgage faster than is required. But before you do, examine what else you could do with that extra cash and what may be best for your situation. See Chapter 12.
- If you're among the increasing number of homeowners who reach retirement with insufficient assets for their golden years, carefully consider a reverse mortgage, which enables older homeowners to tap their home's equity. Reverse mortgages are more complicated to understand than traditional mortgages. See Chapter 13.
- If you fall on tough economic times and get behind on your housing payments, don't resign yourself to foreclosure. Take stock of the situation. Review your spending and debts and begin a dialogue with your lender to find a solution. Make use of low-cost counseling approved by the U.S. Department of Housing and Urban Development. See Chapter 14.
- Use the Loan Amortization Tables in Appendix A to determine your monthly payment after you know a loan's interest rate and term (number of years until final payoff).
- After you've had a loan awhile, see the Remaining Balance Tables in Appendix B to know how much of your original loan balance remains to be paid.

Mortgage Payment Calculator*

To calculate your monthly mortgage payment, simply multiply the relevant number from the following table by the size of your mortgage expressed in (divided by) thousands of dollars. For example, on a 30-year mortgage of $125,000 at 7.5 percent, you multiply 125 by 7.00 (from the table) to come up with an $875 monthly payment.

Interest Rate (%)	Term of Mortgage	
	15 years	**30 years**
4	7.40	4.77
4⅛	7.46	4.85
4¼	7.52	4.92
4⅜	7.59	4.99
4½	7.65	5.07
4⅝	7.71	5.14
4¾	7.78	5.22

Interest Rate (%)	Term of Mortgage	
	15 years	30 years
4⅞	7.84	5.29
5	7.91	5.37
5⅛	7.98	5.45
5¼	8.04	5.53
5⅜	8.11	5.60
5½	8.18	5.68
5⅝	8.24	5.76
5¾	8.31	5.84
5⅞	8.38	5.92
6	8.44	6.00
6⅛	8.51	6.08
6¼	8.58	6.16
6⅜	8.65	6.24
6½	8.72	6.33
6⅝	8.78	6.41
6¾	8.85	6.49
6⅞	8.92	6.57
7	8.99	6.66
7⅛	9.06	6.74
7¼	9.13	6.83
7⅜	9.20	6.91
7½	9.28	7.00
7⅝	9.35	7.08
7¾	9.42	7.17
7⅞	9.49	7.26
8	9.56	7.34
8⅛	9.63	7.43
8¼	9.71	7.52
8⅜	9.78	7.61
8½	9.85	7.69
8⅝	9.93	7.78

Interest Rate (%)	Term of Mortgage	
	15 years	30 years
8¾	10.00	7.87
8⅞	10.07	7.96
9	10.15	8.05
9⅛	10.22	8.14
9¼	10.30	8.23
9⅜	10.37	8.32
9½	10.45	8.41
9⅝	10.52	8.50
9¾	10.60	8.60
9⅞	10.67	8.69
10	10.75	8.78
10⅛	10.83	8.87
10¼	10.90	8.97
10⅜	10.98	9.06
10½	11.06	9.15
10⅝	11.14	9.25
10¾	11.21	9.34
10⅞	11.29	9.43
11	11.37	9.53
11¼	11.53	9.72
11½	11.69	9.91
11¾	11.85	10.10
12	12.01	10.29
12¼	12.17	10.48
12½	12.17	10.48

Warning: Mortgage payments are only a portion of the costs of owning a home. See Chapter 1 for figuring out your total costs and fitting them into your personal finances.

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Contents at a Glance

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Introduction

Welcome to *Mortgage Management For Dummies!* If you own or want to own real estate, you need to understand mortgages. Whether you need a loan to buy your first home, want to refinance an existing mortgage, seek to finance investment properties, or are interested in tapping some of the value you've built up in your home over the years, you've found the right book.

Unfortunately for most of us, the mortgage field is jammed with jargon and fraught with fiscal pitfalls. Choose the wrong mortgage and you could end up squandering money better saved for important financial goals, such as covering higher education tuition for your adorable little gremlins, buying that second home you've always wanted, or simply having more resources for your retirement. In the worst cases, you could end up losing your home to foreclosure and end up in personal bankruptcy. Just look at what happened in the late 2000s when the real estate market declined in many parts of the country. Folks who overextended themselves with risky mortgages ended up in foreclosure.

For typical homeowners, the monthly mortgage payment is either their largest or, after income taxes, second largest expense. When you're shopping for a mortgage, you could easily waste many hours and suffer financial losses by not getting the best loan that you can based on your specific needs and financial situation.

Because so much is at stake, we want to help you make the best decisions possible. That's where we come in.

How This Book is Different

How is this book different and better than competing mortgage books, you ask? Let us count the ways. Our book is

- **Objective:** Our goal is to make you as knowledgeable as possible *before* you commit to a particular mortgage. Most mortgage books are written by mortgage brokers or lenders who loathe to share the secrets of the mortgage business. Typically, they're more interested in promoting their own business by convincing you to use a particular mortgage broker or lender. We're not here to promote any specific brokers or lenders — we wrote this book to help you. Consider us your independent advisors.

- **Holistic:** When you obtain a mortgage, that decision affects your ability to save money and accomplish other important financial goals. We help you understand how best to fit your mortgage into the rest of your personal-finance puzzle. We also offer tips on strategies to pay off your mortgage debt efficiently or use it creatively to build overall wealth. Other mortgage books don't help you consider these bigger-picture issues of personal finance before you buy.
- **Jargon-free:** One of the hallmarks of books intended to confuse and impress the reader, rather than to convey practical information and advice, is the use of all sorts of insider terms that make things sound more mysterious and complicated than they really are. We, on the other hand, pride ourselves on simplifying the complex. Between the two of us, we have more than seven decades of practical experience explaining things to real people just like you. Eric has worked as a financial counselor, teacher, and syndicated columnist. For over 15 years, Robert hosted a real estate radio program; he was the live, on-air real estate expert for NBC-TV, and he has written several real estate books. Our combined experience can put you firmly in control of the mortgage-decision-making process.
- **User-friendly:** You can read our book piecemeal to address your specific questions and immediate concerns. But if you want a crash course on the world of mortgages, read it cover to cover. In addition to being organized to help you quickly find the information you're seeking, each portion of the book stands on its own.

Foolish Assumptions

Yes, we know that making assumptions is foolish, but we just can't help ourselves. We assume that you, dear reader, fit into one of these categories:

- You're preparing to purchase your first home.
- You want to refinance your current mortgage.
- You desire to explore real estate as an investment.
- You're interested in tapping into the equity you've built up in your home.
- You want to find realistic, legitimate ways to pay off or significantly reduce your mortgage early.

Icons Used in This Book

Sprinkled throughout this book are cute little icons to help reinforce and draw attention to key points or to flag stuff that you can skip over.

TIP

This icon flags key strategies that can improve your mortgage decisions and, in some cases, save you thousands of dollars. Think of these little light bulbs as highlighting words of wisdom that we would whisper in your ear if we were close enough to do so.

REMEMBER

This icon designates something important we don't want you to forget when you're researching, applying for, and finalizing your mortgage.

WARNING

Numerous pitfalls await prospective mortgage borrowers. This symbol denotes mistakes committed by those who have come before you. Heed these warnings and save yourself a lot of heartache.

TECHNICAL STUFF

This icon marks stuff that you don't really have to know but that may come in handy at cocktail parties thrown by people in the mortgage industry.

Beyond the Book

In addition to the material in the print or e-book you're reading right now, this product also comes with a free access-anywhere Cheat Sheet that can help you think about the best and most cost-effective ways to select, use, and manage mortgages. To get this Cheat Sheet, simply go to `www.dummies.com` and search for "Mortgage Management For Dummies Cheat Sheet" in the Search box.

Where to Go from Here

If you're not quite sure where to start, flip to the table of contents or index and find a subject that piques your interest. Feel free to dive in wherever you find chapters that apply to your circumstances. If you're more conventional, start at the beginning and trust us to guide you safely through the mortgage maze. By the time you finish the book, you'll be a mortgage master.

1

Getting Started with Mortgages

IN THIS PART . . .

Determine how much mortgage debt you can *really* afford.

Find out how to qualify for a mortgage and why getting preapproved is a smart move.

Discover the importance of your credit score, the secrets your credit report holds, and how to get both in top-notch shape.

IN THIS CHAPTER

» **Understanding how much mortgage debt you can truly afford**

» **Estimating your likely homeownership expenses**

» **Considering your other financial goals**

Chapter 1
Determining Your Borrowing Power

If you're like most folks, the single biggest purchase you'll make during your lifetime will be when you buy a home. And, to make that purchase, you'll likely have to borrow money by using a loan called a mortgage. The cumulative payments on that mortgage will far exceed the sticker price on your home due to the interest you'll pay.

Most people thinking of purchasing a home focus solely on the price of the home. If you're in the enviable position of being able to pay all cash, then the price is really all you need to consider in determining whether you can afford a given home. But the vast majority of people purchase real estate with financing. So although the purchase price is important, the reality is that the mortgage terms that you're able to secure and negotiate will determine the monthly payment that you can afford and will dictate the maximum price you can pay for your new home.

In this chapter, we help you tackle this first vital subject to consider when the time comes to take out a mortgage — how much mortgage can you really afford? ***Note:*** We intend this chapter primarily to help people who are buying a home (first or not) determine what size mortgage fits their financial situation. If you're in the mortgage market for purposes of refinancing, please also see Chapter 11.

Only You Can Determine the Mortgage Debt You Can Afford

Sit down and talk in person or by phone, or use a website to gather information and then meet face to face with a reputable mortgage lender, and you'll be asked about your income and debts. Assuming that you have a good credit history and an adequate cash down payment, the lender can quickly estimate the amount of mortgage debt you can obtain.

Suppose a mortgage lender says that you qualify to borrow, for example, $200,000. In this case, the lender is basically telling you that, based on the assessment of your financial situation, $200,000 is the *maximum* amount that this lender thinks you can borrow on a mortgage before putting yourself at significantly increased risk of default. Don't assume that the lender is saying that you can *afford* to carry that much mortgage debt given your other financial goals.

Your overall personal financial situation — most of which lenders, mortgage brokers, and real estate agents won't inquire into or care about — should help you decide how much you borrow. For example, have you considered and planned for your retirement goals? Do you know how much you're spending per month now and how much slack, if any, you have for additional housing expenses, including a larger mortgage? How much of a reserve or rainy day savings fund do you have? How are you going to pay for college expenses for your kids? Are you or will you soon be helping to care for elderly relatives?

In the following sections, we start you on the path to answering these questions.

Acknowledge your need to save

Unless you have generous parents, grandparents, or in-laws, if you want to buy a home, you need to save money. The same may be true if you desire to trade up to a more costly property. In either case, you can find yourself taking on more mortgage debt than you ever dreamed possible.

After you trade up or buy your first home, your total monthly housing expenditures and housing-related spending (such as furnishings, insurance, and utilities) will surely increase. So be forewarned that if you had trouble saving before the purchase, your finances are truly going to be squeezed after the purchase. This pinch will further handicap your ability to accomplish other important financial goals, such as saving for retirement, starting your own business, or helping to pay for your own or your children's college education.

Because you can't manage the unknown, the first step in assessing your ability to afford a given mortgage amount is to collect data about your monthly spending (see the following section). If you already track such data — whether by pencil and paper or on your computer — you have a head start. But *don't* think you're finished. Having your spending data is only half the battle. You also need to know how to analyze your spending data (which we explain how to do in this chapter) to help decide how much you can afford to borrow comfortably.

Collect your spending data

What could be more dreadful than sitting at home on a beautiful sunny day — or staying in at night while your friends and family are out on the town — and cozying up to your calculator, banking and credit card transactions, pay stubs, and most recent tax return?

Examining where and how much you spend on various items is almost no one's definition of a good time (except, perhaps, for some accountants, IRS agents, actuaries, and other bean counters who crunch numbers for a living). However, if you don't endure some pain and agony now, you could end up suffering long-term pain and agony when you get in over your head with a mortgage you can't afford.

Now some good news: You don't need to detail to the penny where your money goes. That simply isn't realistic. What you're interested in here is capturing the bulk of your expenditures and allowing for some margin for unanticipated expenses, plus savings for an emergency fund. Ideally, you should collect spending data for a three- to six-month period to determine how much you spend in a typical month on taxes, clothing, transportation, entertainment, meals out, and so forth. If your expenditures fluctuate greatly throughout the year, you may need to examine a full 12 months of your spending to get an accurate monthly average. You also want to include any known changes in upcoming expenses. Maybe your child will be starting preschool next year at a private institution or your car is getting old and you know you'll soon want to get a new vehicle.

Later in this chapter, we provide a handy table that you can use to categorize and add up all your spending. First, however, we need to talk you through the specific and often large expenses of owning a home so you can intelligently plug those numbers into your current budget.

Determine Your Potential Homeownership Expenses

If you're in the market to buy your first home, you probably don't have a clear sense about the costs of homeownership. Even people who presently own a home and are considering trading up often don't have a great grasp on their current or likely future homeownership expenses. So we include this section to help you assess your likely homeownership costs.

Making your mortgage payments

A *mortgage* is a loan you take out to finance the purchase of a home. Mortgage loans are generally paid in monthly installments typically over either a 15- or 30-year time span. Chapter 4 provides greater detail about how mortgages work.

In the early years of repaying your mortgage, nearly all your mortgage payment goes toward paying interest on the money that you borrowed. Not until the later years of your mortgage term do you rapidly begin to pay down your loan balance (the *principal*).

As we say earlier in this chapter, all that mortgage lenders can do is tell you their own criteria for approving and denying mortgage applications and calculating the maximum that you're eligible to borrow. A mortgage lender tallies up your monthly *housing expense,* the components of which the lender considers to be the mortgage payment, property taxes, and homeowners insurance.

Understanding lenders' ratios

For a given property that you're considering buying, a mortgage lender calculates the housing expense and normally requires that it not exceed 40 percent or so of your monthly before-tax *(gross)* income. So, for example, if your monthly gross income is $5,000, your lender may not allow your expected monthly housing expense to exceed $2,000. If you're self-employed and complete IRS Form 1040, Schedule C, mortgage lenders use your after-expenses *(net)* income, from the bottom line of Schedule C (and, in fact, add back noncash expenses for items such as real estate and equipment depreciation, which increases a self-employed person's net income for qualification purposes).

This housing expense ratio completely ignores almost all your other financial goals, needs, and obligations. It also ignores property maintenance and remodeling expenses, which can suck up a lot of a homeowner's dough. Never assume that the amount a lender is willing to lend you is the amount you can truly afford.

In addition to your income, the only other financial considerations a lender takes into account are your debts or ongoing monthly obligations. Specifically, mortgage lenders examine the required monthly payments for other debts you may have, such as student loans, auto loans, and credit card bills. They also deduct for alimony, child support, or any other required payments. In addition to the percentage of your income that lenders allow for housing expenses, they typically allow an additional 5 percent of your monthly income to go toward other debt repayments.

Calculating your mortgage payment amount

After you know the amount you want to borrow, calculating the size of your mortgage payment is straightforward. The challenge is figuring out how much you can comfortably afford to borrow given your other financial goals. This chapter should assist you in this regard, especially the previous section on analyzing your spending and goals.

SO YOU THINK YOU CAN HANDLE EXCESS BORROWING?

WARNING

Some people we know believe they can handle more mortgage debt than lenders allow using their handy-dandy ratios. Such borrowers may seek to borrow additional money from family, or they may fib about their income when filling out their mortgage applications.

Although some homeowners who stretch themselves financially do just fine, others end up in financial and emotional trouble. You should also know that because lenders usually cross-check the information on your mortgage application with IRS Form 4506T (the lender receives your actual tax return you filed, which certainly didn't overstate your income), borrowers who fib on their mortgage applications are caught and their applications denied.

So although we say that the lender's word isn't the gospel as to how much home you can truly afford, telling the truth on your mortgage application is the only way to go. It may be painful to learn that you don't qualify for the loan you need to purchase that home of your dreams, but you're likely better off in the long run not overextending yourself with mortgage debt.

We should also note that telling the truth prevents you from committing perjury and fraud, troubles that catch even officials elected to high office. Bankers don't want you to get in over your head financially and default on your loan, and we don't want you to either.

Suppose you work through your budget and determine that you can afford to spend $2,000 per month on housing. Determining the exact size of a mortgage that allows you to stay within this boundary may seem daunting, because your overall housing cost is comprised of several components: mortgage payments, property taxes, insurance, and maintenance (and association dues if the property is a condominium or has community assets like a swimming pool).

Using Appendix A, you can calculate the size of your mortgage payments based on the amount you want to borrow, the loan's interest rate, and whether you want a 15- or 30-year mortgage. Alternatively, you can do the same calculations by using many of the best financial calculators available for less than $50 from companies like HP and Texas Instruments. (In Chapter 8, we discuss the ubiquitous online mortgage calculators, which are often highly simplistic.)

Paying property taxes

As you're already painfully aware if you're a homeowner now, you must pay property taxes to your local government. The taxes are generally paid to a division typically called the County or Town Tax Collector.

Property taxes are typically based on the value of a property. Because property taxes vary from one locality to another, call the relevant local tax collector's office to determine the exact rate in your area. (Check the government section of your local phone directory to find the phone number or search for the name of the municipality and "property tax" online.) In addition to inquiring about the property tax rate in the town where you're contemplating buying a home, also ask what additional fees and assessments may apply. In California, many recently developed areas have special assessments (such as *Mello-Roos* districts), which are additional property taxes to pay for enhanced infrastructure and amenities, such as parks, police/fire stations, golf courses, and landscaped medians.

If you make a smaller down payment — less than 20 percent of the home's purchase price — your lender is likely to require you to have an *impound account* (also called an *escrow account* or *reserve account*). Such an account requires you to pay a monthly pro-rata portion of your annual property taxes, and often your homeowners insurance, to the lender each month along with your mortgage payment. The lender is responsible for making the necessary property tax and insurance payments to the appropriate agencies on your behalf. An impound account keeps the homeowner from getting hit with a large annual property tax bill.

WARNING

As you shop for a home, be aware that real estate listings frequently contain information regarding the amount the current property owner is currently paying in taxes. These taxes are often based on an outdated, much lower property valuation. If you purchase the home, your property taxes may be significantly higher based on the price that you pay for the property. Conversely, if you happen to buy a home that has decreased in value since it was purchased, you could find that your property taxes are actually lower.

Tracking your tax write-offs

Now is a good point to pause, recognize, and give thanks for the tax benefits of homeownership. The federal tax authorities at the Internal Revenue Service (IRS) and most state governments allow you to deduct, within certain limits, mortgage interest and property taxes when you file your annual income tax return.

You may deduct the interest on the first $1 million of mortgage debt as well as all the property taxes. (This mortgage interest deductibility covers debt on both your primary residence *and* a second residence.) The IRS also allows you to deduct the interest costs on additional borrowing known as home equity loans or home equity lines of credit (HELOCs, see Chapter 6) to a maximum of $100,000 borrowed.

To keep things simple and get a reliable estimate of the tax savings from your mortgage interest and property tax write-off, multiply your mortgage payment and property taxes by your *federal* income tax rate in Table 1-1. This approximation method works fine as long as you're in the earlier years of paying off your mortgage, because the small portion of your mortgage payment that isn't deductible (because it's for the repayment of the principal amount of your loan) approximately offsets the overlooked state tax savings.

TABLE 1-1 **2017 Federal Income Tax Brackets and Rates**

Singles Taxable Income	Married-Filing-Jointly Taxable Income	Federal Tax Rate (Bracket)
Less than $9,325	Less than $18,650	10%
$9,325 to $37,950	$18,650 to $75,900	15%
$37,950 to $91,900	$75,900 to $153,100	25%
$91,900 to $191,650	$153,100 to $233,350	28%
$191,650 to $416,700	$233,350 to $416,700	33%
$416,700 to $418,400	$416,700 to $470,700	35%
More than $418,400	More than $470,700	39.6%

Investing in insurance

When you own a home with a mortgage, your mortgage lender will insist as a condition of funding your loan that you have adequate homeowners insurance, which includes both casualty and liability coverage. The cost of your insurance policy is largely derived from the estimated cost of rebuilding your home. Although land has value, it doesn't need to be insured, because it wouldn't be destroyed in a fire. Buy the most comprehensive homeowners insurance coverage you can and take the highest deductible you can afford, to help minimize the cost.

TIP

As a homeowner, you'd also be wise to obtain insurance coverage against possible damage, destruction, or theft of personal property, such as clothing, furniture, kitchen appliances, audiovisual equipment, and your collection of vintage fire hydrants. Personal property goodies can cost big bucks to replace. Some prized possessions like jewelry, antiques, and collectibles are often excluded from your base policy and can require a special added coverage policy with limits that need to be set based on the replacement value of the items.

In years past, various lenders learned the hard way that some homeowners with little financial stake in the property and insufficient insurance coverage simply walked away from homes that were total losses and left the lender with the loss. Thus, in addition to sufficient casualty and liability insurance, lenders require you to purchase *private mortgage insurance* if you put down less than 20 percent of the purchase price when you buy. This is risk insurance that protects the lender by making the mortgage payments to the lender if you're unable to. This could be because you have a loss of income whether from a job loss or an injury/illness.

REMEMBER

Private mortgage insurance is an extra cost that will factor into the calculation for the amount of your loan and reduce your ability to borrow. You may be able to avoid paying private mortgage insurance by using 80-10-10 financing. We cover this technique in Chapter 6.

Budgeting for closing costs

As you budget for a given home purchase, don't forget to budget for the inevitable laundry list of one-time *closing costs.* In a typical home purchase, closing costs amount to about 2 to 5 percent of the purchase price of the property. Thus, you shouldn't ignore them when you figure the amount of money you need to close the deal. Having enough to pay the down payment on your loan just isn't sufficient.

TIP

Some sellers may be willing to assist buyers by paying a portion of the closing costs. This is particularly true with new home subdivisions by major builders but is always negotiable with any seller. However, expect to pay a higher interest rate for a mortgage with few or no upfront fees.