Name: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

***Lesson 6.5: Home Mortgages***

In this lesson we are going to take a look at buying a home – an ideal of “the American Dream.” Now that you know how loans work (because you bought a car in lesson 6.2), this shouldn’t be too complicated to explore and analyze. First we need to discuss what types of loans will cover the high cost of a home.

**Types of Loans** according to <https://www.bankrate.com/finance/mortgages/how-credit-scores-impact-your-mortgage-rate-1.aspx>

**1. Conventional loans**: Many lenders will accept a credit score as low as 620 for conventional loans, but some lenders may have additional requirements such as lower outstanding debt on top of that. You must be able to put 20% down on the value of the home in order to qualify for most conventional loans.

**2. FHA loans**: The Federal Housing Administration guarantees loans for borrowers with less-than-ideal credit and low down payments. You can qualify for an FHA loan with a credit score of 500 to 579 with a 10 percent down payment. FHA’s maximum financing of 3.5 percent down is available for borrowers with a score of 580 or higher. You are also required to pay PMI (Primary Mortgage Insurance) until you can get the 20% value of the home paid off of the principle.

**3. VA loans**: Backed by the U.S. Department of Veterans Affairs, VA loans are offered to active and veteran military personnel and their families. The government doesn’t have a minimum credit score requirement to qualify for VA loans, though many lenders require a minimum score of 620. They also qualify for the lowest interest rates in the country.

**4. USDA loans**: The U.S. Department of Agriculture backs the USDA loan program for low- to moderate-income borrowers purchasing a home in a rural area. Borrowers generally need a minimum score of 640 to qualify for a USDA loan. In some cases, USDA lenders will consider a lower score with additional analysis of a borrower’s credit. Some USDA loans require 0% down.

**5. Jumbo loans**: These loans, which apply to loan amounts that exceed conforming loan limits, are the hardest to qualify for if you have bad credit. At minimum, jumbo lenders require a credit score of 720 or higher to qualify because of the increased risk.

**How does your credit score affect your interest rate?**

Similar to car loans and credit card rates, your credit score will affect the interest rate you are offered when applying for a mortgage. Below are interest rates for the following credit scores for a 30 year conventional loan according to <https://www.bankrate.com/finance/mortgages/how-credit-scores-impact-your-mortgage-rate-1.aspx>



In this lesson we will explore how these interest rates affect the amount you pay over the life of the loan.

**How does the life of the loan affect the total amount you pay?**

The most common mortgages are 15 year fixed and 30 year fixed loans. Most people choose the 30 year fixed option. According to Freddie Mac in 2017, 90 percent of homebuyers chose the 30-year fixed-rate mortgage. Why? The most obvious reason is that the monthly payment is more affordable. But what does that mean over time? How much more will you end up paying?

In this lesson we will explore how the life of the loan affects the total amount paid for a home mortgage.

**Example 1) Zachary**

Zachary is planning on purchasing his first home. After months of meeting with real estate agents and filling out paperwork for his loan application, he has finally found the perfect home. The seller has accepted his offer of $213,500 and he is ready to choose what loan he will go with. The bank has given him several options and they are outlined below.

**Loan 1:** 30 year fixed with interest rate of 4.7% if 20% is put down

**Loan 2:** 30 year fixed with interest rate of 5.2% if 10% is put down

**Loan 3:** 15 year fixed with interest rate of 3.8% if 20% is put down

**Loan 4:** 15 year fixed with interest rate of 4.2% if 3.5% is put down

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Monthly Payment** | **Total Dollars Paid** | **Total Interest Paid** |
| **Loan 1** |  |  |  |
| **Loan 2** |  |  |  |
| **Loan 3** |  |  |  |
| **Loan 4**  |  |  |  |

**Example 2) Credit Scores**

Let’s use the interest rates reported by <https://www.bankrate.com/finance/mortgages/how-credit-scores-impact-your-mortgage-rate-1.aspx> to determine just how much a good credit score can save you over the life of a home loan. Below are 3 people who have listed credit scores. Let’s assume they are wanting to purchase a home that cost $342,800. Fill in the blank pieces of the chart.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Name** | **Credit Score** | **Interest Rate** | **Term of Loan** | **Down Payment** | **Loan Amount** | **Monthly Payment** | **Total Interest** |
| Danielle | 685 |  | 30 year fixed | 3.5% |  |  |  |
| Rochelle | 650 |  | 30 year fixed | 3.5% |  |  |  |
| Pete | 790 |  | 30 year fixed | 3.5% |  |  |  |

**Example 3) 15 year versus 30 year mortgage**

Now change the loans from Example 2 to 15 year loans and see how that affects the monthly payment and total interest paid.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Name** | **Credit Score** | **Interest Rate** | **Term of Loan** | **Down Payment** | **Loan Amount** | **Monthly Payment** | **Total Interest** |
| Danielle | 685 |  | 15 year fixed | 3.5% |  |  |  |
| Rochelle | 650 |  | 15 year fixed | 3.5% |  |  |  |
| Pete | 790 |  | 15 year fixed | 3.5% |  |  |  |