Mortgage 101: An Introduction To Home Loans

Leneiva Head on the three most common loan options

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Unless you work in banking or real estate, purchasing a home will probably mark the first time you've ever even considered a mortgage, let alone attempted to understand the intricacies and variances of each loan option. A home mortgage is the most substantial loan most people will ever apply for, and few enter the transaction with more than a cursory foreknowledge of their options.

That puts the vast majority of home buyers at a significant disadvantage, and many won't end up with the loan that best complements their financial needs. "There is a common misconception that all mortgage options are more or less the same," said Leneiva Head, the principal broker and owner of Welcome Home Realty in Nashville. One size does not fit all when it comes to mortgages, and it's essential that every prospective buyer know their options before applying.

"People get advice from their friends, who say 'I got a such and such mortgage and you should too,' but they don't realize that one mortgage type works for one financial situation but not another," Head said. "You can't look at a friend and say, 'well, it worked for them, it'll work for me too' unless you have looked into their financials and know your situation is identical."

Before applying for a home mortgage, all buyers should equip themselves with a fundamental understanding of each loan type, but most people don't even know where to start. ESTATENVY spoke to Head about the three most common types of mortgages. Anyone considering applying for a home mortgage should start by looking at these three options.

FHA-Insured Loans

Issued through private lenders and guaranteed by the Federal Housing Administration, FHA-insured loans are the most common government-backed loans. FHA insurance was introduced during the Great Depression to buoy the buckling housing market, and FHA-insured loans are still typically awarded to low-income buyers as a form of federal assistance.

"FHA-insured loans are the best way for a lot of people to get a reasonable mortgage," said Head. "The federal insurance means that the lender is not on the hook if the borrower defaults, so the lender can offer loans to applicants who might not otherwise be qualified. So if you go to SunTrust and apply for an FHA-insured loan, the government has told SunTrust, 'hey, if they default on this loan, we'll pay you back.' They typically require 3.5 percent of the purchase price for a down payment, and they allow sellers to contribute to the closing costs."

VA Loans

Available only to U.S. veterans and active military members, VA loans are guaranteed by the U.S. Department of Veterans Affairs and offer some of the more generous terms available. Like FHA-insured loans, VA loans are issued by private lenders, but their terms and requirements are established by the VA.

"If you qualify, VA loans are likely your best option," said Head. "They require zero down payment, and you don't have to pay mortgage insurance premiums, which are not benefits you're going to find with other loan types. They have a funding fee, which runs from one to two percent of the loan amount, and the borrower can roll that into their loan or pay it up front."

Conventional Loans

Conventional loans are not guaranteed or insured by any government agency, making them available to a wider pool of candidates but typically less generous in their terms. Still, Head says conventional loans can offer a number of advantages, including a potentially low down payment for borrowers with good credit.

“Conventional loans are where we typically see the most confusion,” Head said. “A lot of people think that conventional loans are one specific thing with a 20 percent down payment, but that’s not the case. There are a lot of conventional loan options, so most borrowers can find something that works for them. Most conventional loans are fixed-rate, but there are still some adjustable-rate mortgages out there, so it’s important for borrowers to talk with their financial advisor about what’s going to work for them and then survey their option with lenders. Conventional loans do typically have more stringent credit requirements than government-backed loans, but borrowers with good credit can sometimes find a down payment as low as three percent.”