National Association of Home Builders

Mortgage Basics

A mortgage is a long-term loan that uses real estate as collateral. A mortgage loan is commonly used for buying a home. Mortgage loans are usually fully-amortizing, which means that the monthly principal and interest payment will pay off the loan in the number of payments stipulated on the note. Mortgage loans are also described by the length of time for repayment, such as 15, 30 or 40 years, and whether the interest rate is fixed or adjustable. A mortgage loan where the downpayment is less than 20% usually requires private mortgage insurance (PMI) or government insurance or guarantee.

Most mortgage loans require monthly payments of principal and interest plus additional payments that are set -aside in escrow accounts to pay property taxes, homeowners (hazard) insurance, and any condominium or homeowner association assessments. Monthly mortgage insurance premiums for loans that have private or government mortgage insurance are generally included as part of the regular monthly principal and interest payment.

Although it is rare in these days of tight credit markets, some lenders may still offer "nontraditional" mortgage loans such as interest-only loans, in which case the borrower pays only the accrued interest and none of the payment is used to reduce the principal balance, or loans where the borrower chooses each month whether to make a minimum payment, pay the accrued interest only, or pay the accrued interest and a portion of the principal.

Home buyers who opt for a nontraditional mortgage should be aware that, depending on the terms of the loan, sudden and significant changes can occur in the monthly payment due to changes in the interest rate and/or payment terms. It is the home buyer's obligation to fully understand the terms of their loan.

Homebuyers who can afford the higher monthly payment sometimes prefer a 15-year mortgage to a 30-year mortgage. Interest rates on 15-year mortgages usually are slightly lower than 30-year rates. In addition, a homebuyer financing a home purchase with a 15-year mortgage will repay principal substantially faster and will pay far less total interest over the term of the loan.

Conventional Mortgages

A conventional mortgage is one that is not insured or guaranteed by the government. Conventional loans with a downpayment of less than 20% require private mortgage insurance (PMI), which protects the lender if the homeowner defaults on the loan. For more information about conventional loans, please check the Web sites of Fannie Mae and Freddie Mac, the two primary puchasers of conventional loans. Please note that Fannie Mae and Freddie Mac do not lend money to home buyers, rather, these organizations and other investors purchase loans that have been made to home buyers by mortgage lenders.

FHA-Insured Loans

The Federal Housing Administration (FHA), which is a part of the US Department of Housing & Urban Development (HUD), operates several low-downpayment mortgage insurance programs that buyers can use