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UNDERSTANDING HOME MORTGAGE TYPES

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With low property taxes and the absences of state income taxes, Tennessee has become the destination for many new homeowners creating quite the real estate boom. This increase in housing demand links directly with the opportunity for many first-time home buyers. Being new to the home buying process can be overwhelming but this publication can break it down with mortgage terms a buyer will more than likely hear during the search for their new home.

The Tennessee Housing Development Agency (THDA) collaborates with the University of Tennessee Extension (UT Extension) to provide Homebuyer Education for first time homebuyers. THDA is an excellent resource for homebuyers to find information pertaining to home mortgage loan products, particularly Federal Housing Administration (FHA) products. A major purpose of THDA is to offer loan products through private-sector lending partners that help Tennesseans achieve the goal of homeownership.

Home Mortgage Terms

Area Median Income (AMI) – the midpoint of a region's household income distribution, meaning that half of households in a region earn more than this amount and half earn less.

Back-end Ratio (also called debt-to-income ratio) – The maximum percentage of a borrower's gross monthly income that can be spent on the house payment and all other creditor debts. Example: A borrower who is approved for a USDA Rural Development Direct loan has a gross monthly income of $3,000. The loan requires a back-end ratio of 41 percent meaning all the borrower's total debt expenses including the mortgage payment cannot exceed $1,230 ($3,000 x 41 percent = $1,230). Therefore, this borrower will have $1,770 ($3,000-$1,230 = $1,770) of disposable income monthly.

Credit Score – A numerical value based on the analysis of a credit report that is used by creditors to predict how likely an individual is to repay a new loan.

Down Payment – The amount of cash a borrower pays toward purchasing a home.

Energy Efficient Mortgage (EEM) – Federal Housing Administration (FHA) mortgage program which finances energy efficient improvements with FHA-insured mortgages.

Front-end Ratio (also called housing ratio) – The maximum percentage of a borrower's gross monthly income that can be used to make the monthly mortgage payment. Example: A borrower who is approved for a USDA Rural Development Direct loan has a gross monthly income of $3,000. The loan requires a front-end ratio of 29 percent meaning the maximum amount for a mortgage payment based on the borrower's income is $870 ($3,000 x 29 percent = $870).

Loan-to-value Ratio (LTV) – The ratio of the loan balance to the appraised value of the house. Example: A borrower is approved for a conventional loan to purchase a $200,000 home. The loan has a 95 percent loan-to-value ratio which means the mortgage company will loan the borrower $190,000 ($200,000 x 95 percent = $190,000) which would require the borrower to pay $10,000 using their personal funds, a gift or a combination of both.

Mortgage Insurance Premium (MIP) – A policy required by the lender if a borrower puts less than 20 percent cash down when buying a home with a Federal Housing Administration (FHA) loan, which protects the lender from collateral risk in case of default. Referred to as private mortgage insurance (PMI) for conventional loans.

Private Mortgage Insurance (PMI) – A policy required by the lender if a borrower puts less than 20 percent cash down when buying a home with a conventional loan, which protects the lender from collateral risk in case of default. Referred to as mortgage insurance premium (MIP) for Federal Housing Administration (FHA) loans.

Term – The amount of time a borrower has to pay off the principle plus interest of a loan.

Upfront Mortgage Insurance Premium (UFMIP) – A one-time payment due when closing on a home that is financed with an FHA home loan. The UFMIP is 1.75 percent of the base loan amount which helps protect the lender in case default. Example: Borrower has an approved $200,000 FHA loan which has a 1.75 percent UFMIP. In this case the borrower must pay $3,500 ($200,000 x 1.75 percent = $3,500).

Developed by the Tennessee Housing Development Agency (THDA), the chart on the following page includes common home loan products with a mortgage term glossary. Using this chart will hopefully reduce the learning curve for potential home buyers.

Type of Borrower	Has good credit and funds for down payment.	Has good credit but small down payment. Also, does not mind living in a revitalized neighborhood.	Veteran or borrower who meets one of the veteran categories listed by the Veterans Administration (VA).	Has down payment, wants lower interest rate for a few years and can prove they can handle adjustments. May own home for less than five years.	Has little funding for down payment and low credit score but can afford homeownership.	Same as FHA with the addition of borrower buying new construction or rehabbed home that meets Energy Efficient Mortgage (EEM*) requirements.	Desires to live in eligible rural area, meets requirements, and has had trouble obtaining mortgage elsewhere.	Desires to live in eligible rural area, meets requirements, and has had trouble obtaining mortgage elsewhere.
Loan Product	**Conventional Fixed Rate Mortgage**	**Neighborhood Conventional Fixed Rate Mortgage**	**VA Fixed Rate Mortgage**	**5/1 Adjustable Rate Mortgage**	**FHA Fixed Rate Mortgage**	**Energy Efficient Mortgage (EEM*)**	**USDA Rural Development Guaranteed Loan**	**USDA Rural Development Direct Loan**
Terms	15, 20 and 30 years	10, 15, 20 and 30 years	15 and 30 years	30 years	15 and 30 years	Same as FHA	30 years	33 years; up to 38 years
Ratios	Interest rate and monthly payments are fixed for the life of the loan.	Interest rate and monthly payments are fixed for the life of the loan; borrower must purchase home in designated ZIP codes.	Interest rate and monthly payments are fixed for the life of the loan. Veteran requirement.	Interest rate set for first five years, then adjusts annually for life of loan.	Interest rate and monthly payments are fixed for the life of the loan. Smaller down payment requirement and flexible underwriting.	Same as FHA	Interest rate and monthly payments are fixed for the life of the loan. No down payment requirement, used for eligible borrowers and properties.	Interest rate and monthly payments are fixed for the life of the loan. No down payment requirement, used for eligible borrowers and properties.
Overview	Front: 28% Back: 36%	*(Left blank intentionally)*	Front: N/A Back: 41%	*(Left blank intentionally)*	Front: 31% Back: 43%	Front: 33% Back: 45%	Front: 29% Back: 41%	Front: 29% Back: 41%
Requirements Loan-to-Value (LTV*) %	**95%** maximum LTV; **PMI** if LTV is higher than 80%**	**97%** maximum LTV; **PMI** if LTV is higher than 80%**	**100%** maximum LTV; No monthly MIP**	**80%** maximum LTV	**96.5%** maximum LTV; UFMIP** and annual MIP** for all loans	Same as FHA	**102%** maximum LTV; **115% AMI*** or less and property requirements	**100%** maximum LTV; **80% AMI*** or less and property requirements
Down Payment	At least **5%**; can be borrower funds, a gift or combination	At least **3%**; can be borrower funds, a gift or combination	**None required**	**20%**, of which at least **10%** must be from own funds	At least **3.5%**; can be borrower funds, a gift or combination	Same as FHA	**None required**	**None required**
Credit Score	700+	660+	600+	720+	600+	Same as FHA	640+	640+
Target Borrower	Has good credit and funds for down payment.	Has good credit but small down payment. Also, does not mind living in a revitalized neighborhood.	Veteran or borrower who meets one of the veteran categories listed by the Veterans Administration (VA).	Has down payment, wants lower interest rate for a few years and can prove they can handle adjustments. May own home for less than five years.	Has little funding for down payment and low credit score but can afford homeowner-ship.	Same as FHA with the addition of borrower buying new construction or rehabbed home that meets Energy Efficient Mortgage (EEM) requirements.	Wants to live in eligible rural area, meets requirements, and has had trouble obtaining mortgage elsewhere.	Wants to live in eligible rural area, meets requirements, and has had trouble obtaining mortgage elsewhere.

*See definition on page 1
**See definition on page 2

Developed by Russell Catron, THDA HUD Housing Counseling Coordinator, 2021

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