

Step 3: Narrow Down the Loan Types which Are Compatible with your Life and your Finances.

In Chapter 3, we learned all about loans. At the beginning of this chapter, you got clarity on your finances and the other characteristics of your lifestyle which are relevant to selecting the ideal mortgage for you. Now you can start to narrow down the universe of a gazillion mortgage programs down to a couple of mortgage types that might work for you.

Types of Loans & Types of Lives					
TYPE OF LOAN	AKAs	SOUNDS RISKY BECAUSE	IT'S NOT REALLY THAT RISKY BECAUSE	MIGHT BE RIGHT FOR YOU IF	PROBABLY NOT THE RIGHT MORTGAGE FOR YOU IF
Fixed-rate	30-year fixed, 15-year fixed	Doesn't really sound risky, but there is the risk that rates will go lower than your fixed rate.	Fixed rates and payments minimize risk.	Rates are very low when you buy, or you are extremely risk averse.	You are a human being, because no matter how low the rate is, the rate on an ARM will always be lower, allowing you to buy more house or pay off the same house more quickly.
Adjustable rate mortgage	ARM	Can't predict whether interest rates will go up or down.	Most ARMs today are hybrid ARMs, with a fixed rate intro period. Interest rate on an ARM will always be lower than on a fixed rate. Rate & payment increases are capped.	You need a lower payment or want to buy more house than you could with a fixed-rate loan.	You are extremely risk averse.
Hybrid, Interest-only ARM	5/1 ARM, 7 year ARM, I/O ARM, 5 year interest-only.	You don't have to reduce your principal during the introductory period. You can't predict where rates will be when they begin to adjust.	You can totally predict when your rates will start to adjust, and can refinance prior to that. You can also pay toward the principal if you choose. In most areas, you will build equity faster through appreciation than paying toward the principal, anyway! Rate & payment increases are capped.	You need to be able to predict your rate and payments for a period of time. You know your exit strategy: you'll be moving in a few years (e.g., to get the kids in a better school), or make more money in a few years (you are a professional on track to partnership, in a career with step-up raises, or are a tenure-track educator)	Mmmm, can't think of anything.

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Pay Option ARM	Option ARM, Pick & Pay, Flex Pay ARM, Neg-Am	You could end up owing more than you paid for the house. You could even potentially end up owing more than the house is worth!	You only end up with an increasing loan amount if you consistently pay the minimum payment. You can always choose to pay more than the minimum, or to offset your minimum payments some months with much larger payments in other months. Rate & payment increases are capped.	You have tenants in the property, are a commissioned salesperson, or have seasonal fluctuations in income. You can make some higher payments, but need the flexibility of making a very low payment if you need to.	You aren't a financially disciplined person, or don't like to pay attention to financial details. Not great if rates are on the rise. Homes in your area don't appreciate strongly.
Stated Income	Stated	Interest rates might be a little higher.	You might not be able to qualify otherwise.	You are self-employed or make a lot of your income in cash or tips. You have DTI problems.	All your income comes from a "regular" job where you get a W-2 or a 1099 form, or you can document your income with bank statements.
Stated Income & Stated Assets	Stated/Stated	Interest rates might be a little higher.	You might not be able to qualify otherwise.	You have substantial assets and income that you have a hard time documenting.	You have account statements documenting 2-6 month's worth of mortgage payments in liquid assets.