

Understanding the business of mortgage lending

Most people dream of someday owning a home, and that usually means finding the best mortgage rate to get them there.

For the average consumer, the current mortgage rate market can be confusing and intimidating. Just understanding the basic business of the lending industry can greatly help when it comes to mortgage loan shopping, though.

There are three sectors of the mortgage lending industry; conforming and nonconforming loans, primary and secondary markets, and institutional and private lenders.

Any conventional home loan can be separated into one of two categories, which are conforming and nonconforming. A conforming mortgage loan has strict regulations that they must follow. These are set by the major lending institutions. The guidelines for conforming mortgage loans include an analysis of the borrower's gross income, which helps reduce the risk of default payments.

Nonconforming mortgage loans do not follow the same guidelines, and are thus riskier to mortgage lenders. Because of this, they generally do not have low mortgage interest rates. Nonconforming mortgage loans are easier for most consumers to qualify for, though, which is a benefit for many people.

There are primary and secondary markets when it comes to mortgage lending and rates. When someone goes to their bank to apply for a typical mortgage, they're participating in the primary market. Primary mortgage lenders make money off of the points that mortgage borrowers pay at closing. The secondary market consists of the investors who purchase mortgage loans from the original lenders, and make money from the interest rate over many years.

The secondary market consists of major lending institutions such as the Federal National Mortgage Association, the Government National Mortgage Association and the Federal Home Loan Mortgage Corporation.

Mortgage lenders can either be private or institutional. Commercial banks, savings and loans, and credit unions are all institutional mortgage lenders. When a person borrows money from institutional lenders they must meet institutional guidelines that apply to everyone. These guidelines include credit scores, gross income and debt-to-income ratio.

Private mortgage lenders, on the other hand, don't have to follow those federal guidelines. Private mortgage loans are not insured by the government and don't reflect the guidelines of institutional mortgage lenders.

Once a mortgage shopper knows how the system works, they can be better prepared to search for the lowest mortgage rates. A home loan is an investment that someone must pay for during most of their life, so getting the best mortgage rates is very important. A home buyer can spend the least amount of money paying off their home loan if they know how the system works.