Interest Rate vs. APR

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By ANNA CHANG-YEN | Green Shoot Media

What's your rate? If you're like many Americans, you may not have taken a good look at the price tag on what is likely the most expensive purchase you'll ever make. Doing your homework on this crucial component of your home loan can help you save money, and we're not talking pocket change.

Between RESPA, APR, GFE and HUD-1, a home buyer needs an entire education about mortgage lending industry lingo. Two important pieces of terminology — interest rate and annual percentage rate, or APR — can make a big difference in how much the loan will actually cost. A 2015 study by Bankrate, however, revealed that 35 percent of borrowers don't know the interest rate on their home loan.

The interest rate refers only to the percentage by which your mortgage balance is multplied to determine the amount of interest you'll pay each year. The annual percentage rate, or APR, includes not only the interest rate but other costs of the loan, such as points (prepaid interest) and lender fees.

Regardless of whether these costs are paid monthly or in one lump sum at the beginning or end of the loan, including those amounts in the APR can give buyers a better idea of how much they'll be shelling out over the life of the loan.

APPLES TO APPLES

While the Real Estate Settlement Procedures Act requires lenders to disclose the APR, comparing APRs alone may not always provide you with the clearest picture of what your costs will be.

There are no hard and fast rules about which fees must be included in the APR, so be thorough in your research to be sure you're getting the whole picture when comparing loans. Does one loan offer a lower APR but fail to include the credit report, title insurance and loan origination fees?

If you compare the APRs on two different types of loans, your actual costs over the life of each loan could still be vastly different. It's common sense that a 15-year fixed-rate loan will cost considerably less than a 30-year fixed-rate loan with the same rate, but how will a 5/1 adjustable-rate mortgage fare in the comparison?

If you refinance the loan after a few years to avoid a rate adjustment, you can't recoup the up-front fees you paid for the ARM. In this case, it might be wise to pay a higher APR in exchange for lower up-front fees.

Consider how long you'll keep the loan before making a decision. Most homeowners refinance at least once during the term of their mortgage.

TOO GOOD TO BE TRUE

Beware a rate that seems like a gift from the gods. Be sure your credit score and the type of loan you need (for example, a jumbo or low documentation loan) will qualify you for the advertised rate.

As with any financial decision, the small print can have big implications, so read everything carefully before signing on the line.

INFORMATION IS POWER

Take into account all your expenses, as well as cash on hand, to make an informed decision about a mortgage. The interest rate on a loan with no points (or prepaid interest) will likely be higher than the rate on a similar loan with 1 point. You could save money by paying some of the interest up front, but if you don't have the cash to spare, you might still choose the higher interest rate. Knowing your options and having a grasp of the terminology gives you the power to choose the mortgage that's best for you.

REAL ESTATE 101

Know Before You Owe

The Consumer Financial Protection Bureau offers the following tip about shopping for an adjustable-rate mortgage: Take care when comparing the APRs of adjustable-rate loans. For adjustable rate loans, the APR does not reflect the maximum interest rate of the loan. The CFPB offers education and tools to help homeowners understand their mortgage options. Learn more at **www.consumerfinance.gov/know-before-you-owe**.

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HOMEWISE GLOSSARY

Origination services: Any service involved in the creation of a mortgage loan, including but not limited to the taking of the loan application, loan processing, and the underwriting and funding of loan, and the processing and administrative services required to perform these functions.

Consummation: when the consumer becomes contractually obligated to the creditor on the loan, not, for example, when the consumer becomes contractually obligated to a seller on a real estate transaction.

SOURCE: Consumer Financial Protection Bureau