**Shopping for your first mortgage can be confusing. Here's a guide to the most important things you need to know about mortgage loans.**

Deciding what type of home loan is best for your needs is an integral part of the home-buying process. But it’s not always easy. Here are the most important factors you should compare when shopping for a mortgage.

**1. The principal**
Your mortgage principal is simply the amount you are borrowing to buy your house. In other words, it’s the price of your new home minus your down payment. When you shop for a mortgage, each bank will tell you how much it is prepared to lend you based on your income and your credit score. This will help you determine how much house you can afford.

**2. The type of mortgage**
Traditionally, mortgages fall into two broad categories: Those with a fixed interest rate and those with an adjustable rate. With a fixed rate mortgage, you usually pay the same amount each month for as long as you carry the loan. These mortgages can mean less risk and less worry about the future, but typically have a slightly higher interest rate than the initial rates offered by adjustable rate mortgages. Adjustable rate mortgages (ARMs) usually provide you with a lower initial interest rate, but their rates change with the market, so there is always the risk that your payments will increase.

Lenders also offer other options, some of which combine the features of both traditional mortgage types. Some begin with a fixed rate for three or more years and then convert to an ARM. Others let you choose how much you pay each month. When you discuss these mortgage types, make sure you understand the pros and cons of the loan and that your lender understands both your risk tolerance and your level of financial discipline.

**3. The interest rate**
Interest rates are the most visible part of any mortgage advertisement, but finding the best deal isn’t as simple as looking for the lowest posted rate. A loan with a lower rate but higher closing costs -- more on those later -- may end up being more expensive. The best way to understand the overall cost of a mortgage is to look at its annual percentage rate (APR), which takes into account the interest rate and the loan’s other costs.

If you choose an adjustable rate mortgage, you also have to understand how your interest rate may change. ARMs are usually adjusted according to an index, which is a published interest rate set by a third party, such as the federal government. The lender then adds a “margin” to determine the interest rate on your loan. For example, if the index is at 5.5 percent and your margin is 1.5 percent, your rate will be 7 percent. Many ARMs have caps to protect you against drastic increases from year to year.

**4. The monthly payment**
One of the most important things when choosing a mortgage is to make sure you can comfortably afford the monthly payment. However, it’s not enough to simply choose the loan that provides you with the lowest payment. Interest-only mortgages, for example, carry the

lowest possible monthly charges, but they do nothing to reduce your principal -- even after years of payments, you'll still owe as much as you did at the outset. Also, because your payments on an interest-only loan may rise later, you should make sure you can afford the higher payments. In most cases, you'll want a mortgage that also helps you build equity in your home. (Equity is the market value of your home minus any outstanding mortgages or liens.) If you don't build equity, you may not be able to refinance if your house decreases in value. And, when you want to move to a new house, you can put the equity of your current home towards the down payment of your next home.

**5. The term**
The mortgage term is the number of years your loan will be active. Mortgages with shorter terms carry higher monthly payments, but they can save you a lot of interest over the long term. For example, if you borrow $150,000 at 6 percent with a 30-year term, your monthly payment will be $900. The same loan with a 15-year term will cost $1,265 a month, but you'll pay almost $96,000 less in interest and you'll own your home twice as fast.

**6. Discount points**
Lenders may offer you the chance to pay discount points to lower the interest rate of your mortgage. One point is equal to 1 percent of the principal, so on a $150,000 loan, each point costs $1,500. Generally, for each point you purchase you can lower your rate by about 0.25 percent. Whether this is a good deal depends on how long you plan to keep your home -- the longer you plan to stay, the more it makes sense to buy points.

**7. Lock-ins**
When you apply for a mortgage, lenders will quote a specific interest rate and a certain number of discount points. However, the market can change while you are looking for your new home, causing rates to go up or down. That's why it's a good idea to ask your lender to lock in these rates for a specified period, often 30 to 60 days. If you want to lock in your rate, ask whether there will be a fee, if it is refundable, and get the agreement in writing.

**8. Closing costs**
Lenders charge several fees when closing mortgage deals which can add thousands of dollars to your borrowing costs. Depending on the lender and where you live, the fees go by different names and can often be confusing -- origination fees, appraisal fees and prepaid interest are among the terms you may encounter. The best advice is to ask your lender for a good faith estimate of these costs (lenders are required by law to give you one) and ask for an explanation of any charge you do not understand.