Chapter 2
How to Get the Cheapest Loan at the Best Rate

How Banks Make Money By Giving You a Loan

Banks typically make the majority of their money from charging interest on loans they give people. Interest is an amount charged on borrowing money; it's usually an annual fee based on a certain percentage of the total amount of money loaned to you. Banks usually charge you the interest rate and requires monthly payments. For example, if you receive a thirty-year loan for $100,000 at seven percent interest per year, your total monthly payment to the bank would be around $665.30. For the first month, $583.33 of this monthly payment would be interest, and the remaining $81.97 would be the principal paid.

A typical loan requires that the borrower pay back a portion of the money borrowed combined with interest on the total money borrowed. Below is an illustration of the first year of mortgage payments on a 30-year-fixed-rate mortgage:

The isolated slice represents the amount of the year's entire mortgage payment. The green portion is the proportion of this payment that is interest, and the orange portion is the principal.

For interest-only loans, the borrower would on a monthly basis, only pay back the interest and not the principal of the loan borrowed. The principal of the loan would fall due as a lump sum on the maturation date of the loan.

What is a Mortgage?

When a bank allows you to borrow money, they are betting that you'll be able to pay them back. At closing, the bank will require you to sign a note that serves a promise to repay the money based on the terms to which you've agreed. In the event that you're unable to make the payments, the bank has additional security in the mortgage – also called a deed of trust or trust deed in certain states. The borrower signs the mortgage, which permits the lender to take ownership of the property upon a borrower's default in payment. If the borrower does not cure the default, the lender can -- through foreclosure -- obtain ownership of the property and attempt to make up the loss by selling it to another purchaser.

The difference between a mortgage and a deed of trust stems from the addition of a trustee. With a deed of trust, the lender still loans the money, and the borrower still promises to pay the loan back; however, a third party -- the trustee -- holds title to the property until the loan is paid off. Like a mortgage, if the borrower defaults, the lender can repossess the home in question.

Obtaining the Loan: Learning the Bank's Requirements

Obtaining a loan from a bank can be similar to going on a job interview. You need to dress appropriately and present yourself as a well-qualified buyer. Whether you have a mortgage broker with you or not, you will have to convince the bank that you qualify for a loan by showing that you can afford to make the payments.

Lenders look at a number of factors to determine whether you qualify for a loan. The bank will first explore how steady your employment is, and how much you make annually. They'll also examine any other sources of income, how much money you've saved, and the