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The new rules of mortgage lending

Shopping for a home loan? Things have changed - here's what you need to consider.

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NEW YORK (CNNMoney.com) -- If you're shopping for a mortgage these days, it's a whole new world out there.

"There have been a huge number of changes over the past few years in mortgage borrowing," said Gibran Nicholas, founder of the CMPS Institute, which trains and certifies mortgage advisors.

Of course, many of the subprime loans that helped fuel the housing boom - those that didn't require borrowers to show any proof of income, or that let homeowners make minimum payments - are are simply no longer available.

But even buyers looking for a traditional mortgage are now faced with different factors to consider.

Here is what you need to know:

Paying up-front points. Borrowers can pay points - one-time, up-front fees - in order to reduce their mortgage's interest rate over the life of the loan. One point represents 1% of the mortgage value.

But they often assume that they should never pay points, according to Alan Rosenbaum, founder of mortgage broker Guardhill Financial. That's a mistake, in his opinion.

When interest rates were high, paying points didn't make sense because borrowers were very likely to refinance after rates dropped. They wouldn't hold their original loans long enough to recoup their up-front costs.

But now borrowers can get a lot more bang for their buck. The old rule of thumb was that paying one point at closing could lower their mortgage's interest rate by a quarter percentage point or so.

"Today the spread is worth a half point to a full point on the rate," said Rosenbaum.

It means paying $2,000 on a $200,000 mortgage at closing can shave as much as a whole percentage point off the loan's interest rate, changing a 6% loan to 5%.

That would save $126 a month, and pay for itself in 16 months. Even if the rate were only lowered to 5.5%, that would still save $64 a month, paying for itself in 32 months.

Still, not everyone is convinced. Rosenbaum recently had a client who chose a 15-year fixed rate loan at 5.875% with zero up-front points on a $800,000 loan, instead of paying a point to get a 5.375% loan.

Had the borrower chosen to pay that point, he would have recouped that cost in about three years, and then gone on to save more than $200 a month for the remaining 12 years of the loan.

Of course, there are caveats. Buyers who are planning to refinance or sell within a few years shouldn't pay points, since the strategy simply doesn't pay in the short term.

Making more than the minimum down payment. If you can afford to put 25%, 30% or more down, should you do it?

Most lenders require a minimum down payment of 20%; anything less and borrowers will need to obtain private mortgage insurance.

And if a buyer could afford to put more than 20% down, it was generally assumed that they should.

The traditional thinking was, "If you have the capital to commit, why not?" said Keith Gumbinger of mortgage research firm HSH Associates. "It will give you a smaller balance to pay off. But now, in light of declining home markets, not everyone would agree with that."

High down payments can be wiped out in severely declining markets.

Nicholas said he knows of a couple in Arizona who put a whopping $400,000 down on a million dollar house a couple of years ago. That gave them, they thought, a nice home equity cushion should they run into financial trouble.

"But prices are down so much, the couple still fell underwater," he said. "It would have been better to conserve that cash in case home prices continue to decline."

Locking in the mortgage rate. Many borrowers choose not to lock in when rates are falling, as they have been, since they assume that the deals will only get better.

But that's often a mistake.

"We almost always recommend that if you have the numbers that make your deal work, then lock it in," said Gumbinger.

His reason: Interest rates tend to jump up much faster than they inch down, meaning that buyers are much more likely to get stuck with a higher mortgage rate than they are to get lower one because they waited.

Besides, locking in at the currently very affordable rates can give borrowers peace of mind, which is no small matter when you're trying to buy a house.

"You'll sleep better at night," said Gumbinger. ■

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