Remember Those ‘No Closing Costs’ Loans? What Happened to Them?

If you have purchased a home or looked into the mortgage process in the past several years, you have probably heard the term “no-closing cost loan”. While this sounds like a great offer, these loans are not as perfect as the term might suggest. Although you will not pay any closing costs upfront, you will pay for them over time in the form of a higher interest rate—they have long been a popular option for borrowers who can qualify for a mortgage but do not necessarily have a ton of cash upfront. Recently, however, no-closing cost loans have all but disappeared from the market. I spoke with Jaxzann Riggs, owner of The Mortgage Network in Denver, to learn why.

When obtaining a home loan, borrowers traditionally have had three choices in respect to interest rates: choosing a higher rate and receiving money back for closing costs, choosing the “par” rate and breaking even, or choosing the discounted rate by “paying down” the rate.

Different strategies work better for different borrowers. Someone who plans to own their home for a very long time may find that it is not financially beneficial to do so. Borrowers considering a no-closing cost loan, though, may need to rethink their strategy, because while it may be possible to find such an option, the vast majority of lenders are very hesitant to offer them in the current marketplace.

Why? As interest rates continue falling to historic lows, lenders are feeling the pressure of refis. Many borrowers who originally decided to take a higher interest rate to avoid paying closing costs have taken advantage of the consistently dropping rates by refinancing shortly thereafter. This is financially beneficial to the borrower, but it is not ideal for the lender. Lending institutions have historically priced loans with the expectation that the loan would stay in place for an average of 7 years. This allows them to earn either the interest or the servicing income for the loan for that period of time. In either case, the lender misses out on that opportunity when a borrower decides to pay off the loan in the process of the refinance. With interest rates so low and refinance demand so high, lenders are wary of offering no-closing cost loans because of how quickly they are being refinanced.

So, if you are thinking about purchasing a home but are unsure of where you will come up with all of the money needed to cover both a down payment and closing costs, what are your options?

Although in some cases down payment assistance may be an option, it comes with several limitations. Most such programs have fairly low income limits, are limited to first-time homebuyers, and, above all, do poorly in a bidding war against other buyers.

One of the best options is to see if a family member can gift you the money needed. Another possibility is tapping into 401K retirement savings or liquidating stocks and bonds. What works best for you comes down to personal preference and availability of assets. And while no-closing cost loans are hard to find right now, they are almost certain to return once the market begins to settle.

Regardless of what loan type you are looking for, I always find it best to work with a trusted local broker for your mortgage needs. That’s why I always recommend calling Jaxzann Riggs at 303-990-2992 with any loan questions you might have.

And please let me know if she was able to help you.