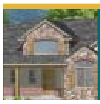

Home Buying

WELCOME AND INTRODUCTION 1

A home is one of the most complicated and costly purchases you'll ever make. 2 Getting the best deal at the time of purchase can reduce the "life-of-the-loan" costs by thousands of dollars. This program will provide complete, objective, and unbiased information so prospective military homebuyers will be confident in their decision whether or not to purchase a home, and better able to negotiate the potential financial pitfalls they may encounter during the home purchase process. Some of the topics this workshop will cover include:

- Are you ready to buy?
  - Renting versus buying.
  - Type of house.
  - Location, location, location.
  - Needs versus wants.
- What can you afford?
- Lenders and loans.
- Selecting a real estate agent.
- Negotiate the deal.
- Closing costs and closing.
- Reducing payback time.
- Homeowner's insurance.

ARE YOU READY TO BUY? 3

To evaluate whether renting or buying is best for your family, consider some of the pros and cons of each choice.

Renting versus Buying

Renting may be a better choice if…

- You move a lot. Unless you live in one place at least a few years, you may lose money when selling your home. If you cannot sell, you may become a landlord by having to rent your home.
- You are unfamiliar with the area. Before taking the plunge and buying a home, you may want to identify a neighborhood and rent there first to determine its ultimate long-term desirability.
- You are low on cash to cover the down payment and initial costs involved in purchasing a home. Renting a while in order to save for a down payment and closing costs makes sense.
- You do not care to commit the time, effort, and expense of maintaining a home. The costs of maintaining a home greatly exceed those of renting. If you cannot imagine not calling a landlord to fix the backed-up drain in the bathtub, you should rent.
- You prefer more fixed expenses. There are a lot of variable, unplanned expenses when you own a home.
- You don't want to lose any equity (you won't gain any, either).
- You don't mind not being able to personalize your home. Often with renting you take the dwelling as-is, and the landlord may not be willing to let you paint or change anything.
- You don't need or want the tax advantages that come with owning a home.
- You don't want to be a landlord. If you buy a home and have to move, you may be unable to sell it for profit, or unable to sell it at all (depending on the home, location, market, etc.). As a result, many military homeowners become landlords. If you don't want to be a landlord, renting may be better.

Buying may be better if…

- You want your equity to grow. If you are moving to an area enjoying high appreciation in the value of residential property, your equity can grow and offset the costs of selling should you be transferred. Equity in a home is also an excellent source of retirement income, as the mortgage is paid off and equity in the home grows.
- You can afford to buy a home that will allow you to itemize on your tax return. It must be expensive enough that the interest paid and real estate taxes nearly equal or exceed the standard deduction.

- You are ready for stability and a sense of community. Buying a home automatically commits you to a region and a neighborhood. You become very interested in the zoning laws, the tax rates, the city's/ county's plans for expansion and growth, and the appearance of your neighbor's property.
- You don't mind the possiblility of becoming a landlord.
- You have money for the large initial investment involved in buying a home.
- You like to remodel and personalize your home.

What type of house?

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Your goals might seem obvious - your growing family needs a larger home or you need a place to live. Once you've made the decision to buy you need to determine what type of house you want to purchase. Do you want a condo, a duplex, or a single family home? Do you desire an older home or new construction? How big of a home do you want, two or three stories and over 2,000 square feet, or a small ranch with maybe 1,200 square feet? How many bedrooms do you need, and how many do you want? Big backyard or no lawn to mow?

Location, location, location!

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There are many factors that go into determining the perfect location for a home.

- How far to work? Many people have very strong feelings about the distance they drive from home to work. This defines the areas where they are willing to look for a home.
- What is the school system like? Do you have school age children? Contact the local school administration or go online to determine which schools can meet your child's academic, athletic or special needs. If you don't have children, still consider the local school system, because that will affect the resale value of the home.
- How safe is the neighborhood? Contact the local police department to get crime statistics for different neighborhoods.
- City, suburb or country? How close do you want your neighbors to be?
- Will you need to use mass transit?
- Is childcare available?

- How close are schools, libraries, parks, shopping, highways, hospitals, fire stations, and other services?

Sit down with the family and talk about your dream house. Make a list. Try to balance your needs and wants. Start by thinking about your present home and identify which features you really like.

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Needs versus Wants

Next, envision your new home and try to build it in your mind. Does it have more bedrooms than your present home or a workbench in the garage, a fireplace, gas or electric stove? Take the list you've created and divide it into "needs" and "wants." The "needs" list will narrow your search by eliminating those houses that are wrong for you. Your "wants" list will help you choose among the remaining possibilities. Examples of both include:

Needs	**Wants**
Enough square footage for comfortable living	Carpeting color, paint color, exterior color, roof color, etc.
Enough bedrooms to accommodate your family	Pool or Jacuzzi (unless for medical reasons)
Adequate number of bathrooms	Wood floors
Eat-in kitchen	Bay windows
Garage or basement for storage needs	Built-in entertainment center
Lot size to accommodate children's play area	Brass lighting fixtures
Adaptation for handicapped	Skylights
Proximity to a specific school	A pretty view
All living areas on single floor for health reasons	Specific brand/types of appliances

It is common to hear that the three most important considerations in purchasing a home are location, location, and location.

- Find a good city map and the classified ads section of your local newspaper. Survey prospective neighborhoods.
- Get to know various areas by selecting a dozen homes from the ads and make a day of visiting them. The idea here isn't to find "the" house, but to narrow your search to the most desirable neighborhood.

Remember it's much easier to fix up a house than a neighborhood.

WHAT CAN YOU AFFORD?

Calculate Your Budget

You've decided to buy a house and you've determined your needs. Now you have to ensure your finances are in order before you even begin looking at houses. If you do not already keep track of your income and expenses with some type of a written budget, then your next step should be to take a long, accurate look at your family's income and expenses. How can you know how much you can afford if you don't know how much you are currently spending? Use the Financial Planning Worksheet to construct your budget or cash flow statement. If you need some help, set up an appointment with your Command Financial Specialist or plan on attending the "Developing Your Spending Plan" workshop at the Fleet and Family Support Center.

Using the information from your budget, use the handout "Setting Your Price Range" to determine price limits for your home search. Considering homes that are beyond a comfortable price limit will only result in frustration and wasted energy. The upper limit of your price range is the mortgage loan amount for which you qualify. However, keep one thing in mind -- you may not want to purchase a home whose price is at your upper limit – some people refer to that as being "house rich and cash poor". Make an honest assessment of your lifestyle. There may be other things you like to do rather than put most of your budget into house payments and maintenance. You can use the handout "Figuring Your Monthly Payments" to determine what the monthly payment would be for any loan amount, or use an online calculator to help you crunch the numbers. Be advised that your mortgage payment will include Principal, Interest, Taxes and Insurance (PITI).

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Financial Planning Worksheet

Setting Your Price Range

Figuring Monthly Payments

Calculating Your Debt-to-Income Ratio

Your Debt-to-Income Ratio

Using the handout "Calculating your Debt-to-Income Ratio", fill in the numbers and determine whether your debt-to-income ratio is within standard guidelines for mortgage lenders.

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Credit Reports and Scoring

Before applying for a mortgage loan, obtain a copy of your credit report. Americans can get one free credit report a year from all three credit reporting agencies by going online to www.annualcreditreport.com. Lenders base mortgage loan decisions on both your credit score as well as their own professional judgment of your ability to repay. Their judgment may be based on the application you fill out, which will list income, expenses and assets, as well as a personal interview. Credit scores, compiled by credit scoring companies such as The Fair Isaac Company (FICO), use information from your credit report. The score is based on a number of factors:

- 35% - Your Payment History
- 30% - Amounts You Owe
- 15% - Length of Your Credit History
- 10% - Types of Credit Used
- 10% - New Credit

Payment history considerations include:

- Number of accounts paid as agreed.
- Delinquent accounts:
    1. length of past-due status
    2. total number of past due items
    3. how long it's been since you had a past due payment
- Negative public records or collections.

Amounts you owe:

- How much you owe on accounts and the types of accounts you carry balances on.

- How much of your revolving credit lines you've used (looking for indications you are maxed-out).
- Amounts you owe on installment loan accounts vs. their original balances (are you paying them down consistently)?
- Number of zero balance accounts.

Credit history length:

- Total length of time tracked by your credit report.
- Length of time since accounts were opened.
- Time that has passed since the last activity.
- The longer your (good) history, the better your scores.

Types of credit you use:

- Total number of accounts and types of accounts (installment, revolving, mortgage).
- A mixture of account types usually generates better scores than reports with only numerous revolving accounts (credit cards).

New credit:

- Number of accounts you've recently opened and the proportion of new accounts to total accounts.
- Number of recent credit inquiries.
- The time that has passed since recent inquiries or new accounts were opened.
- If you've re-established a positive credit history after encountering payment problems.
- In general, checking to make sure you aren't out there opening up numerous new accounts.

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What's a Good Score?

Credit scores usually range from 300 to 850. The higher your score, the less risk a lender believes you will be. As your score climbs, the interest rate you are offered will probably decline.

Here's an overview of credit scores among the US population in 2006:

Up to 499: 1%

500 - 549: 5%

550 - 599: 7%

600 - 649: 11%

650 - 699: 16%

700 - 749: 20%

750 - 799: 29%

Over 800: 11%

Other Factors Influencing Financing

As we mentioned earlier, credit scoring software only considers items in your credit report. Lenders will also look at other factors that aren't included in the report, such as income, specific employment history, and the type of credit you are seeking. Based on all of this information, what do you think lenders are looking for in the "perfect" customer? A high credit score, which means a low level of recurring debt, a long history of repaying on time, steady and reliable employment, and sufficient assets, such as money in savings or investments, are some of the big things they like to see.

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Down Payments

Another factor that influences financing is a down payment, or money you agree to pay, usually in a cashiers check, at the time of purchase towards the price. Your down payment will probably affect your price range because the loan amount is based on the purchase price, minus the down payment.

Typical down payments for various loans are:

- Conventional - 20% of the loan amount, with a minimum requirement of 5 to 10 percent. Conventional loans are not guaranteed or insured by the federal government.

- FHA (Federal Housing Administration) - 3 to 5 %. Available in all 50 states. Government insured.
- VA (Veterans' Administration) - no down payment required. Loan amounts are generally higher than FHA. Both FHA and VA maximum loan amounts change periodically. Guaranteed by the Department of Veterans Affairs.

LENDERS AND LOANS

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Checklist for Financing Your Purchase

Mortgage Shopping Worksheet

Choose a Lender

Finding a reputable lender with a variety of mortgages and attractive loan rates is important. Friends and co-workers can be an excellent source for finding a lender that you are comfortable with. Your realtor will also make recommendations. Use a lender that offers several options, is knowledgeable about those options, and takes the time to explain them to you.

The handout "Checklist for Financing Your Purchase" has the typical steps involved in obtaining a mortgage, including documents to bring with you when you visit a lender. The handout "Mortgage Shopping Worksheet" provides an extensive list of variables that you can use to compare different loans and lenders. When comparing loans, pay special attention to:

- *APR – Annual Percentage Rate:* The total interest rate of a mortgage, including the stated loan interest as well as any up-front interest paid in starting the loan.
- *Discount points:* A discount point is 1% of the loan amount, paid at closing. The lower the interest rate, the higher the number of points. Go for the lowest APR possible. A low APR is an attractive feature when it comes time for you to sell. Be sure you will own the house for sufficient time to recover the cost of the points. In your offer to purchase, ask the seller to pay most of the points. If the seller won't pay points and you must have that house - and the lender will allow you to fold the points into the loan, offer the seller a higher selling price which includes the amount of the points. This allows you to "finance" the points, which adds to the tax deductible amount of interest you pay.
- *Loan origination fee:* A loan origination fee is a charge imposed by the lender for processing the loan, payable at closing. The loan origination fee is generally about 1% of the loan amount and is applied toward the lender's cost of making the loan. The buyer usually pays it. You may

negotiate the payment of points and loan origination fees with the lender. In a hot buyers' market, many sellers will pay all or some of these closing costs.

- *Lock-in Options:* Lenders may offer different options to "lock-in" the interest rate at the time you apply for the mortgage. Lenders usually honor guaranteed lock-in rates for a specific time, such as 45 or 60 days or more. If you close the transaction within that period, the lender guarantees to provide the interest rate you locked in, regardless of whether the rates rise or fall during the interim. Be sure to get a written lock-in agreement if you choose to lock in your rate. If rates are anticipated to decrease before you close on the loan, you may prefer to let the interest rate and points "float," to give them time to go down.

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Choose a Mortgage Loan

There are many types of loans to choose from. A bank or credit union, and many educational and mortgage websites can help you determine the best type of loan for you. Mortgage calculators can help you determine how much loan you can afford, what your monthly payments will be, and evaluate the different types of loans available. Common loan types include:

- *Fixed-Rate Loans:* These are the most popular loans in the market because they offer stable, consistent payments throughout the life of the loan. The most common is the 30-year fixed rate. Other options are the 15-year (save half the interest over a 30-year), the 20-year (saves thousands of dollars of interest over the 30-year), and the relatively new 40-year (reduces the payment below a 30-year but adds three times the loan amount in interest).

- *Adjustable Rate Loans:* A variable interest rate that fluctuates according to the financial index they are tied to and the type of adjustable rate mortgage obtained. Some features that make them attractive even when the fixed interest rate is low are:

    1. First-year rate (the teaser rate) is usually one or two points below the market rate.

    2. Interest rate is capped. It can rise only five or six points, depending on whether FHA or conventional loan, over the life of the loan.

    3. Rise of interest rate is limited to one or two points a year depending on type of loan.

4. Research indicates that less interest is paid with an ARM than with a 30-year fixed rate mortgage.

5. Best for homebuyers who stay in a home no more than five to seven years.

- *FHA Loans:* Government-backed Federal Housing Administration loans are designed for first-time or lower-income homebuyers. The interest rate is usually less than conventional loans. FHA loans are available in both fixed-rate and adjustable-rate mortgages. Down payment is 3% to 5% of loan amount. There are limits to the maximum loan amount.

- *VA Loans:* Loans available to veterans of the United States Armed Forces backed by the Department of Veterans Affairs. Have your lender check the current VA funding fee. No down payment is required. The seller must pay points. If seller is reluctant to pay points, buyer can increase offering price to include the cost of points. Congress controls maximum loan amounts. Check with your lender for current maximums. You may want to explore other mortgage loan options rather than use your VA. If you have to sell and a buyer comes along who wants to assume your mortgage, then your VA will be unavailable to you until that mortgage is cleared by a home sale with a substitution of a completely new mortgage.

- *Assumptions:* Consider assuming the seller's existing loan and interest rate if the rate on the assumable loan is lower than the prevailing rate for a new loan. By assuming a loan, you take responsibility for paying the mortgage owed by the seller.

- *Buy-down:* If you cannot afford the prevailing interest rate, consider a buy-down mortgage. The seller or even a family member can pay extra points to buy down the mortgage for the first few years. For example, a 3-2-1 buy down with a prevailing rate of 7% means that the first year you would pay 4%, the second year, 5%, the third year, 6%, and then the fourth and remaining years, the interest rate would be 7%. Buy-downs are common among new construction and first-time home-buyers.

- *Step Loans:* Combine the stability of a fixed-rate loan with the lower rates of an ARM. There are two options: 5/25 and 7/23: Interest rate is fixed for the first five or seven years, then the loan adjusts once into a 1-year ARM or a fixed-rate loan. Lower interest than the prevailing rate for 30-year fixed rate mortgages.

- *Balloon Loans:* Interest paid during the term of the loan does not fully pay off the mortgage. At the end of the loan term, must pay off the remaining principal in one lump sum. Usually lower interest rates than fixed-rate loans. Most useful to homebuyers who stay in home no more than the term of the loan. Balloon loans are typically not a good choice for a first-time home buyer.

- *Seller Financing:* The seller takes on the role of lender and gives the buyer a loan to purchase his/her property. Generally, the seller owns the property outright and can finance the entire purchase or has significant equity and can "carry back" a second mortgage which then can be used to finance the buyer's down payment. Best bets for seller financing are elderly homeowners who do not need the cash from the sale of their home to finance their next home. The advantage for buyers is they get the prevailing or better interest rate without paying points or fees. The advantage for sellers is they get a higher return on their money from the sale and receive a monthly stream of income.

- *State Veterans Program:* Many states offer veterans benefits. These benefits may include educational grants and scholarships, special exemptions or discounts on fees and taxes, home loans, veteran's homes, free hunting and fishing privileges, and more. Each state manages its own benefit programs. Be sure to take advantage of the benefits you have earned by linking to your State Department of Veterans Affairs.

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Borrower Beware

- *Interest-Only Mortgage:* An-interest only mortgage allows you to pay only the interest for a specified number of years. Since there is no payment on principle, a borrower who takes this type of loan is depending on the housing market to increase the value of the home. Most interest-only mortgages have adjustable interest rates, which mean that the interest rate and monthly payment will change over the term of the loan. The interest-only mortgage payment period is typically between 3 and 10 years. After that, your monthly payment will increase even if interest rates stay the same, because you must pay back the principal as well as the interest.

- *80/20 Mortgages:* An 80/20 mortgage is essentially two mortgage loans which equal the total amount of the purchase price. The first mortgage being 80% and the second mortgage covering the remaining 20%. The first is typically at the going rate for a conventional mortgage, the second is usually significantly higher.

- *Subprime lending,* also called "B-Paper," "near-prime," or "second chance" lending, is a general term that refers to the practice of making loans to borrowers who do not qualify for market interest rates because of problems with their credit history. A subprime loan is one that is offered at a rate well above the prime rate, which is a benchmark that banks set for establishing interest rates for other loans. Subprime lending encompasses a variety of credit instruments, including subprime mortgages, subprime car loans, and subprime credit cards, among others.

Subprime lending is typically defined by the status of borrowers. A subprime loan is, by definition, a loan made to someone who could not qualify for a more favorable rate. Subprime borrowers typically have low credit scores and histories of payment delinquencies, charge-offs, or bankruptcies. Because subprime borrowers are considered at higher risk to default, subprime loans typically have less favorable terms than their traditional counterparts. These terms may include higher interest rates, regular fees, or an up-front charge.

Some common practices in the sub-prime market include:

- Excessive Fees (fees of 5% or more are common).
- Abusive pre-payment penalties (effective for more than three years, cost more than six months of interest). Only 2% of prime loans have prepayment penalties, while 80% of subprime loans have them.
- Kickbacks to brokers ("Yield Spread Premium").
- Loan Flipping.
- Unnecessary Products.
- Mandatory Arbitration.
- Steering and Targeting.

All of these practices and terms fall under the "Predatory Lending" category. Protect yourself by being aware of and avoiding any of these practices. Learn more at www.responsiblelending.org/issues/mortgage/sevensigns.html.

The Mortgage Application Process

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- *Pre-qualification:* Pre-qualifying is an informal way to see how much you may be able to borrow. You can be "pre-qualified" over the phone with no paperwork by telling a lender your income, your long-term debts, and how large a down payment you can afford. Without any obligation, this helps you arrive at a ballpark figure of the amount you may have available to spend on a house. Prequalifying helps you figure your budget and the type of loan that would work best, but it is not a guarantee that a loan will be made. It usually takes only one or two hours to get pre-qualified, depending on the complexity of your finances.

- *Get Pre-approved:* Sellers like pre-approved buyers, as they know you can get the money to purchase their house. This can work in your favor by putting you in a better negotiating position. Pre-approval, however, is different than pre-qualifying. Pre-approval is a lender's actual commitment to lend to you. It involves assembling the financial records and going through a preliminary approval process. Pre-approval gives you a definite idea of what you can afford and shows sellers you are serious about buying.

- *Formal application:* If not pre-approved, when offer to purchase is accepted by seller, a buyer is expected to formally apply for financing within three to five days. If you have already pre-qualified, application time is minimal. If you have been pre-approved, then processing your loan begins.

- *Processing Time:* Processing time for conventional loans can take four to six weeks; for VA and FHA loans, six weeks to two months. In some situations, processing can be sped up depending on successful completion of a title search, home inspection, termite inspection, well inspection, etc.

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SELECTING A REAL ESTATE AGENT

Real Estate Professionals

A real estate agent can help:

- Target suitable neighborhoods.
- Tell you which homes are available.
- Identify their cost.
- Compare the cost per square foot of nearby homes that have recently sold.
- Assess your financial situation.
- Manage the myriad details of your purchase.

Professionals associated with real estate include:

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- *Principal Broker:* A self-employed individual who is licensed to operate a real estate office. May work independently or hire other agents. All real estate professionals must work under a principal broker's license.
- *Realtor:* Is a member of the National Association of Realtors, a state Realtor's association and a local Board of Realtors. The Realtor's Code of Ethics also binds them. Realtors may access the Multiple Listing Service (MLS), a local computerized database of for-sale homes, unavailable to most non-realtors. Through the MLS, a realtor can give you a detailed printout on each listed home you plan to consider.
- *Agent:* The generic name for any licensed real estate professional (e.g., broker, Realtor). The three kinds of agents are:
    - *Listing Agent:* Signs up the home seller with a broker and "lists" the home with the MLS. As a buyer, you may never meet the listing agent. When the house sells, both the listing agent and the selling agent split part of their commission with their respective brokers.
    - *Selling Agent:* Usually learns about the for-sale house through the MLS, then finds the buyer. Though this is the agent that works with the buyer, he/she legally represents the seller and must get the best possible deal for the seller.
    - *Buyer's Agent:* Helps the buyer find the house, terms and conditions most favorable to the buyer. The relationship is defined in a contract. Buyer's agents usually split part of their commissions with their brokers or may charge a fee for services.

Interview Agents

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Interviewing Agents

No matter what kind of agent you use, take time to find one you are comfortable working with. The Handout "Interviewing Agents" lists information you should get from an agent before agreeing to work with them.

- Look for the agents and companies that have the most signs in the neighborhoods you like. However, the agent with the most For Sale signs in the neighborhood may not be the best to work with buyers. They tend to concentrate on listing property.
- Ask the managing broker to pair you with an agent that likes working with buyers. Ask friends and co-workers for a personal recommendation. It's still the best way to find a good agent.

- Look for solid credentials. Find someone who listens well and can translate your wishes into homes and neighborhoods you like.
- Don't be pressured to choose a neighborhood that does not suit you or a house after visiting only four or so prospective properties. Drop that agent and find another.

Once you've decided upon an agent:

- Arrange a meeting with the agent and your family to discuss house hunting goals. The more the agent knows about your family, the more effective he or she can be.
- Review positive features of your previous homes.
- Discuss areas you have visited and ask for recommended neighborhoods you haven't seen yet.
- Have the agent recheck your loan qualifications or pre-approval. Armed with this information, the agent will arrange appointments for you to see homes in your price range.

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Do It Yourself?

Many people prefer not to use a real estate agent to help them purchase a home. The internet is very helpful in this area. Also, networking with family and friends can help you find the right home for sale. Other sources include:

- *FSBO:* This acronym stands for "For Sale by Owner". FSBOs can be excellent buys, but are more difficult to find since they are not listed in the MLS and are not shown by agents. They are usually advertised in the newspaper or on-line (check www.fsbo.com, www.craigslist.com and www.militarybyowner.com for starters). If you have found a house you wish to buy directly from its owner, you should seek the help of an attorney who specializes in real estate transactions.
- *Rent to Own:* Many rental properties give the option of purchasing the home, and will even apply rent payments to the purchase price.
- *Foreclosures:* Foreclosures can be downright bargains. Look in the newspaper for houses for sale by the Department of Veterans Affairs (VA), Department of Housing and Urban Development (HUD), Federal Housing Administration (FHA), Resolution Trust Corporation (RTC), Federal Deposit Insurance Corporation (FDIC)

and other government agencies. Some local lenders may have foreclosed properties for sale. These are called Real Estate Owned (REO). Some come with excellent terms, others are sold at public auctions and require cash payment or a letter of credit. Many foreclosures need repairs ranging from cosmetic to structural. Ask your local agent for lists and acquisition information.

- *Multiple Listing Service (MLS):* Most real estate sales are listed in a computer-based system called the Multiple Listing Service, or MLS. The MLS is accessible to anyone at www.mls.com.

Begin the Search

Remember the ancient Latin principle of commerce, Caveat Emptor (let the buyer beware). The handout "Checklist for Your House Hunt" will help you evaluate features you like – and don't like – in a home. It can also help you develop your "needs" and "wants" list.

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Checklist for Your House Hunt

Make a copy for each home you consider. If you work with a realtor, he or she will likely generate some computerized listings for you from the MLS … attach them to the back of the checklist. Some of the items on the checklist may be duplicated in a realtor-provided printout. If possible, take pictures of the homes you are looking at and attach them to the checklist as well.

To highlight a few areas of the checklist:

- When comparing homes, it is important to know the price-per-square-foot of each, especially if you are unfamiliar with local property values. To establish the price-per-square-foot divide the home's asking price by its square footage. For example, a 2,000 square-foot home listed at $125,000 has a price-per-square-foot of $62.50. Because of potential legal liability, some agents prefer not to disclose a home's estimated square footage. Others simple do not have this information. If your real estate agent does not provide these figures, get them from your local tax assessment agency or the home's builder. Price-per-square-foot can serve as an objective benchmark to help you establish a home's value relative to other similar-sized homes in the area.

- You should also consider any unique features which may affect the cost of insuring the home. Older homes and those built on a slope, for instance, may cost more to insure.

- Research the reputation of a home's builder. Start with the State Consumer Protection Agency or the State's Attorney General. You can also go to the Better Business Bureau website and look at a report on the home builder.

- Examine previous owner's utility bill to get a sense of routine costs.
- Rural homes usually have a septic system and a well. Ask to see copies of the percolation (perc) test made before the septic system was built. It will show whether the drainage on the property is adequate to handle waste disposal. Also ask to see reports certifying the quality of the home's well water.
- Ask the seller to provide a home buyers warranty. They can be purchased for $1000 -$2000 and cover major repairs such as the furnace, roof, plumbing, etc. The cost can be reflected in the purchase price of the house.

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NEGOTIATE THE DEAL

Property Values

A list of *"comparable sales"* during the last six months is important to determine property values. Ask your agent for a list of "comps", which shows the price and square footage of neighborhood homes which have sold recently. Besides the comps, there are many intangibles that go into determining the asking price for a house, including the market (buyer's market or seller's market), location, buyer's emotional attachment to the home, and good old-fashioned greed. If you are planning to buy a home without the assistance of an agent (or, if you are looking for preliminary information), there are sources of information available online through your state and local offices of property taxation.

Use property value information to highlight or eliminate certain neighborhoods. If your budget limits you to $200,000, for example, it really makes no sense concentrating on (and perhaps falling in love with) a neighborhood where the average sale prices are in the $300,000 range. It is far better to focus on those areas where the average sale prices are well within your budget range, looking for a neighborhood that will give you the best value for your money.

When you find the home you want, the next step is to *present an offer to purchase* contract. After you make an offer, the seller may accept it, reject it or make a counter offer. If a counter offer is made, and they are quite common, you, in turn, may accept it, reject it or make another counter offer. This process continues until both parties agree or until one of you refuses to negotiate further. Be certain to put everything in writing.

- Set your price.
- List personal property you may wish included, such as the refrigerator, washer and dryer, curtains, dining room ceiling fan, etc.
- List needed repairs that you want the current owner to complete.
- List any contingencies, or circumstances that must be met in order for you to go through with the sale such as selling your current house, getting financing, a positive home inspection, etc.

You may be asked to put down an earnest money deposit, which although not required, shows your "good faith" while negotiating. The amount of the earnest money deposit may vary, usually $500 up to 10% of the sale price. If you cancel the contract, the earnest money deposit is usually forfeited to the seller; therefore, try to limit the amount of the deposit. Earnest money is applied to the total purchase price of the home.

Home Inspection

Ten Important Questions to ask your Home Inspector

Many home purchasers, either in the desire to save the $200 to $500 that a good inspection costs, or due to simple ignorance, have spent enormous sums of money repairing items that any good home inspector would have pointed out. Any offer to purchase you make should be contingent upon (subject to) a whole house inspection with a satisfactory report. Do not let anyone--not the agent, not your family or friends, and especially not the seller--dissuade you from having the property thoroughly inspected! Not only will you sleep much sounder after you have moved into the house, a professional inspection can give you an escape hatch from a contract on a defective house. If the contract is written contingent on an acceptable inspection, any defects in the home must be either repaired or monetarily compensated for. If you are not satisfied, you have the option to cancel the contract.

Inspections are designed to disclose defects in the property that could materially affect its safety, livability, or resale value. They are not designed to disclose cosmetic deficiencies (for example, an interior wall that needs paint touch up). You will need to determine on your own those types of items that will need attention: don't expect a whole house inspection to reveal them to you. You can find certified home inspectors by visiting www.ASHI.org. The handout "Ten Important Questions to ask your Home Inspector" will guide you through this process.

21 ## CLOSING COSTS AND CLOSING

Closing Costs

Closing cost are fees that are paid in order to "close" or complete the mortgage loan. They usually total approximately 2 to 4% of the loan amount and may be paid by the buyer or seller.

22 Examples of one-time types of closing costs and approximations of cost include:

- Appraisal – Estimate of current value of a home ($300).
- Attorney's or title company's fee – Whoever chooses, usually pays the fees ($400 for an attorney, $300 for a title company).
- Credit report – Furnishes lenders information about buyer's current indebtedness and payment history ($60).
- Escrow company – Acts as third party to both buyer and seller, handles the paperwork and collects and distributes the various money transactions, such as pre-paids, real estate commissions, down payments ($300).
- Home inspection – An independent, professional inspection of the property and all its electrical, plumbing, heating, cooling, and kitchen systems ($200).
- Home warranty program – Offers first-year protection from a breakdown of many household systems, including plumbing, water heater, disposal, heating and cooling, and appliances ($800 and up).
- Loan origination fee – A fee charged by the lender for making the loan, varies from 0 to 2%.
- Pest inspection – Separate from the home inspection which is optional, mortgage companies, particularly for VA loans, require a pest and water damage inspection ($100). Recording fee – The cost to record your deed and your mortgage with the city/county in which the home is located ($75).
- Survey – The measurement of the property by licensed engineers or surveyors in order to determine its area and attest to its boundaries ($250).
- Title search and insurance – Researches the records and insures that the property's title is free from any encumbrances that the

property will transfer with a clear title. The insurance protects the mortgage company (required) and the buyer (optional) against any claims on the property not found during the title search (based on loan amount).

In a buyer's market, the buyer can ask the seller in the Offer to Purchase to pay for all or a portion of the closing costs.

Pre-paid Costs

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At closing, the buyer will pay a number of recurring costs up-front with the money placed in escrow with the mortgage company and drawn when needed. Various pre-paid costs are as follows:

- Private Mortgage Insurance (PMI) – Protects the lender against default on the loan. Can be a lump sum payment, monthly payment added to mortgage payment, or a higher interest rate. Ex. $200,000 purchase price, 10% down ($20,000), $180,000 loan amount, monthly PMI = .0052 x loan amount divided by 12 months = $78/month added to mortgage payment. PMI can be avoided by putting 20% down on home purchase.
- Mortgage Insurance Premium (MIP) – FHA requires a mortgage insurance premium (MIP) for its home buying programs. An upfront premium of 1.50% of the loan amount is paid at closing and can be financed into the mortgage amount. In addition, there is a monthly MIP amount included in the PITI of .50%. Condos do not require upfront MIP - only monthly MIP.
- VA Funding Fee – In order for the VA to guarantee the home loan, there is a closing cost assessed by the VA to originate the loan. This is called a funding fee. This fee will vary, depending upon the type of VA loan, the down payment, whether this is your first time to use your entitlement, if you are a disabled veteran, and if you served active duty or in the National Guard/Reserves.
- Homeowners Insurance – Total of 14 months premium payments are collected, 12 of which are used to pay first year's policy premium. The extra two months are collected and placed in escrow account from which future premium payments are made.
- Property Taxes – Prorated buyer's first month's share of taxes and additional months of payments are placed in escrow from which future tax payments are made.

- Interest – Buyer pays a prorated share of first month's interest due on loan amount depending on the closing date.

24 **Closing**

Closing is the final step in transferring home ownership from the seller to the buyer. It usually takes place at a lender's office, an escrow company, a title company or an attorney's office. It occurs when all the promises in the purchase contract are fulfilled, the loan documents are prepared and the loan is finalized. Take possession, collect all keys/ change locks. Request from the seller:

- Operating instructions for appliances, heating/cooling systems.
- Names of contractors.
- Paint colors.
- Locations of utility turn-offs.
- Security system combinations, if applicable.

While rent payment is made in advance, mortgage payments are paid in arrears--due on the first of a month for the previous month. Set your closing date as close to the end of the month as possible. It will minimize the amount of pro-rated interest charges you have to pay and you can skip a month before your first house payment is due. For example, if you close on the 30th of March you will pay pro-rated interest for the days of 30 and 31 March and your first house payment will not be due until 1 May.

25 REDUCING PAYBACK TIME

Early Mortgage Payment

Many of us dream of retiring debt free with a nest egg large enough to sustain us in our later years. For many, this dream involves paying off a home mortgage. Let's assume that you have available funds – from an inheritance, lump sum payment, or sale of property, for example. Should you use that money to pay off your mortgage?

There are two ways a buyer can reduce the payback time on a loan:

1. *Apply for a shorter-term loan.* You can do this with a surprisingly modest monthly payment increase compared with a 30 year loan.

   For example: a 30-year mortgage of $100,000 at 6% interest carries a principal and interest payment of $600 a month; a 15-year mortgage with 5.5% interest has a P&I payment of $817. In most cases, lenders offer lower interest rates for loans with shorter maturities. A 15-year loan will generally have a lower rate than a 30-year loan.

2. *Prepay the principal.* This will reduce a 30-year fixed-rate loan's 26
   payback time to 20, 15, or even 10 years and will sharply reduce the amount of interest you pay over the life of the loan. If you are a disciplined money manager, and if your loan has no prepayment penalty, you may consider paying-off a 30-year mortgage in 15 years and one month by doubling the principal payment each month. Or you can take a 30-year loan and pay it back in 20 years in one of the three following ways:

   a. Make an extra lump sum payment each year.

   b. Increase monthly payment by 1/12th.

   c. Pay bi-weekly; that means making one-half mortgage payment every other week.

Be sure to fully explore the cost of such prepayments, making sure there are no prepayment penalties or additional fees associated with prepayment.

The option of paying off your mortgage has both advantages and disadvantages.

Advantages 27

- *Emotional Security.* Paying off your mortgage provides emotional relief from the anxiety of owing money. You may simply feel more secure owning your home free and clear. This sense of security may matter a great deal if you plan live in your home when you retire. Also, you may desire to leave a debt-free home to your heirs.

- *Future Investing.* Without a mortgage payment, you'll have more money to invest for the future. Your retirement savings can grow more quickly. Mortgage interest on a large or high-rate loan may be costing you a hefty sum. Instead of paying interest, you could be earning interest with your funds.

- *Retirement Needs.* If you are already retired, paying off your mortgage can free up your money for other things. Experts recommend accumulating enough retirement savings to have at least 70 percent of your working income. If you're short of this goal, eliminating mortgage payments will free up monthly income for living expenses. This approach is especially helpful if you have a large mortgage with high payments.

- *Reducing Loan Stresses.* Paying off your loan removes loan-related stresses, too. Houses gain and lose value, depending on local conditions. These market changes affect the equity you've built in your home. Without a loan, you remove the risk of "owing more than you own." Also, you avoid being hit by climbing rates if the interest on your loan is variable. You may also want to pay down part of a loan if it is large.

Disadvantages

- *Missed Investment Opportunity.* You can lose the opportunity to invest and build up a secure retirement nest egg. If you use your resources to pay off your mortgage, you'll have less money to devote to growing your investments. If the interest rate on your loan is reasonably low, you may be able to earn more by investing. You can build wealth by investing in higher-rate earnings vehicles.

  This drawback particularly applies if you have more than 10 years remaining before retirement. With this extra time, you could grow your money if it is invested well. So, paying off a mortgage may not make sense if you're focused on accumulating wealth at this point in your life.

- *Lost Tax Savings.* Another disadvantage of paying off your mortgage is lost tax savings. The interest on your mortgage is tax deductible. This tax deduction may mean considerable savings for some homeowners. If you pay off your mortgage, you'll lose the interest deduction. This could hurt especially if you are or expect to be in a high tax bracket during retirement, when you could really use the deduction. It also has greater impact if you have more than 10 years left to pay on a 30-year mortgage. During the early years of repaying your loan, you pay more in interest and stand to benefit from a larger deduction.

- *Large monthly payments or more frequent payments.*

HOMEOWNER'S INSURANCE

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Requesting a Quote for Homeowner's Insurance

Since your home usually represents your largest purchase, it only makes sense to protect your investment from possible hazards. Many homeowners are underinsured, be sure to assess your needs and purchase adequate coverage. Of homeowner's policies, HO-5 policies are the most popular because of its broad-based coverage. Remember, if you are renting now or choose to rent later, always protect your possessions and liability to others with renters insurance.

Minimal Coverage

At a minimum, you need to cover the cost:

- To rebuild your house should it be destroyed.
- Of replacing contents of the dwelling.
- Of daily living expenses incurred because the homeowner is unable to stay in the home while repairs are underway.
- Personal liability up to a maximum for each occurrence, usually up to $100,000.
- Medical payment for injuries that occur on the premises.

Additional Coverage

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Replacement cost coverage – Allows for rebuilding the home with exactly the same materials with which it is currently constructed. Replacement cost coverage also allows you to replace your contents at current market prices rather than depreciated amounts.

Umbrella policy (usually for $1,000,000) – Should be considered if the homeowner has a lot of assets, high earning potential, or an attractive hazard (swimming pool, trampoline, aggressive dog) in order to protect property and future earnings from lawsuits.

Riders – Additional coverage can be added for valuable personal property such as gun collections, antiques, and valuable jewelry. The insurance company may require appraisals.

Flood insurance – Will be mandated at extra cost if the survey indicates your new home is located in a flood zone. However, if you are not in a flood zone, therefore carry no flood insurance, and your home is flooded by a freak storm, you will not be covered.

Earthquake insurance – works similarly to flood insurance. If the new home is in an earthquake-prone area, the homeowner may be required to carry the extra insurance at an additional cost.

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Reduce Premium Costs

To reduce insurance costs:

- Shop around for the best rates. Be sure coverage quoted are identical, and company is financially sound and reliable.
- Raise deductible to $1000 or more.
- Ask about non-smoker's discounts.
- Install fire and burglary detection systems.
- Use the same insurance company for homeowners, auto, and life insurance.

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SUMMARY

This workshop has covered a lot of material. Keep in mind these six main concepts as you begin the search for your new home:

- Identify your needs and your wants.
- Know what you can afford.
- Research homes, agents, lenders and loans.
- Get a home inspection.
- Adequately insure the home.
- Enjoy your new home!