Pre-Homeownership

Education Course

The Pre-Homeownership Education Course is designed to provide general information on the home buying process and is not intended as a substitute for professional legal counsel regarding the purchase of real property. It is recommended that competent legal representation be obtained when entering into any real estate contract.

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Module 1 • Planning for Homeownership

Lesson Purpose

To introduce the fundamentals of the home buying process and the structure of home mortgages.

Learning Objectives

After completing Module 1, you will be able to:

- Assess your housing needs and discuss the advantages and disadvantages of homeownership.
- Discuss the factors to consider in deciding when to buy.
- Identify the most common types of mortgages and how they work.
- Identify the costs associated with buying a home and the components of the monthly mortgage payment.
- Estimate how much you can afford to pay.

Summary

Module 1 begins with a discussion of the advantages and disadvantages of homeownership, stressing the importance of thinking about why you want to become a home owner. We then describe the basic structure and types of mortgages and how they work. The various costs associated with homeownership are also reviewed so you can begin the process of determining how much you can afford.

Planning for Homeownership

A home provides us with one of the basic necessities of life – shelter. The type of shelter we have affects the quality of our daily lives. It is the base from which we carry out our daily activities, where we spend time with friends and family, and relax at the end of the day. For many people, renting a home or apartment is the most satisfactory living arrangement. For others, owning a home is a great source of satisfaction and pride.

The Home Buying Decision

If you are thinking of buying a home, take some time to seriously consider the pros and cons of homeownership. You will need to be fully aware of the benefits, costs, and responsibilities of homeownership before you invest in a home. In making the choice between owning and renting, there are two basic questions you should ask:

- Do I really want to own a home?
- Can I afford to buy and maintain a home?

Benefits of Homeownership

- The home is an investment which can increase in value over time. What's more, it's the only investment you can live in at the same time! As you make payments on the house over the years, you are building equity.
- There are also substantial tax benefits to owning a home. Mortgage interest and real estate taxes are deductible from your income tax liability.
- A home generally provides more space; you can adjust the living space and decorate the house to suit your needs and tastes. You can make structural and cosmetic changes to the home whenever you wish.
- Homeownership fosters a feeling of permanence and helps you establish roots in the community.
- A home provides greater feelings of independence and privacy.

Disadvantages of Homeownership

Although there are many advantages to homeownership, there are also certain disadvantages to owning a home that you should consider.

- The costs associated with owning a home are greater than paying monthly rent to a landlord. As a prospective home buyer, you must be able to make a down payment and pay closing costs. As a home owner, you must also pay property taxes, homeowners insurance, and utility and maintenance costs on a monthly basis.
- Homeownership involves a long-term financial commitment to pay monthly mortgage payments, typically over a 30-year period. Your money is invested for a long time in your home and cannot be spent on other things.
- A major financial risk of homeownership is the possibility of foreclosure. If you fail to make your mortgage payments, the lender has the right to repossess and sell your house.
- A house can lose value if not properly maintained. Neighborhood quality can also decrease if you or your neighbors are not maintaining your homes. Once you become a home owner, there is no landlord to call to fix things; it becomes your responsibility.
- When you own a home it becomes much more difficult to move – you can't just pick up and go. It generally takes time and some expense to sell a home.

How Mortgages Work

Most of us cannot afford to pay cash for a home, so we borrow the money from various types of lending institutions that offer home loans. A mortgage is simply a loan which a home buyer uses to purchase a home. The lender gives the home buyer the money now, and the home buyer repays the loan over a number of years.

Most of these loans are **amortized**, which means that borrowers repay the amount of the loan, called the **principal**, over a specified period of time. This gradual reduction in the amount of the principal through periodic payments, usually monthly, is called **amortization**. The length of time given to repay, or amortize, the loan is called the **loan term**.

In addition to repaying the principal, you will also pay **interest** on the loan. Interest is simply the cost of borrowing money. The interest on a home loan is similar to interest you've probably paid on car loans or on the balances of your credit cards.

The Documents

One of two documents, the **mortgage** or the **deed of trust**, pledges the property you are buying as security for the loan. These documents state all the conditions you have agreed to (interest rate, length of term, etc.). The **promissory note** is another document that goes along with the deed of trust or the mortgage. When you sign this note, you are promising to repay the loan. If you fail to meet these obligations, the lender has the right to sell your house to pay off the debts (**foreclosure**). This threat of foreclosure is the major reason all potential home buyers should fully understand the costs of homeownership and what they can afford, before they enter the housing market.

The Costs of Homeownership

There are basically two types of costs:

- One-time, or up-front costs
- Periodic, or monthly costs

Up-Front Costs • Down Payment

1. Down Payment

   Mortgage lenders generally require borrowers to make an initial payment toward the price of the home. The amount of the down payment required depends on the type of mortgage you get. Down payment requirements vary among lenders, ranging from as little as 3 percent (or less) to 20 percent (or more). The size of the down payment you make affects the total amount you will need to borrow.

   To make a 3 percent down payment toward the purchase of a $100,000 house, you would need $3,000 for the down payment, leaving $97,000 for you to borrow and pay off over time.

   $100,000 × .03 = $3,000 down payment
   $100,000 – $3,000 = $97,000 loan

2. Closing Costs

   Closing costs are fees that must be made to complete the transfer of the property from the seller to the buyer. Closing costs include items such as the survey, attorney fees, home inspection, title search, and advance tax and insurance payments. Closing costs may vary, but are usually 3 to 5 percent of the mortgage loan amount.

3. Moving and Settling-In Costs

   There will be some costs associated with moving into your new home, even if you move yourself rather than hiring a professional moving company. There are also likely to be costs for new purchases such as appliances, and fix-ups such as painting, etc. The amount of these moving and settling-in costs will vary according to how far you're moving and how much repair work needs to be done.

Monthly Costs

The monthly payment made to the lender consists of four parts: the principal and interest (called the P & I payment), and the property taxes and insurance (called the T & I payment). Together, these four parts of the monthly mortgage payment are called the PITI payment.

P = Principal (amount you borrow)
I = Interest (the cost of borrowing money)
T = Taxes (taxes charged by local government)
I = Insurance (homeowners hazard insurance and mortgage insurance)

The P & I Payment

The amount of the principal and interest that you pay each month depends upon the amount you borrow, the interest rate and the length of time given to repay the loan.

The T & I Payment

The remaining portion of your mortgage payment is for taxes and insurance. Lenders generally place this portion of your monthly mortgage payment into an escrow account, and then they pay the taxes and insurance bills when they become due. This saves you from having to make the payments directly, and it also means that the lender ensures these payments are paid when they become due. If you make a larger down payment, 20% for example, you may not be required to escrow the payments for taxes and insurance.

Other

In addition to the T & I payment mentioned above, you may have other monthly fees. For example, if you purchase a condominium, you may be required to pay a home owner association fee.

Operating and Maintenance Costs

These are monthly costs for heating and cooling, electricity, repairs and maintenance on the home. Utility costs are an obligation you must meet every month, and it is important that you also set aside funds, approximately 2% of the value of the home for unexpected upkeep and maintenance costs.

How Much Can You Afford?

There's a standard rule of thumb that says you can afford a house that costs up to two and one-half times your annual gross income. Your annual gross income includes the amount you make before taxes are deducted, and it also includes the annual gross income of your spouse or other co-borrower. As an example, if you (and any co-borrower) have a joint annual income of $40,000, you could afford to pay up to $100,000 for a home.

Unfortunately, it's usually not that simple to determine how much you can afford. A more precise measure of how much you can afford is directly related to the funds you have available for a down payment and how much lenders are willing to loan you, based on your income, your financial debts and obligations, and your credit history.

Lenders use underwriting guidelines to determine eligibility for a loan, and these underwriting guidelines affect how much you can borrow. Although these underwriting guidelines vary among lenders, there are certain aspects that are common to all. These common factors are:

- Funds available for the down payment
- Income available for housing costs

Funds Available for the Down Payment

In our earlier discussion of the down payment as one of the major up-front costs you'll have in purchasing a home, we explained how the amount of this down payment makes a difference in the amount you borrow. This is important because of the **loan-to-value ratio** guidelines that lenders use.

If the lender's loan-to-value ratio is 97%, that means they will loan you 97% of the sales price or appraised value (whichever is less). You would then have to make a 3% down payment. For example, if you wish to purchase a $100,000 home and the lender's loan-to-value ratio is 97%, you will have to make a down payment of $3,000.

The lender will want to verify that you have the approximate amount in savings or other assets for the upfront expenditures for the down payment and closing costs. Sources of funds for these expenses may include your checking and savings accounts, mutual funds, stocks and bonds, and – in some instances – gift funds.

Income Available for Housing Costs

In determining how much you can afford on a monthly basis for the PITI payment, lenders work with standard ratios. These ratios set limits on how much of your monthly income can be applied to housing costs. The purpose of these ratios is to make sure that borrowers don't go too deeply into debt when purchasing a house.

Qualifying Ratios

This chart provides examples of three types of lending programs and the different qualifying ratios that are used. The amount of the PITI column represents the maximum payment for principal, interest, taxes, and insurance. The amount in the Total Debt column represents the maximum for the PITI payment plus all other monthly debts. Note that programs with higher ratios permit a higher proportion of your income to go toward housing and other debts.

		Conventional		FHA		Affordable Housing Initiatives	
Gross Monthly Income	Gross Annual Income	PITI 28%	Total Debt 36%	PITI 29%	Total Debt 41%	PITI 33%	Total Debt 38%
$ 1,200	$ 14,400	$ 336	$ 432	$ 348	$ 492	$ 396	$ 456
$ 1,300	$ 15,600	$ 364	$ 468	$ 377	$ 533	$ 429	$ 494
$ 1,400	$ 16,888	$ 392	$ 504	$ 406	$ 574	$ 462	$ 532
$ 1,500	$ 18,000	$ 420	$ 540	$ 435	$ 615	$ 495	$ 570
$ 1,600	$ 19,200	$ 448	$ 576	$ 464	$ 656	$ 528	$ 608
$ 1,700	$ 20,400	$ 476	$ 612	$ 493	$ 697	$ 561	$ 646
$ 1,800	$ 21,600	$ 504	$ 648	$ 522	$ 738	$ 594	$ 684
$ 1,900	$ 22,800	$ 532	$ 684	$ 551	$ 779	$ 627	$ 722
$ 2,000	$ 24,000	$ 560	$ 720	$ 580	$ 820	$ 660	$ 760
$ 2,200	$ 26,400	$ 616	$ 792	$ 638	$ 902	$ 726	$ 836
$ 2,400	$ 28,800	$ 672	$ 864	$ 696	$ 984	$ 792	$ 912
$ 2,600	$ 31,200	$ 728	$ 936	$ 754	$ 1,066	$ 858	$ 988
$ 2,800	$ 33,600	$ 784	$ 1,008	$ 812	$ 1,148	$ 924	$ 1,064

The next step in determining how much you can afford is to follow the procedures outlined above and apply them to your own financial situation. We'll continue this process in Module 2 by looking at your credit history and your household budget.

Module 2 • Credit Analysis and Household Budgeting

Lesson Purpose

To provide guidance on how to plan and prepare for making the mortgage payments and other realistic homeownership and maintenance costs through effective money management and credit management practices.

Learning Objectives

After completing Module 2, you will be able to:

- Discuss the importance of a good credit record.
- Discuss the purpose and operations of credit reporting bureaus.
- Identify ways to solve credit problems.
- Develop an effective household budget and record keeping system.
- Develop a plan for paying up-front home purchase costs.
- Develop a plan for making mortgage payments and paying other homeownership and maintenance costs.

Summary

In Module 2, you will learn why your credit history is important, how to establish credit and build a positive credit record, how to obtain and interpret your credit report, and how to solve credit problems. This session also emphasizes the importance of developing a realistic, effective household budget and record-keeping system to help you get control of current spending, set and reach savings goals for homeownership, plan for maintenance costs and future capital improvements, and meet unexpected homeownership obligations.

A Guide to Credit

The Purpose and Function of Credit Bureaus

Credit bureaus report information about your payment history on your existing and previous debts. Typically, each account is rated to indicate how you have repaid the obligation. Your credit report may reflect a credit score or number grade which is much like a rating for your entire credit history. Your credit score is based on many types of information that are on your credit report such as payment history, new credit, types of credit you use, amount of outstanding debt; and the length of your credit history. The credit report contains information on your residence, how you pay your bills, if you have been sued, arrested or filed bankruptcy.

The purpose of the credit bureau system is to help businesses decide whether or not to grant credit to you. It is important to understand that credit bureaus do not make the decision to grant your request for credit. They merely provide information from their records concerning your credit history to the lender requesting that information. Lenders study the records – and other factors – and then decide whether or not to extend the credit you seek.

How to Obtain and Check Your Credit Report

The Fair Credit Reporting Act (FCRA) requires that each of the nationwide consumer reporting companies Equifax, Experian and TransUnion provide you with a free copy of your credit report at your request, once every 12 months. The three nationwide consumer reporting agencies have set up a central website, a toll-free telephone number, and a mailing address through which you can order your free annual report. To order, call 1-877-322-8228 or visit annualcreditreport.com. The three nationwide consumer reporting agencies are only providing free annual reports through annualcreditreport.com or through the toll free number. You may order all three reports at the same time or from each company one at a time.

You also have the right to request a copy of the information in your credit file. If you have recently been denied credit, insurance or employment creditors are required by law to give you a written notice of that denial. That notice must include the name and address of the credit bureau that provided information about your credit history. You then have the right to contact that credit bureau and receive a copy of your credit report without charge within 60 days of receiving that notice. You're also entitled to one free report if you are unemployed and plan to look for a job within 60 days; if you are on welfare or if your report is inaccurate because of fraud. Other wise a consumer reporting agency may charge up to $9.50 for another copy of your report within a 12 month period. You can request a copy of your credit report at any time. You should consider getting a copy of your report before you apply for a mortgage loan to be sure that the information in your record is correct. If you discover that your file contains negative information from a problem that has been resolved, you should be prepared to correct it before the lender sees the file so that you can minimize the negative effect.

The three major credit bureaus are:

Equifax	Experian	TransUnion
P.O. Box 740241	P.O. Box 949	P.O. Box 1000
Atlanta, GA 30374-0241	Allen, TX 75013	Chester, PA 19022
(800) 685-1111	(888) 397-3742	(800) 888-4213
www.equifax.com	www.experian.com	www.transunion.com

If you have been denied credit, you should check your record promptly, to see if all the information in it is accurate. In a large, nationwide system, there are unfortunately many errors, which will be considered the official record unless consumers speak up and request corrections.

A Summary of Your Rights Under the Fair Credit Reporting Act

The federal Fair Credit Reporting Act (FCRA) promotes the accuracy, fairness, and privacy of information in the files of consumer reporting agencies. There are many types of consumer reporting agencies, including credit bureaus and specialty agencies (such as agencies that sell information about check writing histories, medical records, and rental history records). Below is a summary of your major rights under the FCRA.

- **You must be told if information in your file has been used against you.** Anyone who uses a credit report or another type of consumer report to deny your application for credit, insurance, or employment – or to take another adverse action against you – must tell you, and must give you the name, address, and phone number of the agency that provided the information.
- **You have the right to know what is in your file.** You may request and obtain all the information about you in the files of a consumer reporting agency (your "file disclosure"). You will be required to provide proper identification, which may include your Social Security number. In many cases, the disclosure will be free. You are entitled to a free file disclosure if:
  - A person has taken adverse action against you because of information in your credit report;
  - You are the victim of identify theft and place a fraud alert in your file;
  - Your file contains inaccurate information as a result of fraud;
  - You are on public assistance;
  - You are unemployed but expect to apply for employment within 60 days. In addition, by September 2005 all consumers will be entitled to one free disclosure every 12 months upon request from each nationwide credit bureau and from nationwide specialty consumer reporting agencies.
- **You have the right to ask for a credit score.** Credit scores are numerical summaries of your credit-worthiness based on information from credit bureaus. You may request a credit score from consumer reporting agencies that create scores or distribute scores used in residential real property loans, but you will have to pay for it. In some mortgage transactions, you will receive credit score information for free from the mortgage lender.
- **You have the right to dispute incomplete or inaccurate information.** If you identify information in your file that is incomplete or inaccurate, and report it to the consumer reporting agency, the agency must investigate unless your dispute is frivolous.
- **Consumer reporting agencies must correct or delete inaccurate, incomplete, or unverifiable information.** Inaccurate, incomplete or unverifiable information must be removed or corrected, usually within 30 days. However, a consumer reporting agency may continue to report information it has verified as accurate.
- **Consumer reporting agencies may not report outdated negative information.** In most cases, a consumer reporting agency may not report negative information that is more than seven years old, or bankruptcies that are more than 10 years old.
- **Access to your file is limited.** A consumer reporting agency may provide information about you only to people with a valid need – usually to consider an application with a creditor, insurer, employer, landlord, or other business. The FCRA specifies those with a valid need for access.
- **You must give your consent for reports to be provided to employers.** A consumer reporting agency may not give out information about you to your employer, or a potential employer, without your written consent given to the employer. Written consent generally is not required in the trucking industry.
- **You may limit "prescreened" offers of credit and insurance you get based on information in your credit report.** Unsolicited "prescreened" offers for credit and insurance must include a toll-free phone number you can call if you choose to remove your name and address from the lists these offers are based on. You may opt-out with the nationwide credit bureaus at 1-888-5-OPTOUT (1-888-567-8688).
- **You may seek damages from violators.** If a consumer reporting agency, or, in some cases, a user of consumer reports or a furnisher of information to a consumer reporting agency violates the FCRA, you may be able to sue in state or federal court.
- **Identity theft victims and active duty military personnel have additional rights.**

For more information, including information about additional rights, go to www.ftc.gov/credit or write to: Consumer Response Center, Room 130-A, Federal Trade Commission, 600 Pennsylvania Avenue NW, Washington, D.C. 20580.

The Importance of a Good Credit History

Under the Fair Credit Reporting Act, credit bureaus are authorized to keep the information in your credit record – and to issue a report when lenders ask for it – for seven years. This includes both the positive and the negative information about your history of paying bills and repaying loans. If you have filed for bankruptcy, that information will remain in your file for seven to ten years.

When you are applying for a mortgage loan, a good credit history is extremely important. If you find that your record has a significant amount of accurate, negative information, your first challenge is to develop a plan for getting your credit situation under control. You want your record to show lenders that you pay your bills on time.

How to Solve Credit Problems

Do not be taken in by TV ads from businesses that promise to improve your credit record. There are no quick fixes to a poor credit history. Your financial future depends on your ability to plan and control your use of credit, and that requires time and commitment. Here are some important steps to take in solving past credit problems.

1. The most important guideline if you are having credit problems is to contact each creditor personally and explain your situation. Letting creditors know that you are concerned and that you want to work out a realistic plan to repay your debts is important. Most lenders will cooperate if they believe you are serious about trying to honor your commitments.
2. If your credit report shows a pattern of late payments associated with specific problems such as a sudden illness or the loss of your job, you can write a letter of explanation to the credit bureau about the circumstances behind these late payments. This letter will become part of your credit report.
3. If you have outstanding collections or judgments against you, take steps to pay them off. Contact the creditors and begin making regular payments, however small.
4. Credit problems from a previous marriage often present special challenges. If you co-signed a loan with your ex-spouse for a car, for example, and the payments are not made, these late payments will remain on the credit report of both spouses, even after the separation or divorce. You will continue to be held responsible for this debt until it is repaid.
5. Financial advisors agree that anyone with credit problems should try to solve those problems without filing for bankruptcy if at all possible – even if it takes several years.
6. If a family crisis or loss of income has caused a problem more serious than you can deal with by yourself, contact a non-profit credit counseling service.
7. When working with a credit counselor, be totally honest. A credit counselor may ask you to provide detailed information about your financial situation – income, debts, and essential living expenses – and then help you work out a plan for repaying your debts. If your creditors agree to cooperate with this plan, the credit counselor will then ask you to bring/send the agreed amount of money each month and the agency will make the payments to your creditors. The credit counselor will also help you develop good habits of planning your spending and controlling your use of credit to reduce the chance of future financial problems.

Developing an Effective Budget and Record-Keeping System

Whether or not you have had credit problems in the past, any lender you ask for a mortgage loan will want you to fill out forms describing your financial situation in detail. If you or your family do not have a budget or spending plan for allocating your income or keep records of your spending and saving, you need to develop those habits before you apply for a mortgage loan.

You need to show that you and your family know how to manage money. You will be asked to demonstrate that you are prepared to provide the down payment and closing costs, to repay the loan, and to assume the estimated additional costs of homeownership, home maintenance and repairs.

A budget is simply a management tool – a flexible plan to help you get the greatest possible satisfaction out of how to use your income. If you have a negative attitude toward budgeting, then call it a spending plan or make up some other name that encourages you to master this technique and make your money work for you.

Budgeting and record-keeping are complementary processes – a series of related actions that can be used together to help you reach your financial goals. If you truly want to become an effective money manager, you must be willing to give both time and serious thought to the process. Study the following six-step process as you develop your skills in planning and keeping records of both spending and saving.

Making a Budget

Step 1: Setting Goals

No two people have exactly the same goals, because each person has his or her own values, experiences and ways of looking at the world. It is important for families to talk about the goals of individual family members and then find ways to reach agreement on the ways family income will be used.

Most people think in terms of short-term financial goals – the things you want to be able to buy soon. But if you're thinking about buying a home, that is a major, long-term financial commitment. It may take quite a few years of saving in order to meet the costs of buying and maintaining a house.

Unless you and your family agree that you really want to own your own home, you are not likely to do the planning and saving necessary to make it happen. But you also need to look at other family goals. Think about, and talk about all of your short-term and long-term goals. Recognize that no one can have everything he wants.

Step 2: Estimating Income

Do you know how much money came into your household during the past year? How many different sources of income there were, and how much income you received from each? What changes in income do you think will occur in the coming year? This figure is the foundation for a good budget, and it is important to make it as accurate as possible. A household budget usually looks at the coming year, but you also want to look at the reliability of your income in the years beyond if you're thinking about buying a home.

Step 3: Analyzing Recent Spending

If you already keep a record of your expenses, take time to study how you've been spending personal or family income over the past year or so. Try to get a sense of your average monthly expense for each category of spending. Reviewing previous spending patterns on a monthly basis helps you develop a plan for meeting the costs of homeownership.

Many people do not keep track of how they use their money. When asked to report on recent spending, very few of us can make an accurate account. If you are serious about planning and keeping track of your spending but don't really know how much you are currently spending, you might find it helpful to keep a detailed record for a month or two. Keep all receipts and make extra notes in your checkbook to help you remember what you bought. If you are thinking of becoming a home owner, it's particularly important that you keep track of all long-term debts (debts requiring more than six months to repay).

Step 4: Planning Future Spending – Creating a Budget

The reason for analyzing your recent spending (Step 3) is to help you remember all the things for which you currently use your money. You can then stop and consider whether or not you want to continue that pattern of spending as you develop a spending plan for the future. Think in terms of the fixed and flexible expenses you have every month (rent, car payment, health insurance) and be sure you include the items that only occur periodically (gifts, taxes, car insurance). Ask yourself how much of the money you spend is truly for necessities and where you could cut back in order to increase the amount you are able to save for future financial goals.

After you work out an average amount needed per month for each category of spending, you also need to work out one or more ways to protect the money you set aside, such as a cash reserve for periodic expenses (example: savings account) and savings for emergencies or short-term goals (example: money market account).

If you haven't already begun saving and investing for future, long-term financial goals, you want to develop the PYF habit – pay yourself first. Once you decide how much money you actually need for current living expenses and how much you think you can save, it is important to set that money aside at the beginning of each month. If you wait until the end of the month to see if the extra money is still there, chances are that it won't be.

Making Your Budget Work

Step 5: Record-Keeping

If you develop a budget and then decide not to keep a record of your expenses, you've wasted your time. The reason for planning your spending is to help you gain control over how you use your money – to help you reach your own financial goals. If you don't take the time to keep receipts and make notes of how you use both cash and credit, you won't have the information you need to keep track of your finances.

It's important for all family members to participate in selecting financial goals, in planning how to reach them and to share in the record-keeping. Children whose parents include them in appropriate money management activities will be more financially responsible when they become adults.

Step 6: Analyzing Spending Records and Making Adjustments

The most important step in money management involves comparing actual spending to estimated spending and figuring out the reasons for any differences. Try not to be discouraged if your plan and your spending are far apart. If you're really serious about becoming a master money manager, you can improve all the skills involved in budgeting, in shopping, in record-keeping, and in saving.

As you become more experienced, you will learn when to make adjustments in your budget, how to reduce unnecessary spending for things that are not significant to you, and how to set aside money for things that you do consider important. For example, if your telephone bill seems excessive, talk to family members about curtailing long distance phone calls. If your gasoline bill seems too high, think about ways your family can reduce automobile usage to save money.

When you are confident in your budgeting skills and have developed the saving habit, you are ready to start planning ways to reach some of your long-term financial goals – such as buying a house. As you learn how to estimate the one-time costs and ongoing costs of homeownership, you will use your budgeting skills to help you determine when and whether you can achieve the goal of homeownership.

Planning for the Ongoing Affordability of Homeownership

In order to be sure that you can afford the house you want, you need to learn how to plan and save for the costs associated with the initial purchase and how to plan for the ongoing costs of homeownership, operation and maintenance.

Saving and Investing for the Estimated One-Time Costs of Buying a House

As we discussed in Module 1, the one-time, up-front costs of homeownership include the earnest money deposit and down payment, closing costs and moving and settling in costs. Saving enough money for all these one-time costs should begin with a review of your current assets. What funds are available for these costs? How much more will you need to save? Second, you need to find out about the various types of mortgages for which you might be eligible. You can then calculate the down payment requirements under each plan for the type of house you would like to buy.

Looking at your current savings situation, calculate the highest figure you can handle that would include all of these one-time, start-up costs. If you are planning for the future, estimate the amount of savings you think you will need. Adjust your budget to include regular savings for this purpose and determine the date when you will have reached your goal.

Estimating Realistic Ownership, Operating, and Maintenance Costs for a Specific House

As discussed earlier, a mortgage lender expects you to know and use money management skills in handling household expenses. You must estimate and save enough money to meet the one-time costs associated with getting into a house. You must also estimate and budget for the ongoing costs of homeownership, which may require some extra study.

When Should You Buy?

You've thought about the pros and cons of homeownership and decided that homeownership is for you. You've worked through the financial planning process and determined that perhaps you can afford a house. The next question you may have is, "When should I buy?"

As you've probably noticed, sometimes there seem to be a lot of homes for sale and at other times there are very few homes on the market. When there are a lot of homes for sale, it generally means that home prices will be lower. Competition for buyers tends to drive prices down. When buyers have many homes to choose from, sellers are usually more willing to negotiate their sales price to attract a buyer. On the other hand, if there aren't many homes for sale, buyers may be willing to pay a higher price for what they want, so home prices increase. Home prices have increased tremendously over the past ten years and what about interest rates? The interest rate you pay makes a big difference in the amount you can afford to borrow for a house, so most people try to buy when rates are low. Interest rates change rapidly and it's a bit risky to try and predict how much they will increase or decrease.

If interest rates or home prices increase after you buy, you'll be pleased to know that you have made a smart move. If rates fall a little, it probably wouldn't have made a tremendous difference in your monthly payment. If rates fall considerably, you may want to refinance to get a lower rate.

If you're worried about whether you should buy this year or next, in the spring or fall, or whether you should wait longer for interest rates to decline further, consider this: The best time to buy is when you decide you want to buy a house, when you know you can afford the cost and when you have found the house that suits your needs and financial situation.

Module 3 • Selecting a Home and Neighborhood

Lesson Purpose

To present information that guides you through the process of assessing your housing needs and shopping for a home.

Learning Objectives

After completing Module 3, you will be able to:

- Evaluate your housing needs and preferences.
- Identify the steps to take in locating a suitable house and neighborhood.
- Evaluate the interior/exterior condition of a home.
- Discuss the pros and cons of using a professional home inspector.

Summary

In Module 3, you will evaluate your current and future housing needs and learn how to shop for a home taking these needs into account. Thinking about your personal preferences in home size, type, location, and neighborhood will help you find a house that suits your needs and your budget. This session includes information on how to evaluate the interior/exterior condition of a house, and the benefits/limitations of using a professional home inspector to assess a property before you buy. We will also include some house-hunting tips.

Selecting a Home

Identifying Your Housing Needs and Preferences

Family Needs vs. Wants

The process of selecting a home to meet your family's needs now and in the future is not easy. The number of people, their ages and health, and the varied activities that go on in and around the house are all factors that must be considered. No two people or families live and play in the same way or want and need the same things in their houses.

Before you start to look at possible houses, examine your family members' interests, like and dislikes, and personalities.

- What are the things that mean the most to your family?
- Is your home of utmost importance or is it mostly a place to hang your hat?
- Are you willing to give up other things (travel, recreational activities, hobbies, etc.) to have the home you want? What are your major activities?
- How close must you be to your work, school or shopping?
- Will access to public transportation be important to your family?
- Do you like puttering around the house or do your prefer keeping home work to an absolute minimum?

It is seldom possible to achieve the perfect home. The best you can do is to try and select a home that most closely fits your needs and activities, which you can afford to buy and maintain, and in which you can feel secure. When shopping for a home, start by thinking about where you'd like to live.

Location

One important decision you will have to make is where to locate your home. Whether you are a first time homebuyer or an experienced one, you may already have formed opinions about locations within the community in which you want to live. The location of a house will affect its purchase price as much as the size and features of the house or the size of the lot. It can also affect your satisfaction with the house. Economic and social trends may affect the long-term satisfaction you will experience. Look at the general economic health/growth of the area.

Evaluating a House

You may have some definite thoughts about the style and type of house you want. As you begin to look at house plans there are several factors to keep in mind. Look for a style that will fit your family's needs and wants. The interior arrangement of rooms and the traffic patterns will affect the convenience and livability as well as your satisfaction with a house.

The Exterior

The structure of a house will be defined by the type (number of levels and shape) and the style (traditional, Spanish, etc.). You may prefer a two-story colonial to a one-story ranch. A two-story house may allow for separation of activities while a one-story may be more convenient, especially if a member of the family is elderly or disabled.

Each basic house style has certain characteristics. Consider all advantages and disadvantages associated with a single-family detached house, a condominium, a modular home and a manufactured or mobile home. Cost may also be a factor when considering a single-family detached house versus other housing options. You also need to decide whether you want a new or existing home. You often can get more house for your dollar with an existing home, but you must be very sure that the house will not require extensive and expensive updating. With new houses, you must check thoroughly for construction faults and shoddy materials. Each type of house has advantages and each can have problems that are not readily evident. If you plan to build, the size and shape of the lot, its contour or slope, orientation, natural view and neighboring buildings will have a great deal of influence on the house plan you select. The size and shape of the lot helps determine the basic type and size of the house. It may restrict both length and width or even change the shape of the house. Local zoning regulations can tell you how far back from property lines the house must be set.

The Interior

In addition to the importance of price, location and condition of the house, the floor plan – the size and arrangement of rooms – can help determine your long-term satisfaction with a home. A floor plan can be evaluated by comparing it to generally accepted guidelines for living and storage space.

Living space can be divided into three zones that represent distinct types of activities. These three zones represent distinct types of activities that can conflict with each other and some separation may be desirable. They are often separated by the use of walls or partitions or even by placement on separate floors. Sometimes zones overlap because of the increased amount of leisure time spent in the home, the interests of the family members and the amount of furniture and equipment owned by the family. No single floor plan will be perfect and compromises will have to be made. You will need to decide which activities represent the greatest amount of time or are most important to your family.

Circulation is the movement of people through the living space. Look at the traffic pattern of the house. Generally, there should be easy, quick access from main entrances to any area of the house. Some circulation through living areas is not always a problem, but try to avoid plans that force everyone through work areas like the kitchen.

No matter how it is arranged, living space should be adequate in size to permit the activities intended for the space. Physical size is not always the usable size of a room. The room's shape, the size and locations of windows and doors, and the size and location of special features such as a fireplace will affect the usable size of a room. For example, a wall full of windows can limit furniture placement to other walls. Some model homes look quite nice when they're empty, but after furnishings are in the house the usable space may be limited.

Storage Space is needed in every room, and the attic and basement if available. The amount and type of storage will depend on the activities taking place and the items to be stored. How much storage is enough? The best way to know is to compare what you already have to what exists in houses you are considering. Some experts suggest that storage space should be 10-25% of the total floor area of the house. Any storage area should be accessible, dry and lighted.

Kitchen Arrangements can make a difference in efficiency, comfort and convenience. Think about the type and number of meals your family eats, how many cooks will be working at the same time and what equipment you will need. As life styles change and as new appliances become widely used, kitchen planning is affected.

Bathrooms. There are two factors to consider when evaluating bathrooms – the location within the house and the arrangement of the fixtures. In a single-bathroom house, a central location provides convenience for anyone using it. Houses with more than one bath can provide a private bath for the master bedroom or a guest bath in the social zone.

Mechanical Systems. Pay particular attention to the mechanical systems (heating, cooling, plumbing, electrical) included in any house you are considering. These systems should be in good working order and as efficient as possible. Your local utility companies or a heating/cooling contractor can check the heating and cooling units for you. You may want to have a qualified plumber inspect the plumbing and an electrician check the wiring. These systems are not only necessary to the operation of the house, but can be very expensive to repair or replace.

The Healthy House. In recent years there has been more concern with what is often called "the healthy house." Poor indoor air quality may cause or contribute to poor health. Because we spend a great deal of time indoors, the potential is high for disease or discomfort related to interior environmental conditions.

It is possible to buy a house that will be safe, healthy and comfortable. To do this, you need to know which pollutants you cannot tolerate. High or continuous levels of indoor pollutants may be the result of living in a certain geographic region, as is true with radon gas or industrial pollution. However, many indoor air quality problems can be the result of the practices and activities of the people who live there.

Another product that can cause problems is asbestos. Older homes may contain asbestos in walls and ceilings as insulation, in textured paints, acoustic ceiling tiles, home appliances and wrapped around hot water and steam pipes and heating ducts. The removal of asbestos should always be done by a qualified professional. In many cases, products containing asbestos (i.e., floor coverings) should simply be covered up rather than removed.

Radon is a colorless, odorless, radioactive gas. Continual exposure to elevated levels of radon increases the risk of lung cancer. If you are looking at a house in a region where radon has been a problem, the indoor air should be tested. Names of reliable radon detectors and certified radon-reduction contractors may be provided by your county Cooperative Extension Center and U.S. Environmental Protection Agency regional offices.

The most likely sources of lead contamination in a house are the old painted surfaces with lead-based paint and plumbing systems with lead pipe or lead-based solder in pipe joints. Lead-based paint chips can be particularly dangerous to small children. Consult your state health department for suggestions on how to test for lead in paint and companies that specialize in removal.

Moisture by itself is not a pollutant, however, high humidity levels encourage the growth of microorganisms, increase the risks presented by other contaminants such as formaldehyde, and have a destructive effect on the materials used in building. Obvious signs of excessive moisture are: sweating windows, musty odors, and mildew. The amount of moisture in a house can be controlled by using moisture preventative measures.

Comparison Shopping

Just as no two people are alike or want the same thing, no two houses are alike or offer the same amenities. When selecting a house, you should take the time to do a lot of looking. Compare the condition of homes (exterior and interior), visit open houses, get help from real estate agents and friends, and evaluate the location, house features, and cost trade-offs. Keep notes on each house you visit or each floor plan you evaluate. Buying or building a home can be a long, expensive and frustrating experience, especially if you do not do your homework before starting. And remember, if you plan to build, you need to select a builder that you can trust, who does good quality work, and can build you a house for the money you have to invest. Finding the right person may take some time – time to check references, to look at houses he/she has constructed, and to check on their work-completion record.

House Inspection

Using a Professional Home Inspector

A careful assessment of the physical condition of a house before purchase can save you time and money at a later date. Costly repairs to structural or mechanical systems can be avoided or at least anticipated by a preliminary inspection of the property before a purchase offer is signed.

The inspection of a house is a job that requires specific technical skills. While you can become familiar with common problems that will help you eliminate certain houses from consideration, a professional home inspector can give you a better overview of the house and its potential problems. Your purchase offer can contain a clause that the purchase contract is contingent on acceptable inspection results.

The major areas to inspect are:

- Foundation
- Floors
- Walls and Partitions
- Roof
- Windows and Doors
- Plumbing System
- Electrical System
- Heating, Ventilating and Air Conditioning Systems
- Energy Efficiency

A professional home inspector can be located in several ways. You may choose to look in the yellow pages of your telephone book and call several firms for estimates. Talk to friends who have had inspections to identify a reliable inspector. Also your real estate agent may be able to provide you with a list of inspectors. You can also check with the local Better Business Bureau for reports on various inspectors.

Look for an inspector who is a member of the American Society of Home Inspectors (ASHI) and preferably one who has PE (Professional Engineer) after his/her name. An inspection by a company that also makes repairs presents the possibility of a conflict of interest. When you have an inspection, insist that the detailed report be written and list: (1) major problems and estimated costs to correct, (2) minor problems and estimated costs to repair, and (3) estimates of the expected life of various items such as roof, furnace, electrical system, air conditioning, appliances, and costs of maintenance.

If possible, accompany the professional on the house inspection so that you can learn first-hand the condition of the house as well as maintenance techniques. The inspection will take two to three hours and costs $200-$400, depending on the complexity of the house and credentials of the inspector. If you are spending $40,000 to $100,000 or more for your house, this cost is a wise investment to reduce the chances of a costly oversight.

Conclusion

Selecting the right house for you in terms of your housing needs and your budget can be a time-consuming process. Identifying your housing needs and preferences, evaluating the interior and exterior, considering the pros and cons of different locations and types of houses can be a difficult task. In the next Module, we'll talk about how a real estate professional can assist you. We'll also discuss how to approach submitting an Offer of Purchase when you find a house you want to buy.

Module 4 • A Guide to the Real Estate Professional and Sales Contracts

Lesson Purpose

To present information that guides you through the process of selecting a real estate agent and negotiating the purchase contract.

Learning Objectives

After completing Module 4, you will be able to:

- Discuss the role of a real estate agent and how to select one.
- Discuss techniques for negotiating the purchase price.
- Identify terms and conditions to look for in the sales contract.
- Discuss provisions of fair housing laws and what to do if you suspect housing discrimination.

Summary

In Module 4, we will discuss the role of the real estate agent to the seller and the buyer, how to select a real estate agent and what services to expect from the agent. You will learn how home sales contracts are negotiated, including such topics as making an offer, earnest money deposits, contingency clauses, and financing terms. Module 4 also discusses fair housing laws as they relate to looking for a home and obtaining a mortgage.

A Guide to the Real Estate Professional and Sales Contracts

In Module 3, we talked about how to take stock of your housing needs and preferences. We also talked about how to inspect a home with a critical eye, so that when you're ready to actually start looking at homes, you'll know what to look for. At this point, you'll also want to consider whether or not you want to work with a real estate agent, how to locate a good one, and what kinds of services they can provide. Once you find a house you want to buy, the next steps are to submit an Offer to Purchase, arrange for an inspection, negotiate the sales price, and finalize the Sales Contract.

The Real Estate Professional

Using a Real Estate Agent

Looking for the perfect home can be a frustrating, time-consuming endeavor. Using an experienced real estate agent can take some of the worry out of the process. Here's how an experienced agent can help you.

- An agent can help pre-qualify you for a loan and estimate how much you can afford to pay. As we've mentioned before, looking for a house that is affordable to you is extremely important. It can be a frustrating waste of time for both you and the agent to look at homes you cannot afford.
- An agent who is a member of the Multiple Listing Service can help you identify more homes for sale and cover more ground than you could on your own. An agent can also provide you with background information about the community.
- An agent can help you sort through your financing alternatives, provide information on mortgage lenders, inform you of current interest rates, recommend housing subsidy programs and assist you in other housing matters.
- An agent can also help you identify inspectors, appraisers, and other housing professionals who will be involved in the process.

The Agent's Relationship to the Seller

The agent in a real estate transaction is legally the agent of the seller and is legally obligated to act in the seller's best interest. Following are examples to illustrate the role of an agent.

The Clarks are selling their house. After looking for a qualified agent, they decide to list their house with Agent Smith. Agent Smith helps them decide on an asking price, advertises the house, includes it in the Multiple Listing Service, and shows the house to qualified potential purchasers. If Agent Smith, known in this case as the listing agent, sells the house to one of his clients, he is entitled to the full commission, which is paid by the seller from the proceeds of the sale.

Another scenario might be: Agent Smith has not yet found a buyer for the Clarks' home. Another agent, Ms. Jones, notices the listing in the MLS and suspects that it's just the house her clients, the Browns, have been looking for. Agent Jones shows the house to the Browns and they decide to make an offer to purchase the house. The offer is accepted and the sales contract is signed. In this case, Agent Jones, known as the selling agent, and Agent Smith, the listing agent, will share the commission.

The important point to remember is that both agents represent the seller. Even though the agents work with the buyer and spend a great deal of time showing them homes, etc., they are paid by and work for the seller. To further clarify why agents work for the seller, let's look at the typical services provided by the agent for the seller.

- Advertise the property and handle calls about the ad.
- Qualify prospective clients and make arrangements to show the house.
- Deliver offers to purchase to the seller. If more than one offer is submitted, the agent will review each of them with the seller and advise on which is the best offer.
- Relay the seller's response back to the potential buyer when a decision is made.
- After a contract has been signed by both parties, the agent concentrates on completing the transaction. This involves activities such as arranging to meet with inspectors and appraisers, providing necessary paperwork for others involved in the process, and attending the closing, where the real estate transaction is finalized and property is transferred to the buyer.

The Agent's Relationship to the Buyer

If the agent represents the seller, what is the relationship between the agent and the buyer? An agent offers his or her time, experience, and expertise to you with the expectation of obtaining a fee when the house is sold. Such agents do have certain obligations to buyers. These duties include:

- To use reasonable care and skill in performing their duties;
- To deal with clients honestly and fairly;
- To disclose all facts known to the agent that affects the value or desirability of the property that is not known to the buyer.

In dealing with a buyer, an agent who represents the seller must comply with applicable real estate laws. For example, while it is not legal to exaggerate the desirability of a house, it is considered fraud if the agent intentionally misrepresents the property. Legal action can be taken against a seller or the seller's agent if they fail to reveal something that affects the value of the property, such as violations of zoning or building codes.

Using a Buyer's Agent

A buyer's agent is just what their name implies – a real estate professional who represents your interests as the buyer of a house. The buyer's broker works for you, not the seller. They may not show as much bias in which house you buy and may be quicker to point out problems such as water damage and to steer you away from a "lemon." Buyer's brokers are particularly helpful in negotiating the sales contract and writing a purchase offer that favors your position. The buyer's broker receives a fee for his or her services, which is often a portion of the commission that is paid to the seller's agent. It can also be a fee paid directly by the buyer. Either way, the buyer's agent is usually able to help negotiate a selling price that will compensate for the fee they receive.

Dual Agency

Dual agency occurs when a real estate agent is representing both buyer and seller in the same transaction. The agent promises a duty of confidentiality, loyalty and full disclosure to both parties simultaneously. A dual agent must treat buyers and sellers fairly and equally. In states where dual agency is allowed, it must usually be agreed to by all parties, in writing. With dual agency you no longer have an agent representing you exclusively; you are sharing your agent with the seller. Buyers and sellers can prohibit dual agents from divulging certain confidential information about them to the other party. Some firms also offer a form of dual agency called "designated agency" where one agent in the firm represents the seller and another agent represents the buyer. When this option is available, it may allow each "designated agent" to more fully represent each party. If you choose the "dual agency" option, remember that since a dual agent's loyalty is divided between parties with competing interests, it is especially important that you have a clear understanding of what your relationship is with the dual agent and what the agent will be doing for you in the real estate transaction.

Fair Housing Laws

In many states, the Real Estate Commission is committed to promoting fair housing in the state. Any conduct by a broker or salesperson which violates the provisions of the State Fair Housing Act is also a violation of the License Law. Some State Fair Housing Acts state that it is unlawful to discriminate on the basis of race, color, religion, sex, national origin, handicap, or familial status in real estate transactions.

It is an unlawful, discriminatory practice to:

- refuse to rent or sell to, or otherwise deal with a person
- discriminate against a person in the terms, condition, or privileges of a real estate transaction
- refuse to receive or fail to transmit a legitimate offer to engage in a real estate transaction
- falsely deny that housing is available for inspection, sale or rental
- discriminate through advertising
- practice "blockbusting" – causing person(s) to sell or rent by telling them that members of a minority group are moving into the area
- deny membership or participation in brokerage, multiple listing, or other real estate services
- interfere, coerce, threaten or intimidate a person to keep him/her from obtaining the full benefits of state and federal fair housing laws

Sometimes discriminatory practices are hard to detect. If an agent steers you to a particular area away from others, or comes up with excuses as to why a house is not available for viewing, or if they are hard to reach or don't answer your calls about a certain house, you may want to check into the possibility that discrimination is involved.

If you believe you have been discriminated against or otherwise harmed by the kinds of discriminatory acts which are prohibited by law, you have a right to file a complaint with the state Human Relations Council or the U.S. Department of Housing and Urban Development (HUD). The names and addresses of these agencies are listed in the Resource Appendix.

Choosing a Real Estate Agent

When you are looking for an agent, consider the following.

1. Credentials

   Because agents are engaged in a business that involves other people's money and property, their activities are regulated by the states in which they operate. State laws require real estate brokers and salespeople to be licensed in order to protect the public from fraud, dishonesty or incompetence in real estate transactions. In every state, applicants for a real estate license must meet certain educational requirements and pass an examination to show they have an adequate knowledge of the business. They must also renew their license periodically and must follow certain standards of conduct as established by the state Real Estate Commission.

   You should also be aware of the different categories of real estate professionals:

   - A real estate broker is a person licensed to carry out real estate transactions and to receive a fee for these activities.
   - A real estate salesperson is also licensed, but he or she must operate under the supervision of a licensed broker because the training is not as advanced as that of a Broker. Salespersons receive a portion of the commission paid to the selling broker.
   - A Realtor is a licensed real estate agent who is a member of the National Association of Realtors. The Association, which has local, state, and national chapters, is a trade association which promotes high standards in the real estate profession. The Association also provides members with educational opportunities and resources, such as the Multiple Listing Service.

2. Experience

   There's no substitute for experience. If location is the prime consideration in looking for a house, then experience is the prime consideration in selecting an agent. Word of mouth referrals are among the best ways to locate an experienced broker.

3. Service Area

   The agent you choose should be well-established in the areas where you are interested in buying. They should have a good working knowledge of the services available, current market conditions, schools, etc. They should also express an appreciation of your lifestyle and the type of home that interests you.

4. Professionalism

   Good agents will listen to you and take your housing needs and preferences seriously. As long as you are looking within your price range, they should act in a professional manner and treat you with respect. They should also follow up on their commitments, keep you informed of what's going on, and conduct themselves in a business-like manner.

Other House-Hunting Options

If you've decided that you would like to work with an agent, you may be confused about other options you may have heard about, such as using more than one agent or purchasing properties listed for sale by the owner.

Using More Than One Agent

Some buyers believe that if it's good to use an agent, then maybe using more than one would be even better. In most instances, you'll need only one agent. Working with several agents creates confusion and wasted efforts all around, particularly if all the agents you select are members of MLS.

When you find an agent you like who seems to be doing a good job showing homes in your price range, it's generally best to stick with him or her. However, don't feel obligated to stay with an agent if you are not satisfied with his or her services. If you've been working with the same agent for months and still haven't found anything, you might want to look for another agent.

For Sale by Owner Properties

If you drive around a neighborhood you like or check listings in your local paper, you're likely to come across "for sale by owner" properties (FSBOs, pronounced fizz-bows). By all means feel free to explore them on your own, even if you're already working with an agent. The main advantage to FSBOs is that the agent's commission will not be added to the sales price, making these homes somewhat less expensive. Take extra precautions to have the home inspected before you buy, and have an attorney advise you on drawing up the Sales Contract.

The Sales Contract

When you have found a home you want to buy, the next step is to draw up a Sales Contract. When a contract has been prepared and signed by the buyer, it is known as an Offer to Purchase. This offer is presented to the seller or the seller's agent. If the document is accepted and signed by the seller, it then becomes a Sales Contract. This Sales Contract is perhaps the most important document in a real estate transaction because it states in detail the agreement between the buyer and the seller, establishing their legal rights and obligations. Once the contract is signed by the buyer and the seller, the conditions of the contract cannot be changed unless both parties agree to, and sign, the changes. Therefore, it is important that you know what the agreement says.

The first step in writing the offer is gathering all the information required to complete the form. Your real estate agent will be able to help you. Many agents use a standardized form that has been approved by the state Bar Association and the state Association of Realtors. This is essentially a fill-in-the-blank form, where you indicate how much you want to pay for the house and what conditions you want placed on the sale. Whether this form or another is used, get the advice of a real estate attorney and have him/her explain the legal terms and contingencies to you.

The information generally required in the contract includes:

- Names of the buyer(s) and a statement of intent to purchase the property
- Names of the seller(s) and a statement of intent to sell the property under provisions of the contract
- Property address, if applicable
- Legal description of the property which describes its location and boundaries
- Personal property included in the transaction, such as refrigerators, light fixtures, etc.
- Purchase price and how it is to be paid:
    - the amount of earnest money paid as a deposit and who holds the deposit until closing
    - other cash payments to be made by the borrower (down payment)
    - the amount to be borrowed and the terms of the loan
    - amount to be assumed, if applicable
- Provision for length of time the contract is valid (expiration date)
- Dated signatures of all parties
- Contingencies: any special provision that requires something to be done, (such as a professional inspection on the house) or that something occur (your loan must be approved) before you are legally obligated to buy the house. Contingency clauses give you a way out of the contract if something goes wrong.

Contingencies

The section of the contract that deals with contingencies is extremely important. Contingency clauses give you the right to cancel your contract if certain conditions aren't met. If contingencies are incorrectly stated or omitted, you may run into problems. Make sure everything you want is in the contract because you may not get a chance to correct mistakes later. There are several categories of contingencies.

Financial Contingencies

The purpose of a financial contingency is to release you from the contract if you are unable to get a loan. The contingency clause should describe the terms of the loan you wish to obtain, including the maximum interest rate, discount points, type of loan (such as fixed rate or adjustable), and term (15, 20, or 30 years).

The seller may want to include a good faith effort clause in the contract which obligates you to make every effort to obtain a loan within a certain time frame. Be sure that you are given adequate time to obtain a loan, taking into account that the seller may not want to tie up his property for a long time. If your loan application is rejected by one lender, you will have time to approach a different lender. If you are unable to obtain the loan within the time specified in the contract, you should be able to cancel the contract.

Inspection Contingencies

The purpose of an inspection contingency is to uncover any hidden problems with the house before the purchase. Most lenders require termite inspection as a contingency. Other common inspection contingencies are for structural and mechanical systems, and for hazards such as asbestos, radon, or lead paint. If the results of these inspection reports are unacceptable, you may negotiate with the sellers to repair or remedy the situation at their expense, or you may ask for a lower sales price if you can do the work yourself. If the seller agrees to make additions or repairs, be sure to get them in writing. If you cannot reach a satisfactory agreement, claim your right to cancel the contract. As a new home owner, you don't want to be stuck with expensive repairs.

Survey Contingencies

A survey contingency is done to confirm lot boundaries and reveal any zoning or code violations associated with the property. For example, if the survey shows that the property you want to buy is located in a flood zone or flood plain, you will know that you can expect to pay more for hazard insurance. Another example of how a survey contingency can protect you involves zoning ordinances. Zoning ordinances generally specify that a house must be set back a certain distance from the edge of the property line. If you have an Offer to Purchase on a lot where the previous owner has built a garage too close to the property line, the garage may be in violation of the set-back requirements of the zoning ordinance. You may be required to remove the garage at your own expense if this violation is not discovered until after you become the owner. If this violation is detected before the contract is valid, you have the option to void the contract.

Soil-Test Contingencies

If you are purchasing land located in a rural area that is not served by municipal water and sewer services, you will have to install a well and septic tank. Don't assume that land you want to purchase will take a septic system or well. You will need to have a perk test done to determine if the soil is suitable for a septic system, and if so, where it should be located on the lot.

Earnest Money Deposits

When you submit your Offer to Purchase, you will be required to make a cash deposit which indicates that you are serious about your intent to purchase the house. The deposit is generally given to the listing agent (not the seller) to be placed in his or her escrow account. The deposit will be applied to your down payment at the time of the closing.

The amount of the deposit required varies. It may be as little as $100 or it may be as much as the full down payment. Generally speaking, it is best to pay as little as possible so that you do not tie up your savings. The deposit should be large enough to let the seller know that you are serious about buying the house. Your agent and/or your attorney can advise you on how much earnest money you need.

Your earnest money deposit should be returned to you if the seller does not live up to the terms of the sales contract. The deposit should also be returned if major defects are uncovered by the inspections, or if you cannot obtain the financing you need. The conditions for returning the deposit should be clearly spelled out in the contract. It is also possible that you will lose your deposit if you fail to live up to the terms of the contract.

Conclusion

When you start looking for a home, an experienced real estate agent can take some of the worry out of house-hunting. An agent can help you determine how much you can afford to pay, and help you shop for a mortgage. An agent can also help you identify more homes in your price range more quickly. Remember to choose your agent carefully and take your time in shopping for a home.

Module 5 • Financing the Home Purchase

Lesson Purpose

To provide information about various lending programs and mortgage products so you can determine which programs best suit your needs.

Learning Objectives

After completing Module 5, you will be able to:

- List the steps to take in shopping for a mortgage.
- Identify different types and sources of lending programs at the federal, state, and local levels.
- Discuss criteria for comparing mortgage programs.
- Learn how to pre-qualify yourself for a mortgage.
- Describe ways to increase your borrowing power.
- Understand the process of determining which programs are most appropriate.

Summary

In Module 5, you will learn about the importance of shopping for a mortgage so that you can find the most favorable terms of purchase. Central to this discussion is an introduction to the various lending programs that are available through private lenders, government-insured programs, and local non-profit housing organizations. Differences between these lending programs and mortgage terms can make a great difference in the affordability of a home to purchasers with different income levels.

Financing the Home Purchase

In Module 5, we'll discuss the importance of shopping for a mortgage. Just as you would not buy a car without shopping around to compare prices, you should not finance a home purchase without shopping around to compare terms and conditions of different mortgage loans. The right loan can make a difference in whether or not you qualify, and it can save you thousands of dollars as well.

A common mistake that first-time home buyers make is to assume that all lenders are alike or that each lender has only one type of loan. There's a wider variety of mortgage products on the market now than ever before. This variety makes your search for a mortgage more difficult, but at the same time, it makes it more likely that there's a loan program out there to meet your needs.

Before you begin shopping for a mortgage, you should become familiar with the various types of home loans, where to look, and what factors to consider when comparing programs.

Where and How to Shop for a Mortgage

Loan Sources

Lenders making home loans include savings and loan associations, commercial banks, mortgage companies, credit unions, state and federal savings banks, and finance companies. Commercial banks and savings institutions typically offer other banking services such as consumer and business loans and checking and savings accounts in addition to mortgage loans. Mortgage companies, on the other hand, are primarily in the business of providing residential mortgage loans.

Types of Mortgages

There are basically three major categories of loans offered by lending institutions.

1. Conventional Mortgages

   Conventional mortgages are the standard product of lending institutions. However, the standard, conventional mortgage product of 20 years ago that required a 20% down payment is now joined by a variety of new products that make mortgages more accessible to first-time and low- to moderate-income families. These mortgages are more flexible and do not require as large a down payment. Lenders tend to consider loans obtained with lower down payments (90-95% LTV) to be more risky, and they generally require Private Mortgage Insurance (PMI) that protects the lender if the borrower defaults.

2. Federal Housing Administration (FHA)

   The Federal Housing Administration does not make direct loans; it insures lenders against default by borrowers. FHA loans are originated by many different FHA-approved lending institutions across the state.

   FHA loans are available with both fixed and adjustable rate mortgages and for terms up to thirty years. Down payment requirements are based on percentages of the loan amount. Qualifying ratios are 29/41%.

   FHA loans require mortgage insurance premiums (MIP). An up-front MIP fee equal to 3.0% of the loan amount is charged, but this may be financed for the term of the loan. FHA also charges a monthly MIP of 0.5% of the loan amount.

   Maximum loan amounts are established for various geographic locations, but these amounts are normally adequate for most first-time buyers. Properties must conform to FHA building guidelines and be inspected and approved by an authorized inspector.

   The primary advantage of FHA-insured loans is that they provide financing with a small initial investment, allowing a small down payment and the financing of the closing costs. Qualifying ratios and other underwriting guidelines are also relatively lenient. The primary disadvantage is that they sometimes take longer to process because of government regulations.

3. Veterans Administration (VA)

The Veterans Administration guarantees mortgages for veterans of the armed services, those currently in the service, and their spouses. Check with your regional Veterans Administration to find out if you are eligible and to obtain a copy of your eligibility certificate. You will be asked to furnish the VA with your discharge papers or evidence of current active duty status. Like FHA-insured loans, you may apply for a VA loan through many different lending institutions.

VA loans, for veterans who have not previously used their eligibility, may be available for 100% of the sales price or appraisal, whichever is less. The borrowers must meet income and credit standards very similar to FHA standards and some of the more liberal conventional loan programs.

The VA no longer establishes the maximum interest rate a veteran can pay. The rates are similar to FHA loans, and may be slightly lower than conventional loans. VA loans offer one of the best financing options available today, so if you qualify, you'll want to talk to a lender who handles VA loans. A disadvantage of VA loans is the additional time it takes for processing.

Other Options

In addition to the types of loans offered through lending institutions, there are other sources and types of loan programs that you may want to look into. For example, the U.S. Department of Agriculture Rural Housing Service makes home loans to low- to moderate-income families in rural areas. The State Housing Finance Agency also offers various programs for low- to moderate-income families through many lenders in the state. Find out if there are nonprofit agencies in your area that have housing assistance programs. We hope to be able to help you identify many of these housing programs in your area, and the features of some of these programs are discussed below.

USDA • Rural Development

USDA/Rural Development (USDA-RD) provides loans in rural areas to finance homes and building sites. Rural areas include open country places with populations of 10,000 or less and, under certain conditions, towns and cities with populations between 10,000 and 20,000. Loans may be made for up to 100% of the USDA/RD appraised value of the site and the home. The maximum repayment period is 33 years or, under certain conditions, 38 years. Most loans are subsidized according to income. Typically, borrowers pay 20% of their income toward house payment, property taxes, and hazard insurance. Applicants whose income is classified as "very low income" may qualify for additional subsidies.

Homeownership loans are offered to help families or persons with low and moderate income. They must:

- Be without decent, safe, and sanitary housing.
- Be unable to obtain a loan from other sources on terms and conditions that they can reasonably be expected to meet.
- Have sufficient income to pay house payments, insurance premiums and taxes and necessary living expenses. Persons with inadequate repayment ability may obtain co-signers for the loan.
- Possess the legal capacity to incur the loan obligation.
- Possess the ability to carry out the undertakings and obligations required in connection with the loan.

USDA-RD Guaranteed Program

This program provides 100% guarantee to loans originated through lending institutions. Applications are submitted to participating lenders approved by the USDA Rural Housing Service. The Guaranteed Rural Housing Loan is designed for moderate-income families. To be eligible for this program, applicants must have an adequate and dependable income and have a credit history that indicates a reasonable willingness to meet obligations as they become due. Your housing expense-to-income ratio cannot exceed 29% and your total debt-to-income ratio cannot exceed 41%. Interest rates are established by the lender for 30-year terms.

State Housing Finance Agencies

The State Housing Finance Agency is usually a self-supporting agency of state government. The HFA often operates several programs to help first-time home buyers with low and moderate incomes.

HFA Low Interest Mortgages

The HFA sells tax exempt mortgage revenue bonds to investors to raise money for these low interest mortgages. Because the bonds are exempt from federal income tax, the investors accept a lower rate of interest than for taxable bonds. The savings are passed on to the home buyers, providing mortgages at interest rates that are lower than the market rate.

These mortgages are offered in cooperation with many lenders. You may call the HFA to get a list of participating lenders in your area (See Resource Directory).

Eligibility: You may be eligible for an HFA loan if you buy a home in the state of your principal residence and are a first-time home buyer (or have not owned a home as your principal residence during the past three years). Your annual household income must be within the HFA's eligibility criteria.

Terms: Most HFA's low interest loans may be applied to privately insured (such as Fannie Mae's conventional mortgages), FHA-insured, or VA or FmHA-guaranteed loans. Therefore, the down payment required, the amount of the monthly payment, and the exact mortgage amount for which you qualify will vary.

All loans offer below-market, fixed interest rates, 30-year terms, with 3% to 5% down payments. Some VA and FmHA loans require no down payment. Typically as the buyer, you'll pay a 1% origination fee and the seller or a third party pays the discount points, which can vary.

Mortgage Credit Certificate (MCC)

Mortgage Credit Certificates were authorized by Congress to assist home buyers with moderate and low incomes. While all homeowners can claim an itemized tax deduction for mortgage interest, MCC's go a step farther. An MCC reduces your tax liability, dollar-for-dollar, by a percentage of the mortgage interest you pay. In some states, tax credits of 15% and 25% are offered, depending on your financial situation.

Financing Options

The various mortgage products mentioned previously can be further divided into categories according to how the loan is repaid.

Fixed Rate Mortgages

Most home loans are amortized, which means the loan is scheduled to be fully repaid within a definite period of time with equal monthly payments. The fixed-rate mortgage that has been used in our examples throughout the text is the garden-variety mortgage; it is perhaps the most frequently used because of its simplicity. Many borrowers, particularly first-time home buyers, prefer the security of an interest rate that does not change over the term of the loan. Before you decide, however, you'll want to investigate other financing options as well. Although there are too many varieties of mortgages to be covered in this text, following are some of the more common types.

Adjustable Rate Mortgage (ARM)

An adjustable rate mortgage, as the name implies, is one in which the interest rate varies. The ARM has a lower interest rate in the beginning, and it may increase by certain amounts and within certain set time frames over the term of the loan. The key feature to learn about ARMs is the cap placed on how often and how much the rate can increase. For example, a 2/6 cap means that the rate cannot increase by more than 2 percentage points at any one given time and that the maximum increase is 6 percent. Under this cap, a loan that starts out at 8% may increase to 10% after the first adjustment period (maybe every year, or every 2, 3, 5, or more years), but it could not exceed 14% over the loan term.

The primary advantage to the ARM is that it provides some relief from high interest rates by starting you out at a lower rate. They may also be advantageous for families who do not plan to live in their home for a very long time; they plan to sell the home before the rates are likely to have reached their peak. However, there are pitfalls to ARMs that can have serious financial consequences, so you will need to be especially careful in reviewing all the features of the loan.

Convertible Mortgage

The convertible option combines features of the fixed rate and the adjustable rate mortgages. This option allows the borrower to start out with an ARM with the option of switching to a fixed rate at a later date. Unfortunately, you cannot just pick the time to convert and get whatever the rate happens to be at the time, so the convertible may not represent any real savings to you – in fact, it could cost you more than a regular refinancing option. If you think you might be interested in a convertible mortgage, be sure to find out when you can convert, what fees will be charged, and what the conversion rate will be.

Buy-Down

The buy-down arrangement means that someone (the seller, the builder, or sometimes even the buyer) pays the lender a lump sum to temporarily buy-down the interest rate, from say, 10% to 8%. The buy-down may be in effect for 3-5 years, during which time the rate gradually increases to the contract rate, 10% in this example. During this time period, the borrower's monthly payment is based on the lower rate (8%, 8.5%, 9%, etc.), and the lender is paid the difference between this payment and what the borrower would be paying at the contract rate. In effect, the mortgage payment is subsidized from the initial buy-down set-aside fund. The final contract rate that is in effect at the end of the buy-down period will stay the same for the remainder of the loan term.

A buy-down allows you to make lower payments during the early years of homeownership, which are often the most difficult to manage. However, the buy-down could be a problem if your income does not increase enough to make the higher payments as the rate increases.

Assumable Mortgages and Seller Financing

An assumable mortgage is one in which the buyer takes over the existing financing on a house. When assuming a mortgage, you must pay the difference between the sales price and the remaining balance of the existing loan, so a large down payment is typically required. Occasionally, you may encounter a seller who is willing to take back a second mortgage if you don't have enough funds for the full down payment. This arrangement may work well in some instances, but consult with an attorney before you enter into any contracts with an individual seller.

Interest-Only Loans

Interest-only is an option that can be attached to any type of mortgage. In contrast to traditional mortgages, where the borrower makes payments of principal and interest during the entire term of the loan, Interest-Only loans offer an initial period during which the borrower only pays the interest payments. After the interest only period, the loan converts to payments of both principal and interest. Interest-Only loans may have either a fixed or adjustable interest rate. In either case, payments of interest made during the interest-only period will not reduce the principal balance remaining on the loan. Payments due after the interest-only period will be higher for the remaining term of the loan than those made during the interest-only period. For most Interest-Only loans, the principal and interest payments are calculated so that the loan is paid in full on the date of maturity.

40-Year Mortgages

With a 40-year mortgage, loan payments are calculated on a 40-year term versus the more traditional 15- or 30-year term. This reduces the monthly payments; however a borrower will pay more interest over the life of this loan than for a similar loan with a shorter term. These loans can be easier to qualify for and can be fixed or adjustable rate loans. 40-year loans can be covered by private mortgage insurance.

Mortgage Comparison Terms

Interest Rate

Interest rates are constantly changing and different rates are applied to different programs, even within the same lending institution. As previously mentioned, the rate you get affects how large a loan you qualify for and it affects the size of your monthly payment. In shopping for a mortgage, find out what rates lenders are charging and be sure your information is current. The lender with the lowest rate one week may not have the lowest rate the following week.

Interest Rate Lock-Ins

The interest rate that is quoted at the time of your application may not be the same rate that is available at the time of closing. Since a higher rate may affect your ability to qualify, you'll want to know if the lender will hold, or lock-in, the initial rate quoted until closing. Be sure to get this lock-in agreement in writing, find out how long it will be in effect and determine if there are fees associated with the lock-in.

Origination Fee

An origination fee is a lender's charge for originating and processing the loan. The fee may be 1% or more of the loan amount.

Application Fee

Lenders frequently charge an application fee to cover the costs of credit reports, appraisal fees, and other miscellaneous expenses related to determining whether the borrower qualifies for the requested loan.

Points

A point represents one percent of the loan amount. On a $50,000 loan, one point would be $500. Although the concept of points can be confusing at times, it is more understandable when thought of simply as prepaid interest. Points increase the lender's yield on a loan without raising the interest rate. Some borrowers may decide to pay points to keep the interest rate lower and, thereby lower their monthly payments. A seller might agree to pay points to help with closing costs. These points, whether paid by the borrower or the seller, are normally paid at closing.

Annual Percentage Rate (APR)

The APR is the total yearly cost of a mortgage stated as a percentage of the loan amount. The APR includes the contract interest rate, mortgage insurance, and points. The APR is a better source of comparison than the interest rate alone, because it takes all fees into account.

Eligibility Criteria

In comparing mortgages, you'll find that most lenders evaluate borrowers on the same issues. Lenders will evaluate your income, assets, and credit history. They will also evaluate the property you wish to buy. However, some lenders are more flexible than others in interpreting these guidelines. For example, some lenders will accept non-traditional methods of establishing a good credit history if you don't use credit. Some lenders require eligible borrowers to have been on the same job for the past two years, while other lenders will accept one year on the same job. Take a realistic look at your employment and residential stability and your credit history, and then ask various lenders how they evaluate these factors.

Qualifying Ratios

Pay close attention to income restrictions and lending ratios. Compare these to your own financial situation to find the best fit. Don't forget to check the back-end ratio – adding your total debt to housing costs as a percentage of your income. If your debts are high, you may not qualify for a program with a back-end ratio of 36% or 38%. You may need to try FHA instead, where the back-end ratio is 41%.

Closing Costs Estimates

There are certain closing costs associated with all mortgages, but the fees can vary among lenders, usually from 3 to 5 percent of the amount of the mortgage. Find out what the fees are for items such as the application fee, origination fee, credit report fee, appraisal fee, costs of title search and title insurance, attorney fees, and the survey, if required.

Property Evaluation

Does the lender place restrictions on the type of house you wish to buy? Will it finance manufactured or mobile homes? Modular homes? What are the lender's property evaluation criteria? What is the appraisal fee? For Adjustable Rate Mortgages, be sure to ask these additional questions.

Initial Interest Rate

Some lenders may advertise an introductory discount rate on an ARM which seems unusually attractive. Find out how long these low rates last; you may find yourself paying the full rate before you can actually afford it.

Adjustment Interval

How often can the interest rate be adjusted? A loan with short intervals, such as one year, results in your payments rising more rapidly. Will you be prepared for this? A longer interval protects you longer from the higher rates, if rates are increasing.

Financial Index and Margin

Most ARMs are tied to the price of a financial index such as Treasury notes. These index figures are widely published in newspapers, so they are easy to track. Ask about the lender's margin – how much higher is the ARM rate than the index rate? If the financial index falls, the interest rate on the ARM should also decrease.

Payment Caps

A payment cap sets limits on how much your monthly payments can increase, regardless of how high the interest rate rises. Remember, payment caps are different from rate caps. Rate caps set limits on how much and how often the interest rate changes; your monthly payments will increase accordingly. However, if there's a payment cap which limits how much your payment can increase, you could have a problem. If your payments don't go up enough to cover the additional interest due, this unpaid interest is added to your loan balance. Under these circumstances, the amount you owe increases rather than decreases with each payment, and you could end up owing the lender more than the original amount you borrowed. This results in negative amortization, and it is a situation you want to avoid. Be sure to discuss this possibility with your lender.

Conclusion

The importance of shopping for a mortgage cannot be over-emphasized. The right mortgage can make the difference in whether you qualify and it can save you thousands of dollars as well. The importance of identifying the mortgage product that is right for you will become more evident in Module 6, as we advance to the topic of the loan application process.

Module 6 • Applying for a Mortgage

Lesson Purpose

To prepare you for the loan application process to maximize your chances for loan approval.

Learning Objectives

After completing Module 6, you will be able to:

- Understand the purpose of the application interview.
- List the information lenders require for the application.
- Discuss mortgage qualifying guidelines.
- Discuss verification procedures that take place during the loan processing phase.
- Discuss options if the loan application is rejected.

Summary

In Module 6, you will learn about the loan application process, what information is required by lenders, and how this information is verified. This segment also includes a discussion of mortgage qualifying guidelines, such as ability to repay, creditworthiness, available assets and collateral. You'll be given tips for submitting a successful application.

The Loan Application Process

The Initial Interview

After you've done some comparison shopping for a mortgage, the next step is to begin the loan application process. The first thing you'll need to do is schedule an interview with the lender. The purpose of this initial interview is to give you the opportunity to learn more about the lender's programs. The interview also allows the lender to learn more about you. This meeting sets the stage for making a formal application if you decide to do so.

In most lending institutions, your initial interview will be with a loan officer or loan originator. Call ahead for an appointment and allow at least an hour for the interview. If you're married or have another co-borrower, it's best for you to go together. When you go to the interview you'll want to put your best foot forward, but there's no need to be uneasy about it. Lenders are people in the business of making loans and they want to help you.

Getting Pre-Qualified

The loan officer will use the appropriate lending ratio requirements to see if you fall within specified ratios. For example, if you are applying for an FHA loan, the loan officer will want to find out if your Principal, Interest, Taxes, and Insurance (PITI) payment exceeds 29% of your gross monthly income. He or she will also add your total debts to this projected PITI payment to see if your total debts will exceed 41% of your gross monthly income. If you don't fall within these guidelines, the loan officer may be able to offer some advice as to how you might be able to qualify at a later date, or he or she may suggest a different mortgage program that would be more suitable for your situation.

If you do fall within these ratios, the lender will proceed to find out more about you and the property you wish to buy.

Knowing What You are Qualifying For

You are under no obligation to make a formal loan application at the interview. This interview is your opportunity to make sure you fully understand all the terms and conditions of the loan.

Interest Rate Lock-Ins

Some lenders will be willing to lock in the current rate, and points, if applicable, for a set amount of time. The advantage to locking in an interest rate is that you'll know that the rate won't increase before you close on your loan. You may want to consider locking in the rate if you know you won't qualify at a higher interest rate. Beware of lenders who put a short time limit on the lock-in. You'll want your lock-in to be in effect through closing, and be sure to get it in writing.

Closing Costs Estimates

When you submit your mortgage application, the lender is required to provide you with a good-faith estimate of the closing costs that you are likely to have to pay. This estimate must come to you within three days after your application is filed. Although the lender will not know exactly what these costs will be, the estimates are usually fairly accurate.

Annual Percentage Rate (APR)

You'll want to verify the lender's annual percentage rate on the loan. The APR includes not only the interest rate, but also discount points and certain other fees.

Completing the Application Form

If you do decide to take steps to apply for the loan, you will need to be prepared to supply the loan officer with all the information needed for the application form. Most lenders use a standard residential loan application form (see example at the end of this module). This is another fill-in-the-blank form, and the loan officer will help you complete the form. There are six types of information generally required for the loan application.

1. Personal Data – Full names, addresses, and Social Security numbers of all borrowers.
2. Income – The amount and source of all income for all borrowers.

3. Assets – Information on all your other assets, such as checking and savings accounts, stocks and bonds, real estate, etc.
4. Debts and Obligations – Information on all outstanding debts and other financial obligations.
5. Credit References – Information concerning loans or debts that have been paid plus other good credit references.
6. Property Information – Information on the property you wish to buy including your sales contract with its legal description of the property and the sales price.

The loan officer will ask you a lot of specific questions about your personal financial situation. It's important that you cooperate fully and be honest. The lender will verify all the information you give them; chances are they will find out if you've been dishonest, and this will hurt you in the long run.

Verifying the Information

Your loan application and all the other information you supplied to the loan officer form the basis of your loan package. After your loan application has been taken, the next step is for the loan officer to turn your loan package over to a processor who will begin verifying this information. Because so much money is at stake when lenders make mortgage loans it is necessary for them to thoroughly investigate your financial and employment background to determine if you're a good risk.

Remember, most lenders cannot make a verbal commitment to approve your loan at the time of the interview. A decision on whether or not your loan will be approved is not made until all these verifications are in. The verification process takes time, and this is when the waiting begins. Waiting to find out if your loan will be approved is one of the most frustrating aspects of the entire home-buying process. It will be helpful, however, if you understand what's going on behind the scenes.

Typically, lenders use standard verification forms to request information from credit bureaus, your employer, and your bank. There are four major areas that require verification.

1. Employment and Salary

   Lenders will not just take your word for what kind of job you have or what your salary is. They will ask your employer for written verification of your current position, how long you've been with the company, your current salary and your prospects for continued employment. If you frequently work overtime and need this extra income included in your gross salary to qualify for the loan, you'll also need to provide the lender with your W-2 forms for the past year or two. Your W-2 forms show that you receive overtime pay on a regular basis.

   Employment stability is another concern of the lender. Lenders usually don't look favorably on an applicant who has changed jobs several times in recent years. Changing jobs should not be a problem if you have upgraded your job status or moved from one company to another to accept a better job in the same field. However, if you've held many different jobs in different fields within a relatively short period of time, you are likely to be considered a poor risk. The so-called job-hopper generally has a hard time getting a mortgage.

   Self-Employment – If you are self-employed, you will need to submit copies of your personal federal income tax returns for the previous two years. Lenders will also ask for your partnership or corporate tax returns, unless you are the sole proprietor. Other information that may be required of the self-employed includes profit-and-loss statements and balance sheets for the current and previous two years.

2. Other Assets

   The lender will want to know if you have any sources of income in addition to your salary. This may include alimony or child support, social security, disability payments, savings accounts, trust funds, and stocks. All assets that you list will be verified by the lender.

   The lender will also contact your bank to verify the balances in your checking and savings accounts. This information tells the lender that you have enough money to make the down payment and pay closing costs. In addition, most lenders will want to verify that you will have some savings left over after you pay these costs.

Gifts – As mentioned earlier, many lending programs now allow part of the down payment to be in the form of a gift. Most lenders, however, do not want you to borrow money to make the down payment, so they will verify that this money is a gift and will not have to be repaid. Gifts from parents or other close relatives (grandparent, sibling, or child) are generally more acceptable than gifts from distant relatives or friends because there is less likelihood that a gift from a close relative is a loan in disguise. Lenders will usually ask for a letter from the donor specifying the relationship and confirming that the amount does not have to be repaid. The lender will also verify the source of the gift in order to determine that the donor has the resources to make the gift.

3. Credit History

   You'll recall from Module 2 that we talked about the importance of establishing good credit. We also advised you to get a copy of your credit report before you apply for a loan so that you will have time to pay off delinquent accounts or correct mistakes on your report. When the lender pulls your credit report, they will be looking at several things.

   - Bankruptcy – The lender will look to see if you have filed for bankruptcy in the past. A bankruptcy will stay on your credit report for up to ten years, and can negatively impact the way the lender views your application. However, some lenders will work with you. It's important to be honest and tell the lender about your circumstances.
   - Debts – The lender will verify balances on charge cards and other installment or revolving charge accounts. If your debts are excessive you may not be able to qualify.
   - Payment History – The lender will also look at how you've paid these accounts, whether or not you've paid them on time, and how often your payments have been late. An occasional late payment probably won't diminish your chances to get a loan. We've all had times when we've lost an invoice or accidentally let the due date go by before paying the bill. However, a pattern of making payments late can hurt you because the lender may feel that you will not take your commitment to make monthly mortgage payments seriously.
   - Rent Payments and Residential Stability – Your history of paying rent or mortgage payments is important because it indicates your commitment to pay for shelter. If you rent, the lender will verify the amount you pay for rent each month and the length of time you have lived at your present address. Your history of paying the rent will be particularly important if you pay cash for most of your purchases and do not have an active credit file. You can establish a credit history by showing evidence of paying rent and utilities on time, so be sure and keep these accounts up to date.

4. The Property

   The lender will ask for an appraisal on the house you wish to buy. The purpose of an appraisal is to determine the market value of the property. The appraised value tells the lender whether or not you are trying to borrow more than the house is worth. This is where the loan-to-value ratio (LTV) comes into play.

The Approval Process

The verification process eventually leads to a decision regarding your loan. When all the necessary information and verifications have been received, your loan package will be submitted for approval. In most instances, the person making this decision will be an underwriter. The underwriter will evaluate all the information in light of the lender's eligibility rules, called underwriting guidelines.

The underwriter will look at the verifications of your employment, income and assets to evaluate whether you have the resources to repay the loan. The information drawn from your credit report tells the lender whether or not you are likely to repay the loan. The appraisal tells the lender whether or not the property supports the loan.

Here's another way of looking at how lenders evaluate the risk in making loans – by looking at the four C's of credit.

1. **Capacity** – Can you make the monthly mortgage payments required to pay off the loan?
2. **Credit History** – Is your credit good? Do you pay your debts on time? If you've had problems in the past, have you made an effort to correct them? Is your employment and residential history stable?
3. **Capital** – Do you have enough money to make the down payment and pay closing costs?
4. **Collateral** – Does the value of the property support the loan? Is the appraised value in line with similar homes in the area?

The Waiting

The wait for a mortgage approval only seems to take forever; most applications can be processed within 4-6 weeks. It may take longer if you are applying for an FHA or VA loan or if you are applying through a special assistance program that requires more than one approval.

Keep in mind that it takes time for all the verifications to be returned to the lender. It also takes time to schedule the appraisal and get the work done and the reports filed. You may be able to help speed things up by staying in touch with the loan officer. If you're told that your employer has not returned your verification form, for example, you could remind him/her to do so. Don't wait until just before the contract expires to find out that there are problems.

The Commitment Letter

After weeks of waiting, you finally get the commitment letter telling you that your loan has been approved. Be sure to read the entire letter to make sure that all the terms and conditions are what you expected.

The following terms and conditions are included in a typical commitment letter.

- First mortgage amount
- Interest rate
- Term of loan
- Discount points
- Origination fee
- Other fees

The letter will list a number of other conditions that must be met before the closing such as evidence of homeowners insurance, termite inspection, a final inspection of the property, the title search, and payment of closing costs. Your commitment letter will also include an expiration date. If all these conditions aren't met within the specified time, the lender will withdraw the commitment.

Be sure to read the commitment letter carefully before you sign. Your signature indicates your acceptance of the terms and conditions of the loan.

Dealing with Rejection

If your loan application is rejected, you can certainly apply somewhere else. But before you do this, you'll want to know why your loan was turned down. There are several reasons a loan is not approved.

1. **Poor Credit History** – Did the lender uncover unpaid collections or judgments against you? Have you failed to pay your bills on time consistently? If you have credit problems, you may need to take some time to clear up your credit before you re-apply.
2. **Low Appraisal** – If the contract sales price on your house is higher than the appraised value, the lender may reject your loan. Review the options discussed earlier in this module to see if there's a way to remedy the situation.

3. Insufficient Income or Assets – Although you've been pre-qualified by the lender before your application is taken, sometimes a closer look at your income, assets, and debts shows that you don't fall within the lender's underwriting guidelines. Talk to the lender about ways to improve your situation.

Predatory Lending

Predatory lenders target low-income and minority homebuyers, capitalizing on the buyers' lack of understanding of the complicated transactions or use outright deception to close loans that inevitably lead to a loss of equity or foreclosure. Predatory mortgage lending involves a wide array of abusive practices. The following are brief descriptions of some of the most common.

- Excessive Fees
- Abusive Prepayment Penalties
- Kickbacks to Brokers (Yield Spread Premiums)
- Loan Flipping
- Equity Stripping
- Packing Unnecessary Products
- Mandatory Arbitration
- Steering & Targeting

Excessive Points and Fees

Points and fees are costs not directly reflected in interest rates. Because these costs can be financed, they are easy to disguise or downplay. You can expect to pay a 1% origination fee and possibly another 1% of the loan amount in points, as well as basic closing costs that include appraisal and attorney's fees. Some predatory lenders load up loans with these up-front charges and charge additional "junk fees" to pad the closing costs.

Abusive Prepayment Penalties

Borrowers with higher-interest subprime loans have a strong incentive to refinance as soon as their credit improves. However, up to 80% of all subprime mortgages carry a prepayment penalty -- a fee for paying off a loan early. An abusive prepayment penalty typically is effective more than three years and/or costs more than six months' interest. In the prime market, only about 2% of home loans carry prepayment penalties of any length.

Kickbacks to Brokers (Yield Spread Premiums) Mortgage Broker Compensation

Most mortgage brokers arrange a loan with the best terms and at the lowest possible rate and charge a reasonable fee for their services. However, in the sub-prime market, some mortgage brokers do just the opposite by attempting to sell you a loan with the most fees and highest rate possible so that they get more compensation. Some of these brokers may charge fees of 8 to 10 points. That could cost you an additional $8,000 to $10,000 on a $100,000 loan. In addition, the broker may get additional compensation by arranging a higher-than-necessary interest rate for you. For example, you may qualify for an 8% interest rate, but if the broker can sell you a 9% rate, he can keep the difference. This method of indirect payment is called a "yield spread premium." Before contracting with a mortgage broker, find out how the broker will be paid.

Flipping

Flipping is the repeated refinancing of your loan. When you have paid down the loan slightly, a predatory lender may encourage you to refinance and get a little more cash out of the available equity in your home. Each time the loan is refinanced the lender charges fees, placing you further in debt over a longer period of time.

Equity Stripping

If you have a significant amount of equity in your home, you could be a target for the predatory practice known as equity stripping. An unscrupulous lender may lend an amount that is more than you can afford, knowing that you are likely to default. The lender can then foreclose and sell the house, stripping you of all the equity you have earned over the years.

Packing

Packing is the practice of adding unwanted extras to the loan without your full knowledge. The most common product added to loans is credit life or disability insurance. Credit insurance is almost always overpriced and a poor value for consumers, but in mortgage loans, the cost can be enormous. For example, on a $28,000 loan, the cost of credit life insurance can exceed $4,000. The $4,000 premium is added to the loan and financed over the life of the loan, earning the lender more interest income in addition to the commission from the sale of the insurance.

Mandatory Arbitration

Some loan contracts require "mandatory arbitration," meaning that the borrowers are not allowed to seek legal remedies in a court if they find that their home is threatened by loans with illegal or abusive terms. Mandatory arbitration makes it much less likely that borrowers will receive fair and appropriate remedies in cases of wrongdoing.

Steering & Targeting

Predatory lenders may steer borrowers into subprime mortgages, even when the borrowers could qualify for a mainstream loan. Vulnerable borrowers may be subjected to aggressive sales tactics and sometimes outright fraud. Fannie Mae has estimated that up to half of borrowers with subprime mortgages could have qualified for loans with better terms.
According to a government study, over half (51%) of refinance mortgages in predominantly African-American neighborhoods are subprime loans, compared to only 9% of refinances in predominantly white neighborhoods.

How to Avoid a Predatory Loan

- Always shop around.
- Ask questions.
- If you don't understand the loan terms, talk to someone you trust to look at the documents for you.
- Don't trust ads promising "No Credit? No Problem!"
- Ignore high-pressure sales tactics.
- Don't take the first loan you are offered.
- Remember that a low monthly payment isn't always a 'deal.' Look at the TOTAL cost of the loan.
- Be wary of promises to refinance the loan to a better rate in the future.
- Never sign a blank document or anything the lender promised to fill in later.

References:
www.responsiblelending.org—“How to spot and avoid predatory Lending”
www.nchfa.com—“Avoiding Predatory Lending”

Lender Responsibilities

Lenders are required by law to operate under certain rules, regulations and procedures when taking loan applications. You should know your rights under these laws.

Equal Credit Opportunity Act

This Act prohibits discrimination in lending practices. The lender may not discriminate because of race, creed, religion, national origin, sex, marital status, or age. If your loan application is rejected, the ECOA requires the lender to send you a written explanation of the reasons for rejecting your application within 30 days of your request.

Fair Credit Reporting Act

This Act guarantees your access to your credit report. You are entitled to know the full contents of your report. Remember, if you are turned down for credit anywhere, you are entitled to a free copy. If there are errors, you also have the right to have mistakes corrected.

Real Estate Settlement Procedures Act (RESPA)

This Act requires lenders to give you a good faith estimate of all closing costs you are likely to pay. The lenders won't know exactly what the closing costs will be when you submit your application, but they are required to estimate these costs so you will be prepared. The lender is also required to give you a HUD-approved booklet about closing costs. This booklet and the good-faith estimate must be mailed to you within three days of your application.

Truth-In-Lending Settlement (Regulation Z)

Lenders must tell you the annual percentage rate (APR) on the loan. The APR is based on the contract interest rate plus discount points and certain other fees. The APR gives you the true costs of your loan and is a better basis of comparison than the interest rate alone.

Conclusion

The loan application process is long and tedious, and it requires your full cooperation and patience. Be prepared to furnish the lender with all the information needed and be prepared to wait for a response. The waiting period will be easier if you are fully aware of what happens after you apply for a mortgage. This process is summarized in the chart on the following page. If your loan is approved, you'll be ready to plan for the closing, which is the topic of Module 7.

Module 7 • Closing the Real Estate Transaction

Lesson Purpose

To provide an explanation of the closing and settlement process so you will be prepared to meet the obligations and expenses of closing the transaction.

Learning Objectives

After completing Module 7, you will be able to:

- Discuss considerations in selecting a settlement agent.
- Identify necessary preparations for the closing.
- Discuss what happens at the closing.
- Discuss the purpose of closing documents.
- List various closing costs normally paid by the buyer and the seller.

Summary

In Module 7, you will learn how real estate transactions are finalized. Topics discussed in this segment include the purpose of the closing, where they are held and who attends, the role of the settlement agent, the legal requirements, title search and title insurance, closing statements, allocation of closing costs, and the recording of documents.

Closing the Real Estate Transaction

The closing is the final step on your way to becoming a home owner. The purpose of closing is to transfer ownership of the property from the seller to the buyer. This is also sometimes called the settlement because all financial arrangements and legal documents are “settled” at this time. The participants attending the closing include the buyer, the buyer’s attorney (if possible) and the lender’s closing agent. The seller, the seller’s attorney and the real estate agent may also choose to attend.

What Happens at Closing

It’s simply the time when all parties pay and receive the money to which they are entitled. It’s also the time when all agreements and transactions are signed and notarized to make them legally binding. The sales contract is the controlling document at the closing. This contract clearly states all the items agreed to by the buyer and seller. The contract also calls for documentation of certain items, such as the inspection report, tax certificates and the title commitment.

Preparing for Closing

The closing process actually begins several weeks before the scheduled closing. Pre-closing activities include:

1. Selecting a Settlement Agent. Since the sales contract is the controlling document at closing, it’s to your advantage to have an attorney present to make sure your interests are protected. The attorney you choose should practice real estate law and it’s important to note that attorney fees and services vary. Don’t hesitate to find out how much is charged for various services. Ask what the fees are for:
   - Reviewing documents and giving advice on them
   - Attending the closing
   - Conducting the title search
   - Preparing the documents
   - The closing fee (if it is a separate charge)

   If an attorney’s fees seem too high, shop around for another attorney, but don’t just select the one with the lowest fees. Experience and qualifications are important as well.

2. Setting the Date and Time. The sales contract should specify when the closing will take place, usually in the form of a statement such as “the closing will take place on or before (date).” This date can be extended if the buyer and seller agree to the extension. The exact date and time of the closing are generally set by the lender’s closing agent or the real estate agents. Be sure that the closing takes place before the lender’s commitment or any interest rate lock-in expires.

3. Closing Costs. A day or so before the closing, you’ll be told the exact amount of money you need to bring to the closing and what forms of payment are acceptable. Certified checks or cashiers checks are normally required. Personal checks may be acceptable only for small amounts.

4. Final Walk-Through Inspection. Your sales contract should spell out your right to inspect the property within 24 hours of the closing. Don’t skip this last step. This inspection serves several purposes. After months of waiting for the financing to be arranged, you need to be sure that the property is in the same condition as when you offered to buy it. Use the opportunity to make sure that items that were included in your contract (appliances, curtain rods, light fixtures, etc.) are left intact.

   Arrange for the final inspection the day before closing. If you inspect the property too early, the seller may still be living there, and furniture and carpets not yet removed may conceal damage. Arrange for the gas, electricity and water to be on when you make your final walk-through inspection; otherwise, you won’t be able to tell if all of the house’s systems are working.

   If you find problems or damage that was not there before, talk with your real estate agent and lawyer prior to closing. Many times the seller will agree to correct the problems after closing, but you need some type of guarantee that the work will be done. Once you sign the final papers, you have less chance to get repairs made.

Requirements for Closing

You'll recall from Module 6 that the lender's commitment letter approving your loan also specifies various conditions that must be met before closing. When you sign and accept the lender's offer, the advance preparations for the closing will begin. This is the time when the home inspection, survey, title search, termite inspection and any other contingency requirements are done. Talk to your attorney and real estate agent about who is responsible for which activities so you'll know what you are responsible for. Many buyers are dismayed to learn that their closing has been delayed because one of the contingencies has not been taken care of. You or your attorney should contact the closing agent several times during this period to confirm that everything is on track. Typical pre-closing activities include:

Title Search

A title search is done to ensure that the seller is the legal owner of the property and that he or she is free to sell it. The title search also checks the title records to make sure that there are no liens on the title. A lien is a legal claim against a property that must be paid when the property is sold. For example, there may be liens filed by creditors in an attempt to collect unpaid bills or there may be outstanding taxes due.

Title Insurance

If a title search checks title records, why is title insurance required? Even the most careful search of public records might not uncover risks such as forgery or fraud, false representation by those acting as owners of the property, incorrect representation of marital status or grantors, undisclosed or missing heirs, improperly probated wills, and inadequate or incorrect surveys or clerical errors, just to name a few potentially serious problems that could arise. There are two types of title insurance that provide protection against these title defects:

- Mortgagee Title Insurance protects the lender's loan in the event a flaw is discovered after the property has been purchased. The lender requires this type of title insurance.
- Owner's Title Insurance protects the owner's equity in the event a title defect is discovered. The owner's title insurance does not guarantee that these defects won't occur, but it does protect you against loss arising from claims against your title.

As the buyer, you will pay for title insurance, and you should get both types. Most companies offer combination policies and the addition of owner's title coverage is very inexpensive.

Survey

Lenders generally require a survey on the property before closing. A survey verifies property boundaries and confirms that the legal description of the property as stated in the sales contract is correct. Occasionally, a survey will show that a fence or tool shed was built over the property line, extending into a neighbor's property (or vice versa). Violations of this kind are common and some are more easily remedied than others.

Termite Certification

Termite inspections are required before closing to certify that the property is not infested with termites and that there is no termite damage.

Homeowners Insurance

Lenders require borrowers to purchase homeowners or hazard insurance that protects against loss in the event the house is damaged or destroyed by a disaster such as fire. Most lenders require you to buy insurance coverage that equals the home's replacement value – what it would take to replace your house should it be destroyed.

The types of coverage and premiums vary widely. Various insurance packages are available, including:

- Personal liability insurance. This type of insurance protects you from personal liability in the event someone injured on your property or injured by a member of your family sues you. Automobile related injuries are not included.
- Insurance covering you against fire, theft and some weather-related hazards.

In obtaining homeowners insurance, consider these additional factors:

- For continuing coverage that is adequate as your home's value increases from inflation, make sure your policy has an inflation rider that increases your coverage automatically as the value of your property rises. Most lenders require you to have coverage that equals 80% of the replacement cost of your property. If your property values increase and you incur serious damage, insurers will only pay 80% of the value stated in the original policy.
- Get quotes from several different companies, but make sure you are comparing the same types and levels of coverage.

Homeowners Warranty

If you are buying a new home, find out if you'll have a homeowners warranty that protects against certain defects in the home. A certificate of occupancy is required before you can occupy the dwelling. Homeowners warranties and the certificate of occupancy should be provided at closing.

Explanations of Closing Documents

There are numerous documents you'll be asked to review and sign at the closing. Some of these are summarized below.

HUD-1 Settlement Statement

The HUD-1 Settlement Statement itemizes the services provided and lists all charges to the buyer and the seller. Both the buyer and the seller must sign. This form is required by federal law – the Real Estate Settlement Procedures Act (RESPA). The closing agent generally fills it out.

Truth-in-Lending (TIL) Statement

Lenders are required to disclose the annual percentage rate (APR), which reflects the annual costs of your mortgage as a yearly rate. Lenders are required to provide this information within three days of the original application. The TIL statement also describes other terms of the loan, including finance charges, the amount of the loan and the total payments required. Check with your lender before closing to see if all TIL disclosures that were in the original TIL statement are still correct.

The Note

The mortgage note is a legal IOU that represents your promise to pay the lender according to the terms. The note also describes the penalties that you will incur should you fall behind in paying the loan (Default). The note states the lender's right to 'call' the loan, requiring full payment before the end of the loan term, if you fail to make the required payments. The loan may also be called if you sell your house without prior written consent of the lender or if you violate the terms of your note or mortgage in any way.

The Deed of Trust

In some states, the Deed of Trust is the legal document that secures the note. In some states a mortgage is used instead of a deed of trust, and the terms are often used interchangeably, although there are some differences between them. In practical terms, a mortgage and a deed of trust accomplish the same thing. The deed of trust (or mortgage) gives the lender a claim against your house if you default on the note's terms. If you default, the lender can foreclose on the property, sell it and use this money to pay off the outstanding loan balance plus foreclosure costs.

The primary difference between a mortgage and a deed of trust is the means by which foreclosure can take place. Under a deed of trust, the borrower receives title to the property and then conveys this title to a third party, called a trustee, by signing a deed of trust. The borrower keeps the original recorded deed from the seller, but the trustee holds title until the loan balance is paid in full. If the borrower defaults, the trustee may take steps to foreclose. Foreclosure procedures for defaulted deeds of trust are usually simpler and faster than those for mortgage loans.

The Deed

The deed transfers ownership from the seller to the buyer. The seller should provide his or her deed at the closing, properly signed and notarized. The deed specifies how you will own the property and what name(s) should appear on the deed. If you are to be the only owner, you will have sole ownership of the property. Joint ownership may take several forms. Tenancy by the entirety is available only to married couples, and the house may not be sold without both spouses agreeing to the sale. Both spouses have survivorship rights – if one spouse dies, the house automatically goes to the surviving spouse. Joint tenancy provides equal ownership shares without survivorship. Talk to your attorney about these options.

Recording the Documents

After the closing, the deed of trust, the note and the deed must be recorded, usually at the registry of deeds of the town clerk's office. The house is then officially yours!

Closing Costs

As mentioned in Module 1, closing costs are 3-5% of the loan amount. What are all these costs for? There are three basic categories of closing costs.

1. Charges for Establishing and Transferring Ownership

   This category includes items such as:
   - Title search and title examination
   - Title insurance
   - Settlement or closing fee
   - Document preparation (if separate from the above)
   - Notary fee – paid to licensed notary public to authenticate signatures
   - Attorney fees

2. Amounts Paid to State and Local Governments, including:
   - City, county and state transfer taxes
   - Recording fees
   - Prepaid property taxes

3. Costs of Obtaining a Mortgage

   These items are payable in connection with the loan, including:
   - Loan origination fee
   - Points (the loan discount fee)
   - Appraisal fee
   - Credit report fee
   - Lender's inspection fee (for new construction)
   - Mortgage insurance premium (may be first year's premium or monthly premium paid in advance)
   - Assumption fee (if applicable)
   - Survey fees
   - Pest inspections
   - Hazard insurance (may be first year's premium paid in advance)
   - Adjustments or pre-payments of interest

Allocation of Costs to the Buyer and the Seller

After reading the list of closing costs, you're probably wondering which of these you, as a buyer, will have to pay. Because of the uniqueness of every property and every settlement transaction, it's difficult to know what will apply in every situation. The payment of some closing costs, such as points, is negotiated between the buyer and the seller. In general, the buyer pays the costs associated with obtaining the mortgage – the loan origination fee, appraisal fee, credit report, appraisals, hazard insurance, etc.

Adjustments

Other costs for which you may be responsible include items that are split between the buyer and the seller. These are generally items that are billed on an annual basis, such as property taxes. The buyer and the seller pay their portion of these bills according to how long they lived in the house during the year. For example, if you buy your home in July, you will be responsible for property taxes from July to December. The seller would owe the taxes due for the period of January to June. Another type of adjustment you may be responsible for is interim, or "odd days," interest. This represents interest charged from the date when you take possession of the house until the first day of the following month. If your closing is July 20, there will be 11 days of interest due.

Summary

The activities that take place at a closing can be summarized as follows:

- The buyer shows evidence of paid insurance on the house.
- The closing attorney lists all closing costs and who is responsible for payment.
- The buyer signs the deed of trust and promissory note.
- The lender's agent formally 'loans' money to the buyer and the buyer 'pays' the seller for the house.
- The title passes from seller to buyer, giving ownership to the buyer.
- The lender's agent collects closing costs owed by the buyer and the buyer is given the TIL, which lists all items paid.

In order for all of these activities to take place, each party to the transaction is responsible for furnishing certain items.

1. From the Lender or Lender's Agent

   Documents such as the RESPA statement, the TIL statement, the mortgage, the note, applications for escrow accounts, if any, plus a check for the seller.

2. From the Seller

   The seller must bring the deed and final tax or utility bills, special certificates that verify work that has been done (lead paint removal, for example), documents required to clear the title (if applicable) and the keys to your new house.

3. From the Buyer

   Insurance policy or binder, purchase money for closing costs and the down payment and any other documents requested by the lender. Again, it's advisable to bring your own attorney.

After the closing, you'll be able to relax and to celebrate your new home. You'll then need to think about how and when you will move and how you will maintain your home. These topics will be covered in Module 8.

Module 8 • Living In and Maintaining Your Home

Lesson Purpose

To ensure the ongoing success of the homeownership experience by providing information that emphasizes the privileges and responsibilities of homeownership.

Learning Objectives

After completing Module 8, you will be able to:

- Discuss plans for moving into and adjusting to your new home and neighborhood.
- Identify ways to safeguard your home.
- Describe routine maintenance procedures; discuss seasonal differences in maintenance needs.
- Discuss how to deal with emergency repairs and major home improvements.
- Discuss basic water and energy saving techniques and improvements.
- Discuss appliance and furniture selection.

Summary

In Module 8, you are given basic information on how to plan for the move into your new home, taking care of unfinished business in your apartment or rental unit, selecting and paying for home furnishings and major appliances, securing your home with fire and theft prevention techniques, planning for home maintenance and repair problems, and conserving water and electricity.

Living In and Maintaining Your Home

Planning to move from one home to another can be an exciting, if sometimes traumatic, experience, especially if the move is into a new home. Many steps are required in becoming a home owner and the moving process is one step in taking responsibility for your family's housing needs. Taking care of unfinished business in your apartment or rental unit, selecting and paying for home furnishings and major appliances, securing your home with fire and theft prevention techniques and insurance, planning for home maintenance and repair problems, and conserving water and electricity will make the homeownership experience successful and enjoyable.

Planning Ahead for Moving Day

Planning a move across country or across town, especially when it is into your first home, can be an exciting time. Moving can also bring overwhelming feelings and confusion because changing your residence is never easy. If all goes smoothly, it is because the move has been planned and well organized. The two most important matters to take care of include making arrangements to move out of your current residence and planning for the move to your new home.

However, in spite of the best prepared plans, you might begin to ask yourself questions about every major and minor detail of your life: How much will it cost to move? Do I have enough money? How much work do I need to do in my current residence before moving? Should I shampoo the carpets and clean all the rooms and floors? Should I make repairs to broken screens or windows? Do I need to paint? Is moving to the new house the right decision? Will I make new friends and will my children be happy in the new house, neighborhood, or school?

All of these questions are valid concerns to a home buyer. The thing to remember is to plan ahead. Creating a moving plan for the big day, as far in advance as possible, can minimize the worry you may feel.

The Moving Checklist

The most important thing you can do to make your move easier is to keep things as simple as possible. Making and following a checklist of things to do at suggested intervals can help the moving process go much more smoothly.

Learning about the Neighborhood

When you first move into a new neighborhood, try to become acquainted with your neighbors. Also, you need to learn as much as possible about city services, such as trash pick-up or recycle day; where the schools are and, when needed, the bus stops; and where to shop for groceries, household and hardware items or health and beauty needs, including prescriptions. All of these are good ice-breaker questions to ask your neighbors and, in the process, you may make a friend. As you become more acquainted with the neighborhood, you will learn about neighborhood organizations and resources.

Safeguard Your Home

Home Security

Your home should provide a sense of safety and privacy. However, you need to be sure that your home has the necessary protection devices. These devices include: lighting, fences/walls, locks, smoke detectors, and alarms.

Good exterior lighting is considered an effective method of crime prevention as well as a necessary safety precaution. In particular, you should have lights at each exterior door, in garages or carports, on porches, and along walkways. If you have a large yard, you may want to consider adding lights that can be controlled from a central switch inside the house.

Fences and walls can give you a more secure feeling. Just be sure that any fence or wall installed does not cross your property lines. Some communities prohibit certain types of property barriers.

One of the most important security precautions against burglars is an adequate system of locks, such as double cylinder dead-bolt locks on each exterior door. In addition, each window should have a lock of some type. Contact a locksmith service in your community for help.

Fire Prevention

Home fires kill approximately 6,000 people in the U.S. each year and injure thousands more. Most fatal home fires occur at night while people sleep. Studies show that most die from smoke and toxic gases rather than the fire itself. Many never wake up to know that there was a fire. For these reasons, smoke detectors and an evacuation plan become necessities.

There are two basic types of smoke detectors (ionization and photoelectric) and many brands to choose from. The most important thing in selecting your smoke detector(s) is to make sure that the model has been listed by a nationally recognized testing laboratory. A labeled smoke detector, properly installed and maintained, offers adequate protection whether it is powered by batteries or house current. Both the ionization and photoelectric detectors will do a good job.

Home Maintenance

Basic Home Information

There is very basic information that every responsible household member should know about your home.

- Where the heating fuel main shutoff is located.
- Where the main electrical shutoff or fuse box is located.
- Where the main water shutoff is located.
- Where all fire extinguishers and smoke alarms are located.
- Where the main drain line cleanout is located.

Taking Care of Your Home

Once you are in your house, you and your family need to plan for regular or routine housekeeping. Many people find that frequent, systematic, light cleaning has advantages over periodic upheaval. For one thing, the concept of continuous-cleaning is far easier on you and on the household surfaces. It minimizes the need for whole days devoted to housecleaning. It also minimizes the need for abrasive cleaning and forceful scrubbing – both of which can cause unnecessary wear and tear on wall, floor, and furniture finishes. Some families find it easier to do one or two chores each day.

Lawn care also becomes a responsibility when you are a home owner. This task can become a regular chore for one or more family members. Another option is to hire someone in the neighborhood or a lawn care company to regularly maintain the outside property.

Identifying and Correcting Potential Problems

Any house will occasionally need repairs. It is important that needed repairs be made quickly to keep up the value of your property. Keep careful records of any significant maintenance or repair activities.

Do-It-Yourself Repairs vs. Using Professionals

There are many simple home repairs that you can learn to do yourself. There are many home repair books and video tapes which can teach you to repair a leaking toilet, a light switch that will not work, or a hole in the wall. To do any simple home repair, you will need not only the skill but also some basic tools. Check your local library or bookstore.

There are some repairs that are better made by a professional. Many electrical and plumbing repairs fit into this category as well as roof and foundation repairs. When in doubt of your skills, time or knowledge, call a professional. This can save you not only time and money, but your life. If you plan to do any repair work on your home, be sure that you have adequate homeowners liability insurance coverage. This is a protection for you or anyone who works on your home. Talk with your insurance representative for help.

Appendix A • Glossary of Real Estate Terms

Acceleration Clause A provision in a mortgage that gives the lender the right to demand payment of the entire outstanding balance if a monthly payment is missed.

Adjustable-Rate Mortgage (ARM) A mortgage whose interest rate changes over time based on an index.

Amortization The gradual repayment of a mortgage by installments.

Amortization Schedule A timetable for payment of a mortgage showing the amount of each payment applied to interest and principal and the remaining balance.

Annual Percentage Rate (APR) The total yearly cost of a mortgage stated as a percentage of the loan amount; includes the base interest rate, primary mortgage insurance, and loan origination fee (points).

Appraisal A professional opinion of the market value of a property.

Appreciation An increase in the value of a house due to changes in market conditions or other causes.

Assessed Value The valuation placed upon property by a public tax assessor for purposes of taxation.

Assumable Mortgage A mortgage that can be taken over ("assumed") by the buyer when a home is sold.

Assumption The transfer of the seller's existing mortgage to the buyer.

Binder A preliminary agreement, secured by the payment of earnest money, under which a buyer offers to purchase real estate.

Cap A provision of an ARM limiting how much the interest rate or mortgage payments may increase.

Cash Reserve A requirement of some lenders that buyers have sufficient cash remaining after closing to make the first two mortgage payments.

Clear Title A title that is free of liens and legal questions as to ownership of the property.

Closing The occasion where a sale is finalized, the buyer signs the mortgage, and closing costs are paid. Also called "settlement."

Closing Costs Expenses (over and above the price of the property) incurred by buyers and sellers in transferring ownership of a property. Also called "settlement costs."

Commitment Letter A formal offer by a lender stating the terms under which it agrees to loan money to a home buyer.

Condominium A form of property ownership in which the home owner holds title to an individual dwelling unit plus an interest in common areas of a multi-unit project.

Contingency A condition that must be met before a contract is legally binding.

Conventional Mortgage Any mortgage that is not insured or guaranteed by the federal government.

Convertible ARM An adjustable-rate mortgage that can be converted to a fixed-rate mortgage under specified conditions.

Cooperative A form of common property ownership in which the residents of an apartment building do not own their own units but rather shares in the corporation that owns the property.

Covenant A clause in a mortgage that obligates or restricts the borrower and which, if violated, can result in foreclosure.

Credit Report A report of an individual's credit history prepared by a credit bureau and used by a lender in determining a loan applicant's creditworthiness.

Deed The legal document conveying title to a property.

Deed of Trust The document used in some states instead of a mortgage; title is conveyed to a trustee rather than to the borrower.

Default Failure to make mortgage payments on a timely basis or to comply with other conditions of a mortgage.

Delinquency A loan in which a payment is overdue but not yet in default.

Deposit Cash paid to the seller when a formal sales contract is signed.

Depreciation A decline in the value of property; the opposite of "appreciation."

Discount Points See points.

Down Payment The part of the purchase price which the buyer pays in cash and does not finance with a mortgage.

Due-on-Sale Clause A provision in a mortgage allowing the lender to demand repayment in full if the borrower sells the property securing the mortgage.

Earnest Money A deposit given to the seller to show that a prospective buyer is serious about buying the house.

Easement A right of way giving persons other than the owner access to or over a property.

Equal Credit Opportunity Act (ECOA) A federal law that prohibits lenders from denying mortgages on the basis of the borrower's race, color, religion, national origin, age, sex, marital status, or receipt of income from public assistance programs.

Equity The difference between the market value of a property and the home owner's outstanding mortgage balance.

Equity Loan A loan based on the borrower's equity in his or her home.

Escrow The holding of documents and money by a neutral third party prior to closing; also, an account held by the lender into which a home owner pays money for taxes and insurance.

Fair Credit Reporting Act A consumer protection law that sets up a procedure for correcting mistakes on one's credit record.

FHA Loan A mortgage that is insured by the Federal Housing Administration.

First Mortgage The mortgage that has first claim in the event of default.

Fixed-Rate Mortgage A mortgage in which the interest rate does not change during the entire term of the loan.

Flood Insurance Insurance required for properties in federally designated flood areas.

Forbearance The lender's postponement of foreclosure to give the borrower time to catch up on overdue payments.

Foreclosure The process by which a mortgaged property may be sold when a mortgage is in default.

Graduated Payment Mortgage A mortgage that starts with low monthly payments that increase at a predetermined rate.

Hazard Insurance Insurance to protect the home owner and the lender against physical damage to a property from fire, wind, vandalism, or other hazards.

Homeowners Insurance An insurance policy that combines liability coverage and hazard insurance.

Homeowners Warranty A type of insurance that covers repairs to specified parts of a house for a specific period of time.

Interest The fee charged for borrowing money.

Interest Rate Cap A provision of an ARM limiting how much interest rates may increase per adjustment period. See also Lifetime Cap.

Joint Tenancy A form of co-ownership giving each tenant equal interest and equal rights in the property, including the right of survivorship.

Late Charge The penalty a borrower must pay when a payment is made after the due date.

Lease-Purchase Mortgage Loan An alternative financing option that allows low- and moderate-income home buyers to lease a home from a non-profit organization with an option to buy. Each month's rent payments consist of PITI payments on the first mortgage, plus an extra amount that is earmarked for a savings account in which money for a down payment accumulates.

Lien A legal claim against a property that must be paid when the property is sold.

Lifetime Cap A provision of an ARM that limits the total increase in the interest rate over the life of the loan.

Loan Commitment See Commitment Letter.

Loan Servicing The collection of mortgage payments from borrowers and related responsibilities of a loan servicer.

Loan-to-Value Ratio (LTV) The relationship between the amount of a mortgage and the total value of the property.

Lock-In A written agreement guaranteeing the home buyer a specified interest rate provided the loan is closed within a set period of time. The lock-in also usually specifies the number of points to be paid at closing.

Margin The set percentage the lender adds to the index rate to determine the interest rate of an ARM.

Mortgage A legal document that pledges a property to the lender as security for payment of a debt.

Mortgage Banker A company that originates mortgages exclusively for resale in the secondary market.

Mortgage Broker A company that for a fee matches borrowers with lenders.

Mortgage Insurance See Private Mortgage Insurance.

Mortgage Insurance Premium (MIP) The fee paid by a borrower to FHA or a private insurer for mortgage insurance.

Mortgage Note A legal document obligating a borrower to repay a loan at a stated interest rate during a specified period of time; the agreement is secured by a mortgage.

Mortgagee The lender in a mortgage agreement.

Mortgagor The borrower in a mortgage agreement.

Negative Amortization Payment terms under which the borrower's monthly payments do not cover the interest due; as a result, the loan balance increases.

Notice of Default A formal written notice to a borrower that a default has occurred and that legal action may be taken.

Origination Fee A fee paid to a lender for processing a loan application; it is stated as a percentage of the mortgage amount, or points.

Owner Financing A purchase in which the seller provides all or part of the financing.

Payment Cap A provision of some ARMs limiting how much a borrower's payments may increase regardless of how much the interest rate increases; may result in negative amortization.

PITI Stands for principal, interest, taxes, and insurance; the components of a monthly mortgage payment.

Points A one-time charge by the lender to increase the yield of the loan; a point is one percent of the amount of the mortgage.

Prepayment Penalty A fee charged to a borrower who pays off a loan before it is due.

Pre-Qualification The process of determining how much money a prospective home buyer will be eligible to borrow before a loan is applied for.

Principal The amount borrowed or remaining unpaid; also, that part of the monthly payment that reduces the outstanding balance of a mortgage.

Private Mortgage Insurance (PMI) Insurance provided by non-government insurers that protect lenders against loss if a borrower defaults.

Purchase and Sale Agreement A written contract signed by the buyer and seller stating the terms and conditions under which a property will be sold.

Qualifying Ratios Guidelines applied by lenders to determine how large a loan to grant a home buyer.

Radon A radioactive gas found in some homes which in sufficient concentrations can cause health problems.

Rate Lock See Lock-In.

Real Estate Agent A person licensed to negotiate and transact the sale of real estate on behalf of the buyer or seller.

Real Estate Settlement Procedures Act A consumer protection law that requires lenders to give borrowers advance notice of closing costs.

Refinancing The process of paying off one loan with the proceeds from a new loan secured by the same property.

Rent with Option to Buy See Lease-Purchase Mortgage Loan.

Second Mortgage A mortgage that has rights that are subordinate to the rights of the first mortgage holder.

Secondary Mortgage Market The buying and selling of existing mortgages.

Seller Take-Back An agreement in which the owner of the property provides financing, often in combination with an assumed mortgage.

Settlement See Closing.

Settlement Sheet The computation of costs payable at closing which determines the seller's net proceeds and the buyer's net payment.

Subsidized Second Mortgage An alternative financing option for low- and moderate-income households that also includes a down payment and a first mortgage, with funds for the second mortgage provided by city, county, or state housing agencies, foundations, or nonprofit corporations. Payment on the second mortgage is often deferred, carries no or low interest rates, and part of the debt may be forgiven for each year the family remains in the home.

Survey A drawing showing the legal boundaries of a property.

Tenancy by Entirety A type of joint ownership of property available only to a husband and wife.

Tenancy in Common A type of joint ownership in a property without right of survivorship.

Title A legal document establishing the right of ownership.

Title Company A company that specializes in insuring title to property.

Title Insurance Insurance to protect the lender (lender's policy) or the buyer (owner's policy) against loss arising from disputes over ownership of a property.

Title Search A check of the title records to ensure that the seller is the legal owner of the property and that there are no liens or other claims outstanding.

Transfer Tax State or local tax payable when title passes from one owner to another.

Truth-in-Lending A federal law that requires lenders to fully disclose, in writing, the terms and conditions of a mortgage, including the APR and other charges.

Underwriting The process of evaluating a loan application to determine the risk involved for the lender.

Appendix B • References

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Appendix C • Community Resources

As a potential home buyer, there are a number of resources in your community that provide services you may find helpful as you work toward homeownership. The resources listed in this Appendix are those organizations at the federal, state and local level that provides state-wide services or that have offices located in various areas across the state. Local experts can help you identify additional resources specific to your area, such as programs and services provided by local governments or non-profit organizations.

This Resource Directory gives a brief summary of the types of services provided by these organizations.

- Consumer Credit Counseling
- Community Action Agencies
- Legal Services Agencies
- State Cooperative Extension Services
- Banks, Savings Banks, Mortgage Bankers, Mortgage Brokers, and Credit Unions

- Public Agencies
    - State Housing Finance Agency
    - State Human Relations Commission
    - U.S. Department of Housing and Urban Development (HUD)
- Utility Companies

Consumer Credit Counseling Services, Inc.

The Consumer Credit Counseling Services (CCCS) is a non-profit community service agency available in many communities whose purpose is to provide individual family counseling on the proper management of personal finances. This includes situation analysis, evaluation of spending habits, budget development, and recommendations for action steps to be taken by the client. CCCS counseling staff receives extensive, in-depth training in counseling techniques. These counselors provide one-on-one counseling sessions that are oriented toward helping the client maximize income, control spending, use credit wisely, establish goals and priorities, and save for emergencies as well as the future.

In addition to these individual counseling services, many CCCS offices extend their expertise into the community through educational presentations to schools, community groups, and employers. Special services that address the financial needs of senior citizens may also be available. Contact the office nearest you for more information.

There are over 600 CCCS offices nationwide. In the event that you need assistance from an office in another state, call (800) 388-CCCS for a toll-free referral.

Community Action Agencies

Community Action Agencies are non-profit organizations committed to alleviating the conditions contributing to poverty. At the present time, there are numerous CAAs across most states, offering a variety of programs to improve the quality of life for all residents. Community Action Agencies typically offer programs such as Head Start, Weatherization, emergency assistance, job training, rental subsidies, employment and housing counseling. Contact the CAA nearest you to find out which programs are available in your area.

Legal Services Agencies

Legal Services Agencies are usually private non-profit organizations that provide legal services free of charge to low income individuals and families. Legal Service offices provide legal assistance and representation in a wide variety of legal problems regarding public benefits, consumer rights, debt collection, family violence, and many other civil issues. Legal Services housing-related services include tenant rights, tenant-landlord relations, evictions, and foreclosures. These housing services focus on consumer housing rights, and on ways to remove legal barriers to homeownership or to continued homeownership. Priorities are set by local boards, so the specific legal issues handled by each office vary. Contact the office nearest you for more information.

Cooperative Extension Services

State Cooperative Extension Services are educational organizations. They are different from other educational organizations in structure and purpose. The Extension receives support from three levels of government – federal, state, and county. It usually has close ties to the state's land-grant universities. This unique partnership allows the Cooperative Extension Service to serve as a bridge between the people of a state and the scientists of the U.S. Department of Agriculture and the land-grant universities.

How it Works

Extension Agents, located in each county of most states, are a major link between the universities and the people. Supported by a staff of university specialists, the agents have the research-based information people need for problem solving.

State Cooperative Extension Services have many lay leaders involved in their Extension Advisory Leadership Systems. These private citizens, who use Extension services, help keep university researchers and Extension professionals apprised of local concerns and needs. This two-way communication enables Extension to help individuals, families, and communities learn to identify and solve their problems.

What it Offers

State Cooperative Extension Services provide a broad range of educational programs that are of benefit to farmers, rural and urban residents, community leaders, homemakers, parents and youth. These initiatives focus on the following concerns of state citizens: sustainable agriculture; rural revitalization; waste management; water quality; food safety and quality; youth-at-risk; environmental protection and conservation of natural resources; families in crisis; health and human safety.

How to Get Help

The Cooperative Extension Educational Services are available to all the people in many states. Extension disseminates information through meetings and workshops; demonstrations, field days, and conferences; computer programs; radio, TV, and video; newspapers, newsletters, and publications; and telephone contacts and office visits.

For more information, call your local Extension Center, listed under County Government.

Public Agencies

For more information about special programs through a state Housing Finance Agency, or to find out which lending institutions in your area are participating in these programs, write or call your state Housing Finance Agency.

The Human Relations Commission in most states administers the Fair Housing Law, which is substantially equivalent to federal fair housing laws. The commission promotes fair housing by receiving, investigating, and resolving charges of discrimination in housing. They also are involved in receiving, investigating, and conciliating charges of discrimination in employment. The housing programs conducted are fair housing counseling and assistance. For more information or to report suspected housing discrimination, call or write the Human Relations Commission in your state.

Or, you may contact the U.S. Department of Housing and Urban Development with complaints of suspected housing discrimination.

Regional Office:
HUD - Fair Housing and Equal Opportunity (FHEO)
Richard B. Russell Federal Building
75 Spring Street, S.W.
Atlanta, GA 30303-3388

You may also use the toll-free hotline number (800) 424-8590, or write:
Office of Fair Housing and Equal Opportunity
U.S. Department of Housing and Urban Development Room 5204
Washington, D.C. 20410-2000

If HUD has determined that your state or local agency has the same fair housing powers as HUD and has fair housing ordinances that are substantially equivalent to federal laws, HUD will refer your complaint to that agency for investigation and notify you of the referral.

Utility Companies

Utility companies offer a variety of programs and resource materials to help you save on energy costs.

Energy saving programs for utility customers may include these features:

1. The Maximum Value Home (MAX) uses energy efficiently, saves on heating and cooling costs, and qualifies you for the lowest residential rate.
2. Home Energy Survey – a specialist will make recommendations to upgrade your home to energy efficiency standards so you can qualify for lower rates.
3. Energy Saver Loan – loans to increase insulation, add insulated windows, and/or install a high efficiency heat pump/comfort machine.
4. Comfort Incentive – you receive an average of $200 back when you have a comfort machine installed by an authorized comfort machine dealer. Comfort machines must have a Seasonal Energy Efficiency Rating (SEER) of 11 or higher.
5. Load Control can reduce your summer bills. Load control customers allow power companies to temporarily interrupt service to their central air conditioning systems during emergency situations. These situations arise when the demand for electricity exceeds our ability to supply it. As a Loan Control participant, you receive monthly credits from July through October on your electric bill – even if the service to your air conditioning system is not interrupted.
6. With Time-of-Use-Rate you pay less for electricity used during periods of low overall demand for power – called "off-peak" hours. By shifting some of your daily chores, such as clothes washing and dish washing, to these hours, you may pay a lot less for electricity you use. A Time-of-Use Comparative Billing Program is also available. This program allows you to compare your current monthly electric bill to what you would be paying on the Time-of-Use-Rate.

Utility 6% Energy Loans allow you to borrow up to $1,500 to make energy efficiency improvements to your home. The repayment period on these loans is three to five years. Loans are available to increase your attic insulation (up to R-30); wall insulation (up to R-16); floor insulation (up to R-19); duct insulation, storm windows and replacement double glass, storm or insulated doors, electric water heater (minimum insulation level R-10), and programmable heat pump thermostats. To qualify for some utility company energy loans, you must own the home where the improvements are to be made; have either electric heat or central/whole-house air conditioning; be served by the utility on a residential rate; and have credit approved by the utility.

Some utility companies also offer a Heat Pump Finance Program. This program provides loans for homeowners wishing to replace their heating systems with a high-efficiency heat pump. The interest rate varies according to the efficiency level of the heat pump, and no down payment is required.

Other programs may include:

- Equal Payment Plan – allows spreading your payments into 12 equal payments, easing the impact of higher seasonal electric bills.
- EZ $64 – save $64 per year by allowing the utility to occasionally interrupt power to your air conditioner and water heater.

For more information on services and programs, call your local utility company's marketing representative.

Republic Mortgage Insurance Company
Republic Mortgage Insurance Company of North Carolina (NY only)
190 Oak Plaza Boulevard
Winston-Salem, NC 27105
800.999.RMIC (7642)
www.rmic.com