

# *HOMEBUYERS HANDBOOK*

COMPLIMENTS OF

*MICHAEL CHIARO*

*SOLDONYORK.COM*

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

# *Preface*

You want to buy a house - a place of your own. You're probably excited and a bit nervous at the prospect, especially if you're a first-time buyer. My goal is to take the confusion and uncertainty out of the home-buying process. Whatever your concerns about buying a home, this guide should help you feel more confident as you undertake what will probably be the largest purchase of your lifetime. In fact, by the time you complete this guide, you will probably know more about the home-buying process, and the financial planning that goes with it, than many current homeowners.

This guide will take you through the home-buying process step by step - from deciding what home is right for you, to shopping for a house that meets your needs, obtaining a home mortgage and closing the sale. After you read this guide, you will be knowledgeable about home buying and better able to evaluate the terms of your mortgage and be confident that you can afford it.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

# *Preparing for Homeownership*

For many Americans, owning their own home is the American dream. If homeownership is your dream, it too can become a reality, but not without realistic goals, sound advice, careful planning, and a clear understanding of the costs involved. As in any new endeavor, the more you know about homeownership, the better able you will be to reach your goal. This opening chapter will help you decide if homeownership is right for you, and whether or not you can afford to buy a home at the present time. It will also provide you with a good idea of how much home you can get for your money, and what mortgage lenders look for in approving a mortgage loan. Finally, it will show how first-time buyers and low- and moderate-income households can stretch their borrowing power with a variety of financing options and flexible lending programs - options that can help you make your dream of homeownership come true.

Do you really want to own your own home?

Have you considered what it is about owning your own home that you find appealing? The decision to buy a home is certainly not one to be made lightly because owning a home requires a significant investment in time, energy, and money. Therefore, the best way to start the home-buying process is by taking a realistic look at what you can expect from homeownership and what owning your home implies. There are many good reasons for buying a home.

## **Advantages of homeownership**

If you are planning to buy a home, you probably have good reasons in mind, ranging from the purely personal to the very practical.

## **A place of your own**

“Your home is your castle,” as the saying goes. A home is a place you can call your own. Perhaps you are ready to settle down in your community, and want the feeling of permanence and involvement that comes with owning your own home. Perhaps you need more space in which to raise a family. Or, maybe you want more leeway than you have in a rental unit to adapt your living space to suit your individual taste and needs.

## **Financial incentives**

For many people, the motivation for homeownership is primarily financial. Owning your own home is a first-rate investment for a number of reasons.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

**Scheduled savings**

When you buy a house, your monthly mortgage payments serve as a type of scheduled savings plan. Over time you gradually accumulate what lenders call “equity”, an ownership interest in the property that you can often borrow against or convert into cash by selling the house. In contrast, renters must continue paying rent to a landlord for as long as they rent, without the opportunity to build up equity.

**Stable housing costs**

Another advantage of homeownership is that while rents typically increase year after year, the principal and interest portion of most mortgage payments remains unchanged throughout the entire repayment period (typically 30 years). In fact, because of the effect of inflation, this means that over the years you pay the same amount but with ever “cheaper” dollars.

**Increased value**

Houses typically increase in value, or “appreciate”, over time. It’s not unusual to find a house that sold for \$50,000 fifteen years ago to be valued at much more than that amount today. This increased value is as good as money in the bank to the homeowner.

**Tax benefits**

Homeowners also get significant tax breaks that are not available to renters. Most important, interest paid on a home mortgage is usually deductible. This alone can save you a substantial amount each year in federal income taxes. You should discuss the tax benefits of homeownership with your financial advisor or tax preparer.

## **The costs of purchasing a home**

Let’s look a little more closely now at the main costs involved in purchasing a home. These include the upfront costs (the down payment and closing costs), and the ongoing costs (the monthly mortgage payment and other homeownership expenses, such as utilities and home maintenance).

**Upfront costs**

Your upfront costs will include the down payment, various closing (or “settlement”) costs, and the costs of moving and settling into your new home.

**Down payment**

Virtually all home buyers rely on a loan (or “mortgage”) from a financial institution. However, no lender will give you a loan for the full purchase price of a house. Instead, a lender will insist you contribute a sizable chunk of your own funds (the down payment) as part of the deal. Lenders feel much more secure knowing you have some of your own

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

money invested in the house because you are not likely to walk away from it if your finances take a turn for the worse.

Traditionally, lenders expected buyers to make a down payment amounting to at least 20 percent of the purchase price of the house. This meant that buyers needed a down payment of \$20,000 to buy a \$100,000 house. Today, buyers can pay as little as 5 percent down provided they purchase private mortgage insurance (PMI), which protects the lender in case the borrower fails to repay the loan. This would reduce the down payment requirement on a \$100,000 home to \$5,000. You could buy the same house with a still lower down payment by taking out a government-insured (FHA or VA) mortgage or by taking advantage of Fannie Mae's new "3/2 Option".

The 3/2 Option allows borrowers to qualify for 5 percent down payment loans by using just 3 percent of their own funds - for our example of a \$100,000 home purchase, that's just \$3,000! This 3 percent outlay must be coupled with a 2 percent gift from a family member or a 2 percent grant or unsecured loan from a nonprofit organization or state or local government.

### **Closing costs**

Besides the down payment, home buyers must be prepared to pay a number of additional upfront costs incurred in buying a home. Collectively called "closing costs" (they will be discussed in detail later), these expenses typically amount to 3 to 6 percent of the amount of the mortgage. If you were to buy a \$100,000 house with a 5 percent (\$5,000) down payment, you could expect to pay between \$3,000 and \$6,000 in closing costs on your \$95,000 mortgage. Sometimes, as part of the purchase agreement, the seller will pay some of the buyer's costs to allow the buyer to retain cash for other expenses.

### **Settling-in costs**

You will also need to consider what it will cost to move and settle into your new home. If you buy a house that is in need of immediate repairs, you will need to have enough money left after buying the house to make those repairs. You may also need to purchase major appliances such as a stove and refrigerator. The point is that you do not want to spend all of your money on buying the house.

### **Ongoing costs**

As a renter, your primary housing cost is the amount of your monthly rent payment. As a homeowner, your housing costs will include your monthly mortgage payment, property taxes, homeowner's insurance, mortgage insurance (if required by the lender), utilities, and maintenance. Owners of condominiums or cooperatives also pay a monthly maintenance fee (often called a "homeowners' association fee" or "carrying charge").

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

## Monthly mortgage payment

Since most home buyers are used to paying rent on a monthly basis, they are usually prepared to make monthly mortgage payments. Each mortgage payment includes both the repayment of a portion of the principal (the amount you actually borrowed) and the interest (a fee for using the lender's funds). Lenders refer to payments of principal and interest as "P & I".

The amount of your monthly payment depends on the amount you borrow, the interest rate, and the repayment period (or "term"). The shorter the term, the higher your monthly payment will be. For example:

<b>Size of mortgage</b>	<b>Interest rate</b>	<b>Term</b>	<b>Monthly payment (P &amp; I)</b>
\$100,000	7%	30 years	\$700
\$100,000	7%	15 years	\$899

For this reason, most home buyers repay their mortgage over the longest term possible, usually 30 years.

## Taxes and Insurance (T&I)

In many cases, a home buyer's monthly mortgage payments include not only the amount required to repay a portion of the principal and accrued interest (P&I), but also an added amount for property taxes, homeowner's insurance, and private mortgage insurance. The lender holds these additional amounts in separate "escrow" accounts and then pays the tax and insurance bills when they come due. In this way, the lender ensures that these important annual expenses get paid on time. If taxes and insurance are not paid by the lender, the homeowner must be prepared to pay these bills when they come due each year.

Because taxes and insurance are an essential part of a homeowner's housing costs, lenders often refer to the components of a mortgage payment as "PITI" (standing for principal, interest, taxes and insurance). Lenders also view condominium and cooperative fees as belonging in this category of basic housing costs.

## Other costs of homeownership

Other ongoing costs of owning a home include utilities (oil, gas, electricity, and water) and maintenance costs. First-time buyers often are surprised by how costly basic upkeep is, both in terms of time and money. The cost of utilities may vary greatly (increasing during the heating season, for example), while repairs often represent an unexpected expense. This makes it imperative that homeowners always have available cash reserve on hand.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

On the other side of the affordability scale is the fact the homeowners receive significant federal income tax benefits.

We've looked now in general terms at the kinds of expenses that go along with homeownership. But before you begin house hunting, you will need to have a more precise idea of what price range you can afford.

## How much can you afford?

There's an often-quoted rule of thumb that says you can afford a house that costs up to two and one-half times your annual gross income (that is, the amount you make before taxes are deducted). If you are buying a house with someone else (spouse, parent, adult child, partner/companion, brother or sister, etc.) you can also consider your co-purchaser's annual gross income in deciding how expensive a home you can buy.

(Remember, however, that your co-purchaser's debts and credit history will also be considered in determining how much you can borrow.) According to this guideline, if you and your co-purchaser together have an annual income totaling \$40,000, you should expect to buy a home priced at about \$100,000; if you have a joint income of \$20,000, your new home should cost about \$50,000.

This provides a quick ball-park figure of the approximate amount you may be able to pay for a home. But your buying power ultimately depends on two things:

- how much you have available for the down payment, and how much a financial institution will agree to lend you.

Let's look first at what resources you may be able to tap for your down payment (and closing costs). Then we will look at the guidelines lenders use to determine how much they will lend you.

### **Your down payment**

If you are a first-time home buyer, the price you can afford to pay for a house may well be limited by your ability to come up with the required down payment and closing costs. Unlike homeowners who can rely on their equity in a property they already own, your savings are probably your principal resource. If you haven't accumulated much savings, you may need to specifically set aside funds for a down payment on a regular basis from your paycheck.

The worksheet titled, "Your available cash and assets," is provided to help you consider

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

all possible sources of funds for your down payment and closing costs. While lenders will frown on your borrowing money toward the down payment, they will permit you to use money that has been given to you as a gift, provided that you are able to make at least a 3 percent down payment of the total mortgage amount with your own money. Perhaps you can enlist the help of your parents or other relatives to provide the necessary 2 percent of funds to qualify for the 3/2 Option. If so, you will need a “gift letter” to verify that no repayment is “expected”. You may also be eligible for a grant from various nonprofit organizations or state or local governments that will provide the necessary 2 percent.

The size of your down payment determines how large a mortgage you need, as shown by these two examples:

\$100,000	Purchase price
<u>-5,000</u>	5 percent down payment
\$95,000	Mortgage amount

\$50,000	Purchase price
<u>-2,500</u>	5 percent down payment
\$47,500	Mortgage amount

## Your borrowing power

Apart from your down payment, the other major factor that determines how expensive a home you can buy will be how much you can borrow. When you apply for a mortgage, the lender will primarily consider two factors in determining how large a loan to grant you

- your earnings, and your existing debt.

### **Lenders’ qualifying guidelines**

Lenders use two qualifying guidelines to determine what size mortgage you are eligible for. They are as follows:

1. Your monthly housing costs (including mortgage payments, property taxes, insurance - and condominium or cooperative fee, if applicable) should total no more than 30 percent of your monthly gross (before-tax) income.
2. Your monthly housing costs plus other long-term debts should total no more than 38 percent of your monthly gross income.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

Lenders feel that if they follow these guidelines, homeowners will be able to pay off their mortgages fairly comfortably and lenders won't have to worry about loan defaults and foreclosures. For low- and moderate-income home buyers who participate in the Community Home Buyer's Program and who earn 115 percent or less of the median income for their area, the qualifying guidelines are 33 percent of total income on housing expense and 38 percent on total indebtedness. The result is that borrowers don't need as much income to qualify for a mortgage.

**Your gross income.** In calculating your gross (before-tax) income, you can count all income that you get on a regular basis, from whatever source. The worksheet titled, "Your gross monthly income," lists sources of income that you should consider.

### **Your debt payments.**

Lenders will also consider your existing debt in determining how large a mortgage to grant you. They are interested in your "long-term debt," which is defined as any debt that will take more than 10 months to pay off. Use Worksheet 4, "Your monthly payments," to tally your debts.

If your monthly debt payments are excessive for your income level (based on the qualifying guidelines), this will reduce the amount you can borrow to buy a house. If your debts are excessive, you may consider paying off some of your debt in preparation for buying a house. This will enable you to obtain a larger mortgage, which may mean you can afford more house with your income.

## Your credit record

As a part of the prequalification process, there is one more thing that I will do for you at the outset that can help ensure that the loan application process will go smoothly. In preparation for applying for a loan, I will order a credit report that we can review together. It sometimes happens that credit reports are inaccurate or give a misleading picture of past credit problems that have since been resolved. You don't want to be turned down for a mortgage because of an erroneous credit report.

### **Repairing a bad credit report**

You may also find that your past credit record is not as clean as you might wish. If you are currently having credit problems, you may not be in a position to buy your house until they are resolved. To do so would only compound your problems. If, on the other hand, your problems are in the past, your more recent track record of keeping current on your debt payments may be persuasive. By law, most unfavorable credit information must be

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

dropped from your credit file after seven years. Bankruptcy stays on your credit record for ten years.

### **Establishing a credit record**

If you have no credit record, either good or bad, now is the time to establish one. Lenders want to see a track record of debts owed and duly repaid.

If you do not have a traditional credit record that shows payments made on credit card purchases, a car loan or a student loan, it is still possible to establish a credit history. For

example, you can build a nontraditional credit history by documenting your monthly rent payments to previous landlords and your monthly payments to utility companies for electricity, gas, and water and telephone services.

## **Mortgage Insurance**

Mortgage insurance protects the lender in the event the buyer fails to repay a loan. Loans that are insured, either by the government or by a private mortgage insurer, enable the home buyer to purchase a home with a lower down payment than would otherwise be acceptable to the lender.

### **Private mortgage insurance (PMI)**

I have already mentioned that with PMI, lenders will reduce the down payment requirement from 20 percent of the purchase price to 5 percent of the purchase price. On a \$60,000 home, instead of putting down \$12,000, you might be able to make a down payment as low as \$3,000! The cost of PMI will be added to your monthly mortgage payments and your closing costs.

### **Government insured loans.**

Mortgage insurance also is available through two programs of the federal government: the Federal Housing Administration (FHA) mortgage insurance program operated by the Department of Housing and Urban Development (HUD) and the Veterans Administration's (VA) loan guarantee program. To obtain either an FHA or VA loan, you apply through a lender that is approved to handle FHA/VA loans. Both the FHA and VA require that the properties being purchased meet certain minimum standards.

**FHA loans.** With FHA insurance, you can purchase a home with a very low down payment, from 1.5 to 3 percent of the FHA appraisal value or the purchase price.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

**VA loans.** The VA guarantee allows qualified veterans to buy a house with no down payment. Moreover, the qualification guidelines for VA loans are less strict than for FHA or conventional loans. If you are a qualified veteran, this can be an attractive mortgage program. To determine whether you are eligible, check with your nearest VA regional office. We can determine your eligibility by consulting a qualified lender.

**FmHA-guaranteed loans.** The Farmers Home Administration (FmHA), a branch of the U.S. Department of Agriculture, offers low-interest homeownership loans to low- and moderate-income persons who live in rural areas or small towns.

**State and local loan programs.** Pennsylvania sponsors programs such as PHFA to help first-time home buyers qualify for mortgages. Local housing agencies also offer attractive loan terms to eligible home buyers in some areas. These programs typically offer very attractive loan terms (low down payment or interest rate) to first-time home buyers that meet specified income guidelines.

## **Alternative financing mortgages**

Many lenders have begun offering new types of mortgages in recent years, some specifically geared toward helping first-time home buyers qualify for a larger loan.

### **Adjustable-rate mortgage (ARM)**

With a fixed-rate mortgage the homeowner's monthly payment never changes because the interest rate is fixed for the life of the loan.

With an adjustable-rate mortgage (ARM), the interest rate paid by the borrower is adjusted from time to time to bring it in line with changing market rates. This means that when interest rates go up or down, your monthly mortgage payments go up or down as well, sometimes significantly.

ARMs are attractive to some borrowers because they offer a lower interest rate in the beginning. Since the monthly payments on an ARM start out lower than for a fixed-rate mortgage of the same amount, the home buyer qualifies for a larger loan. The chief drawback, of course, is that your monthly payments could increase if interest rates go up. How much your payments can increase will depend on the terms of your mortgage.

You may want to consider an ARM if it's the only way you can afford to buy the house you want and you're confident that your income will increase enough in the coming years to comfortably handle any increase in payments.

### **Two-Step mortgage**

The Two-Step mortgage is a new type of ARM in which the interest rate is adjusted only

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

once (3,5, or 7 years after origination). The new rate then remains in effect for the remaining 27, 25 or 23 years of the loan. This loan carries a lower beginning interest rate than a traditional fixed-rate mortgage and it protects home buyers from rising interest rates during the early years of homeownership. For those homeowners who anticipate that they will move (and repay their mortgage) within the initial period of buying a home, this may be a very appealing mortgage. However, if you are planning to buy a home to settle in for the long-term, you may prefer a fixed-rate mortgage, which offers you the certainty that your monthly payment rate won't increase to a level that may become difficult to meet or completely unmanageable.

### **Seller take-back mortgage**

If you assume an existing low-interest mortgage, the balance on the mortgage will usually be far less than the purchase price of the house. This means you must come up with a very large down payment unless you can get the owner to finance part of the difference. Often sellers are willing to take back a second mortgage, often a below-market interest rate. Just be sure you can afford both mortgages.

## **Financing options**

For households of modest means, the greatest barriers to homeownership are coming up with the down payment and closing costs, establishing a credit history, and managing housing expenses that often are higher than the standards permitted in traditional mortgage lending.

There are low- and moderate-income household financing options that are designed to overcome these common barriers to homeownership. These options are offered in partnership with lenders, mortgage insurers, public agencies, and nonprofit organizations across the country.

Let's look at each of these financing options in turn, and see how they can be combined to make it easier for low- and moderate-income buyers to obtain affordable housing.

### **Community Home Buyer's Program**

The Community Home Buyer's Program provides financing for low- and moderate-income buyers who represent a good credit risk, but who might not qualify for home financing based on traditional lending criteria.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

Recognizing that you may have a long history of managing high rental payments, the Community Home Buyer's Program builds flexibility into the lender's standard lending requirements. This increases your purchasing power and decreases the total amount of cash needed to purchase a home.

The same flexibility also allows you to build a nontraditional credit history. For example, if you do not have a credit history that is reflected in a credit report, your demonstrated willingness and ability to pay on a timely basis may be documented by verifications from utility companies, current and previous landlords, and other sources of credit or service where you were, or still are required to meet a regular financial obligation.

**The 3/2 Option.** An important feature of the Community Home Buyer's Program is the 3/2 Option. The 3/2 Option makes it easier for you to accumulate the minimum down payment necessary to obtain a mortgage. By taking advantage of the 3/2 Option, you can buy a home with a 3 percent down payment of your own funds instead of the 5 percent down payment usually required by lenders. The remaining 2 percent of the down payment can be supplied by a relative as a gift, or can come from a nonprofit organization or a state or local government program in the form of a grant or an unsecured loan.

**Housing finance agency assistance.** PHFA, Pennsylvania Housing Finance Agency, makes mortgage money available at below-market interest rates. If mortgage money is available, you may be able to obtain a Community Home Buyer's Program or other low down payment mortgage at a lower interest rate.

**Flexible underwriting ratios.** Under the Community Home Buyer's Program, you can qualify for a mortgage if your monthly housing costs (mortgage payments, property taxes, and insurance) total no more than 33 percent of your monthly gross income and if your monthly housing costs plus other long-term debts total no more than 38 percent of your monthly gross income. As we have seen, these ratios are higher than the standard, qualifying housing expense-to-income ratio of 28 percent and total monthly debt-to-income ratio of 36 percent. As a result, you need less income to qualify for a mortgage.

**Less cash at closing.** Normally, you are required to have a cash reserve equal to two mortgage payments when you purchase your home. This requirement is waived in the Community Home Buyer's Program, so you need less cash at closing. You can put more of your cash into your home.

**Home buyer education.** The flexibility in underwriting described above is possible because of the home buyer education provided to the home buyer by the lender of a nonprofit group. This education covers such topics as applying for a mortgage, budgeting household expenses, shopping for and inspecting a home, and maintaining a home. Home

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

buyer education helps ensure that former renters will become successful homeowners.

### **Subsidized second mortgages**

You can also take advantage of subsidized (financially assisted) second mortgages. The funds for subsidized second mortgages are provided by city, county, and state housing agencies, as well as by foundations and nonprofit corporations.

The typical financing for this program includes a down payment, a first mortgage, and a subsidized second mortgage that makes it easier for you to afford a house.

You must provide the down payment, usually amounting to 3-5 percent of the purchase price. The first mortgage then provides most of the financing for the home purchase, with the subsidized second mortgage coverage the remainder of the purchase price. (This allows the limited public or nonprofit funds that are earmarked for homeownership subsidies to be used as effectively as possible to help the greatest number of home buyers.)

Subsidized second mortgages offer several features that can help you close the affordability gap on a home purchase. Their payment is often deferred (delayed), they carry no or very low interest rates, and part of the debt may be forgiven for each year that you remain in the home. Also you may use part of the subsidy to pay for closing costs or rehabilitation costs that are not covered in the sales price of the home.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

## **Are you ready for homeownership?**

At our initial meeting, we will answer the following questions and insure a successful beginning to your home purchase.

1. Do you have steady income and stable employment?
2. Do you anticipate remaining in the same geographic location for the next couple of years?
3. Have you created a budget so you know how much more you can realistically afford to pay for housing?
4. Do you have an established credit record or can you build a nontraditional credit history with records of payments to previous landlords and utility companies? If so, is your credit profile favorable?
5. Do you have enough money saved up for a down payment and closing costs? If not, can you enlist the aid of relatives or government or nonprofit agencies that might give or loan you money?
6. Have you been “prequalified” by a lender so you know how much you can borrow based on your income and existing debt?
7. Is your existing debt low enough that it will not limit your ability to qualify for a mortgage? If not, can you pay down your debt before attempting to buy a house?
8. Have you considered the benefits and requirements of the numerous financing options that are now available to low- and moderate-income home buyers?

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

# *Shopping for a home*

## **Deciding what you want**

Whether or not you have a vision of your “dream house,” you probably have some idea of the type and size of house you want and what type location suits you. Making a “wish list” (see the worksheet titled, “Your housing priorities”) can help us assess your house-hunting requirements. By narrowing the range of suitable houses, you will waste less time looking at homes that don’t meet your basic requirements. The following is a short guided tour of housing options to get you started.

## **New vs. older home**

Eight out of ten home buyers purchase existing rather than new homes. Some people like the idea of moving into a brand new house, but many home buyers can’t afford this luxury. On the other hand, many people prefer older homes because they often offer more special features and more space for the money.

If you’re handy with tools, you may be willing to consider a house that needs work (what real estate ads call a “handyman’s special” or “fixer upper”). Or, you may insist on a house that is in perfect condition. Most home buyers fall somewhere between these two extremes, and even finicky buyers often decide to accept some imperfections when they see the price of perfection.

New houses are typically clustered together in areas where the sizes, styles, and prices of the homes are much the same. New homes are likely to have more efficient heating systems, may be better insulated, and should cost less to maintain than older homes. Older homes, on the other hand, may be larger, more individual, or made with better quality materials.

For most buyers, the location of the home they buy is their most important consideration. You probably know already whether you will be shopping for a home in an urban, suburban, or rural area. You may already know exactly what neighborhood or school district you want to live in.

## **Choosing a neighborhood**

Consider what’s important to you - do you need to find a house that is near your job site, public services, or daycare facilities, or are you able to travel some distance to and from work in order to live in a house with a yard? Is the school district a major factor in your home-buying decision? Is nearness to shopping, recreational activities, or public transportation particularly important?

Two identical houses may be priced very differently depending on their location, so it’s important to have a clear idea of what you want and need from your neighborhood.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

Some neighborhoods are social hubs for the people living in them, while others offer little social interaction. Neighborhoods have definite personalities, and the best way (really the only way) to get a feel for a neighborhood is to spend time there talking to as many people as you can. It's wise to spend a little time in the neighborhood at different hours of the day and night to be sure you're comfortable in the environment.

### **Size requirements**

In choosing a home, an important consideration is the number and size of rooms. Is the house large enough or too large for your family size? Will your family soon outgrow the house? Will you be paying for more house than you need? The amount of land on which the house sits, or the size of the lot, also will influence the price of a house. If space for a yard, garden, or off-street parking is important to you, this will narrow your options.

In determining what size house to buy, you will want to consider both your current and future housing needs. You will want to consider looking for a house that will be adequate for at least the next five years.

### **Special features**

You should also consider whether there are any special features in a home that would be particularly important to you and your family. Do you need space for laundry facilities? Is a garage a necessity? A second bathroom? A porch? Air conditioning? Wheelchair accessibility? You may not find a house in your price range that offers everything you want, but it helps to be able to tell me what features matter most.

## **Finding the right house**

How do you start the search for a house that you can afford and that comes closest to meeting your needs? The first step is to identify houses on the market. As your agent, I can provide you with a broad range of services including the following:

- “Prequalify” you so you know what price range you can afford;  
Use your “wish list” to generate a computer printout of houses that meet your specifications;
- Show you houses that meet your requirements;  
Provide you with information about the houses in a particular community, including the prices and characteristics of houses sold in the area, the location of schools, and property tax rates;
- Present your offer to the seller; and  
Advise you regarding mortgage lenders, real estate attorneys, professional home inspectors, and title companies.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

## Comparison shopping

Home buyers look at several houses before settling on one. Comparison shopping is an essential part of the home-buying process, so approach it objectively and consider these pointers.

### **Keeping records**

Once you start looking at houses, it won't be long before they will become a blur in your mind. For this reason it's helpful to keep records of all the houses you look at. You want to be able to compare features and prices of various houses you have seen.

### **What to look for**

Train yourself to look critically at every house. Rate houses based on your own needs. Don't be afraid to ask questions.

**The neighborhood.** The amount you are willing to pay for a house may be affected by the nature of the community. Is it a designated historic district, and if so will you be bound by regulations? Are many houses for sale in the area? If so, why? Are there plans underway to change the zoning regulations? If so, how will it affect the neighborhood? Is it convenient to public transportation? To shopping? To recreational facilities?

**Physical details.** Start with what is visible from the outside: the size and age of the house, its structural condition and outside maintenance, the size of the lot, and landscaping. Inside, you might want to make a sketch of the floor plan. How many rooms and baths are on each floor? Is there adequate storage space? Is the basement finished? What built-in appliances are there? Is the kitchen functional? Is there central or room air-conditioning? Does the basement flood, or the roof leak?

**Construction details.** Whether the house is new or older, both the quality of the building materials and the craftsmanship, as well as the condition, are important considerations. How well insulated is the house? Are there storm windows all around? Does the house appear to have been well maintained?

**Major systems.** Are the plumbing, heating and cooling, and electrical systems all in good working order? Or does the house need to be rewired and replumbed, and a new furnace installed? What type of fuel is used for heating, and what is the approximate cost per year? How much do the other utilities cost?

**Seller's disclosure.** PA State law requires that a seller's disclosure statement be available to a buyer prior to writing a purchase agreement. This is a valuable document for buyers and sellers alike. Read it carefully and ask questions.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

## **Deciding how much to offer**

In deciding how much you should offer, there are a number of factors you should consider.

### **Market value of the house**

How does the asking price compare to the market value of the house, based on recent sales of comparable houses in the area? I will provide you with a comparative market analysis (CMA) on the property. This reviews prices of comparable homes that are currently on the market, that are currently under contract, and that have closed (sold) in the past several months.

### **Condition of the house**

If you are buying an existing house rather than a new house, you should consider having the house inspected by a professional.

### **Financing terms**

Remember that there are two aspects to an offer - the price and the financing terms. The terms may actually be more important to you than the price. For example, if the seller is willing to pay part of your settlement costs, which reduces the amount of cash you need to use, you may not want to quibble on price.

### **Earnest money**

This is a token payment you submit with the offer to show the seller that you are serious. There is no set amount that is required, and what is customary differs by location. This check is made out to the real estate agent and deposited in escrow to be returned to you if the seller does not accept your offer within a specified number of days. You usually forfeit the money if the contract is accepted by the seller and then you back out of the deal.

### **What the offer includes**

If the seller agrees to your offer by signing it, your purchase offer becomes the basis for the legally binding sales contract. This is why it is so important that you read the offer carefully and make sure you understand everything in it before you sign it.

The offer to purchase should include at least the following:

- A complete legal description of the property.

The amount of earnest money accompanying the offer.

The price you are offering.

The size of your down payment and how the remainder of the purchase will be financed

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

(including the maximum interest rate you are willing to pay).  
Any items of personal property the owner has said will stay with the house or that you want to be included.  
A proposed closing date and occupancy date.  
Length of time the offer is valid.  
Inspections to be performed.

## **Negotiating the final purchase price**

The seller may respond to your offer in one of three ways: by accepting it, by rejecting it (in which case you must decide whether to make another offer), or by making a counteroffer.

## **Terms of the contract**

Once the seller has signed the agreement, the detailed negotiations that will produce the formal sales contract begin. Remember that your offer to buy the property is dependent on the negotiation of a satisfactory contract. In addition to the basic terms of the sale that were already included in your offer to buy, certain “contingencies” may be included in the contract. These are conditions that must be met in order for the contract to take effect. Some contingencies and other provisions that are commonly written into a contract are summarized here.

### **Financing contingencies**

As we noted earlier, unless you are buying a new home it is essential to have the house inspected by a professional. You may also want to specify that certain inspections are completed before the sale contract takes effect.

**Professional home inspection.** Your contract should be contingent on a satisfactory report by a professional home inspector. If any major problems with the structure or systems of the house are uncovered, you have the right not to go ahead with the purchase or to re-negotiate the terms of the purchase.

### **Appraisal contingency**

When you apply for a loan, the lender will require a professional appraisal of the market value of the property. The appraised value of the house determines how large a mortgage the lender will be willing to give you. If the appraised value is lower than the agreed-

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

upon purchase price, this contingency gives you the right to withdraw your offer.

### **Other provisions**

You also may want to include certain other provisions in the terms of the contract so that nothing is left to chance.

**Repair work.** You may also want to stipulate that the sellers are responsible for ensuring that the plumbing, heating, mechanical, and electrical systems are in working order at closing. You and I will also do a walk-through inspection of the house on the day of settlement to determine if all conditions in the contract have been satisfied.

## **The home inspection**

As we noted previously, one of the contingencies in your contract should be that you obtain a satisfactory building inspection report. You will, of course, have examined the house to the best of your ability before making an offer on it. But before you go through with the purchase, you will want an expert to take a critical look at the property. Although you will pay for this inspection, it is well worth the cost in peace of mind.

### **What the inspection includes**

The home inspection is not the same as appraisal. The inspection is meant to evaluate the structural and mechanical condition (not the market value) of the property. The inspector's findings will be based on observable, unconcealed structural conditions. The inspector will not normally guarantee or warrant the condition of the home, or determine whether a house is in compliance with local building codes.

If possible, you should plan to accompany the inspector on his or her rounds. You will undoubtedly pick up some valuable maintenance tips along the way, get a chance to ask questions, and learn more about the extent of possible problems. You will also be in a better position to understand the written report.

Every inspection should include an evaluation of at least the following:

- Foundations
- Doors and windows

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

Roof  
Plumbing and electrical systems  
Heating and air conditioning systems  
Ceilings, walls, and floors  
Insulation  
Pest - wood destroying  
Ventilation  
Septic tanks, wells, or sewer lines  
Common areas (in the case of a condominium or cooperative)

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

# *Obtaining a mortgage*

## **Overview**

Most home buyers have to rely on their borrowing power to buy a house. We begin by listing the sources of mortgage loans and explaining how to search for a lender that offers the most attractive terms on mortgage loans. I will provide a checklist that will help you shop for a loan by comparing terms being offered by different lenders. I will also assist you with the loan application process itself, including what to expect from a loan interview and the procedures lenders follow in determining whether or not to approve a loan.

## **Shopping for a loan**

Shopping for a mortgage that meets your particular needs is not an easy job, but it is an inescapable part of the process of buying a home. Since we went through the process of “prequalifying” for a loan before you started house hunting, you will know which lender best suits your needs.

By the time you have a signed sales contract, you will have a clear idea of what kind of financing you need or want.

## **Loan terms**

**Types of mortgages available.** Begin by telling the loan officer what type of loan you are interested in - for example, a 95 percent 30-year-fixed-rate mortgage. (If you plan to make a down payment of 5 percent of the purchase price, lenders call this a “95 percent loan.”) If you’re shopping for an ARM, you will want to ask about a one-year, three-year, or five-year ARM (the number of years indicates how often the interest rate is adjusted).

For some home buyers, an important decision is whether a fixed-rate or adjustable-rate mortgage is preferable. As we discussed in earlier, fixed-rate mortgages are “safer” than ARMs because your monthly payment is fixed for the life of the loan. However, ARMs offer a lower initial interest rate, which means lower initial monthly payments, the possibility that rates will go down, and the possibility of qualifying for a larger mortgage

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

amount. If you're confident that your income will increase steadily over the years, you may have no qualms about an ARM. Please note, however, that the financing options available to low- and moderate-income home buyers apply only to long-term fixed-rate loans. Again, you will have to consider your own circumstances.

**Interest rate.** Lenders change their rates often, even daily. In addition, the same lender will quote different rates for each specific type of loan it offers. The interest rate you get will not only determine how large a mortgage you qualify for (as we saw in Chapter 1), but the size of your monthly payments. Even a quarter of a percent difference in the interest rate represents a lot of money over the term of a 30-year loan.

In order to accurately compare the rates quoted by different lenders, you also need to know how many "points" the lender will charge and what other fees may be charged.

**Points.** Lenders typically charge a loan origination fee in the form of points. Each point is equal to 1 percent of the loan amount. For example, one point on a \$50,000 mortgage would be \$500. Each point paid is also roughly equal to 1/8 of a percentage point added to the interest rate. For example, a 7 percent loan and 3 points are roughly equivalent to a 7 1/4 percent loan and 1 point. Points are usually paid as a one-time expense at closing.

**Annual percentage rate (APR).** To compare easily the various combinations of interest rates and number of points that lenders quote, ask for the APR of a particular mortgage. This is the actual interest rate taking into account the points and other costs of financing.

**Loan term.** Find out the longest maturity, or repayment period, the lender offers. Most home loans are repaid over 15 to 30 years. With a shorter repayment term, you pay far less interest over the terms of the loan, but your monthly payments will be higher. First-time buyers typically take the longest mortgage term offered in order to get the lowest possible monthly payments.

**Down payment requirement.** Ask what a lender's lowest allowable down payment is - with and without private mortgage insurance. Remember that with the 3/2 Option, you can buy a home with a 3 percent down payment instead of the 5 percent down payment usually required by lenders. However, you must obtain the remaining 2 percent for the down payment as a gift from a relative or as an unsecured loan or grant from a nonprofit organization or a state or local government.

**Private mortgage insurance (PMI).** If mortgage insurance will be required, how much will it cost? Ask about the upfront cost (payable at closing) and the monthly premiums. Also ask how long PMI will be required. Lenders are required to cancel PMI when the loan balance drops below 80 percent of the purchase price. You the homeowner must notify the lender when this occurs, otherwise the lender will continue to collect this fee.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

**Rate lock-in.** When a lender quotes you an interest rate, that is the rate in effect today, but it may not be the rate available to you when you actually close the loan. Since a higher interest rate may reduce the size of the mortgage for which you qualify, it's important for you to know whether a lender will agree to hold the quoted rate for you. This is called a "lock-in". Particularly if interest rates are rising, and early lock-in may save you thousands of dollars in interest over the life of the loan.

Some of the questions you should ask are these: If the lender will lock in a rate, when will it do so - at the time of application or only upon approval? Will the lender lock in both the interest rate and points? Can you get a written lock-in agreement? How long does the lock-in remain in effect? Is there a charge for locking in a rate? If the rate drops before the closing, can you lock in at a lower rate?

**Prepayments.** Some lenders charge borrowers a prepayment penalty if they pay the loan off early. If you think you may sell your house before the loan is paid off (the majority of mortgages are repaid with seven years), you should look for a loan with no prepayment penalty.

**Escrow requirement.** Generally, the lender will include the cost of property taxes and insurance in your monthly payment. \* Please note that if your insurance company notifies you that your homeowners insurance has not been paid by your lender, pay the premium immediately to have the protection and then contact your lender. You do not want to be uninsured at any time.

**Processing time.** How long does this lender normally take to process a loan application? Traditionally, loan approvals have taken 30 or 60 days or more. Some lenders now promise very short approval times (some within 24 hours), which may be an advantage, especially in times of rising interest rates or if you are particularly anxious to complete the purchase and get moved.

**Closing costs.** Many of the closing costs are fees imposed by the lender which can vary considerably from one lender to the next. Ask specifically about the following: the application fee, origination fee, credit report fee, appraisal fee, survey (Is one required?), fees for the lender's attorney, cost of title search and title insurance, and document preparation fee. If you plan to assume an existing mortgage, what is the "assumption" fee?

**Payment schedule.** Normally borrowers make one payment a month, or 12 payments a year. With a bimonthly payment plan, you make two smaller payments each month, or 24 payments a year. With a biweekly payment plan, you make payments every other week, or 26 payments a year.

### **Adjustable-rate mortgage checklist**

If you are shopping for an adjustable-rate mortgage, you want an ARM that offers you

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

the best protection in the event of skyrocketing interest rates. The most important thing to find out is the maximum amount your payments might increase.

**Initial interest rate.** Watch out for “introductory discount” or “teaser” rates, in which lenders offers very low initial rates. They may appear to be a bargain, but the low rate lasts only until the first adjustment. After that you will be charged the “full rate,” at which point your payments may become unmanageable. Such loans may cost more than a standard ARM in the long run.

**Adjustment interval.** How often can the interest rate be adjusted - annually? Every three years? Every five years? A loan with an adjustment period of one year is called a “one-year ARM,” and the interest rate and monthly payment change once every year. A longer adjustment interval insulates you longer from rising interest rates.

**Financial index and margin.** What financial index is listed to determine the interest rate? Most ARMs are pegged to the price of Treasury notes, which are widely published in newspapers, making them easy to track. How much has this index changed in the past five years? Also, what margin does the lender use (that is, how much higher is the ARM’s rate than the index rate)? Does the interest rate of the ARM come down if the financial index falls?

**Rate caps.** These limit how much the interest rate on an ARM can increase. Periodic caps limit the increase per adjustment period, whereas a lifetime cap limits the amount the rate can increase over the entire life of the loan. For example, the lender may stipulate that the interest rate on an ARM can increase up to 2 percent a year but not more than 5 percent over the life of the loan. A lifetime cap provides you with the most protection, but look for an ARM that offers both types of rate caps.

**Payment caps.** Don’t confuse rate caps with payment caps, a feature of some ARMs that may seem attractive but can get a buyer into real trouble. With a payment cap, there is a limit on how much your monthly payments can increase, regardless of how high the interest rate rises. As a result, you may end up paying the lender less than the amount of interest you owe each month. The lender doesn’t just forget about this. Instead, any unpaid interest is added to your loan balance. The result is that the amount you owe increases rather than decreases with each payment - a phenomenon that lenders call “negative amortization”.

You might eventually owe the lender more than the original amount you borrowed, despite all your monthly payments! Moreover, if your mortgage has a cap on negative amortization, your monthly payments could increase substantially when you reach that point. If you agree to a mortgage with a payment cap, be sure you discuss the possible consequences with the lender.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

**Convertibility.** Some ARMs include a provision allowing conversion to a fixed-rate mortgage at specified times, typically during the first five years of the loan. If the convertibility feature is an added expense (some lenders charge an extra point, for example), find out the exact conversion terms and how much it would cost you to convert your ARM to a fixed-rate loan. This will help you decide whether this is a cost-effective option.

## **Applying for a loan**

After we have gathered information from several lenders, you may see that one lender is quoting the lowest interest rates but another lender charges less in upfront costs payable at closing. Perhaps yet another lender has the most liberal lock-in policy. That's why you need to select the features that are most important to you. If you need help, I may be able to sort out your options.

When you have decided which lender offers the kind of mortgage you want with the best terms for your situation, we are ready to make an appointment with the lender.

### **Loan interview**

It is important to prepare for the loan interview. Try to anticipate everything you will need and have all of the necessary information (including names, addresses with zip codes, phone numbers, dates of employment, etc.) readily available. Filling out the "Pre-application worksheet" before you meet with the loan officer will help.

If you and your co-purchaser will both be signing the mortgage, you should both go to the loan interview.

### **Required documentation**

You will speed up the loan processing if you bring the following documents with you to the loan interview:

- The purchase contract for the house;
- Your bank account numbers, the address of your bank branch, and your last 3 bank statements;
- Pay stubs, W-2 forms, or other proof of employment and salary (if you are self-employed); balance sheets, tax returns for the past two years, and year-to-date profit and loss statement);
- Information about debts, including loan and credit card numbers and names and addresses of your creditors; and
- Evidence of your mortgage or rental payments, such as canceled checks or money order receipts.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

## The Four Cs

Lenders speak of the “four Cs” of credit - capacity, credit history, capital, and collateral.

**Capacity.** Can you repay the debt? Lenders ask for employment information: your occupation, how long you’ve worked, and how much you earn. They also want to know your expenses: how many dependents you have, whether you pay alimony or child support, and the amount of your other obligations.

**Credit history.** Will you repay the debt? Lenders look at your credit history: how much you owe, how often you borrow, whether you pay bills on time, and whether you live within your means. They also look for signs of stability: how long you’ve lived at your present address and how long you’ve worked at your present job.

**Capital.** Do you have enough cash for the down payment and for closing costs? Do you need a gift from a relative? Will you have a cushion left after your home purchase, or will you spend your last penny at settlement?

**Collateral.** Will the lender be fully protected if you fail to repay the loan? Lenders want to be sure the property you are buying is sufficient to back up your loan.

**Some additional considerations.** You will not help yourself by trying to cover up past credit problems in hopes that the lender won’t discover them. Rather you want to be completely truthful, but try to show that those problems are behind you.

### **Locking in the current rate**

If you are concerned that interest rates may rise during the time the loan is being processed, the lender may agree to lock in the current rate (and number of points) for a given period. Find out when the lock-in rate takes effect and how long it remains in effect, and get the lock-in agreement in writing. A lock-in for a very short time period may be useless; you want something that will get you to closing without having to be extended.

### **Estimates of closing costs**

Within three days after you have submitted your application for a home loan, the lender is required to provide you with an itemized estimate of the costs to settle (or close) the loan. This report is referred to as a “good faith estimate”. The lender must also give you a copy of the government publication. *A Home Buyer’s Guide to Settlement Costs*. Read it!

### **Speeding up the approval process**

Be sure to respond promptly to the lender’s request for information while your loan is

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

being processed. I will call the lender occasionally to check on the status of your application. You can then contact your employer or others who need to provide documents or other information for your loan.

## **Loan processing**

In processing your loan application, the lender primarily will be interested in two things:

- the property that you plan to buy (since it serves as collateral for the loan), and your financial situation and your credit history (since they will determine your ability and your desire to repay the loan).

The lender will request an appraisal of the property, request a credit report on you and any co-borrowers, and verify the information in your loan application. Let's look at each of these steps in turn.

### **Property appraisal**

The lender will arrange to have the property appraised. A professional appraiser will determine the market value of the house. This information is required because the lender will loan you not more than a given percentage (often 95 percent) of the value of the property (what lenders call the "loan-to-value ratio"). If the appraised value is less than the purchase price you have agreed upon, the amount of your mortgage may be smaller than you anticipated and you will have to come up with a larger down payment. However, if you have included an appraisal contingency in your contract, you may be able to negotiate the purchase price in the event of an unexpectedly low appraisal.

### **Credit report**

The lender also will order a credit report on you and your spouse or any other co-purchasers. The credit bureau's report will show how you have handled past debt and credit accounts, such as car loans, charge accounts with stores, and any purchases made on credit. Since you have already seen your credit profile, you can rest assured there will be no surprises. Similarly, if the lender has welcomed your submission of documentation to establish a nontraditional credit history, you should already have a good idea of the lender's willingness to accept it, provided that the documentation is complete and shows you to be a dependable credit risk.

It is not usual for the lender to ask you for a written explanation of any problems that appear on your credit report (although hopefully you have been able to clear them up prior to applying for your mortgage). Even one late payment on just one account usually requires an explanation by you. Don't be alarmed by this request. Just respond promptly with a truthful statement about whatever circumstances may have caused the late payment(s).

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

**Verifications**

The lender will also verify the information provided on the loan application as to your income and employment history, your assets (checking and savings accounts, etc.), and your rent payment history.

**Approval of mortgage insurer**

If mortgage insurance is a requirement of the loan, the loan will also have to be approved by the mortgage insurer. If you are obtaining an FHA or VA loan, the loan must also meet FHA/VA standards.

**Commitment letter**

When your loan is approved, the lender will send you a commitment letter. This is the formal loan offer. It will state the loan amount (the purchase price less the down payment), the term of the loan (number of years you have to repay the loan), the loan origination fee (a percentage of the loan amount), the points, the annual percentage rate, or APR (the actual finance charge taking into account the interest rate, origination fees, and mortgage insurance fees), and the monthly charges (principal and interest, taxes, and insurance, or PITI).

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

# *Closing*

## **Setting the closing date**

The closing date is set after your loan has been approved and the commitment letter is accepted. Morgan Collins and I will coordinate this. You need to be sure that closing takes place before the lender's commitment expires and while the rate lock-in, if there is one, remains valid. You can now make definite moving plans.

## **Selecting a settlement agent**

In different parts of the country, closings are variously conducted by lending institutions, title insurance companies, escrow companies, real estate brokers, or attorneys for the buyer or seller. In the York area, it is customary for the Buyer to select the settlement agent. I can recommend an attorney to represent you and conduct the settlement, if you do not have your own.

## **Meeting conditions of the loan offer**

Be sure you understand any conditions of the loan offer that are stated in the lender's commitment letter. If the home you are buying has been found to be in violation of a building code or zoning regulation, the commitment letter may specify that those problems must be corrected before the closing. If the Seller has agreed to make repairs by the lender, we will want to make sure the work is finished (and done properly) before closing.

## **Securing title services**

Before the closing, I will make sure that a title search on the property has been made and that you have obtained title insurance.

## **Title search**

Lenders require a title search to prevent fraudulent sales. They want to be sure that the seller is indeed the owner of the property. The title search also attempts to uncover any "encumbrances" on the title. This includes liens (legal claims against a property) filed by creditors in an attempt to collect unpaid bills, as well as liens filed by the IRS for nonpayment of taxes. Any such claims against the property must be paid before (or often at) closing. The buyer typically pays for the title search.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

### **Title insurance**

As further insurance that the seller is giving the buyer a “marketable title,” the lender will require that title insurance be bought. There are two types of policies, and you should get both:

- a lender’s policy; and  
an owner’s policy.

The lender’s policy protects the lender in the event a flaw in the title is detected after the property has been bought. The owner’s policy protects you. Generally the buyer pays the cost of both, and obtaining a combined lender’s/owner’s policy will save you some money. You may also get a price break if the company that previously insured the title will give you a “reissue” policy.

### **Survey**

The lender may require a survey of the property before closing. This is done to confirm that the property’s boundaries are as described in the purchase and sale agreement. This is another charge that is normally paid by the buyer. This survey, or plot plan, may show that a neighbor’s fence extends onto the seller’s property (or vice versa). Sometimes more serious violations are uncovered that must be addressed. Again, you may be able to save money by requesting an “update” from a surveyor who has surveyed the property previously. If you, the buyer, have any questions or concerns about the boundaries of the property, a survey is your answer.

### **Termite certificate**

Some lenders may require the home to be inspected for termites before closing. Usually the buyer pays for this. You want a certificate from a termite inspection firm that states that the property is free of both visible infestation and termite damage.

### **Homeowner’s insurance**

Your lender will require that you purchase homeowner’s or “hazard” insurance, which protects you and the lender from loss in the event the house is damaged or destroyed by fire or storm. Most home buyers purchase a homeowner’s package of insurance that includes:

- personal liability insurance, which protects you in the event you are sued by someone who is injured on your property or injured by a member of your family, except in an automobile accident; and
- coverage against fire, theft, and certain weather-related hazards (various options are available).

You will want to get quotes from several companies as to what types of coverage your homeowner’s policy should include and how much coverage you need. Generally, the

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

lender will require you to get only minimal coverage up to the “replacement value” of the house.

Be sure that when you compare quotes from different companies that you have been quoted rates for exactly the same types and amounts of coverage. In some cases, it may be advantageous to take over the existing insurance policy held by the seller. In other cases, the lender may recommend a particular policy. Or, you may want to use an insurance company with which you already do business; You may save money by having two or more policies with the same company. In any case, make sure the coverage is what you need and want.

Note that by requesting a higher deductible amount (the insurance company pays losses only above the deductible amount), you can significantly reduce your insurance costs. In this way, you pay for minor damage yourself but have protection against major losses.

Lenders typically want the first year’s premium to be paid at or before closing. A lender may insist on paying subsequent hazard insurance premiums in order to ensure that the policy remains in effect for the life of the loan. If so, the cost of the insurance policy will be added to your monthly mortgage payments. The lender will then keep this portion of your payments in an escrow account and then will pay the insurance bill when it comes due each year. If you are obtaining the insurance on your own, you will need to bring the insurance policy and paid receipt with you to the closing.

### **Type of ownership**

Are you going to be the sole owner, or are you buying the home jointly - either with your spouse or with one or more other partners? The name or names on the deed must normally be the same as those who will be responsible for the mortgage.

In the sale contract, you may already have specified the type of ownership interest. Again, this is something you should discuss with your attorney. The chief options are these:

- Sole ownership - you’re the only owner.

Tenancy by the entirety - available only to married couples, both owners have to agree before the house can be sold or even refinanced; when one spouse dies, the house automatically goes to the surviving spouse with going through “probate” (the legal process by which property is distributed after someone’s death).

Joint tenancy - during their lifetimes, any of the owners may sell their interest to whomever they choose; when one owner dies, the surviving owner automatically gets deceased owner’s share in the property.

Tenancy in common - the property is owned jointly, but if one owner dies, the deceased owner’s share goes to his or her heirs rather than to the surviving owner.

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

### **Homeowner's warranty**

If you're buying a new house, you may be able to get a homeowner's warranty that protects against certain defects in your home. Both the homeowner's warranty and a certificate of occupancy should be provided at closing. Without this certificate, it's illegal to live in a newly constructed home. Recently, homeowners' warranties have become available for older homes as well, typically covering repair of the major systems during the first year of ownership. If you are considering buying such a policy, look carefully to see which potential problems are covered and which are excluded.

### **Final walk-through inspection**

The day of settlement, I will accompany you to examine the property. This allows you to make sure that the seller has vacated the house and left behind whatever property (such as appliances) that was agreed upon.

If your sales contract made the seller responsible for ensuring that the plumbing, heating, mechanical, and electrical systems are in working order at the time of settlement, this is your last chance to make sure that everything works. During the walk-through, all remaining deficiencies should be noted. If they cannot be corrected before settlement, funds may also be withheld from the seller by the settlement attorney for payment of the agreed-upon repairs.

### **If you need help with closing costs**

If you are a low- to moderate-income home buyer and you find that you will need help in meeting closing costs, consider some of the financing options described earlier. For example, the Community Home Buyer's Program waives the usual requirement that home buyers have a cash reserve equal to two mortgage payments when they purchase their home. This means that lower income borrowers need less cash at closing.

Relatives may be able to provide funds for closing costs as a gift. Or, you may be able to borrow these funds through a local community organization or public agency, as long as the loan is not secured by your home. If you borrow these funds, keep in mind that your lender will include your monthly payments on the loan in your total debt payments to qualify you for the mortgage.

## **Closing - the big day!**

The closing is a formal meeting typically attended by the buyer, the seller, the listing and selling agents, and representatives of the lender and the title company. You will certainly want your attorney at your side to read all the documents along with you, advise you concerning the signing of papers, and generally to represent your interests at this final important meeting. You will be asked to sign numerous documents and affidavits, you will pay the closing costs assigned to you, and you will be given the keys to your new

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

house!

## **Explanation and signing of closing documents**

A significant part of the process of closing is the explanation and signing of various documents. These are described here.

### **HUD-1 Settlement Statement**

This form, required by federal law, itemizes the services provided and lists the charges to the buyer and the seller. It is filled out by the settlement agent who conducts the closing. Both the buyer and seller must sign it.

### **Truth-in-lending (TIL) statement**

This is another document required by federal law that mortgage lenders are required to give to all loan applicants within three days of receiving their initial application. Among other things, it discloses the annual percentage rate (APR), which reflects the cost of your mortgage as a yearly rate. This rate may be higher than the interest rate stated in your mortgage because the APR includes any point, fees, and other costs of credit. The TIL statement also sets forth the other terms of the loan, including the finance charge, the amount financed, and the total payments required.

### **The note**

The mortgage note represents your promise to pay the lender, according to the agreed terms. It is, in effect, a legal "IOU". Again, the terms of the loan are set forth, including the date on which your payments must be made and the location to which they must be sent.

The note also details the penalties that will be assessed if you default (that is, if you fall behind in paying the loan) and warns you that the lender can "call" the loan (require full payment before the end of the loan term) if you fail to make the required payments, if you sell the house without the prior written consent of the lender, or if you otherwise violate the terms of your note or mortgage.

### **The mortgage**

The mortgage (or "deed of trust" in some localities) is the legal document that secures the note and gives the lender a claim against your house if you default on the note's terms. In effect, you have possession of the property, but the lender has partial ownership (called an "encumbrance") until the loan has been fully repaid.

The mortgage restates the basic information contained in the note as well as the date of the final scheduled payment. It states the responsibilities of the borrower to pay principal and interest, taxes, and insurance in a timely manner; to maintain hazard insurance on the

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

property without lapse; and to adequately maintain the property and not allow it to deteriorate.

The mortgage also states that if the borrower fails to comply with these requirements, the lender can demand full payment of the loan balance. Moreover, if the borrower defaults, the lender can foreclose on the property, sell it, and use the proceeds to pay off the outstanding loan and the foreclosure costs. The borrowers will receive anything left over after any liens (legal claims against a property) and second (or third) mortgages are repaid.

### **Affidavits**

You may be asked to sign numerous affidavits (for example, that it is your intention to occupy the property). These may be required by state law, by the lender, or by the secondary market agencies. If you provide false information, you can face criminal penalties and you run the risk that the lender will call your loan.

### **The deed**

The seller must bring the deed to the closing, properly signed and notarized. It is the document that transfers ownership from the seller to you. As discussed previously, you should have decided what name or names are to appear on the deed.

### **Allocation of closing costs**

We will now briefly discuss the various costs that are likely to be paid by the seller. Note, however, that local custom varies and, in addition who pays the various closing costs can be negotiated between the buyer and seller (and should be specified in the sales contract). It's possible to have an agreement in which the buyer pays all closing costs or one in which the seller pays all closing costs.

### **Fees paid to the lender**

Certain fees must be paid to the lender at closing. A brief description of these fees follows here.

**Loan origination fee.** This fee covers the administrative costs of processing the loan. It may be expressed as a percentage of the loan (for example, 1 percent of the mortgage amount).

**Loan discount points.** These are the "points" charged by a lender to adjust the yield on the loan to market conditions. Each point equals 1 percent of the mortgage amount.

**Appraisal fee.** This pays for the appraisal, which the lender uses to determine whether the value of the property is sufficient to secure the loan should you default on the loan. The appraisal fee is usually paid by you when you apply for the mortgage and may show on the settlement sheet as "POC", or "paid outside closing".

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

**Credit report fee.** This covers the cost of the credit report, which the lender used to determine your creditworthiness. Like the appraisal fee, you probably paid this fee when you applied for the mortgage.

**Assumption fee.** You pay this processing fee if you take over the payments on the seller's existing loan.

**Advance payments**

The lender may require you to prepay some or all of the following items at the time of settlement.

**Interest.** You will probably have to pay the interest on the mortgage from the date of settlement to the beginning of the period covered by the first monthly payment. For example, suppose you settle on February 10. Your first monthly payment begins to accrue on March 1st and will be payable at the beginning of April. At closing you may be required to prepay interest for the period from February 10th through the end of February. This means that if you settle later in the month, your closing costs will be less than if you settle early in the month.

**Mortgage insurance premium.** The lender may require you to pay for your first year's premium or a lump sum premium at settlement.

**Hazard insurance premium.** You may be required to pay the first year's premium at settlement. Or, you may be expected to bring proof that you already have paid for such a policy.

**Escrow accounts or reserves**

Reserves are required if the lender will be paying your property taxes, mortgage insurance, and hazard insurance. Again, state and local law and lenders' policies vary.

**Title charges**

These primarily are charges payable to companies or persons other than the lender. This includes the settlement (or closing) fee, title search/title insurance program (lender's and owner's coverage), document preparation fees, and attorney's fees (for legal services provided to the lender). Note that the fees you pay for your own attorney are not part of the settlement procedures.

**Recording and transfer fees**

Most states impose a tax on the transfer of property and require payment of a fee for recording the purchase documents.

**Additional charges**

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

Included here are the surveyor's fees, charges for termite and other pest infestation inspections, and any other inspections required by the lender.

### **Adjustments**

Another part of the settlement costing-out involves looking at items paid by the seller in advance and items yet to be paid for which the seller is responsible. The most common expense to be prorated between the buyer and seller is property taxes, which are split so that you take responsibility for them beginning at settlement. If the seller already has paid taxes beyond that date, you reimburse the seller; if taxes for the current period have not yet been paid, the amount owed is deducted from the buyer's settlement payment.

### **Final reckoning - the bottom line**

In calculating the total amount that the borrower must pay, the Settlement Statement begins with the sales price and adds in the total closing costs for which you are responsible. Any prorated adjustments payable by you (as discussed above) are then added in.

From this total is deducted your deposit (which has been held in escrow ever since the seller signed your purchase offer) and the principal amount of your mortgage (or of any existing loan being assumed). Then, any adjustments payable by the seller are deducted. The resulting figure is the amount you may pay at settlement.

### **Recording the documents**

After all the papers have been signed and the fees have been paid, the mortgage (or "deed of trust"), the note and the deed must be officially recorded at the registry of deeds by the closing agent.

### **Getting the keys to your new home!**

You will receive all keys to your new home along with remote garage door openers and information about your new home from the seller such as warranties, operating instructions for security systems and others.

# ***Congratulations!***

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect

**Michael Chiaro**  
Professional Service and  
Personal Attention That You Expect