Buying A Home

Take a moment to think about the milestones you have reached and hope to achieve in your life – the events that define who you are, where you've been and where you're going. Do notions of beginning school, starting your first job or getting married come to mind? If so, chances are good that buying a home may be one of the next milestones your future holds. Like other milestones, the road to owning your own home may be rocky, but the right information may make the path to your own front door easier to navigate. At the State of Wisconsin Department of Financial Institutions we believe that this booklet, which is part of the department's *Your Money Matters* financial education program, may aid in this process and help you to avoid home buying hazards. It contains information on the home buying process from deciding if home ownership is right for you to closing the purchase of your own home. If you think your future may contain home ownership, please take the time to familiarize yourself with this material so home buying can be a milestone you look back on with certainty and pride.

- Note: This booklet contains many definitions for terms commonly used in the mortgage banking industry. Terms listed in **bold** have been taken from the 8th edition of *Mortgage Banking Terms, A Working Glossary* produced by the Mortgage Bankers Association of America, copyright 1997. If you would like more information from the MBA or have questions for them, direct correspondence to:

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Is Buying a Home Right For you?

Before diving headfirst into the home buying process, weighing the advantages and disadvantages of purchasing a home could help you decide if ownership is right for you. One of the largest advantages of home ownership is its impact on your taxes. Mortgage interest and local property taxes on your primary residence may be deductible from your federal income taxes. These benefits are not available to renters and can add up to substantial savings for homeowners. Consult a tax adviser to determine the specific tax advantages that may be available to you. A second advantage of home ownership is that you can build equity, which is an asset equal to the portion of your home that you actually own. Equity is determined by calculating the difference between the market value of your home and the balance owed on your loan. Equity may build in two ways: primarily, equity accumulates because a portion of your monthly mortgage payment reduces the principal amount owed on your mortgage, but secondarily because your home's market value should appreciate, or increase. The advantage to building equity is that homeowners may use it to secure a home equity loan, commonly called a second mortgage. Home equity loans may offer comparatively low interest rates and attractive tax advantages. In addition, you may be able to make payments toward your own home and receive the tax and equity benefits that come with home ownership for the same amount you would pay monthly for rent. Financial advantages aside, owning your own home can instill you with the pride and experience of owning something that is all yours. You have the freedom to do with your home anything your creativity can imagine, and the experience of ownership can teach you lessons you will always remember.

However, along with the advantages of home ownership come disadvantages. The primary disadvantage is that you sacrifice mobility. Owning a home may restrict your ability to move in the event that you change careers or dislike the area in which you live. Before committing to buy, make sure you are fond of the area and that you plan to stay there for awhile. A second disadvantage of home ownership is the necessary upkeep. Owning a home comes with the responsibility of maintaining it. Keep in mind that older homes usually require more maintenance and care than newer homes. Although your home is likely to appreciate, a third possible disadvantage is that your home's value could decrease, or depreciate. This may result from neighborhood changes or wear and tear on the property. A fourth disadvantage of ownership is the possibility that your monthly mortgage payment may far exceed what you used to pay for rent, sometimes called payment shock. Payment shock could happen to you if you were paying low rent in proportion to your income level and then applied for the maximum mortgage amount available to you. You may also find yourself paying more for monthly responsibilities such as utilities, maintenance and insurance that were previously taken care of in your rent payments. You will want to take these factors and any others you can think of into account before deciding to purchase a home.

The Home Buying Process

Home Buying In A Nutshell

As we have discussed, the first step in the home buying process is deciding that home ownership is the right route for you. Once you have established that you are both financially and mentally ready for home ownership, the next step is pre-qualification. This stage can be a catalyst for home shopping, as it informs you of specifically what you can afford in a home. The third step is pre-approval, which guarantees financing from a lender up to a certain amount. Once you have found a house you would like to buy, you will make an offer to purchase, which must be accepted before you can close the sale. After your offer is accepted you will apply for a specific mortgage loan unless you are purchasing the home outright. When your loan is approved the final step is closing the sale, including transferring the property to your name.

Who Will You Work With?

When buying a home there are many professionals whom you could encounter and come to rely on. It is important to understand the various roles that these people may play in your journey to home ownership.

One of the first and most important resources in home buying is your loan officer, who will most likely play an essential role in your purchase from pre-qualification to closing. When choosing a loan officer, choose someone who answers your questions confidently and informatively. Since you will have to work closely with your loan officer you should also make sure he or she is someone who you feel comfortable around and are not intimidated by. This comfort level may encourage you to ask questions and respond honestly when questioned yourself.

A second individual you may work with when buying a home is a real estate agent or Realtor®. A **Realtor**® is a person licensed to sell and/or lease real property, acting as an agent for others, and who is a member of a local real estate board affiliated with the National Association of Realtors®. However, it is important to note that not all real estate agents have to be Realtors®. A Realtor® or agent may be most able to match your needs and wants in a home to a house that is on the market. As with your loan officer, your agent should make you feel comfortable about expressing any concerns you may have. Remember, however, that most agents represent the seller, and consequently work primarily on behalf of and for the benefit of that seller. If you are concerned that a seller's agent may not satisfy your needs, you can hire your own agent known as a buyer's broker. Your buyer's broker will be responsible for pursuing your best interest while negotiating with seller's agents.

Additional professionals you may encounter include a title agent, an insurance agent and an attorney. A title agent provides a legal description of the property, and reveals whether there are any liens, restrictions or unsettled claims against it. An insurance agent furnishes the homeowners' insurance that many lenders require you to obtain before closing the sale. Home purchase does not require an attorney; however, employing one to examine your real estate documents may shift the responsibility away from you in the event that problems arise. For example, if another party claims title to your property, you can refer them to your attorney. There are attorneys who specialize in real estate law who may be best prepared to handle your needs. An attorney may also handle the actual closing of the sale. In this case the attorney facilitates the process by making sure all documents are legal and properly prepared.

Finding a lender

Your lender is perhaps the most important party you will deal with when buying a new home. As a result, it is imperative that you search out a lender with whom you feel comfortable and who can provide for your specific needs. When choosing a lender, you should look at the big picture. Your overall satisfaction will likely include more than just a low interest rate. Keep in mind that many options exist - banks, savings and loan institutions, credit unions, mortgage companies and various state government lenders are all places you can look for home financing.

However, not all lenders offer every available type of loan. It is a good idea to attain a general knowledge of loan options so that you can shop for a lender that can accommodate your desires. Consider the mix of products and services that lenders offer to find one with which you feel comfortable. You may be able to lower the interest rate on your loan by pre-paying interest, known as “paying points.” This does not mean you will end up paying less in the end, rather you are just paying more up front and less each month. There may also be different closing costs depending on your lender. However, the easiest way to differentiate between lenders is by comparing their interest rates. When doing so be sure to compare the **annual percentage rate (APR)**, which is a term that expresses, on an annualized basis, the charges imposed on the borrower to obtain a loan, including interest, discount and other costs. Interest rates fluctuate daily, so comparing the rates of different lenders on the same day may give you the most accurate comparison.

Although the interest rate is an easy and important number to compare, remember that financing is a business and like all business competitors, lenders want to win you over with the whole package. Consider the servicing features mentioned before as well as factors such as proximity to your lender. If there is a problem with your mortgage, is it important to you to be able to talk to your lender in person? Asking your friends and family for suggestions may be a good place to start when looking for a lender. An independent opinion that you can trust may already have positive and negative experiences to share with you.

Another option for finding a lender is employing the services of a **mortgage broker**, which is a firm or individual who, for a commission or other means of payment, matches borrowers with lenders. A mortgage broker accepts loan applications and passes them on to the lender, but does not actually fund or service mortgages once loans are closed. The lender or the borrower may pay the compensation that the mortgage broker receives for its services. These are all options that you should investigate and consider before deciding on a lender. Taking some extra time to investigate the options and services that different lenders can offer you could result in much greater satisfaction with your lender.

Pre-qualification

If you did not begin the home buying process with pre-qualification, you may want to take this step after choosing a lender. The pre-qualification process entails providing unverified information about your personal financial situation, which allows the lender to estimate the largest loan affordable to you. This can give you an idea of the price range in which you should stay when you look for a home. For pre-qualification, be prepared to provide information on your income, debts and assets. Many lending institutions also offer websites or worksheets that allow you to enter personal financial information and obtain a pre-qualification estimate on your own. Once pre-qualified you can begin looking at what size and features you can realistically afford in your home.

Pre-approval

Pre-approval involves a lender committing to finance your home purchase up to a certain amount. To determine the pre-approval amount, the lender examines your complete financial profile including your income, saving and checking accounts, stocks, bonds, life insurance and credit history. In doing this they will often use qualifying ratios, such as the front end ratio or the back end ratio as measuring sticks. The front end ratio is calculated by dividing your monthly housing expense (including mortgage payments for principle, interest, taxes and insurance) by your monthly gross income. In general, this should not exceed 28%, meaning that 28% of your gross monthly income is the maximum amount lenders want you to allow for housing. The back end ratio is determined by dividing your total monthly debt by your monthly gross income. Usually 36% is the upper barrier, meaning that your total monthly debt should not exceed 36% of your monthly income. Again, these percentages are purely general; lenders may use compensating factors when determining your individual qualifying ratios. Keep in mind that the qualifying ratios do not tell you how much you should spend on a home, rather they give you the theoretical maximum amount you could spend.

Another important check that lenders often perform during pre-approval is obtaining your personal credit report. An independent agency that verifies certain information concerning an applicant's credit standing provides a credit report. You may want to request a copy of your credit report so you know exactly what your lender is using to evaluate your credit worthiness. This will give you a chance to review and correct any mistakes you feel the report may contain. To request a copy of your credit report you can call any one of three main credit reporting agencies: Equifax at (800) 685-1111, TransUnion at (800) 916-8800 or Experian at (800) 682-7654. A credit report will probably cost you between $7-$10. For more information on credit reports and credit in general, see the *Your Money Matters* publication entitled "Understanding Credit." Along with the credit report, the following table includes other important documents your lender may need during the pre-approval or application process. To be fully prepared for any questions that could arise, it may be a good idea to have the following documents in order before meeting with your lender:

Section of Form:	**Useful Documents/Information:**
Personal Information	▪ Social Security card/numbers ▪ Drivers license ▪ Department of Veterans Affairs (VA) Certificate or discharge papers (if applicable) ▪ Present and former addresses
Borrower Information	▪ Current Rental Agreement
Employment and Income Data	▪ Address of current and Past employers

	▪ Pay stubs (3 to 12 most current) ▪ Resume ▪ 2-year employment history ▪ Investment account statements or year end summaries ▪ Proof of Social Security, disability or pension income ▪ Tax Returns with attached schedules (2-years) ▪ W-2's (Tax withholding sheets) ▪ Lease for any investment properties
Assets	▪ Checking/savings/security statements ▪ Renter's insurance inventory list
Debts	▪ Monthly financial obligations (including car payments, credit card debt, insurance payments and household expenditures)
Legal Declarations	▪ Details on any historical defaults or foreclosures
Property and real estate information	▪ Real estate agent's business card ▪ Offer to purchase (if completed)

Pre-approval guarantees financing up to a certain amount, provided you follow certain contingencies set by the lender. However, keep in mind that pre-approval and mortgage application are different. Pre-approval is not a requirement to make an offer to purchase; however, it may allow you to shop for a home with extra bargaining power since a lender has assured your financing. It may also shorten the actual mortgage application process.

Finding Your Home

Pre-qualification allows you to begin thinking about a house that will probably fit your budget. Once pre-approved and guaranteed a specific loan amount, you can search more seriously for your home.

When scouting out your new home, there are several guidelines to keep in mind to make your home buying experience manageable and successful. First, start with the important details and navigate your way to the least important. A solid starting point is location. A few good questions to ask yourself about your desired location are:

- Do I want to live in a rural or urban area?
- Do I want to live close to my job, or will I commute?
- Is proximity to schools and parks important?
- Do I want to live in a neighborhood with older or younger residents?
- Do I want to live in a neighborhood with older or newer houses?

All of these are decisions that could play a large role in your satisfaction with your home.

After you have set some location guidelines, you should think about some of the physical characteristics you would like your home to have. Beginning with the outside of the house may be the easiest way to narrow down your choices. Take a drive and look for some of the following things in potential home sites:

- Yard size
- Lot size
- House style – number of floors, etc.
- Landscaping
- Garage existence/size

You should now be able to picture your house as you coast to a stop in the driveway.

Next imagine what you would see walking in the front door, and think about what is important to you inside your home. Possibilities to remember include:

- Kitchen – size and amenities
- Other household appliances
- Formal dining room
- Family room
- Fireplace
- Number of bedrooms
- Closets, walk-in or not
- Number of bathrooms, bathtubs, showers, or both
- Basement, finished or not

…And the list goes on. Take a night before actively pursuing a home and expand this list to include the conveniences that you would like your new home to possess.

Finally the time has come to consider employing a real estate agency or simply getting out there to search for a home. Perhaps you have put off home shopping while waiting for your pre-qualification and pre-approval to inform you of what you should shop for. If this is the case there are several ways for you to begin your search at this point. One option is to contact a real estate agency and make an appointment to meet with a buyer's broker. A buyer's broker will work for you, looking for what you want in a home. Your meeting with the agent is the time to tell him or her the needs and wants you have for your home. Discussing the location, and outside and inside features that you may already have in mind will give the agent a better starting point for finding your ideal home. A second place you can hunt for your home is on the road. Tour the area in which you are interested in living and look for homes that bare a "For Sale" sign. The sign or accompanying material will likely name the real estate agency and a specific agent you can contact for more information. A third option for home hunting is on the Internet. Many real estate websites have listings along with pictures of the houses. They may also contain written descriptions, pictures inside the house, and even virtual tours of the homes and their grounds. Many real estate websites also offer the option to contact one of the company's agents through e-mail. Other places to look for homes are newspapers and real estate publications. Keep in mind that if you contact an agent about a property, he or she is most likely an agent of the seller, and therefore paid to look out for the seller's best interest.

Making an Offer

Once you have found a home, the next step is making an offer to purchase, also known as a purchase agreement. The real estate agent involved will most likely help you draft an offer to purchase. This document spells out the details of your offer. Some of the items that may be in the offer to purchase include the purchase price, what furnishings and appliances are included in the deal, and various contingencies upon which the offer may be dependent. It may be beneficial to include a home inspection as a contingency. You may want inspectors to examine the heating, cooling, electrical and plumbing systems of the home, as well as its structure. Some of the main reasons that you may want your home inspected before committing to buy are:

- To be confident that the systems inspected work properly
- To have some recourse if problems are found later
- To be informed about the house, including learning how the systems and fixtures work and should be maintained
- To get an expert opinion on any renovations or upgrades you may want to make.

When ordering a home inspection be aware of any limitations the seller or real estate agent places on the time you may have to conduct an inspection, and make sure your home inspector is properly qualified. The buyer of the home often pays for a home inspection, but it doesn't hurt to inquire as to whether the seller would be willing to contribute a share of the inspection price. Another component of the offer to purchase describes the type of mortgage, if any, you will use to finance your home. Various mortgage types are discussed later in this guide. In order to make the offer to purchase legally binding you must pay the seller what is called earnest money. It is a payment meant to show the seller you are serious about purchasing the property. However, how much earnest money you pay is negotiable. There is no legal minimum. Be confident you agree with the terms of the offer to purchase when you sign it, as it is a legally binding document once the earnest money is paid. It may be wise to consult a lawyer to help draft the offer to purchase or to examine the agreement before you sign it.

You and Your Mortgage

In order to make a knowledgeable decision on the purchase of a home you should be aware of the financing options that are available. In addition, the offer to purchase requires you to disclose the type of financing, if any, that you will use for the purchase. Your monthly mortgage payment can be broken down into four components: principal, interest, taxes and insurance. The following are the most common financing options and a brief description of each. For more information on whether these mortgage plans are best suited to you, consult a lender.

Types of Mortgages

Fixed rate mortgages are mortgages where the monthly interest and principle payment remains constant for the life of the loan, which is commonly 15 or 30 years. However, your property taxes or insurance costs may increase or decrease during the term of the loan, meaning that your overall monthly payment may change. Even so, principle and interest make up the majority of your payments, and since they will never change, fixed rate mortgages offer a fair amount of stability. This may be attractive if you plan to stay in your home for a long time and don't intend to refinance. A disadvantage to fixed rate mortgage plans is that the payments may be higher in the beginning when compared to other available mortgage plans.

Adjustable (Variable) rate mortgages (ARM) are mortgage loans that allow the lender to adjust the interest rates periodically in accordance with a specified index and as agreed to at the inception of the loan. With an ARM, initial monthly payments are usually smaller than those of a fixed rate mortgage, but your rate and payment are subject to change a number of times a year, as stated in your mortgage note. The time between these changes is called the adjustment interval. The movement of an ARM's interest rate is based on one of a number of indexes that are readily available to the general public and are not controlled by your lender. Your lender will use the same index to determine your interest rate throughout the life of your loan. A second feature of an ARM, which is controlled by your lender, is its interest rate margin. This is a percentage added to the index value to determine the final interest rate of the loan. However, once your lender establishes a margin, it may not change. It is important to know that even though the same lender may issue several ARMs, they can be based on different indexes and/or margins, and therefore carry different final interest rates. Some of the most common indexes used in ARMs include the Six-Month Treasury Bill Index; the One, Three or Five-Year Treasury Bond Index; and the 11^{th} District Cost of Funds Index. If you are curious as to the values of these mortgage indexes, they are reported frequently in the business or real estate section of major newspapers such as *The Wall Street Journal*.

The specific terms of ARMs can vary significantly. For example, the frequency and number of adjustment intervals is not restricted by federal regulation, but may be governed by applicable state laws. Your ARM's interest rate could be subject to change several times a year; however, the adjustment interval schedule of your mortgage will be specified in your mortgage note. Lenders do place limits, called caps, on your mortgage's interest rate. There are two types of caps: lifetime and periodic. A lifetime cap limits how much an interest rate can increase or decrease during the entire life of the loan. For example, a 5% life cap means the interest rate cannot increase or decrease by more than 5% from your initial interest rate during the entire life of the loan. A periodic cap limits how much the interest rate can go up or down from one adjustment period to the next. For example, a 2% periodic cap means that when the lenders adjust the ARM's rate, it cannot increase or decrease by more than 2%. Be aware that if the interest rate increases or decreases by more than your periodic cap, the excess may be carried over and applied to another adjustment period. Once you have reached a lifetime cap, however, your interest rate will not exceed that percentage.

Advantages of ARMs include the ability to purchase more home, since your current income will be used to justify only your initial payments, not payments for the entire loan term. Remember that by taking on an ARM you should receive a low initial interest rate for accepting the risk of increasing interest rates down the road. ARMs may suit you if you plan to move or refinance in the near future, as you could benefit from the lower initial rates, and therefore payments, ARMs provide.

Convertible Mortgages are adjustable rate mortgages that may be converted to fixed-rate mortgages during a predetermined time period within the life of your loan. The times for conversion can vary substantially from lender to lender. Some lenders let the borrower decide when to convert their mortgage, while others may only allow conversion during the first five years, or after the first five years. A convertible mortgage may be favorable if you are looking for a fixed rate mortgage but interest rates are relatively high at the time you want to buy. Convertible mortgages allow you to begin at an ARM's low rate and then convert to the more stable fixed rate mortgage you initially hoped for.

Balloon mortgages are mortgages with payments of a principal and interest that do not fully pay off the loan during the loan term. The balance of a balloon mortgage is due in a lump sum at a specified date, usually the end of the term. A balloon mortgage could be right for you if you are sure that you will be selling your house or refinancing the loan before the mortgage term ends and the lump sum is due. In this way you could receive a low initial interest rate or make payments smaller than with other types of mortgages. Then the money you received from selling or refinancing could pay off the lump sum amount.

Graduated payment mortgages are flexible payment mortgages where payments commence at a low level and then increase gradually at a predetermined rate until leveling off after a portion of the mortgage term expires. This type of loan may interest you if you feel income growth lies in your future and you want to make larger payments as time goes on. A disadvantage of graduated payment mortgages is that they often produce **negative amortization** which occurs when the mortgage principal balance increases rather than decreases after a payment, because the payment does not cover the full amount of interest due. In this case the amount of principle owed would not be paid down, but actually increased since extra-accrued interest not paid would be added to the principle due.

Biweekly mortgages are mortgages with payments due every two weeks, totaling twenty-six payments a year. This pays off your mortgage faster by having the same effect as making one additional, or thirteenth, monthly payment per year. If your lender does not offer a biweekly mortgage, a third party may be willing to electronically debit your checking account twice a month and then make the payment to your lender. The down side of enlisting a third party to provide this service is that the third party will have control and use of your funds until they are paid to your lender. The third party may also charge a processing fee for this service. Having a third party involved in your loan may also cause complications, especially if there are changes in your mortgage or mortgage servicing. If you choose to enlist a third party's services, be sure to review the contract in detail.

C**onstruction loans** are short-term interim loans for financing the costs of construction. If you choose to build your own home, a construction loan allows the lender to advance funds to the builder periodically as work progresses. Lenders have many different options for construction loans, and so it may be best to ask lenders specifically about these if this is where your interest lies.

Government insured loans are guaranteed or insured, but not funded, by the state or federal government. With these types of loans, lenders still provide the funds, but the government guarantees the <u>lender</u> against loss in case the borrower defaults. There are several different types of government insured loans, which are discussed below.

- **FHA loans** are loans made through a lender approved and insured by the Federal Housing Administration (FHA). These loans are designed to finance moderately priced homes, have a low down payment, and can be a fixed or adjustable rate mortgages. One major advantage to FHA loans is the low down payment they often offer, which can be as little as 3%. Though FHA loans require only a small down payment, this does not mean that they carry high interest rates. Interest rates on FHA loans are comparable to those available through other loan programs. Another advantage FHA loans provide is the ability to prepay or refinance without any penalty charges. A difference between FHA loans and conventional loans is that FHA loans require a one-time mortgage insurance premium (MIP). MIP payment can be made at the closing of the sale, or more commonly, added on to the mortgage loan. This is in contrast to a conventional loan where you may be required to pay monthly mortgage insurance premiums if you make a down payment of less than 20%. MIP insures lenders in case of buyer default. For more information on FHA loans contact either the Federal Housing Administration or the U.S. Department of Housing and Urban Development (HUD). HUD has a website at www.hud.gov that you can browse.

- **VA loans** provide veterans with home financing advantages that do not exist to all citizens. If you have devoted part of your life to serving our country, it is possible that you could qualify for financing from the Department of Veterans Affairs (VA) either at a state or federal level. The requirements for state VA mortgage loans vary greatly from state to state and are not available in some states. In addition, you are not guaranteed a VA loan if you are a veteran. For example, in the state of Wisconsin, you must also be able to verify residency in the state, either at the time you entered the service or as a continuous state residence of five years. Tax records may be the best way to verify residence. Also, to qualify for a state VA loan in Wisconsin, you must have served active duty for two years. State VA loan interest rates are set by the state legislature and are non-negotiable. They also require a 5% minimum down payment. The major advantage of state VA loans is their low interest rates. Federal VA loans differ greatly with state VA loans. For one, the qualification standards may not be as narrow with a federal VA loan. In addition, Federal VA loans can include 100% financing (no down payment) and interest rates can be negotiated through individual lenders.
- **WHEDA home mortgage loans** are available through the Wisconsin Housing and Economic Development Authority, which offers several different loan programs, including financing for first time or low income homebuyers. If you qualify for a WHEDA home mortgage loan you will receive the advantages of a low down payment and a below-market fixed interest rate. There are some restrictions and

limitations on who can qualify for WHEDA loans, so talk to your lender to see if you are a candidate for such a loan.

Time to Apply

Now that you have your house picked out and have thought about what type of financing you would like to pursue, it is time to fill out the actual mortgage application with your lender. If you have been pre-approved, your application process will be shortened considerably. With pre-approval completed, you must simply finalize the purchase details of the mortgage. Providing your lender with your offer to purchase should be sufficient to accomplish this. If you did not opt for pre-approval, the application process may be longer. Refer to the table in this guide for information on how to prepare for the application process. The application's length and time required for a decision on it varies greatly from lender to lender. Consult your lender for a time frame specific to you.

At the time of your application you will have the opportunity to lock in an interest rate with your lender or the option to let your interest rate "float." Locking in an interest rate guarantees that interest rate from that lender for a limited amount of time. Various lock term lengths are available, but lenders typically offer 30, 45 or 60-day locks. While the interest rates for longer locks may be slightly higher, it is important to be sure that the lock you choose will last through the closing date of your purchase. If you do not close by the time your lock ends, you will have to accept the prevailing market interest rate, which may be higher than your locked rate was. It is important to take different lock periods into consideration when comparing APRs earlier in the mortgage shopping process, as a higher rate with a longer lock may be preferable to a lower rate with a shorter lock. Also, when locking in a rate, make sure your lender puts it in writing. If you choose to float your interest rate, you choose to forgo a rate lock until the market interest rate reaches a level desirable to you. By doing so, you risk the chance that interest rates will climb without reprieve.

After submitting your mortgage application it is wise for you to stay in touch with your lender to keep tabs on how the process is going. Within three days of your mortgage application, your lender must provide you with a good faith estimate, as required by the Truth-in-Lending Act. This will provide you with estimated closing costs and a notification of your APR. Also between application and approval, your lender will contact an appraiser to conduct an appraisal of your home's value. Once your loan is officially approved you will need to schedule a date and time for the closing.

Closing

The final stage of home purchase is often referred to as either the closing or settlement. A title company typically handles the closing process, but it is becoming more common for a lawyer to do so. Participants at the closing may include real estate agents, your loan officer and lawyers. It may be in your best interest to have your lawyer attend the closing with you no matter who handles it. At the closing you will sign the mortgage note, mortgage or other evidence of indebtedness promising to repay the loan. Make certain that you understand what you are signing; don't be afraid to ask questions about the legal terminology involved. The seller will execute a deed, which will convey title (ownership) of the property to you. After the documents are in order, you will need to pay the balance of the down payment and your share of the closing costs involved. The papers signed on the closing day will be recorded with the local government such as the register of deeds and the county title office. The security instrument will remain as a lien against the home until your loan has been paid off. At the closing you will receive many important documents that you will want to keep. These papers include the receipts for the payments you made, a copy of the land survey, if performed, and your closing statement or settlement sheets. The closing statement or settlement sheets, commonly referred to as the HUD-1, discloses all charges imposed in the transaction including the down payment, settlement costs and any amounts previously paid.

The Total Cost of Home Buying

Buying your home involves a cost greater than just the purchase price of your home. As we have discussed, the home buying process requires the performance of many various services, which of course cost you money. Recall the activities of your lender, real estate agents and agencies, title and insurance companies as well as credit and appraisal agencies. Listed below are descriptions of various fees that should be anticipated with these services.

Finance Charge

The finance charge, including the interest expense, represents the major cost beyond the purchase price of your home, and is specifically the money that you pay to obtain the funds to purchase your home and the ability to pay that principle back over time. The APR that you receive from your lender, along with other fees charged by your lender, will determine the amount of your finance charge. Federal law requires both of these be disclosed in a truth-in-lending statement presented to you before the closing of your loan. As described before, the major portion of your monthly mortgage payments contributes to paying back the principle (the purchase price of your home) you borrowed and paying your lender the finance charge.

Escrow Account Deposits

Your mortgage servicer may deposit part of your monthly payments into an escrow account, which is an account set up specifically to hold monies used to pay debts as they become due. Setting aside this money each month ensures you will have funds to cover expenses such as hazard insurance, private mortgage insurance and property taxes when they are due.

Insurance Policies

Your lender may require you to hold hazard insurance, otherwise known as homeowners’ insurance, to minimize the financial loss to both you and your lender in the event of property loss or damage due to a fire, storm or other natural disaster. In addition to hazard insurance, some lenders may require specific kinds of natural disaster insurance, such as flood or hurricane insurance. Some lenders or state governments may also require that you maintain title insurance, which protects you against loss caused by defects of title. In other words, if it were discovered that another party has a claim, such as a lien, to your home or property after you have purchased it, you would be protected against loss up to a specified amount. Title insurance is paid in a one-time fee at closing. Even if it is not required, title insurance may be a wise protection for your investment. If you are going to enter into a mortgage to purchase your home, you may want to consider mortgage insurance. There are several different types of mortgage insurance, all serving different purposes. If you are interested in a low down payment on a conventional loan, your lender will require you to carry **private mortgage insurance (PMI)** to protect it from financial loss in the event that you default on your mortgage. **Mortgage disability insurance (MDI)** and **mortgage life insurance (MLI)** provides insurance in the event that you become disabled or die.

Settlement and Closing Costs

The fees that you will be charged at your closing or settlement will be itemized and disclosed in a HUD-1 Uniform Settlement Statement, which is the standard form used for this purpose. All charges accompanying the transaction, including mortgage broker fees, title fees, etc. must be disclosed as separate line items within the statement. Your HUD-1 must also disclose any escrow deposits that you must make at the closing, such as for taxes, hazard insurance or mortgage insurance. It is your right to inspect your HUD-1 statement one day prior to your closing. Once you set up your closing time, be sure you notify the closer at least 24 hours in advance that you wish to examine your HUD-1. Items from the following list may appear on a HUD-1 Settlement Statement.

- Loan discount - an amount payable to the lender which represents pre-paid interest, allowing the lender to offer a lower interest rate on your loan. This enables you to pay a lower monthly mortgage payment. These are also referred to as discount points, where again each point is one percent of the loan amounts.
- Sales/broker’s commission - the fee paid to a real estate broker when he or she fulfills the terms of his or her contract. Usually this entails a seller’s broker selling a home or a buyer’s broker finding a home that is purchased. Most often the seller pays this

fee, but if you hired a buyer's broker you may pay his or her fee. This fee is commonly a percentage of the home's selling price.

- Loan origination fee - covers the lender's administrative and processing costs including the loan officer's compensation. The amount of this fee varies from lender to lender, but is most often expressed as points, which as we have said, are a percentage of the loan. The buyer generally pays this fee.
- Mortgage broker fee - If you use a mortgage broker to obtain your loan, they may charge fees for various services. Consult your mortgage broker to find out what they need to do to receive payment and exactly what fees coincide with certain services. For example, some mortgage brokers may charge a fee for being able to offer a loan at a stated interest rate. In this case, even if you chose not to use the broker or close the loan, the broker has fulfilled his or her obligation, and is due payment if he or she finds a loan and offers it to you with that interest rate.
- Appraisal fees - If your lender had an appraiser assess the value of your home and property, you would be liable for that cost.
- Credit report fee – If a credit report was required to determine how much you would be allowed to borrow, you would be liable for this fee in addition to any amount you may have paid for a personal copy of your credit report.
    - Note that the appraisal fee and credit report fees are both commonly paid at the time of application or included in the application fee. Check with your lender to find out which fees are taken care of at the time of application so you don't end up paying for the same fee twice.
- Lender's inspection fee - In addition to any appraisal or inspection that you had performed on your property, the lender may want to have additional inspections done for their benefit. Inspections are most important in newly constructed homes, because everything must be built according to codes, but you will also want to make sure that older houses are in sturdy condition.
    - A lender my request specific inspections such as pest inspections and lead-based paint inspections be performed for your safety and their protection. You typically pay these fees.

- Assumption fee - a fee paid by a buyer when taking over the duty of paying off a seller's existing mortgage.
- Survey fee - The lender may require that a survey be conducted on the property. This protects the buyer as well as the lender. Usually you will pay this fee but sometimes the seller may pay it.
- Title fees – These cover a variety of services performed by title companies and others. These may include charges such as an abstract of title search, a title examination and a title insurance binder. The following charges may accompany the title of your home/property:
    - Title settlement or closing fee - paid to the settlement or escrow holder, the responsibility for this payment can be negotiated between you and the seller.
    - Document preparation fees - additional fees that lenders or title companies may charge to cover the cost of legal preparation of the mortgage papers, note or deed.
    - Notary fee - A licensed notary public charges a fee to witness the signing of the mortgage and title documents by all parties involved in the transaction.
    - Attorney's fees - may be charged if the lender enlisted legal services during your loan process, for example, to examine a title binder.
    - Government recording and transfer charges - may be imposed when the title is legally transferred from the seller to you. These fees can be paid by you or the seller, but are traditionally paid by the buyer.
- Pre-paid Expenses - Your lender may require you to pay some expenses at the closing before they are actually incurred. For example, at the time of settlement you must pay the interest that will accrue from the settlement date until the date of the first monthly payment. Some lenders will also ask you to pre-pay up to a year of hazard or other kind of insurance at the time of closing.

Your Protection

As a homebuyer, you will be obliged to put your trust in many different individuals and institutions. When doing so, you should understand what rights you have and what exists for your protection. The **Real Estate Settlement Procedures Act**

(RESPA) is a federal law, which regulates the settlement practices within the real estate industry. RESPA is one of the most important laws to familiarize yourself with when buying a home. It is key to know what functions RESPA serves and what it can do for you. RESPA was enacted because Congress felt that consumers needed protection from "…unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country." As outlined by RESPA you have the right:

1. To shop for the best loan for you and compare the charges of different mortgage brokers and lenders
2. To be informed about the total cost of your loan including the interest rate, points and other fees
3. To ask for a Good Faith Estimate of all loan and settlement charges before you agree to the loan and pay any fees
4. To know what fees are non-refundable if you decide to cancel the loan agreement
5. To ask your mortgage broker to explain exactly what he or she will do for you, and when and under what circumstances payment will be required
6. To know what fees the mortgage broker is receiving from you and the lender for his or her participation in your loan process
7. To ask questions about charges and loan terms that you do not understand
8. To receive a credit decision that is not based on your race, color, religion, national origin, sex, marital status, age or income source
9. To know the reason why you were denied credit if your loan was turned down
10. To ask for the HUD settlement costs booklet "Buying Your Home"

RESPA also requires that the entities with which you deal in the home buying process disclose certain important information to you. These disclosures include:

- **Good Faith Estimates of Settlement Costs -** Lenders must provide you with an accurate estimate of the settlement service charges you would most likely face if you closed with them. In most cases lenders have three business days to supply you this estimate if you do not receive it at the time you apply. Remember that good faith estimates are predictions, not contracts, based only on the information the lender has available at the time. Changing market conditions and actual costs may cause an estimate to be inaccurate. However, RESPA requires lenders to make every effort to supply as accurate a prediction as possible. You will want to keep your good faith estimate to compare with your final settlement costs.

- **Servicing Disclosure Statement -** Your lender or mortgage broker must inform you in writing within three business days of your initial application, if another entity may service your loan (collect payments).
- **Affiliated Business Arrangements -** Your lender may be affiliated with other businesses that offer settlement services and may refer you to one of these affiliates. However, with certain exceptions, you are not required to use these affiliates, and you may employ the firm of your choice for settlement services. When recommending an affiliate to you, your lender must provide you with an Affiliated Business Arrangement Disclosure, which reminds you of your freedom to choose settlement companies.
- **HUD-1 Settlement Statement** - Remember your right to inspect the HUD-1 Settlement Statement one day before your closing. This is the time to compare your Good Faith Estimate and any other useful documents with your HUD-1 to see if you dispute any charges.
- **Escrow Account Operation & Disclosures –** If your lender requires you to maintain an escrow account for taxes, insurance, etc., you will need to pay an initial amount, commonly referred to as a reserve, at settlement to begin this account. After this initial payment, escrow payments will be included in your monthly mortgage payments. Your escrow account may contain an extra amount, or “cushion,” to ensure that the lender has enough money to cover payments as they come due. RESPA limits the cushion size to a maximum of two months worth of escrow payments. Also, at the settlement or within the following forty-five days, the party servicing your loan must provide you with an initial escrow account statement. This will illustrate the total payments that will be deposited into the escrow account and all of the disbursements that are expected to be made from the account in the coming year. The escrow account must be reviewed yearly by the lender, who must send you an annual disclosure showing the prior year’s activity and any adjustments for the coming year.

RESPA also protects you from illegal referral fees by establishing prohibited fees, permitted payments and penalties for violators.

- **Prohibited Fees -** It is illegal to pay or receive a fee, kickback or anything of value, due to an agreement to refer settlement service business to a person or organization. Stated simply, a lender cannot get paid for recommending another company to perform settlement services. Another type of fee that RESPA prohibits is an "added-on fee," which means that lenders may not order a service, such as an appraisal, to charge the consumer more than their cost and then keep the added charge.
- **Permitted Payments** - Any title company, mortgage broker, appraiser, attorney or settlement/closing agent who actually performs a service connected to the loan or settlement should be paid for the reasonable value of their work. However, if you are aware of a party involved in your settlement that is claiming a fee without providing a service, you should advise the party of the RESPA referral fee prohibitions.
- **Penalties -** If an entity pays or receives any prohibited fee, it is an illegal act that RESPA deems punishable by fine, imprisonment or both. If you are aware of any prohibited fee charged to you, you may bring a private lawsuit against the offender and be awarded up to three times the amount of the charge.

In addition to RESPA, several other regulations relating to home buying exist for your protection.

- **Truth-in-Lending Act –** This federal law requires lenders to provide a truth-in-lending statement for all consumer loans. This statement must disclose your APR, amount financed and finance charge, as well as other details of your specific mortgage loan.
- **Regulation Z** - Written by the Federal Reserve Board to implement the Truth-in-Lending Act, regulation Z requires lenders to provide the FDIC's "Consumer Handbook on Adjustable Rate Mortgages" to all consumers who apply for an adjustable rate mortgage. In addition, Regulation Z outlines acceptable advertising practices to which firms in the mortgage banking industry must adhere.
- **Equal Credit Opportunity Act (ECOA)** - This federal law requires lenders and other creditors to make credit equally available to all persons without discrimination based on race, color, religion, national origin, age, sex, marital status or receipt of

income from public assistance programs. This act is commonly referred to as Regulation B.

Your Right to Complain

Once you understand your rights as a consumer, you should not be afraid to protect them. If you feel that your personal rights, defined by RESPA or any other law, have been violated, action can be taken to address and hopefully remedy the situation. In most cases it is best to begin by directing your concerns toward their origin. Contact your lender or servicer first if you feel that they may be violating your rights. If talking directly to your loan officer about the matter proves unsuccessful or unsatisfactory, talk to a supervisor at the institution. If you are still not satisfied you can contact the lender's primary regulator. Depending on the institution this regulator may be at a state or federal level. The regulator may be able to help you with your complaint and/or provide insight into your concern. The U.S. Department of Housing and Urban Development (HUD) is another resource you may utilize. Since HUD administers RESPA, this may be a good place to investigate your situation or make a complaint. You can contact HUD by calling their toll-free number, 1-800-669-9777; visiting their website, www.hud.gov; or filing a written complaint with the Fair Housing hub closest to you.

Ready to Buy!

After a little Home Buying 101 you are prepared to begin your journey through the world of lenders, realtors and lawyers to search out and buy your home. We hope that this guide has been informative and helps point you down a smooth home buying path. Remember not to rush or be pressured into any decisions, and don't be afraid to ask for directions along the way. Good luck!