The 2010
Home Buying Guide

by Brandon Cornett,
Publisher of Home Buying Institute

The 2010
Home Buying Guide

Your guide to the home buying process, from the initial self-assessment to the final closing process ... and everything in between.

by Brandon Cornett
www.HomeBuyingInstitute.com

Please Note:
The information contained in this guide is for educational purposes. Always verify this information against your current local laws and conditions. During the home buying process, it is wise to have professional help from a real estate agent. This guide is not meant to take the place of professional one-to-one advice, but only to complement such advice.

Table of Contents

Introduction - About This Book

Hello, and welcome to the 2010 Home Buying Guide. My name is Brandon Cornett, and I'll be your guide through this educational journey into the world of home buying.

As the publisher of HomeBuyingInstitute.com, and several other real estate websites, I get a lot of questions from home buyers. Many of these questions come from first-time buyers who are new to the home buying process. This book addresses most of the repeat questions I've received over the years, as well as plenty of topics that people haven't asked me about.

Believe it or not, there are a lot of home buying and mortgage topics that first-time buyers don't even know to ask about. That's one of the reasons I've created this book. It is my sincere hope that by the time you finish this book, you will understand the home buying and mortgage process from start to finish.

More importantly, I want you to be educated enough to *know what you don't know*. In other words, I want to illuminate the world of home buying and mortgage loans to such a degree that your realize where your knowledge gaps lie -- and how to address them.

For example, this book goes pretty deep into the topic of mortgage loans, but it does not (and could not) cover every aspect of every mortgage product that ever existed. There's just too many other home buying topics to cover in this book, so I address the fundamentals of mortgage loans and then guide you to some related resources on the subject.

So even if this book leaves a particular question unanswered in your mind, you will at least know enough to research that question further (and where to go to conduct your research). You will *know what you don't know*, and that's an important thing in real estate.

I hope you find this book helpful in preparing for your home buying experience.

Brandon Cornett
www.HomeBuyingInstitute.com

Part 1 - Getting Started

Self-assessment, finding an agent, setting a budget and more

The Home Buying Process - In a Nutshell

Lesson Summary

This reference sheet explains how to buy your first home, in step-by-step fashion. The Home Buying Institute recommends that you take all of these steps, in the order they are presented.

In a Nutshell

- Start saving money. You'll need it for the down payment, closing costs, etc. Start today.
- Check your credit score. It takes time to improve a score, so start early if needed. On ***average***, you'll need a score above 650 to get a loan, and above 760 to get the best rates.
- Get copies of your credit report at AnnualCreditReport.com. Check them for errors, and make corrections if necessary. Mistakes on your reports can hurt your credit score.
- Establish a home-buying budget by comparing your monthly debt to net monthly income.
- Determine how much you can afford to spend on a mortgage payment each month. ***Do not exceed*** this amount, even if a mortgage lender approves you for a higher number.
- Get pre-approved for a mortgage loan. This is where the lender reviews your finances and tells you how much they're willing to lend you.
- Hire a real estate agent. This is optional but recommended for first-time buyers.
- Determine what kind of house you want. What area? How many square feet? One story or two? How many bedrooms and bathrooms? Write all of this down for your agent.
- Start the house hunting process. Your agent will help you locate suitable homes, but you should do your own searching as well. Save time by screening homes online first.
- When you find a suitable home, evaluate the seller's asking price. It might be reasonable, or it might be inflated. Look at recent / comparable sales in the area.
- Make your offer including any contingencies (such as a successful home inspection).
- Get a home inspection. It only costs a few hundred dollars, and it eliminates surprises.
- Stay in touch with your agent and escrow company up until the closing date.
- The final step is the closing process. This is where you sign all of the paperwork, pay all remaining fees and commissions, and take possession of the keys. You're now a homeowner!

Where to Learn More

www.HomeBuyingInstitute.com/homebuyingprocess.php

Conducting a Financial Self-Assessment

Starting a home shopping / home buying process means answering a lot of questions. Are you ready to buy a home? How much of a mortgage can you afford? How's your credit? What size house do you need? What area do you prefer to live in? How are your cash reserves?

The more Q&A and research you do in advance, the smoother the process will be later on. So let's look at some key questions you should ask yourself in the self-assessment phase.

What Can You Afford?

Before house hunting, determine how much of a mortgage you can comfortably afford. "Comfortably" means you can pay your mortgage each month and still have money for living expenses, savings, and quality-of-life niceties. In other words, you don't want a mortgage payment that forces you to "squeak by" each month.

Here's the key lesson I want you to take away from this article, and it's something you will hear me say over and over again. You are the only person who can determine how much house you can afford to take on. A real estate agent cannot determine this for you, nor can your mortgage lender.

Your lender can tell you how much of a mortgage loan you are qualified to borrow, but that's it. Their duties end there. They are not your financial advisor, and they are not acting in your best interest. They are acting in their own best interest. So let's talk about the steps you can take to determine how much house you can take on.

Set Your Home-Buying Budget Early On

You should establish your budget early on in the home buying process, long before you start talking to lenders. Failing to do this in advance is one of the biggest mistakes a home buyer can make. The worst thing you can do is go to a mortgage lender and say, "What can I afford to borrow?" A lender might actually approve you for a bigger mortgage loan than you can comfortably afford. It happens all the time. In fact, it's the number-one cause of foreclosure in the United States.

The best way to figure out how much house you can afford is by examining your monthly expenses versus income. Subtract your monthly expenses from your net monthly income (after taxes), and you'll have a general idea of what you could afford to pay toward a mortgage each month.

Your list of monthly expenses should include:

1. Car payment and auto insurance payment
2. Grocery costs and other shopping expenses

3. Credit card payments and other monthly loan payments
4. Any ongoing healthcare costs you have
5. Whatever you put toward savings and retirement each month
6. Entertainment / leisure expenses (dining out, movies, etc.)

By the way, if you are currently renting a house or apartment, you can leave that monthly expense off this list. That expense will disappear as soon as you buy a house. Hooray!

Add up the monthly expenses from the list above, and then subtract them from your net income (i.e., your take-home pay after taxes have been taken out). The number you are left with represents the amount you can afford to put toward a house / mortgage payment. You should not exceed that amount when taking on a home loan. If you do exceed that amount, one of two things will happen:

- You will increase your income in some way, possibly by taking a second job.
- Or, you will begin to fall behind on your mortgage payments and face foreclosure.

This is not the kind of position you want to be in. It's often referred to as being "house poor," and it happens to thousands of new homeowners every year.

Here's how it usually works:

The home buyers have a pretty good idea of how much house they can afford to buy. In the beginning of their home buying process, they have every intention of staying within that budget range. But then they visit a property that's slightly above their budget (or maybe even a lot above it), and they fall in love with the house. "It's everything we dreamed about!" So they buy the place, and the next thing they know their life is one big sacrifice. No more dinners out. No more vacations. No more extra money to put aside into savings each month. In other words, they have become house poor.

It's in your best interest to avoid this kind of thing, and you can do it through proper research and planning. It also helps to be realistic about your budget, through every step of the process. Buying more house than you can afford is a recipe for financial hardship.

Using Mortgage Calculators

Let's say you have followed my advice and determined your home buying budget. You've added up your monthly expenditures and subtracted that amount from your monthly net income. Now you know how much you can afford to put toward a mortgage payment each month, approximately. You can now "reverse engineer" the asking price of a particular house to see if it's affordable for you. Mortgage calculators make this quick and easy.

You can use one of these calculators to break down the price of a home into monthly mortgage payments. You can even factor in the type of down payment you have, as well as the interest rate on the loan. Of course, you won't know the exact interest rate until you start getting quotes / offers from lenders. But you can use the mortgage calculator with average interest rates, and that will give you a general idea of the monthly payment size.

You can find a list of free mortgage calculators on our website, or you can do a Google search for the phrase. Most banking, lending and financial services websites offer these tools as well.

To determine your mortgage comfort-zone, you need three things: a budget, a price and a mortgage calculator. For the price, just start with the cost of a house you think you might be interested in buying. We're just experimenting here. At first, don't worry about whether the price is too high -- you'll find that out soon enough when you run the numbers.

Next, run the home price through a mortgage calculator, using the current average interest rates and a 30-year fixed mortgage. You might choose a different mortgage type later on; but this exercise is just to get a ballpark mortgage payment based on home price, so choose the 30-year fixed option for the sake of simplicity.

Sample Mortgage Calculation

Let's say I've done some research, and I've found that a home in my preferred area with the number of rooms I want comes to about $200,000. I plan to get a loan for 80 percent of this amount and make a down payment for the remaining 20 percent.

I want to find out what my mortgage payment would be on $160,000 (80% of the home price of $200,000). So I find a mortgage calculator on Bankrate.com to run the numbers.

For the "principal" amount, I enter $160,000. For "interest rate," I enter 5.75%, which is the current average rate at the time of this writing. Most mortgage calculators will have this field filled in for you, based on current rates. For "number of years" I put 30.

Remember, we're just trying to get a ballpark monthly mortgage payment. There are many different loan types to choose from, but for demonstrations purposes we've chosen a common type of mortgage (30-year fixed).

I hit the "Calculate" button, and this is what I get:

Your Monthly Payment for 30 Years

for an Interest Rate of 5.75 %

on a Loan Amount of $ 160,000:

$933.72 a Month

I would run these numbers through at least one more calculator, just to validate them. Now I can more accurately figure this price range into my budget — a quick and easy way to see if I'm in my comfort zone, and to find out exactly what my comfort zone is in the first place.

We will talk more about mortgages in a later chapter.

Your Credit - Another Part of the Self-Assessment

Continuing in the self-assessment phase, you need to take a good, hard look at your credit situation. Try to do this a few months before beginning your home search to prevent delays later on. Start by ordering copies of your credit report.

Credit reports are maintained by three credit agencies: Experian, Equifax and TransUnion. These agencies maintain any and all information pertaining to your personal credit — payment habits (including late payments), bankruptcy and other issues.

Your credit score is based on the information in your credit reports, which come from the three aforementioned agencies. Three agencies, three reports, three credit scores ... all about you!

* We will get "knee-deep" into credit scores later in this book. I just wanted to plant the seeds in advance so you can begin thinking about your credit. It's a critical part of your financial self-assessment.

Do You Have Cash Reserves?

Your lender will also want to see that you have funds in the bank. Lenders know that the home-buying process requires cash reserves for the down payment and closing costs. They also prefer to see some stability with your reserves, meaning the money has been in the bank for a couple months or more (as opposed to being loaned to you by a family member the day before you applied for the loan).

Closing costs usually include the appraisal fee, loan fees, attorney's fees, inspection fees, and the cost of a title search. They can easily add up to $5,000 to $7,000 (or up to five percent of the mortgage amount).

It's worth repeating: Start saving as much as possible, and as early as possible.

Once you've conducted a self-assessment and determined you're ready to move forward, a logical next step would be to get pre-approved by a mortgage lender. So let's talk next about the mortgage pre-approval process…

Getting Pre-Approved for a Mortgage Loan

Getting pre-approved for a home mortgage loan is the first step to getting the actual loan. Through this process, a mortgage lender will review your qualifying criteria (credit score, income, debt, etc.) to determine how much they are willing to lend you.

Pre-approval goes a step further than pre-qualification, which is just a basic review of your finances. Through this pre-approval process, a lender will review your finances in greater detail and will pre-approve you for a certain amount. Before we go any further (and before I confuse you with any more lingo), let's define each of these similar-sounding terms:

- ***Pre-qualification*** -- The process of determining how much a borrower (home buyer) can afford to borrow, based on a basic review of their finances. Gives you a general idea of what you can borrow. Pre-qualification is non-binding, which means there is no guarantee you'll actually get approved for this amount.

- ***Pre-approval*** -- Similar to the pre-qualification process described above, but based on a more in-depth review of the borrower's financial history. Gives you a more accurate idea of how much you can borrow. This process takes place before you have selected a home, which distinguishes it from the final approval described below. Pre-qualification is non-binding.

- ***Approval*** -- This is the final approval by the mortgage lender. It takes place after you have chosen a home and made an offer. It usually requires a home appraisal as well.

So there you have them, the three mortgage terms that create the most confusion among first-time home buyers. I hope this clears things up for you.

Which Steps Are Necessary in the Approval Process?

If you wanted to, you could skip the first two steps listed above -- but obviously not the last step. Theoretically, you could start house hunting before you even get a pre-qual or pre-approval letter from a lender. Or, you could skip the pre-qualification process and request a more thorough pre-approval review, right from the start.

What's my advice? I recommend the second path. I recommend that you apply for the pre-approval process before you hire an agent or start looking at houses. Here's why:

Being pre-approved for a home loan helps you in several ways as well. For one thing, it shows the sellers you're capable of buying their home. This can give you a leg up during the offer process, especially when multiple buyers are competing for the house. When you've been pre-approved by a lender, it's the next best thing to having the money in hand. Of course, the pre-approval is not a binding agreement, so you don't know for sure if you'll get final approval for that amount. But it gives you a pretty good idea of what to expect.

Finding a Real Estate Agent

Even with the wealth of information available on the Internet these days, it's a good idea to have an agent. The fees you'll pay an agent are nominal when you consider what all an agent can do for you.

Buying a house is a monumental event that can affect you for years to come -- an agent can help you make sure it's a *positive* event. Among other things, a good agent will act as your home-buying expert, tour guide, negotiator, paperwork administrator, and, most importantly, your trusted advisor.

Additional Benefits of Having an Agent

- They can help you understand the different financing options available to you.
- They can likely refer you to a lender who can help pre-qualify you for a loan.
- They almost always have access to the Multiple Listing System (MLS), an electronic listing of homes for sale by other agents.
- They may know of homes for sale in the area that are not yet being marketed.
- They can help you stay on track throughout the buying process, with the many appointments and events the process brings.
- They will handle the home-buying paperwork … and there's *a lot* of paperwork.
- They can help you negotiate with sellers.
- They can help you determine the realistic value of homes based on recent sales.

How to Find an Agent

Seek referrals from friends who have bought homes in the area. Look on the Internet. Look in the "Homes" or "Real Estate" section of your local newspaper.

You can request info from several agents at once by using this page of our website: www.homebuyinginstitute.com/agent.php

Choosing a Real Estate Agent

Choosing a real estate agent seems like an easy task. But it's important to choose an agent who makes you feel comfortable, listens to your needs, and has the resources at his or her disposal to show you the right homes to fit your needs.

Consider the "Vibe" Factor

You should get a good vibe from the agent you plan to select. When you sit and meet with him or her, you want to make sure they are really listening to you and trying to get an understanding of what your ideal home will be. The more open and honest you are with the real estate agent, and the more receptive they are to hearing your needs, the easier it will be to find and choose the right home.

Ask About Their Search Tactics

Ask prospective real estate agents how they go about searching for a home. You want to find someone who's willing to use all available avenues to help you find your dream home. In other words, you want an agent who will be just as quick to look through the Multiple Listing Service (MLS) as they are to look through their own exclusive listings.

Ask About Networking

Many real estate agents can also refer you to competent mortgage professionals, home inspectors, termite inspectors, appraisers, contractors and other professionals who can help you through the home buying process. Ask about such networks when choosing your Realtor.

Read Paperwork Carefully

When meeting with a real estate agent, you will want to find out who is paying the agent's fees. In many cases, the seller will pay the buyer agent's fees, but you need to find out for sure before signing any paperwork. Make sure you understand all the provisions of any paperwork you sign. Your chosen agent should make you feel comfortable enough to ask questions, and he or she should not rush you through the paperwork process.

Geographical Familiarity

The more familiar the real estate agent is with a specific area, the better equipped they will be to help you find the right home. It's perfectly acceptable to have multiple agents working for you if you are looking in more than one geographic area. You should ask what area or areas an agent is particularly knowledgeable about so you know what their level of expertise is.

Consider the Communication Factor

Communication is crucial in the home buying process. A good agent will keep you informed, without you having to bug them for updates all the time. If there are red flags early on in the process, chances are they will only get worse. So keep that in mind before you commit to any particular agent.

Find an Agent by Reading Real Estate Blogs

Real estate is obviously a service-oriented business. You will work closely with your real estate agent over a period of weeks or months, dealing with matters of great financial importance.

For this reason, it's important to choose a real estate agent who (A) you can trust, (B) you can get along with, and (C) is very familiar with the area in which you'll be buying a home. But how do you find a real estate agent who has all of these important qualities?

Obviously there are many ways to find a real estate agent. But perhaps one of the best ways is to read the real estate blogs of agents in your area. A blog is a frequently updated website arranged in reverse-chronological order (with the most recent posts at the top of the blog).

Many real estate agents publish blogs about the real estate scene in their area. By reading such a blog, you can get to know the agent's personality, specialties and skill level -- without having to call them right away. In this way, real estate blogs can serve a screening function to help you find a real estate agent you're comfortable with.

By following real estate blogs in your area, you'll also be keeping up with the local real estate scene (new listings, new communities, etc.). This is an added bonus of reading real estate blogs.

Finding Real Estate Blogs Near You

To find some real estate blogs in your area, just enter your city or town name into a search engine, followed by the word "blog." For example: "San Diego real estate blog." This will bring up quite a few blogs published by real estate agents in your area.

Check Out the Blogs at ActiveRain.com

You can also find blogs of real estate agents in your area by visiting a website called ActiveRain.com. Active Rain is a network of real estate bloggers -- *a big network* -- and you can search through the various blogs by state, city, etc. This makes it easy to find agent blogs related to your area ... and to potentially find your real estate agent as well.

House Hunting for Beginners - 10 Steps to Success

Choosing a home can be one of the most important, fun, exciting and nerve-wracking steps in the home buying process. Being such a big decision, you'll want to keep certain things in mind when choosing a home. Here are the steps I recommend, as you enter the house-hunting phase. Some of this we have already talked about in the previous sections.

Step 1 - Establish Your Budget Early

Before you start looking at houses, you need to know what you can afford to pay each month toward your mortgage payment. In other words, you need to establish your home buying budget. Many first-time buyers think that the lender will take care of this for them, but that's a dangerous notion. Believe it or not, it's possible to be approved for a home loan that's too big for you. It happens all the time, and it's the primary cause of home foreclosure in this country. You need to set your budget before you even start talking to lenders.

Step 2 - Get Pre-Approved for a Mortgage

This is another thing you should do early on, before you start the house hunting process. It's at the top of our checklist for that very reason. There's no sense in shopping for a home until you know how much you can get from a lender. That's where the pre-approval process comes in.

During this step, the lender will review all aspects of your finances (your income, debt, credit score and more) to determine how much they're willing to lend you. This will help you narrow your house hunting efforts on the types of homes you can afford. It also shows sellers that you are financially capable of buying their home, which increases the chance of your being accepted.

Step 3 - Research Neighborhoods and Home Prices

When you buy a home, you are buying into the neighborhood around it as well. This has an impact on your quality of life and your property values alike. So do some research to find out which neighborhoods appeal to you the most. Your real estate agent can help you with this process, but it's a good idea to start early.

Here's one way to go about it. Start by making a list of neighborhoods in the area where you want to live. You can use the Internet for this process, with the websites listed below. After that, you should drive through each neighborhood and see it for yourself. Find out which school district each neighborhood falls into, and research the schools system as well. Keep notes every step of the way -- you might even want to start a house hunting notebook or journal for this purpose.

* http://www.neighborhoodscout.com/neighborhoods/

* http://realestate.yahoo.com/neighborhoods

Step 4 - Find a Local Real Estate Agent

Can you buy a home without the help of a real estate agent? Technically and legally, yes. But if you want to find the best home in the fastest time, without overpaying for it, you should seek the help of an experienced agent.

Step 5 - Start House Hunting

Now we come to the part of the checklist you're probably most interested in -- the actual house hunting process. And if you have followed the recommended steps up to this point, you'll be well prepared for the process. The key to success here is to use a variety of house hunting techniques at the same time. Your agent will obviously help you with this, but you should help yourself as well.

You can use the Internet to find homes you like in your area, and you can also find them by driving around through your preferred neighborhoods. The weekend edition of your local newspaper probably showcases homes for sale too. Use all of these techniques together.

Step 6 - Focus on the Permanent Features of the House

A lot of first-time buyers focus too heavily on the cosmetic items during the house hunting process. They look at the paint on the walls, the carpet on the floor, and similar features. But these things can all be changed, and sometimes fairly easily. So it doesn't make sense to base your home buying decision on such things. Instead, you should focus on the things you cannot easily change. Pay attention to the neighborhood, the lot, the view, the style of house, the square footage, the number of bedrooms and bathrooms, and other fixed and semi-fixed features.

Step 7 - Ask Plenty of Questions

Home buyers naturally have a lot of questions when house hunting for the first time. That's why it's so important to have a checklist, a wish list, and a seasoned real estate agent on your side. It's also important to ask plenty of questions when looking at potential homes. Your agent should expect this from you, and he or she will gladly answer all of your questions.

Step 8 - Make a Smart Offer

When you make an offer on a home, it should be based on hard data — not wishful thinking on the seller's end. That's why they call it an "asking" price, and many sellers ask for too much. Your agent will help you review recent, comparable sales (or "comps") in the area. This will help you shape your offer, because it's an indicator of what the true market value is.

Home prices go up and down all the time. Real estate bubbles grow and then they break. It's an endless cycle of appreciation and depreciation. In some cities, the cycle is rapid. In other cities, appreciation comes more slowly and homes tend to hold their values better.

What does all this mean to you, as a buyer? It means that a particular home in today's market may be worth more or less than what the homeowners paid some years ago. Many sellers simply look at what they paid for the house originally and then add on some arbitrary amount of appreciation. But this runs contrary to reality. The only way to measure the value of a home in its current market is to look at recent, comparable sales in the area.

Lastly, be sure you make your offer contingent upon a successful home inspection. This gives you a way out of the contract if you find an unacceptable flaw in the house later on. You might also want to make the offer contingent upon your financing. These are common contingencies you should ask your agent about.

Step 9 - Be Prepared to Negotiate

What will you do if the buyer rejects your offer? Will you walk away or make a higher second offer? What if the seller comes back with a counteroffer at a higher price, right from the start? You should have a plan for this kind of thing, because it happens all the time in real estate. Use your comparable sales data we talked about above to guide you in this process.

It's never a good idea to pay more than a house in the worth in the current market, because you can end up in a negative equity situation right from the start. If you have chosen a veteran real estate agent like we recommended, his or her past experience will be invaluable at this point. Let them advise you on the best offer to make.

Step 10 - Get the House Inspected

A home inspection will generally cost between $400 and $500, and for that price you get the comfort of knowing the true condition of the house. That's a small price to pay for peace of mind. Home inspectors are trained to see things that folks like us tend to overlook. They inspect the home's foundation, the roof, the electrical system, plumbing, heating and cooling, and the general condition of the property.

When the inspection has been completed, the inspector will give you a list of discrepancies. He will also review this list with you, explaining how serious each item is. Everything on the list is a negotiable item, so technically you could ask the seller to fix anything on it. But you need to listen to your agent's advice on this. If you are overzealous with your "fix it" list, the sellers might tell you to forget it. Be reasonable with your requests, consider the age of the home, and let your agent guide you through it.

More House Hunting Tips

The home buying process can be an emotional roller coaster, especially if it's your first time. This is especially true for the actual house hunting process when emotions run high. It is, after all, one of the biggest financial moves you'll ever make. So before you begin house hunting, make sure you have a good plan in place.

Here are five tips for success with first-time house hunting:

Tip #1 - Bring a Friend Along

Do you have a friend or family member with strong opinions on everything? You know the one. Well, bring them along during your house hunting trips!

When you think about it, it makes perfect sense. The house hunting process stirs up a lot of different emotions -- excitement, anxiety, joy, fear, frustration, exhilaration. And while these emotions are perfectly normal, they can also cloud your judgment. That's not something you want when making a big financial decision.

You can balance this out by bringing a friend or family member along on your house hunting trips. This gives you an objective ally who can help you identify the pros and cons of each house. Chances are, they'll also be able to spot aspects of a house you might have missed otherwise.

Tip #2 - Take Pictures of Each Home

Do you have a digital camera, or do you know somebody who does? If so, you have the ideal tool to help with the house hunting process. Take pictures of every house you visit, and then categorize them in file folders by house address. This will help you recall the details of each house later on (when the details tend to blur together).

The photos will also give you an opportunity to see each home more objectively, after your initial excitement has faded. Then you can more easily decide which houses you'd like to follow-up on.

Tip #3 - Compare the House to Your Budget

Have you heard the expression "house poor"? House poor is what happens when people spend too much money and take on more of a mortgage loan than they can comfortably afford.

Think of it this way. If you have to work longer hours and scrape by each month just to afford a house ... is it really worth it? Keep your finances in mind, no matter how beautiful a house may be.

Tip #4 - Consider the Commute

So you've found a home you like, and it's well within your price range. The next thing to consider is the location. How far is the home from work? Does it have easy access to the major roadways you need? How long is your daily commute going to be?

It's easy to be so enamored with a home that you forget about the drive time. But if you commute every day, drive time is a quality-of-life issue you can't afford to dismiss. Try driving to or from the house during rush hour. That will give you a good idea of what you'll face every day.

Tip #5 - Avoid Snap Decisions

Buying a home will probably be the biggest financial decision of your life. So it deserves careful consideration each step of the way. Even in a hot market where homes sell quickly, you have to make wise decisions based on research.

Remember, there will always be another house to come along. So even if you miss one due to your cautious approach, another home will be right around the corner. Keep these tips in mind while house hunting and you will have a much better experience.

It's Okay to Snoop When House Hunting

Most people are not comfortable peeking into the nooks and crannies of a stranger's house. Maybe it's a closet you don't feel comfortable entering. Maybe it's the attic or basement, or that shed out in the yard. Examining the dark corners of someone else's house is just plain weird.

But here's the thing. You have to look. That is, if you're serious about buying the home. There's no other way to know what you're buying into. So you have to accept the fact that it's okay to snoop.

Of course, some areas are obviously off limits. For example, you wouldn't snoop through somebody's sock drawer [eek!] or a bookshelf. Those things are moving with the sellers. But any item that transfers with the property is fair game for snooping, including...

- Attic
- Basement
- Cabinets
- Garage
- Closets
- Sheds or outbuildings
- Areas hidden by furniture

Still don't feel comfortable snooping? Consider this:

1. Sellers were once buyers. So they've done some snooping of their own, and they probably expect you to be no different.

2. If you have a real estate agent, he or she will likely do some of the snooping with you.

3. Most sellers will step aside and give you plenty of privacy when you visit. It's part of the unofficial home-selling "protocol."

4. By listing a home for sale, the owners have knowingly turned their private domain into a publicly viewable product.

5. Sellers with nothing to hide won't mind where you look. If you feel rushed, closely escorted, or "blocked" from certain areas ... it's a red flag!

Be Respectful

Keep in mind that snooping does not mean disrespecting the home. Be respectful. Be polite. But at the same time be thorough. I hope this home buying tip has helped you realize ... it's okay to snoop!

How to Research Neighborhoods, And Why You Should

A home is only as good as the neighborhood it's in. If you find a home that meets most of your other home-buying requirements but resides in a neighborhood you hate, you'll never be truly happy.

The Resale Factor

The same thing applies to the resale value of your home. A nice home in a less-than-desirable neighborhood becomes a less-than-desirable home. In other words, the value of your home is greatly determined by the area that surrounds it.

What Makes a Good Neighborhood?

Here are some of the ingredients that make up a good neighborhood. You'll have to evaluate each item based on your own home-buying priorities:

- Safe
- Close to work, school and shopping
- Closet to good healthcare
- Clean and attractive
- Conducive to your lifestyle and interests
- Aesthetically pleasing
- Well maintained

How to Research Neighborhoods

The Internet is a great tool for conducting neighborhood research. It will help you determine which areas are worth visiting and which ones aren't. Here are some online resources to get you started:

- In the Real Estate section of Yahoo.com, you'll find a variety of neighborhood research tools. This makes a great starting point. Just enter the name of a town (or a zip code), and you'll get back a series of topics for further exploration.

- You'll also find some neighborhood research tools at Realtor.com, BestPlaces.net, and monstermoving.monster.com.

- Lastly, conduct some general searches on the Internet. You can find interesting resources by adding keywords like schools, crime rate, taxes, best neighborhoods, etc.

Make a Neighborhood Checklist

You probably have a home-buying checklist already. But what about the neighborhood? Is it on your checklist? If not, you should it add it, or even create a separate checklist just for neighborhoods.

Some items to include on your list:

- What's your first impression?
- Does it "feel" like a place you'd like to live?
- How are the homes and yards maintained?
- How are the common areas and streets maintained?
- Do people seem friendly?
- How close is it to school and/or work?
- Is it quiet or noisy?
- Access to major roadways?
- Access to shopping, dining, etc.?

A house is part of the neighborhood that surrounds it, and vice versa. So keep this home buying tip in mind: Research neighborhoods as thoroughly as you would research the home itself.

Part 2 - The World of Credit

What a home buyer should know about credit scores and reports

Your Credit Score - In a Nutshell

Lesson Summary

A good credit score will help you get approved for a mortgage loan. In this lesson, you'll learn about the connection between credit and mortgages, and also how to maintain a good credit score.

In a Nutshell

- Your credit scores are based on information found within your credit reports. Your credit reports are basically a record of how you have borrowed and repaid money over the years.
- You have three reports and three corresponding scores, because there are three companies that collect this kind of data (Experian, Equifax and TransUnion).
- There are different kinds of credit scores, but as a home buyer you only need to be concerned with one -- your FICO credit score. This is the one used by mortgage lenders.
- FICO scores range from 300 - 850. The higher the number, the better. The average FICO score in the U.S. is around 680.
- When you apply for a home mortgage loan, the lender will review all aspects of your financial history. They'll look at your income, your debts, and your current credit score.
- If your credit score is too low (based on a particular lender's underwriting guidelines), you might not get approved for the loan. If you do get approved with a less-than-ideal score, you'll end up paying a higher interest rate than a borrower with good credit.
- So there are two benefits to having a good credit score. It helps you get approved for a mortgage loan, and it also helps you qualify for a lower interest rate on the loan.
- Unfortunately, you have to purchase your credit score. Federal law entitles you to free credit ***reports*** each year, but this law does not apply to credit ***scores***. You can expect to pay around $15 for each of your scores (through Experian, Equifax and TransUnion).
- If your score is below average, the lender may consider you a "subprime" borrower. They might reject your application because of this, or they might approve you with a high interest rate.
- You can improve your score by paying all of your bills on time, reducing your credit card balances, and correcting any errors you find in your credit reports.
- Nobody can improve your score but you, so be wary of any company that makes promises to "repair" your credit for you. Nearly all of these companies are scams.

Where to Learn More

www.HomeBuyingInstitute.com/credit.php

The World of Credit - An Introduction

Good credit is the key to qualifying for a mortgage loan and buying a home. Bad credit, on the other hand, will make it harder to buy a home or even qualify for a mortgage.

Early on in the home buying process, you should review your credit situation. That way, if you need to improve your credit score, you can start right away. Improving a credit score takes time, so you want to find out where you stand by obtaining your credit reports and scores.

What is a Credit Score?

Your FICO credit score is a numerical "grade" between 300 and 850. The higher the score, the better. This credit score is based on your credit report, which is basically your credit history on paper.

To summarize:

You credit history → [*leads to*] → Your credit report → [*leads to*] → Your credit score

Credit reports are maintained by three credit agencies: Experian, Equifax and TransUnion. These agencies maintain any and all information pertaining to your personal. Your credit score is based on the information in your credit reports, which come from the three companies mentioned above. Those companies sell your credit reports to banks and other creditors, so they can review your past credit history.

Credit Reports Defined

Let's start with a basic definition, just so we're on the same page. A credit report is a document that shows how you have managed your finances in the past. In particular, it shows how you have managed your credit accounts, including all of your credit cards, bank loans, and other financial obligations. In other words, it shows how you have borrowed and repaid money in the past.

If you have used any form of credit in the past, it's safe to assume you have a credit report. In fact, you probably have three different reports, because there are three different companies that maintain credit reports in the United States. We'll talk more about these three companies in the next section.

How to Get Free Credit Reports - With No Strings Attached

You are entitled to receive one free credit report each year, from all three of the reporting companies. Let me say that again, because it's a key principle for this entire lesson. According to the Fair Credit Reporting Act, you're entitled to receive free credit reports once per year, from Experian, TransUnion and Equifax.

Want to hear it in government speak? Here's the relevant passage of the Fair Credit Reporting Act, quoted directly from the Federal Trade Commission website:

"All consumer reporting agencies described in subsections (p) and (w) of section 1681a of this title shall make all disclosures pursuant to section 1681g of this title once during any 12-month period upon request of the consumer and without charge to the consumer."

It says pretty much what I said, but in a more convoluted way. You get one free report per year, from all of the reporting agencies. Pretty straightforward, right? Moving right along.

The law goes even further to help you obtain your free reports. These companies are also required to grant you access to your reports through a jointly owned website, which you can find at AnnualCreditReport.com. This is the only official website for obtaining your free credit reports from all three companies. It is the only website that is monitored and regulated by the Federal Trade Commission. And it's the only website I recommend using to obtain your free credit reports online.

How Your Credit Affects You

When you apply for a home mortgage loan (or some other major purchase), you can be sure your credit will go under the microscope. Mortgage lenders will analyze your credit to find out what risk category you fall into.

When your credit score is high, your risk factor is low. In this scenario, you'll have a good chance of qualifying for a loan. But when the opposite is true -- low credit score and high risk factor -- you could have trouble obtaining a loan.

What Score Do I Need to Get a Mortgage?

It's impossible to answer this question with a single score, because there are many variables at work. Lenders will review other things beyond your credit score when considering you for a loan. So the best I can do is give you some average score requirements based on current lending guidelines and practices.

In 2010, you'll probably need a minimum score of 660 (give or take a few points) to be approved for a home mortgage loan. You would need an even higher score to qualify for the best rates, and we'll take more about that in a moment.

There are many variables involved with the mortgage qualification process, and the minimum credit score needed is just one of those variables. For example, a person with a FICO score of 740 but mountains of debt might get denied for a certain loan. While a person with a score of 710 and very little debt could get approved for that same loan.

Lenders will look at many factors when considering your application -- credit score, income, amount of debt, the affordability of the loan and more. This is why it's so hard to say what minimum score is needed to get a home mortgage loan.

Also, keep in mind that there's a difference between (A) qualifying for a home loan and (B) getting the best rates on that loan. You might be able to get a mortgage with a minimum score of 660 or so, but you won't get the best rates at that level. In 2010, you'll probably need a FICO score over 760 to get the lowest interest rates.

I'd like to reiterate that this is certainly not set in stone. The only way to know if you qualify for a home loan is to apply for one. Only a lender can tell you whether or not you meet their standards, or what their minimum credit score requirements are. Anyone else who talks about this subject (including myself) is merely offering an educated guess -- so don't take it as gospel.

How to Improve Your Credit Score

If you are planning to buy a home soon, you should review your credit score right now. If your score is high, you're in a good position to apply for a mortgage loan. But if it's low, you need to work on fixing your credit score before you start applying for loans. Here's why.

Mortgage underwriting guidelines will be stricter in 2010 than they were in the past. Lenders are simply unwilling to make risky loans these days, following the wake of the subprime crisis that devastated our economy. So you will need to have your financial ducks in a row if you want to be approved for a loan. Among other things, this means fixing a bad credit score (if you happen to have one). Here are some tips to help you do that.

First, let's talk about the primary factors that influence your FICO credit score. After all, you can't improve your score until you know what goes into it. On the following page, you'll find a pie chart that shows these factors.

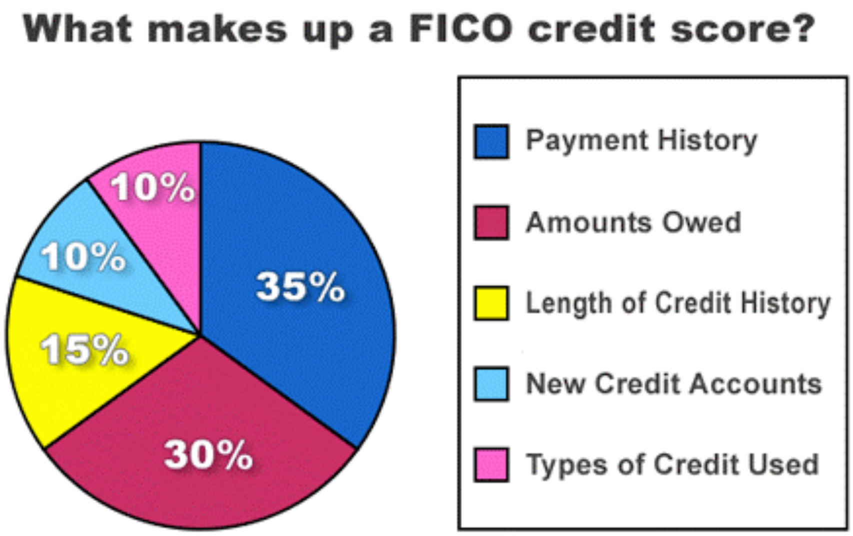

Image Source: Home Buying Institute, www.HomeBuyingInstitute.com

- ***Payment History*** – This shows how you have repaid loans and credit over the years. Going forward, you need to make every effort to pay your bills on time (especially mortgage payments, credit cards, etc.). A pattern of timely payments can help you rebuild your credit faster than any other single factor.

- ***Amounts Owed*** — This is your credit utilization ratio. If John has two credit cards with a combined limit of $10,000, and he's using about $9,000 of that limit, then his utilization ratio is high. John is maxing out his credit, and this will hurt his credit score. So, if you want to improve your score, you need to pay down your credit card balances. Keep the accounts open for now (next topic), but pay down the amount owed.

- ***Length of History*** — How long have you been borrowing and repaying money? When did you open your first credit card account, or take out your first loan? This is your payment history. In a lender's eyes, an ideal applicant is somebody with a long and stable credit history. So the length of your credit usage goes into the scoring mix. This is why you should be cautious when closing your old credit accounts. If you close the oldest ones, you could shorten your overall history and possibly lower your score.

- ***New Credit Accounts*** — I'll keep this one short and sweet. Don't open any new credit lines unless you absolutely need them. If you start opening credit cards, department store cards and the like, it sends a bad signal through the reporting system: "Uh oh, somebody is over-relying on credit!"

- ***Types of Credit*** — I'm not going to waste your time with this one right now. When combined, the first three items listed above count for about 80% of your FICO credit score. So if you're trying to improve your score, focus your energy there.

Surely there's more to it than this, right? Wrong. Credit scoring is not as complicated as some people make it out to be. Granted, the scoring systems themselves are trade secrets built around "fuzzy math." But the steps needed to improve a credit score are pretty straightforward. Pay all of your bills on time. Reduce your credit card balances as much as possible, but keep your oldest accounts open for now.

And steer clear of those shady "credit repair" companies out there. The vast majority of them are scams!

How Long Does it Take to Improve a Credit Score?

How long it takes to improve a credit score will depend, in part, on how actively you are trying to improve your score. It also depends on the cause(s) of the credit problem. Because of these and other variables, it's hard to put an exact time frame on it.

With that said, I will say that you can make significant improvements within a matter of months -- if you are proactive about improving your score.

We've already talked about the primary factors that influence your credit score. So now, let's talk about the things that will have the biggest effect in the least amount of time. How long it takes will still vary from one person to the next. But you can certainly expedite the process by focusing on the following:

1. Your history of bill payments.

By most estimates I've seen, your history of making payments can account for 35% of your score. So if you have a habit of neglecting car payments, credit card payments and the like, you need to correct that behavior immediately.

2. Your credit card balances.

This is another factor that influences your overall score. Having one or two credit card balances is not necessarily an issue. But if you have a lot of cards, or if you're nearly maxed out on one or more credit card, it can lower your score. The solution is to work out a budget that allows you to gradually reduce those balances, starting with the ones that are near their limits.

3. The length of your credit history.

There's nothing you can do to lengthen your credit history. But without realizing it, you could shorten your history. This in turn could lower your score. That's why you have to be careful when closing old accounts. In most cases, it's best to keep your oldest accounts open, even if you reduce the balance considerably. When you close your oldest account -- such as your first credit card from when you turned 18 -- you are in essence shortening your credit history.

Closing unused accounts, or those that have low balances, is a good practice that can help you prevent identity theft. But you have to be careful not to close the oldest one. If you close anything, start with the newest accounts. Or better yet, keep the accounts open but pay the balances down as much as possible. This will show a long history of good debt management, and that's what lenders want to see.

Learn More

I don't want to overwhelm you with credit information at this point. So I've limited this chapter to the most important information that relates to home buying. If you want to learn more about the subject of consumer credit, check out the library on our website.

Credit Learning Center at Home Buying Institute:
www.homebuyinginstitute.com/credit.php

Part 3 - Mortgage Loans

The mortgage process, types of mortgages, applying for a mortgage and more

Types of Mortgage Loans - In a Nutshell

In a Nutshell

- First, you need to understand the differences between the fixed-rate mortgage loan and the adjustable-rate mortgage loan (ARM). This is one of the key decisions you'll have to make.
- A fixed-rate mortgage loan keeps the same interest rate for the entire life of the loan. If you get a 30-year fixed loan at 6.5% interest, it will always carry 6.5% interest (unless you refinance).
- If you plan to stay in the home for more than five years, we recommend that you choose a fixed-rate mortgage. This gives you greater financial security in the long term, compared to an ARM.
- An adjustable-rate mortgage loan (ARM) has an interest rate that adjusts or "resets" over the life of the loan. In most cases the rate will adjust upward, making the monthly payment larger.
- There are many different versions of the ARM loan. Most ARMs today are actually "hybrid" loans. They start out with a fixed rate for a few years, and then they begin adjusting after that.
- The 5/1 ARM is an example of a hybrid loan. It has a fixed rate for the first five years. After that, it will begin to adjust each year for the rest of the term. That's what the 5 and the 1 signify.
- FHA home loans are popular among first-time home buyers. Generally speaking, it's easier to qualify for an FHA loan than a traditional mortgage, and you can put as little as 3.5% down.
- FHA loans are insured by the Federal Housing Administration (FHA). The FHA does not actually make the loan -- they simply insure it against loss, to protect the lender.
- To apply for an FHA home loan, you would need to find an FHA-approved lender. You can do this on the FHA's website: http://www.fhaoutreach.gov/lender/lender.do
- RHS loans work similar to FHA loans, but they are insured by the Rural Housing Service (U.S. Department of Agriculture). You can learn more about it here: http://www.rurdev.usda.gov
- VA home loans are available to military members who have served for a certain length of time. Eligibility requirements can be found here: http://www.fhaoutreach.gov/lender/lender.do

How Mortgage Loans Work

Let's start off with a mortgage definition, just so we're on the same page. Of all the books and articles I've read on this subject, the best definition I've encountered was in *Home Buying for Dummies*, by Eric Tyson and Ray Brown.

In their book, Tyson and Brown state that, "a mortgage is nothing more than a loan that you obtain to close the gap between the cash you have for a down payment and the purchase price of the home..."

You have a certain amount of money. The home costs a certain (larger) amount of money. The home mortgage loan covers the distance between the two. That's a basic definition of mortgage loans. Now let's talk about the parts of a mortgage, and how they interact.

Primary Parts of a Mortgage:

1. Size of the loan (the principal amount)
2. Interest rate on the loan
3. Term (or length) of the loan

1. The Size of the Mortgage Loan

This one is fairly obvious. How much will you borrow? The size of your loan will primarily depend on your budget, your credit, and how much of a down payment you can afford. This is also referred to as the "principal" part of your mortgage loan, which is the main loan amount not including interest.

2. The Interest Rate

The interest rate is what the lender charges for the loan they give you. This is how they make money, by charging interest. The interest rate is a percentage of the principal loan amount. So if you take out a $200,000 loan with a 6% interest rate, you'll be paying $12,000 in interest (spread out over the term of the loan). To find current interest rates, you can start by visiting Bankrate.com or Interest.com.

3. The Term / Length of the Loan

Just like there are many types of mortgage loans, there are also a lot of mortgage terms (or lengths). The 30-year fixed-rate mortgage is one of the most common terms. "Fixed rate" means that the interest rate you get upon loan approval is the interest rate you maintain for the life of the loan. Fixed-rate mortgages also come in the 15-year variety, but you'll generally pay a lower interest rate with the 30-year option.

The term of a mortgage refers to the number of years the mortgage is established for. Mortgage terms are generally 15, 20, 30 and 40 years. The vast majority of mortgages are 30-year mortgages.

New, Longer-Term Mortgages

Forty-year mortgages do exist, and some lenders are even offering 50-year mortgages. These longer-term mortgages will lower your monthly payment, but they will also result in a much higher lifetime payment since you are paying interest over an additional 10 or 20 years. These mortgages are popular with those home buyers who need to keep their initial payments low and expect to refinance down the road.

What Terms are Right for You?

The right mortgage term for you will depend on your unique circumstances. That's why it's important to have a realistic idea of your future plans and discuss them with your mortgage lender. Ask for amortization schedules so you can see the difference in monthly payments and overall payments based on the various mortgage terms available to you. An informed decision is the best decision.

Conclusion

Understanding the primary parts of a mortgage will help you plan financially for the home buying process. But don't stop with this lesson. Build on the knowledge you've gained here by learning about the various types of mortgage. The more you know, the better your home buying experience will be.

And speaking of *types of mortgages*, that's the next section of the book…

The Basic Types of Mortgage Loans

Let's start with the biggest difference between home loans -- fixed-rate vs. adjustable-rate. With a fixed-rate mortgage loan, your interest rate will never change, regardless of what the economy does. On the contrary, adjustable-rate mortgages (ARMs) have interest rates that adjust periodically during the life of the loan.

Terminology note: Adjustable-rate mortgage are also referred to as "variable rate" mortgages. But the more common usage is adjustable-rate mortgage, or ARM.

There are many different types of home loans, but they can all be classified as either fixed-rate or adjustable-rate. There are even "hybrid" loans that have both of these qualities, but one thing at a time. As a first-time home buyer, you need to understand the pros and cons of fixed-rate and adjustable-rate home loans. If you start with a good grasp of this concept, things will be much simpler as we continue through the book.

Fixed-Rate Mortgage Loan: Pros & Cons

As the name suggests, a fixed-rate mortgage is a mortgage where the interest rate stays the same over the life of the loan. As a result, your monthly mortgage payment does not change.

Predictability is the primary benefit of a fixed-rate mortgage loan. You always know what your interest rate will be, regardless of what the economy does. The downside is that you'll pay a premium for this predictability, in the form of a higher interest rate.

Adjustable-Rate Mortgage (ARM) Loan: Pros & Cons

These days, most adjustable-rate mortgages start off with a fixed rate for an initial period of time, usually 3, 5 or 7 years. During this introductory period, the interstate rate is fixed and will not change. After the introduction period, however, the loan converts to an adjustable-rate. This makes it a "hybrid" loan.

Generally speaking, the <u>initial</u> interest rate for an ARM loan will be lower than the rate on a fixed mortgage loan. The downside is that you can never predict what the rate will do when you reach the first adjustment period. In rare cases, the rate will adjust downward. In most cases, in will adjust upward. And in some cases, the rate will increase significantly.

During the adjustable phase of the mortgage, your monthly payments will rise and fall in accordance with the "going rate" at the time. It would be great if they fell, but bad if they rose. The important thing to remember is that you'll have no way to predict the average interest rates in advance, so the adjustable nature of the loan is something of a gamble. We will talk more about ARM loans in a moment. First, I want to cover a few more types of loans.

A Closer Look at the Adjustable Rate Mortgage

Many home buyers choose the adjustable rate mortgage (ARM) in order to save money during the first few years of homeownership. But later, these same homeowners run into trouble when the adjustable rate mortgage adjusts (hence the name) to higher interest rates.

In many cases, such adjustments can greatly increase the size of the overall mortgage payment, which catches a lot of homeowners off guard. So let's take a closer look at the ARM loan. It's critical that you understand the risks associated with these loans.

In other words, an adjustable rate mortgage is a loan with an interest rate that changes at some point in the future. Most of the time, ARM loans start off with a lower monthly payment than a fixed-rate mortgage. But keep the following points in mind:

- Unlike a fixed-rate mortgage, the payments on an adjustable-rate mortgage can change. This can increase the size of your mortgage, sometimes significantly.
- You cannot predict what the interest rates will do three or five years from now, when your ARM loan adjusts.
- If you lose value in your home, and are therefore unable to sell or refinance the property later on, you could be stuck with your risky ARM loan. This happened to millions of Americans between 2007 and 2009.
- If you want to pay off your ARM early to avoid payment increases, many lenders will charge a penalty fee for it.

Key Ingredients of the Adjustable Rate Mortgage

To get an even better understanding of how the ARM loan works, you should understand the key ingredients of such a loan.

Initial Rate - We have already discussed how an adjustable-rate mortgage loan starts off with a relatively low interest rate in the beginning. This is known as the initial rate, and it will stay in place for a limited period of time -- usually 1 to 5 years. But here's the thing to remember. On most adjustable-rate mortgages, the initial interest rate (and by extension the initial payment amount) can vary greatly from the rates and payments you would face later in the loan's term.

When taking out an adjustable rate mortgage loan, always ask about the annual percentage rate (APR) in addition to the initial rate. If the loan's APR is much higher than the initial rate, there's a good chance your rate and payments will also be much higher when the ARM adjusts. This catches a lot of people off guard, and it's a primary drawback of the adjustable rate mortgage loan.

Adjustment Period - This is just what it sounds like, the period during which your adjustable-rate mortgage adjusts to a new interest rate (and payment amount). Usually, the interest rate on an ARM loan will change every quarter, every year, or every 3 to 5 years, with the latter options being the most common.

Loan Descriptions - The law requires that mortgage lenders must give you written information on each type of ARM loan you are interested in. The information they provide must explain the term / conditions for each adjustable rate mortgage, as well as details about the index and margin (which determine the interest rate), how your rate will be determined, how often the rate will change, caps (or limits) on rate changes, plus an example of how high your monthly mortgage payment might go based on adjustments.

If you apply for an adjustable rate mortgage and the lender does not provide you with this information, be sure to request it.

Interest Rate Caps - Interest-rate caps are an important concept in the world of adjustable-rate mortgage loans. A cap is just what it sounds like ... a limit on the amount your interest rate can increase. Interest rate caps come in two versions:

1. Periodic adjustment caps limit how much the interest rate can go up or down from one adjustment to the next (after the first adjustment).

2. Lifetime caps limit the interest-rate increase over the life of the loan. Lifetime caps are required by law, so you'll find them on nearly all adjustable-rate mortgage loans.

Payment Caps - Many ARM loans also cap (or limit) the amount your monthly payment can increase at the time of each adjustment. So if your adjustable-rate mortgage loan had a payment cap of 8%, your monthly payment would not increase more than 8% over your previous payment amount.

Be Careful Choosing an ARM Loan

Here's what you need to take away from this lesson. Adjustable-rate mortgages offer benefits up front (during the initial period) in the form of lower interest rates. But they are full of uncertainty later on, and this can lead to unpleasant financial surprises.

If you understand this concept, and you plan to sell the home a few years down the road, an ARM loan might be a good option for you. But if you're not comfortable with the uncertainty of rate and payment adjustments, or if you plan to stay in the home (and hold the mortgage) for many years, then the ARM loan is probably a bad idea.

The Balloon Loan

When buying a home and evaluating your mortgage loan options, you'll likely encounter the term "balloon loan." This type of loan allows you to make fixed payments for a certain period of time, but then requires you to pay off the remaining balance in one lump-sum payment.

The balloon loan is a short-term, fixed-rate loan that lets you make small payments for an introductory period of time. After the introductory period – usually five, seven or ten years – you must refinance or pay off the remaining balance with one lump-sum ("balloon") payment.

When buying a home and evaluating your mortgage loan options, you'll likely encounter the term "balloon loan." This type of loan allows you to make fixed payments for a certain period of time, but then requires you to pay off the remaining balance in one lump-sum payment.

Key Points of the Balloon Loan

The interest rate on a balloon mortgage loan is almost always lower than the interest rate on a traditional 15- or 30-year mortgage loan. This is the primary benefit offered by this type of loan. The result of the lower interest rate, of course, is a lower overall monthly payment.

Balloon mortgage loans usually have a term of five to seven years. After that, you must pay off the remaining balance in full (either by refinancing or paying out of pocket).

Some balloon loans can be converted to a fixed-rate mortgage loan at the end of the original term. In such cases, the fixed-rate loan will take on current interest rates at the time of conversion.

A balloon loan may be a good idea if you only plan to stay in a house for five to seven years. It can save you money each month, and if you sell the house before the term ends, you'll avoid the lump sum payment. Before deciding whether or not a balloon loan is right for you, you should educate yourself on all of the loan types. It's also a good idea to seek the advice of a qualified, reputable mortgage professional.

Conclusion

If you only plan to stay in a home for a few years, a balloon loan might be a good option for you. In most cases, a balloon loan will offer lower interest rates than a conventional, long-term loan. Educate yourself before choosing a balloon loan, and be sure to have a plan in place for when the loan terms ends. Always seek the advice of a qualified mortgage professional.

Government Loans (FHA, VA, RHS)

FHA Loan – A loan insured by the Federal Housing Administration, open to all qualified homebuyers. There are limits to the size of FHA loans, but they are usually enough to cover most moderately priced homes. FHA loans also offer low down payments (usually 3-5 percent).

VA Loan – A long-term, low or no-down-payment loan guaranteed by the Department of Veterans Affairs. Because this loan is insured by the VA, it has the added benefit of zero down payment. This type of loan is only available to qualified military veterans who have obtained a certificate of eligibility from the Department of Veterans Affairs.

RHS Loan – The Rural Housing Service (RHS) loan offers low interest rates with no down payment. It is available to households with low to moderate income located in rural areas or small towns.

➢ FHA Home Loans

The Federal Housing Administration (FHA) was established in 1934 to improve housing standards and to make home financing available to more American families. Families that would otherwise be excluded from the housing market were finally able to buy the homes of their dreams.

It's important to understand that the FHA does not actually make home loans -- it insures loans made by traditional lenders. If the homeowner later defaults on the loan, the lender gets paid from the FHA's insurance fund.

With an FHA loan, you can usually buy a house with as little as 3.5% down, instead of the higher percentages required by conventional loans. There are limits to the size of FHA loans, but they are usually enough to cover most moderately priced homes.

So the primary benefits of an FHA loan include an easier qualification process, a lower down payment, and a better chance of qualifying for those people with bad credit.

To get an FHA home loan, you'll need to have a good credit history, and sufficient income to qualify for the loan. Other requirements and limitations differ from state to state, so check out the following websites for more information: www.hud.gov/fha

➢ VA Home Loans

Here's how the Veteran's Administration defines their home loan program:

"Through more than 60 years of change, the VA home loan guaranty program has stayed true to its mission: helping veterans become homeowners, and helping them stay in their homes. Since it began in 1944, VA's loan guaranty program has helped some 18 million veterans achieve the American dream of homeownership."

VA loans are similar to FHA loans in that the VA (Veteran's Administration) does not actually make the loan. Rather, they insure the loans given by conventional lenders. Because of this insurance, lenders are willing to give VA loan participants favorable terms, such as no money down.

Who Qualifies for VA Loans?

VA loans are available to active duty military personnel and to most National Guard and Reserves personnel. In order to obtain a VA home loan, you must request a certificate of eligibility. Eligibility may also be extended to the spouses of military veterans.

Helpful Websites

If you're a military veteran (or the spouse of one), and you'd like to learn more about the VA home loan program, I recommend starting with the two websites listed below. One is an official governmental website, and the other offers a lot of helpful information.

- www.fha.gov
- www.military.com/Finance/HomeBuying

➢ RHS Home Loans

Much like the FHA and the VA, the Rural Housing Service (or RHS) also insures home loans for qualified borrowers. RHS Loan offer low interest rates with no down payment. These loans are available to households with low to moderate income located in rural areas or small towns. Because of the rural aspect of RHS loans, they are usually not available for home purchases within major cities.

RHS loans are for low and moderate-income families who want to buy modest, single-family homes within rural areas. The borrowers must plan to live in the homes they buy (as opposed to renting them out). Because the federal government guarantees RHS loans, they do not require private mortgage insurance (PMI) like many other types of loans.

To Learn More

At the time of this writing, the government's website on RHS loans is somewhat confusing. But it's always wise to start with the official source. If you think you qualify for an RHS loan, I recommend visiting the website listed below and finding someone to contact directly with your questions.
www.rurdev.usda.gov/rhs/sfh/indiv_sfh.htm

New Types of Mortgages and Hybrid Loans

This book is a fairly thorough review of the home buying process. But to cover all of the different mortgage types would require an entire book dedicated to that one subject. So far, we have looked at the most popular types of mortgage loans. The vast majority of home buyers will choose one of the mortgage types covered in this book.

But with that being said, there are new types of mortgages being introduced each year. The mortgage industry is a highly competitive one. As a result, mortgage companies are constantly creating new and enticing mortgage products to attract different home buyers with different financial backgrounds.

The topic of "hybrid loans" alone can be dizzying. Hybrid mortgage loans combine characteristics of the primary types of mortgages, and they do so in a variety of ways.

Here's what it all boils down to:

Each mortgage lender is different. Thus, each lender will offer different types of mortgage products. Some specialize in a particular type of mortgage, while others offer just about anything you can imagine. On top of that, each home buyer is different. Buyers with excellent credit will qualify for a wider range of mortgage products than a buyer with bad credit.

This book will serve you well as an educational tool. Many of the topics covered in this book are covered so thoroughly that you will "get it" without the need for further research. But that's simply not the case with the many types of mortgage loans. So I recommend you use this book as a springboard for further research into mortgage loans.

Choosing a Type of Mortgage - 3 Steps to Success

One of the most frequent home buying questions I receive is: "What type of mortgage loan should I choose?" This is not a good question for one person to answer on behalf of another. It's just too big of a decision to be made by anyone other than the actual mortgage applicant. So I've taken the liberty of creating a 3-step process to help you answer this question for yourself.

Step 1 - Determine your mortgage profile.

First, write down your answers to the following questions. (A) How long do I plan to live in the home? (B) How much can I afford to put down up front? (C) How much can I comfortably afford to pay on a monthly basis?

Step 2 - Study the mortgage types.

Next, you'll need to do a bit of homework to understand the different types of mortgage loans. We have covered the most common types of mortgages in this book, but you may want to do some more research on your own. When reading about the different types of mortgages, pay careful attention to any sentence that starts with "This mortgage might be a good idea for you if..." Also pay attention to any pros and cons mentioned for each of the mortgage types, and the ones outlined in this book.

Step 3 - Match your mortgage profile to a mortgage type.

Now that you know (A) more about your mortgage "profile" and (B) more about the types of mortgages, you can take the next logical step. You can match your profile to a particular type of mortgage loan.

For instance, if you know you're only going to be in a home for less than three years, and you want to minimize your monthly payments as much as possible, then an adjustable-rate mortgage (ARM) might be the way to go. If you're going to stay in the home for many years, you're better off with a fixed-rate loan. If you cannot afford a big down payment, you might want to look into FHA home loans.

These are all examples of matching your mortgage profile to a type of mortgage. Once you understand your own profile, you'll be able to weight it against the pros and cons of each mortgage type to choose one that's best for you.

Now let's assume you've chosen a type of mortgage loan, and you're ready to move forward in the process. What's next? The next logical step is to apply for a mortgage loan. Here's how to go about it…

Applying for a Mortgage Loan

Keeping in mind that this process differs slightly from one home buyer to the next, here is the basic process of applying for a mortgage loan:

Comparing Interest Rates

Interest rates will change by the time you are approved for your mortgage, but it's still wise to compare the rates offered by the different lenders you're considering. At some point, you will be offered the chance to "lock in." This is a written agreement that guarantees you a certain interest rate. This means your interest rate won't be affected by fluctuations during the processing period.

Lenders are highly competitive about their interest rates. Interest rates are one of the key marketing techniques used by most mortgage lenders. Because of this, interest rates will vary from one lender to the next, and they will change often to keep up with the national economy as a whole.

With that being said, you can keep track of national interest-rate trends by using such websites as *Interest.com* and *Bankrate.com*.

Just remember, you may or may not qualify for the lender's best rates. When they offer a low rate on their websites and brochures, it will always be followed by a disclaimer. The disclaimer will say something to the effect of: "For well-qualified borrowers only." This means you must meet their definition of "well-qualified" in order to get their best rates. Generally, a well-qualified borrower is somebody with a good credit score and a sufficient down payment (as defined by a particular lender).

Filling Out the Mortgage Application

Once you've selected a lending institution or mortgage broker, you will fill out the mortgage application. Be sure to complete the application completely and honestly. If you inadvertently (or deliberately) put incorrect information on your mortgage application, it could seriously hinder your chances of being approved. So be careful filling out the paperwork and be sure to get all your questions answered by the lender.

Providing Mortgage Documents

During the mortgage application process, you will have to provide a series of documents to the lender. This usually includes pay records, bank statements and tax returns for the last couple of years. Whenever you provide documents to the lender, ask them whether or not they require an original document. If they require an original, make sure you keep a copy for your records.

Mortgage Approval With Conditions

Generally speaking, you will receive a mortgage approval with conditions. It's rare to receive a mortgage commitment without conditions. These conditions may include satisfactory appraisal of the property, termite inspection report, etc.

Make sure you are aware of all requirements and satisfy them by the date(s) requested. Some items are needed before a closing date is set, while other documents can be delivered at the actual closing.

Making Changes to Your Application

If anything substantial changes during your application (like a change in employment, significant financial change, marriage, etc.), inform the lender as soon as possible. At the closing, you will be certifying that no substantial changes have occurred. So it's important to address and resolve changes as they arise (and before closing day).

Mortgage Application Summary

- The application process may vary slightly from one mortgage lender to the next, but the basic steps are the same. This is a highly regulated industry, so they have to follow certain procedures.
- Long before you apply for a home loan, you need to establish a budget for yourself. Believe it or not, you can actually be approved for a loan that's too big for you. It happens all the time.
- When you apply for a home loan (or a pre-approval), you'll have to provide certain documents to the lender. This includes tax returns for the last two years, bank statements, and proof of income. The lender should give you a complete list of required documents.
- You can start the pre-approval process by calling a mortgage lender, or by requesting it through their website. At some point, you'll probably have to visit the lender's local office or branch to sign documents.
- Once you find a home and have your offer accepted by the seller, you would go back to the bank that pre-approved you and ask for a final approval.

This is how to apply for a home loan the right way. You need to start by establishing a budget for yourself, before you start talking to lenders and submitting applications. It's not the lender's job to tell you what you can afford -- they can only tell you what they're willing to lend you. So set a monthly spending limit before you apply for a mortgage.

Mortgage Points Explained

Some home buyers will pay for points during their closing / settlement process, as a way to lower their interest rate over the life of the loan. Because interest is a primary part of the mortgage loan, this will in turn lower the monthly mortgage payments.

Basically, paying points up front is a way to shift a portion of the loan's cost. Instead of paying that portion over the life of the loan, you would pay it in advance. Let's examine this more closely.

Definition: A point, or a discount point, equals one percent of a loan amount. For instance, on a mortgage loan of $200,000, one point would equal $2,000.

Some home buyers pay points to their lender at closing in order to lower their interest rate over the life of a loan. Paying a point on a standard 30-year loan will typically lower the interest rate by .125 percent.

Should I Pay for Points?

To determine if it makes sense to pay points, you'll have to do a little math. Ask the mortgage lender for amortization schedules for the various interest rates that are available to you based on the points you pay – this is critical information.

Next, try to determine realistically how many years you plan to live in the house before you either sell it or refinance it. This may not always be easy to estimate, but it's important to have a general idea of your long-term plan.

For instance, if you only plan to stay in the home for a couple of years, paying for points probably won't help you. On the other hand, if you plan to stay in the home (and keep the mortgage) for a long time, paying points could very well save you money.

To find out whether or not points will benefit you, you need to calculate your "break even" point. In other words, you need to run the numbers to see how many months you'll have to stay in the home to make points a wise investment.

To calculate your "break even" point:

1. Figure out what your monthly payment would be without buying points.

2. Figure out what your monthly payment would be if you did buy a point (or points).

3. Subtract the lower payment from the higher to determine your monthly savings.

4. Divide the amount charged for points at closing by the amount you save each month. The number you end up with equals the number of months you must stay in the home (and keep the mortgage) to reach your "break even" point.

Example calculation:

Let's run the numbers for a $200,000 loan for 30 years at a fixed rate.

1. 7% interest rate with no points = $1,330.60 monthly payment

2. Buying 1 point for $2,000 = $1,313.86 monthly payment

3. Monthly savings after the point: $16.74

4. $2,000 / $16.74 = 119 months

In the above example, the "break even" point is 119 months, or about 10 years. You would have to stay in the house for 10 years to recoup the cost of the point you paid at closing. If you plan to stay in this house for only three or four years, paying for points would be a bad investment.

Remember, the numbers used are purely for illustration purposes. You will need to do the math based on the information you are provided about your loan and the number of months you estimate living in the home before selling or refinancing it. Do the math for yourself, and you might find there's a good point to paying points!

Summary of Points

A point equals one percent of your loan amount. You can pay points to your lender at closing to lower your interest rate. Paying points may be a wise option if you plan on living in the home for more than a few years. You should always run the numbers to determine whether or not points are a good investment for you.

Primary Lenders vs. Mortgage Brokers

Buying a home is an exciting time for most buyers. As exciting as the home search is for most, the mortgage process is sometimes overwhelming.

One of the most confusing decisions for many home buyers, especially first-time home buyers, is whether to use a primary lender or a mortgage broker when obtaining a loan.

Difference Between Primary Lenders and Mortgage Brokers

Before deciding which option is best for you, it is important to understand the difference between primary lenders and mortgage brokers. When meeting with a mortgage professional, you will want to know whether he or she represents the lending institution directly (a primary lender) or represents multiple lending institutions (mortgage broker).

Primary lender representatives are able to place you in any of the programs offered by that particular bank, for which you quality. Mortgage brokers are able to place you in any of the programs offered by all of the lenders they work with, for which you quality.

The question most home buyers have is, "What are the broker's fees, and who pays them?" This is an important consideration, given the fact that the fees are generally expressed in points, with each point representing one percent of the mortgage.

Before making a decision on whether or not to use a mortgage broker, you will first want to find out who pays his or her fees. In many cases the fees are paid directly by the lending institution they place the loan in. Thus, they do not cost the home buyer any money. But in other cases, the home buyer may have to pay the fees directly.

Home buyers with questionable credit, or those with problems proving their full income, may consider using mortgage brokers because they will have more options at their disposal. The last thing you want to do is start applying to many banks on your own, since each bank will run your credit which impacts your credit score.

Choosing a Mortgage Professional

When meeting with a mortgage professional from a primary lender or from a mortgage brokerage, make sure you feel comfortable with them and feel confident in their abilities. You should feel free to ask questions and feel confident you are having your questions answered to your satisfaction.

Know Your Rights Under RESPA

Buying a home can be a complicated and confusing process. It's also probably the biggest investment you'll ever make. These two factors combined add up to this — you need to understand your home-buying rights under RESPA.

What is RESPA?

RESPA is the Real Estate Settlement Procedures Act (RESPA). Here's how the Department of Housing and Urban Development defines it: RESPA was "enacted in 1974 to provide consumers advance disclosures of settlement charges and to prohibit illegal kickbacks and excessive fees in the home buying process."

RESPA sets procedures and requirements relating to the closing or settlement process (when home ownership is transferred from the seller to the buyer). Settlement is a paperwork-intense process where the home buyer officially assumes the mortgage. It's an important part of the process, and as a result it is clearly defined by the government (under the RESPA act). Again, the Department of Housing and Urban Development: "RESPA requires that borrowers receive disclosures at various times. Some disclosures spell out the costs associated with the settlement…"

Your Rights Under RESPA

To understand RESPA is to understand your rights as a home buyer, so it's vital that you do some reading. Start with HUD's website and read up on RESPA, particularly the part that explains your rights under the act. Here's a summary of your rights:

A Summary of Your Rights:

- You have the right to shop around for loans and compare the fees and charges of various mortgage lenders.
- You have the right to be informed about the total cost of your loan (to include all associated fees, interest rates, and other add-ons).
- You have the right to receive a Good Faith Estimate of all loan and settlement charges before settlement day.
- You have the right to ask the mortgage lender to explain every aspect of the mortgage, line by line if necessary.
- You have the right to ask questions about fees and terminology you don't understand.
- You have the right to know why your loan was denied (if such an even occurs).

Learn more: www.HUD.gov | www.RespaReform.com

Private Mortgage Insurance (PMI)

If you're entering the home buying process, the term PMI will probably pop up on your radar. So what is PMI, and what does it have to do with your bottom line?

Private Mortgage Insurance, or PMI, is required on most mortgages with a loan-to-value ratio of 80% or more. In other words, if you put less than 20% down when buying a home, you will probably have to pay PMI.

A third-party insurer provides PMI to protect the mortgage lender. This is a critical point. Many home buyers think PMI is designed to somehow protect them, but this is not the case. PMI protects the lender in case you default on your loan. The only way PMI benefits a buyer is by helping them qualify for a loan in the first place. Beyond that, PMI does nothing for the home buyer is merely one more thing to pay each month (normally half a percent of the loan amount).

This is not to say that PMI is all bad. It helps people with bad credit (or those who can't afford a 20% down payment) obtain a loan they wouldn't otherwise be able to obtain. So for some, PMI is the only path to home ownership. But for others, PMI is more avoidable.

Even if you can't afford a 20% down payment, there are ways to avoid paying PMI:

PMI Sidestep #1

You can get an 80-10-10 loan. In this option, you would pay 10% down and then obtain two loans for the remaining 90%. And because no single loan accounts for more than 80% of the home's value, you would avoid having to pay PMI. Interest on the second loan (the loan for 10%) will be higher, but the two loan payments combined will still probably be lower than a single loan with PMI on top.

PMI Sidestep #2

Another way to avoid PMI (while putting less than 20% down) is to pay a higher interest rate.

Here's the key to the two approaches above. Mortgage interest is tax deductible -- PMI is not. In the options above, you could conceivably pay less each month and have more to write off at tax time. With the PMI option, you might end up paying more each month with less of a write-off.

Bottom line: PMI can help some people qualify for a loan who might not qualify otherwise. But in most cases, PMI is best avoided if at all possible -- or discontinued as soon as you reach the 20% equity mark (80% loan-to-value or lower).

How to Avoid Common Mortgage Problems

If you plan to buy a home in the near future, you will likely be applying for a mortgage as well. After all, home buying and mortgage loans go hand in hand (unless you've just won the lottery).

The key to a smooth mortgage application process is to understand the most common mortgage problems, and then work hard to avoid them. So what are these common problems when applying for a mortgage, and what can you do to steer clear of them?

Problem #1 - Too Much Debt

When you apply for a mortgage loan, the lender will check your debt-to-income ratio. Basically, they will want to see how much money you make (next item) compared to how much you owe. The rule of thumb is 20%. Mortgage lenders prefer that your overall debt be no greater than 20% of your net income. If your debt is too high as compared to your income, it sends a signal that you cannot mange your finances. This can hurt your chances of qualifying for a loan at a good interest rate.

Possible Solutions

The solution here is simple. Reduce your debt. I know it's not always that simple, but if you want to qualify for a good mortgage loan, you'll need to have your debt under control. So the ideal scenario is to pay off as much of your debt as possible. If you are unable to do so, you could always shop for a more affordable home that would require a smaller loan.

Problem #2 - Not Enough Income

If you apply for a loan that a lender thinks you can't afford, your chances of being approved for the loan are slim. This may actually be a good thing, as it will prevent you from amassing more debt than you can cover with your income, which can lead to bigger problems like foreclose.

Possible Solutions

An obvious solution, of course, is to increase your income. But this is easier said than done. Another option would be to put more money down up front. If you make a down payment higher than the 20% average (say, 25% or 30%), you could qualify for a mortgage loan that doesn't require income verification. Just realize you'll probably pay a higher interest rate with this type of loan. A final option would be to get a co-signer, such as a parent or other relative ... somebody with good credit standing and favorable debt-to-income ratio.

Problem #3 - Low Credit Score

FICO credit scores range from 300 to 850, with 850 being the best. The higher your credit score, the easier it will be to qualify for a mortgage loan. You can also get a better interest rate when your credit is strong. But when your credit is low, you could have problems qualifying for a loan, and you'll likely pay a much higher interest rate. This means a bigger mortgage payment each month. Every lender looks at credit a little differently. The national average (U.S.) is around 723. Anything above 650 is usually considered good, and anything above 700 is considered excellent. Below 600, and you will start to have problems, in the form of higher interest rates.

Possible Solutions

The first thing to do is make sure you don't have errors on your credit report that are dragging your score lower than it should be. Visit AnnualCreditReport.com to request a copy of your credit report from all three credit-reporting agencies. Check your report to make sure there aren't any errors. If the reports are accurate, and you simply have a low credit score, you'll have to work on improving your credit. Pay your bills on time, and try to pay off as much of your credit card debt as possible. In time, this kind of financial responsibility will help you increase your credit score.

Online Mortgage Loans & Lenders

Many home buyers are curious about the concept of online mortgage loans. After all, the word "online" usually suggests convenience and affordability. But how exactly does the process work, and what should you know about online mortgage lenders before contacting them? These are the questions we will answer below.

Obtaining a Mortgage Loan Online

Before we talk about online mortgage lenders and how to choose one, let's briefly look at the process of obtaining a mortgage loan online. This process varies based on the type of lender you select.

For example, some online mortgage lenders are just regular lenders who happen to have a website where you can apply for a loan. Other websites are actually "aggregators" that give you online access to multiple lenders. Lending Tree and Ditech are two good examples.

When applying for a mortgage loan online, you will submit information through a secure website that will allow the company to obtain your credit score. The online lender will then review your credit, income and other factors to determine whether or not they can lend you money.

If your financial profile meets their minimum level of acceptance, the lender will present you with an interest rate, mortgage terms, and other details. Then it's up to you to review their offer and see if you want to accept the loan or continue shopping elsewhere.

Key Traits of an Online Mortgage Lender

When shopping for an online lender, you should limit your search to only those companies that appear trustworthy. Trust is sometimes a hard quality to judge in advance, so it's best to stick with companies you have heard of, companies with a long track record, and companies with good reputations.

If you have never heard of an online mortgage lender, or if you cannot find any information about them online, it's probably best to steer clear. Mortgage loans are too important a decision to invite unknown variables into the mix!

There are some online mortgage lenders who use the Internet as a tool for unethical practices. Protected by the anonymity of the Web, these companies prey on consumers with misleading rates, hidden costs, etc. Thankfully, these so-called "predatory" lenders are a minority, but they are still something to watch out for.

Home Buying Grants

Home buying grants are a popular subject among home buyers. And why wouldn't they be? The very word "grant" suggests free money, and any home buyer could use free money.

But there's more to home buying grants than simply applying for the grant and getting the money. Home buying grants run the gamut from government-sponsored grants to private grants. The question is, where do you begin? How do know if you're qualified for a home buying grant? And if you are qualified, how do you apply for a home buying grant?

Grants for Home Buying in Your State

Here's a trick you can use to find home buying grant information in your city and/or state. Using a major search engine like Google or Yahoo, enter the phrase "home buying grants" followed by the plus sign, followed by your city name (or state name). For example, if I wanted information on home buying grants in Texas, I would enter the following into Google:

home buying grants +texas

You can also learn more about home buying grants by visiting the website the Department of Housing and Urban Development (HUD):
http://www.hud.gov/offices/adm/grants/grantsrsrc.cfm

Subprime Mortgage Loans

I've saved this subject until the end of the mortgage section for a reason. I'm hoping you can avoid the world of subprime loans altogether.

Subprime mortgage lending is a relatively new but fast-growing component of the mortgage industry. Lately, however, subprime lenders have come under fire for their tactics -- specifically, for how their tactics relate to the increasing number of home foreclosures in the United States.

But what exactly is a subprime mortgage loan? How are they related to the current rise in foreclosures? And how can you protect yourself if you find yourself in need of a subprime mortgage loan?

These are some of the questions we will answer in this article, a guide to subprime lending and loans.

What is a Subprime Mortgage Loan?

In this context, a subprime loan is a mortgage loan made to a borrower who would not normally qualify for a loan, perhaps due to bad credit issues or other financial problems. Subprime lenders will charge these borrowers a higher interest rate for potential losses the lender might incur (should the borrower default on the mortgage loan).

A History of Subprime Lenders

The number of subprime mortgages rose dramatically through the mid 1990's through early 2000's, as increased competition (largely from online mortgage lenders) forced lenders to offer a broader range of mortgage products.

Subprime lenders, as they became known, tried to outmaneuver competitors by offering mortgage loans to borrowers that their competitors were turning away. In other words, they offered subprime mortgage loans to subprime borrowers, usually with a much higher interest rate.

At an annual housing policy meeting in 2004, Governor Edward Gramlich (then a member of the Board of Governors of the Federal Reserve system) had the following remarks about subprime mortgage lending.

On the advantages of subprime lending:
"The obvious advantage of the expansion of subprime mortgage credit is the rise in credit opportunities and homeownership. Because of innovations in the prime and subprime mortgage market, nearly 9 million new homeowners are now able to live in their own homes, improve their neighborhoods, and use their homes to build wealth."

On the challenges of subprime lending:
"While the basic developments in the subprime mortgage market seem positive, the relatively high delinquency rates in the subprime market do raise issues. ... For mortgage lenders the real challenge is to figure out how far to go. ... If lenders do make new loans, can conditions be designed to prevent new delinquencies and foreclosures?"

So there are two sides to the issue of subprime lending. Yes, they extend home ownership to many Americans who might not otherwise afford it. But they are also a contributing factor in the number of home foreclosures in the United States.

Current Criticism of Subprime Mortgages

As the number of foreclosures continued to rise through 2000 to 2007, data analysis suggested a strong link between rising foreclosures and the subprime lending market. Predictably, the federal government got involved and began to scrutinize subprime mortgage lenders.

As a result of increased pressure, banking regulators have tightened their standards for mortgage lending. According to Randall Kroszner, current Federal Reserve Board Governor: "This guidance ... underscores that the Federal Reserve and other banking regulators expect lenders to make sure subprime borrowers not only can afford their monthly payments while the introductory rate is in effect but also after the interest rate resets."

When he refers to "interest rate resets," he is talking about adjustable rate mortgages. With an adjustable rate mortgage, the interest rate adjusts (or resets) after an introductory period of lower interest. The adjustable rate mortgage, or ARM, is another piece of the puzzle connecting subprime lending and foreclosures.

The Subprime-ARM-Foreclosure Connection

As mentioned above, adjustable rate mortgages (or ARM loans) have a role in the subprime foreclosure fiasco of late. The best way to illustrate how ARM loans relate to subprime mortgage foreclosures is to look at an example scenario. The borrowers in this scenario are fictitious, but the scenario itself is realistic and happens every day in this country.

Bob and Jane Smith are shopping for a home mortgage loan, but they are having trouble finding a willing lender because of some credit problems in their past. Eventually, they find a mortgage lender who is willing to loan them money under subprime conditions. Essentially, they extend a loan to the Smiths, but they charge a high interest rate in response to the couple's bad credit history.

At first, the Smiths are concerned with the high interest rate. But the mortgage will be an adjustable rate mortgage with a lower interest rate in the first three years. So the Smiths reason that they can refinance the mortgage before the ARM loan adjusts (or "resets"), thus avoiding the payment shock that can come from higher interest rates.

Two and a half years fly by, and before they know it, the Smiths are facing the uncertainty of their ARM loan adjusting to new interest rates. A higher interest rate (which is likely) could significantly increase the size of their monthly mortgage payment. So the Smiths try to refinance the mortgage.

The trouble is that the couple has not improved their credit situation since they took out the subprime mortgage loan, so they are unable to find a favorable refinance loan -- one that won't make their situation worse by lumping closing costs on top of everything else.

So the adjustable rate mortgage resets to a higher interest rate, the Smiths have trouble making the new mortgage payments, and they end up becoming another foreclosure statistic.

This kind of scenario happens every day in the United States. Just watch your local news for a week straight, and you're almost guaranteed to see a story about mortgage refinancing, home foreclosures, subprime lending, or all three topics combined.

2010 Update - Subprime Mortgages are Virtually Extinct

The subprime lending industry collapsed in 2008 to 2009. As a result, you won't find many of these loans available in the 2010 economy. In the grand scheme of things, this is a good thing. But for borrowers who fall into the "subprime" category, it means that hard work lies ahead. You'll need a good credit score and some kind of down payment to get a loan these days. That's just the way it is.

Mortgage Conclusion - The Truth About Mortgage Loans

The financial industry as a whole can be a little deceptive at times, and the same goes for mortgage lenders. I'm not saying they're all bad. In fact, some "small-time" lenders actually care about the people behind the paperwork. But there are enough bad apples in the bunch to warrant an article like this one. Let's face it. We live in a time when the phrase predatory lending is practically a household term.

That's where this website comes into the picture. We work hard to provide honest and objective information to home buyers and consumers. This lesson will be no different. In this lesson, you'll learn the truth about the mortgage lending industry. You'll also learn how to protect yourself during the mortgage process, how to choose the right type of loan, and how to attain long-term financial stability.

So without further ado, here's the hard truth about mortgage loans.

1. Your mortgage lender is not your financial advisor.

The first thing you need to realize, before venturing into the mortgage process, is that your lender is not your financial advisor. What do I mean by this? I mean that mortgage lenders are not concerned with your long-term financial wellbeing, not the way a financial advisor would be. Nor should you look to the lender for advice -- you'll learn why as we go along.

Here's what it boils down to. Mortgage lenders make money by charging interest on the money they lend you. The more interest they charge, the more money they make. They sit on one side of the seesaw, and you sit on the other. That is the full extent of your relationship with your lender. They are looking out for their own interests at all times. They are not looking out for you. Which brings us to our next bit of mortgage truth ...

2. You are your only advocate in the mortgage process.

There is only one person looking out for you during the mortgage process, and that's you. The mortgage lender will do whatever it takes to protect their own interests during the relationship, but they're not too concerned about what's best for you. Remember, it's just business. They are basically selling you money, at interest. That's it. So you need to be your own advocate during the process.

For starters, you need to research the different types of mortgage loans to understand how they work. You need to buy within your means. You need to examine every document they put in front of you, and ask questions when you don't understand something.

I know what you're thinking at this point. Like many first-time buyers, you might think the mortgage lender has an interest in looking out for you. After all, if you suffer some kind of financial calamity, they won't get their money back. Right? Well, not exactly. These days, most of the big mortgage companies sell their loans into the secondary mortgage market (see below). As a result, they're not too concerned about what happens to you five years from now.

Mortgage truth takeaway: You are your only advocate during this process. Aside from your friends or family, nobody else will be looking out for you. So it doesn't really matter what people say to you. It only matters what is written on the paperwork.

3. Secondary mortgage market = double-edged sword.

Without going too far into Economics 101, let's talk briefly about the secondary mortgage market. Here's a basic definition for you. The secondary mortgage market is where existing home loans are bought and sold. Much of it takes place on Wall Street. Mortgage lenders make loans to consumers (like you), and then they package them into "mortgage-backed securities" and sell them off. Freddie Mac is a major player in this market. Freddie buys (and later sells) many of these bundled securities. Not all lenders engage in this practice, but most of the big ones do.

Fair enough. But what does this mean to you, as a home buyer? You can think of the secondary mortgage market as a double-edged sword. On the one side, it encourages lending and makes home loans available to more people. On the other side, it removes the "burden" of responsible lending from the mortgage industry.

Think about it this way. If the lender were to keep your loan on their books for the entire life of the loan, they would be more concerned with putting you into an affordable loan. But they can sell the loan and get it off their books for good, which means they no longer care about you staying afloat. It no longer affects them.

And that brings us to the next bit of truth about mortgage loans...

4. You can be approved for a mortgage that's too big.

"Why would a lender give me a mortgage that I might not be able to afford down the road? Don't they stand to lose money if I default on the loan?" Sometimes they do. Other times they don't. We just learned the reasons for this, in our discussion of the secondary mortgage market. Chances are, the lender won't even have the loan on their books if and when you default on the loan. For this very reason, it's possible to get approved for a mortgage loan that's too big for you.

Going forward, you need to remember these steps.

1. Review your monthly debt versus your monthly income.
2. Determine a realistic home-buying budget, based on step #1 above.
3. Apply for a mortgage loan.
4. If the monthly payments would exceed your pre-determined budget, don't get the loan.

You need to do all of these steps, and you need to do them in this particular order. I cannot stress this enough. Some borrowers skip the first two steps altogether. They say, "Well, the mortgage lender will tell me how much I can afford." But this is dead wrong. Why? Because -- say it with me this time -- it's possible to get approved for a mortgage you cannot afford. It happens all the time.

5. Good faith estimates are not always faithful.

When you apply for a mortgage loan, the lender is required by law to give you a good faith estimate. This is a list of fees and other costs associated with your loan, collectively referred to as closing costs. The lender must provide this estimate within three business days of your application. That way, you'll know if you can afford the loan. All of this is required by the Real Estate Settlement Procedures Act, or RESPA.

But "estimate" is the key word here. In some cases, mortgage lenders will downplay the closing costs of the loan. And then later, when the home buyers receive a finalized statement of the costs due at closing, they are surprised to see that it's a higher amount than previously stated. Why would they do this? To get more business, of course. They do this to seal the deal and put you into a mortgage.

Is it unethical? Yes. Does it violate the rules set forth under RESPA? Certainly. But it still happens quite a bit. How often does it happen? It happens often enough to warrant changes to lending laws. In fact, in January of 2010, the federal government will begin enforcing some new requirements for good faith estimates. Starting in 2010, mortgage lenders are required to use a new form that is supposed to give a more accurate estimate of closing costs.

This will help borrowers understand the full cost of the loan and comparison-shop more effectively. I think this is some much needed reform, but I don't expect it to fix the problem completely. So even after these new rules take effect, your actual closing costs could still be higher than the amount disclosed at application time.

What can you do about this? Two things. First, you can expect your closing costs to be higher than the amount quoted in the good faith estimate. If it's the same amount, great! If it's a higher amount, you'll be prepared for it. Secondly, you can start putting extra money aside for your closing costs -- the more, the better. You're going to need some extra cash for moving expenses anyway, so you should start saving early.

6. In certain scenarios, ARM loans can be dangerous.

Over the last few years, adjustable-rate mortgage loans (ARMs) have gotten a lot of homeowners into trouble. It's not that these loans are inherently evil or anything. It's just that many people don't understand how they work -- or else they're in denial about how they work. These days, most ARM loans are actually hybrid loans. They start with a fixed interest rate, and then at some point (usually three to five years later), the interest rate begins to adjust periodically. The rate will often adjust upward, and sometimes significantly.

We saw a lot of this between 2007 and 2009. Lenders were giving out ARM loans like crazy in the early to mid 2000s, and a lot of them started resetting at the same time. Millions of homeowners suddenly saw their monthly payments increase in size, often doubling. You know the rest of this story. It fueled a housing and foreclosure crisis, which eventually led to a full-scale economic recession.

So what did all of these homeowners do wrong? Two things. They took on more of a mortgage loan than they could realistically afford, and they held onto the loan past the adjustment point. You see, an ARM loan is basically a way to push some of the interest back a few years, to make the loan more affordable in the early years. Mortgage lenders often use this (and other) strategies to lure in borrowers. The borrowers fail to read the fine print, and in some cases they are simply lied to. In the end, the borrower is taking on a loan that's going to bite them in butt one day down the road.

Another key point. If you cannot afford to buy a house, you just cannot afford it. Nothing the lender does will change this fact. The idea of "home ownership for everyone" is part of the problem. Lenders are always finding new and creative ways to put people into loans they simply cannot afford. That's what the subprime lending industry was -- a way to give mortgage loans to people who were unable to carry a mortgage.

Like I said earlier, the ARM loan is not to blame. It's the manner in which they are used that leads to such problems. If you plan to stay in the home for many years, do yourself a favor and get a fixed-rate mortgage loan. Avoid the ARM altogether. That's my advice.

7. Knowledge is your best asset.

This lesson has given you much of the information you need to be a smart mortgage shopper. But it hasn't given you everything, so you'll need to continue your research on this website and beyond. Here is some recommended reading to get you started:

Mortgage Advice for First-Time Home Buyers
www.homebuyinginstitute.com/mortgage-types-29.php

The Major Types of Home Loans
www.homebuyinginstitute.com/mortgagetypes.php

Get Help from a HUD Housing Counselor
www.hud.gov/offices/hsg/sfh/hcc/hcc_home.cfm

Mortgage Tips from the FTC
www.ftc.gov/bcp/menus/consumer/credit/mortgage.shtm

Part 4 - Making the Offer

Making a smart offer on the home of your dreams

How to Make an Offer on a Home

The offer is a critical part of the home buying process. It's when you, as the buyer, say to the seller: "Here's what I'm willing to pay for this house." Here's how to do it wisely.

1. Base the offer on hard evidence.

Before making an offer, you should have a good idea of the home's estimated value. This will come from understanding your market and knowing what comparable homes are selling for in your area. Making a realistic offer increases your chances of acceptance, while preventing you from overpaying.

2. Make the offer contingent.

It's a safe practice to make your offer contingent on two things -- loan approval and home inspection. Even if you've been pre-approved by a lender, there's a chance you could get turned down for the actual loan (especially if the price you agree to pay is higher than the pre-approval amount). The home inspection is also critical, because you won't know the true "health" of the house based on a casual walk-through. Only a qualified home inspector can dig up the facts. Your offer should be contingent on both of these things.

3. Set a time limit.

The last thing you want to do is sit around wondering when you'll hear back from the sellers (if at all). For this reason, it's common practice to put a time limit on a home buying offer. It shows the seller you're serious and prevents the process from dragging on. Some buyers limit their offer to 24 hours, some for 48 hours, and others even longer. It will depend on your comfort level and unique circumstances.

4. Hope for acceptance, but plan for everything.

Of course you want the seller to accept your offer. But there's always a chance they won't, so you need to have a plan in place so you can react quickly. Discuss this with your agent before making the offer. Have a plan for three different scenarios -- an acceptance, a rejection, and a counteroffer.

5. Know your limits

If you've been pre-approved for a certain loan amount by a mortgage lender, then you have a pretty good idea of your limitations. Be careful making offers that exceed your pre-approval amount (unless you can make up the difference in cash).

Let's talk a little more about item #1 on this list. Here's how to validate the asking price.

How to Validate the Seller's Asking Price

The phrase "asking price" is very telling. Sellers will ask for a certain amount. They may get that amount, they may get more, or they may get less. It all depends on the market. So the first thing to understand is that price and terms are always negotiable. If an asking price weren't negotiable, it would be called a fixed price.

What Makes Up the Asking Price?

A seller (and a seller's agent) will look at market conditions, comparable sales in the area, home improvements and other factors. Based on that information, they'll ask for a certain amount. With that being said, there are some people who take a less analytical approach when setting the price. These people want a profit, and they're willing to ignore reality in hopes of getting it. These types of sellers price their homes well above market conditions and comparable sales, in the hope of earning a big payday.

Some sellers will base the asking price on the amount they owe on the mortgage. But these two things have nothing to do with each other. It really doesn't matter how much the seller paid for the house -- it only matters how much the house is worth <u>in the current market</u>.

The lesson here is that some sellers set realistic prices, while others don't. So don't ever think: "Well, gosh, that's the price they've set ... so it must be realistic." Always do your homework. Remember, if the home is priced high by the seller and gets appraised low by the lender, you could have trouble getting approved for the loan.

How to Research Comparable Prices

***1. Use the Internet* -** Over the past couple of years, a number of home-valuation websites have sprung up. These sites will give you the *estimated* value of a particular home, based on local sales data and other factors. Keep in mind, however, that the "freshness" of their data varies greatly. Check a home's value on three different sites, and you'll probably get three different price ranges. The key is to shoot for the averages.

Some websites to get you started:

- www.homegain.com
- www.housevalues.com
- www.zillow.com

2. Know Your Market - Are you in a buyer's market, a seller's market, or somewhere in between? You should be able to answer this question without hesitation. If you don't know what kind of market you're in, you won't know your true bargaining power. For example, in a seller's market, you'll probably be less successful trying to negotiate price. But in a buyer's market, you'll have more leverage. Keep up with real estate news and trends in your area. Know your market!

3. Follow Your Agent's Advice - Real estate agents are tapped into the local real estate scene. A good agent will help you identify and evaluate comparable sales in the area. This kind of analysis will help you set a realistic offer based on actual data.

Conclusion

Don't accept the asking price at face value. Verify and validate it. Do some homework to see if it's realistic or out of left field. Keep up with the real estate market in your area. Choose a knowledgeable agent who can help you make sense of all the data. This home buying tip will help you become a smart shopper and a well-informed negotiator.

Part 5 - Between Offer and Closing

A summary of events after your offer and before the final closing

The Various Home Inspections You May Encounter

Home inspections confuse a lot of first time home buyers, because there are a number of different inspections that take place during the home buying process. But it's important to understand the most common inspections, so we've summarized them for you below.

Primary Home Inspection

The home inspection is the most important step. It generally takes place within a few days of the offer being accepted. Keep in mind that when you buy a home, you are generally buying it in "as-is" condition (unless specific provisions are added to the contract saying otherwise). For this reason, you want to make sure you know what is, and *is not*, working properly in the home. You also want to know what repairs you might have to make, or what repairs you might ask the seller to make. For all of these reasons, the primary home inspection is essential.

Rest assured, we will talk more about the home inspection. But before we do, I want to mention some other inspections you might want to consider.

Termite Inspections

About the same time as the primary home inspection, you will likely have a termite inspection. As the name implies, this inspection checks for the presence of termites or other wood-destroying insects within the home. This inspection is done on behalf of the buyer and the mortgage company. In most cases, you will have to provide a copy of the inspection for your mortgage lender.

Oil Tank Inspections

Some homes also need oil tank inspections. Some sellers will not allow this type of inspection, as it can be invasive (for example, if the oil tanks are underground). In most states, the homeowner is responsible for any leaks.

Well Water Inspections

Depending on where the home is located, you may also need a well water test to make sure the water is potable. This inspection is more common in rural areas.

Appraisal / Appraiser's Inspection

Your bank will also inspect the home in order to appraise the value of the property. They do this to protect their investment in the home, and also to ensure that the home is worth the amount you've agreed to pay.

Final Walk-Through Inspection

You should also do an inspection near the end of the real estate transaction, just before the closing process. That way, you can make sure the house is in the same condition it was when you agreed to buy it. During this final "walk-through," you'll want to ensure that everything is in working order, and that the house has not been damaged in any way since you first signed the contract.

As each of these inspections take place, keep in mind that no home is perfect. You'll need to weigh the pros and cons of every home in order to make the right purchasing decision. It's also a good idea to have an off-the-record conversation with all of the inspectors to get additional insights, if they are willing to give them.

All in all, you can expect a number of inspections to take place during your home buying process. Most of these inspections are for your benefit, as the home buyer, so you need to take them seriously and consider the outcome carefully.

With that introduction out of the way, I'd like to talk more about the main home inspection.

The Primary Home Inspection

A home inspector checks the safety and functionality of your potential home. Inspectors focus primarily on the structural and mechanical aspects of the home. You should get a home inspection as soon as possible after the sellers accept your offer. Make the contract contingent upon the home inspection. That way, if the inspection uncovers a major flaw you are unwilling to accept, you have a legal way out of the contract.

Don't confuse the home inspection with the home appraisal. The home appraisal protects the lender's financial interests. The home inspection protects you, the buyer. The inspection is your way of identifying structural or mechanical problems with the house.

How to find a home inspector:

- Ask a friend or coworker who has recently bought a home in the area.
- Ask your agent if he or she can recommend a qualified inspector.
- Visit the American Society of Home Inspectors website: www.ashi.org.
- Visit the National Association of Home Inspectors website: www.nahi.org.

Is a Home Inspection Worth the Price?

Consider this. Home inspections usually run between $300 and $500. Weigh that small cost against the comfort of moving into a known situation, and the answer is obvious … get a home inspection!

The Home Inspector's List

Your home inspector will go through your home with a fine-toothed comb. So be present for the inspection – you'll learn a lot. Afterward, the inspector will make a list of discrepancies. Some items won't be a big deal to you, but it's still the inspector's job to point them out. But other items will be more serious, and these are the items you should discuss with your agent.

Who's Fixing What?

When you review the inspector's list with your agent, you'll have to decide which items (if any) you want the sellers to repair. Like everything else in real estate, the fix-it list is negotiable. When you submit your list of requested repairs to the sellers, you face one of several outcomes:

1. The seller will agree to fix all of the items.
2. The seller will agree to fix some of the items.
3. The seller won't agree to fix any of the items.
4. The seller will reduce the price in lieu of certain repairs.

How you proceed in light of the seller's response is up to you and your agent. A good rule of thumb — don't ever turn a blind eye to a major repair issue just because you're excited about getting in the house. If you're an experienced investor and you're buying the house specifically to fix it up, that's one thing. But if you're buying your first home, be conservative and carefully consider each item on the inspector's list.

Summary of Key Points

- The home inspection is designed to protect you, the home buyer. It eliminates unpleasant surprises and gives you a clear assessment of the house you are buying.
- A home inspector will examine the structural components of the home, as well as the installed systems. This includes the foundation, walls, roof, plumbing, electrical, heating and air, etc.
- An inspector will *not* tell you if you're getting a good deal on the home. That's your agent's job. The inspector's job is to look for flaws within the home, and to tell you about them.
- The inspection takes place shortly after the seller accepts your offer, usually within a few days of the acceptance. You want to do it early, in case you need to back out of the deal.

- On average, home inspections cost $300 - $500. This is a small price to pay for peace of mind. I strongly recommend that you have a home inspected.
- Ask the inspector if you can follow him through the inspection (or as much of it as possible). This is a great way to learn about the inner workings of the home.
- You should include a home inspection contingency in your purchase agreement. That way, if the inspector finds something you're unwilling to accept, you can back out of the contract.
- You can find an inspector through two organizations. Visit the National Association of Home Inspectors at www.nahi.org, and the American Society of Home Inspectors at www.ashi.org.
- Your real estate agent may be able to recommend a local inspector. If a friend or family member has recently purchased a home, ask them who they used for the inspection.
- The inspector will give you a copy of the inspection report. It will include all of the discrepancies found during the inspection. He should also explain each item to you in person.
- You can handle discrepancies in several ways. You can ask the seller to fix them, you can repair them yourself out of pocket, or you can ask for a price reduction to cover the repair cost.
- The market will partly determine how you handle repairs. In a *buyer's* market, the sellers will be more likely to make the requested repairs. In a *seller's* market, they might not fix anything.

That wraps up our discussion of home inspections. Now let's talk about the related subject of home warranties.

Do I Need a Home Warranty?

A home warranty is a policy that covers future repair and replacement costs, resulting from failed appliances and systems within a home. It's an optional item in the real estate transaction. Sometimes they are included in the purchase agreement, while other times they are not. People with older homes will often include home warranties to entice home buyers. But either party can purchase the warranty. The two parties can even share the cost.

Cost and Coverage

Cost will vary based on coverage and other factors. Most home warranties are in the $400 to $600 range. When the initial policy expires, there's usually a renewal fee as well. Home warranties vary quite a bit. So it's important to ask a lot of questions and read all the fine print before purchasing one. With that said, here are some of the common items covered:

- Heating and cooling systems
- Plumbing systems
- Electrical systems
- Major appliances
- Garbage disposals
- Sometimes the roof (but not always)

What Isn't Covered Under the Warranty?

It's important to understand that a home warranty is not hazard insurance. Hazard insurance (sometimes referred to as disaster insurance) covers your home in case of earthquake, fire, hail, etc. Home warranties cover home systems and appliances that fail.

How Long Do Home Warranties Last?

Most are effective for one year. After that, you have the option to renew the policy. Find out in advance how much it will cost to renew, because renewal is sometimes more expensive than the initial cost of the policy.

Should I Buy a Home Warranty?

The home buying process might drain your cash reserves, so a major repair could put you in a financial bind. In such cases, a home warranty will give you coverage and peace of mind. Age is also a factor. An older home with systems near (or beyond) their life expectancy would be a good candidate for warranty protection. But a brand new home might already have coverage provided by the builder. If you do decide to purchase a warranty for your home, be sure to shop around and compare prices. Find out what's covered, how long the policy is, and how much it costs to renew.

The Pre-Closing Inspection

The pre-closing inspection is the buyer's opportunity to ensure that the house they are buying is in the same condition it was in when they first inspected it (prior to signing contracts).

The pre-closing inspection (also referred to as "the final walk-through") is a critical step in the home buying process, but many home buyers fail to take it seriously. As a buyer, you need to conduct a thorough inspection prior to closing on the house. Why? Because in most states, once the closing is completed, the seller has no further obligations to you.

How to Conduct Your Inspection

When you are doing the final inspection, start with the basics. Examine the windows and doors and make sure all of them open, close and lock properly. Double-check that the windows are not cracked or broken, and that all screens are present.

Make sure there are no signs of flooding, leaking or water damage of any kind. Look on the ceilings and floors for evidence of this. If you see anything that seems amiss, make sure you speak to your agent about it.

Check that all appliances are working. That includes turning the oven on and ensuring it gets hot. Turn on the burners on the stove to make sure all of them light. Open the refrigerator and freezer to make sure they are working. Run the dishwasher, turn on the washing machine and the dryer.

You should also turn all lights on and off to make sure they work. You might even check all the electrical plugs to ensure they work. Make sure none of the walls were damaged by movers or anyone else. Verify that any pools, hot tubs, saunas or other items are all operational and able to be tested.

Check on Repair Items

If the seller was required to do any repair work in the home (after the initial home inspection), inspect the work carefully. Ask if there are any copies of work orders and warranties / guarantees by the vendors who performed the work.

It's usually a good idea to have your agent present when conducting your inspection. That way, you can speak to him or her about any concerns you have along the way. Your agent can negotiate any agreements that need to be made based on any of your findings.

The pre-closing inspection usually takes place right before the closing (within 24 hours in most cases). Because of this, many buyers are anxious and exited, and therefore fail to do a thorough inspection. Slow down, keep a cool head, and give your future home a thorough pre-closing inspection.

The Home Appraisal

During the home buying process, you'll hear the term "appraisal" mentioned at some point. Chances are, you already have a general idea what this term means. But when it comes to mortgages and home buying, you need to know exactly what an appraisal involves and how it affects you.

First, a definition:

Appraisal -- A professional appraiser's estimate of the market value of a property. Appraisals take into account the local market conditions and the characteristics of a property. They are required by most lenders.

In other words, the appraisal is the lender's way of determining a realistic market value of your future home. The lender uses the appraisal to ensure that the home is actually worth the price you've agreed to pay. In the unfortunate event that you can't pay your mortgage, the bank will foreclose on the home and resell it. Not a nice thought -- but it's reality. The appraisal is how the lender protects its own financial interests.

Generally, you'll have little control over the appraisal process and won't even be present for it. Your lender will arrange the appraisal, and the house will either appraise at the asking price or not. Hopefully the former!

If the home appraises for less than the asking price, you have two options. You can come up with the difference, or the seller can reduce the asking price to match the appraisal.

Keep in mind that an appraisal is not a home inspection. A home inspection is something you should obtain to protect your investment. An appraisal is the appraiser's opinion about the value of your prospective home. But that's it. Appraisers will not test the functionality of appliances, inspect the roof, or perform other tasks a home inspector would do.

Part 6 - The Closing / Settlement Process

What to know about the final step of the home buying process

The Closing / Settlement Process

Settlement (also referred to as closing) is the final stage of the home buying process. During settlement, ownership of the home gets transferred from the seller to the buyer. This involves a lot of paperwork, a lot of signatures, and usually a lot of questions.

You have probably heard about the closing that lasted for days, or the one that blew up over something as trivial as a doorknob. Or perhaps you have heard stories of closings where the sellers were getting a divorce and could not even sit in the room together.

These stories can be entertaining, but they are usually 10% fact and 90% fiction. In reality, the vast majority of closings go quite smoothly. And there are certain things you can do to increase the likelihood of a smooth transaction.

Keep in mind that everyone present at the real estate closing is there for the same reason. They want to complete the transaction so you can buy your new home. It's highly unlikely that anyone at the closing has ulterior motives beyond that.

At closing, you can expect to sign a substantial number of documents. This may include the mortgage, the note, HUD Settlement Statement, and a variety of other documents that are signed to protect your interests and the bank's interests.

There will be a title insurance report and policy at the closing, which is further assurance that no one has a claim to the home you are about to buy. The title insurance offers important protection for you as well as the lender. Every lender will require title insurance, though the specifics of the policy and the title search will differ from state to state.

Bring photo identification to your real estate closing, and make sure you have a checkbook with plenty of checks. Though you may not have to write a single check, there is the possibility you'll have to write several.

Also during the closing, you will confirm that the mortgage application you filled out contains accurate information, and that your circumstances have not substantially changed since you completed the application (e.g. you changed jobs, etc). Keep in mind, it's always better to advise your mortgage lender about changes in your circumstances *before* the day of closing.

You should feel comfortable asking questions at closing. Also, take your time to read each document before signing it. Sometimes, you can request that the lender let you come to the closing early to review documents (so the rest of the people in the transaction are not waiting for you to do so).

Pre-Settlement Checklist

Some of the items on this list may seem obvious, but I've included them anyway to make the list as complete as possible. Keep in mind that settlement laws and requirements may vary from state to state.

- *Loan Approval* - This is first and foremost, because you can't proceed toward settlement / closing until you get approved for the loan. Once you're approved for the loan, the settlement process is in motion.

- *Truth-in-Lending Statement* - Shortly after applying for the loan (usually within three business days), the lender will give you a truth-in-lending statement. This statement shows the total estimated cost of the loan, including fees, interest rates and payment terms.

- *Set the Date* - The time and place of settlement will usually be agreed upon between the lender, the settlement company, and the buyer and seller.

- *Transfer Utilities* - Call to transfer all applicable utilities (gas, electric, etc.) to your name, effective on the settlement date.

- *Hazard Insurance* - Most lenders will require hazard and liability insurance, at least up to the loan amount. You need this to satisfy their requirements, but you should also choose a policy that protects your investment and give you peace of mind.

- *Final Walk-Through* - A day or two before settlement, you will conduct a final walk-through of the house. This is your last chance to view the property before taking ownership of it. Make sure everything is as you remember it (no new damages, all conveyed items present, etc.). Also, if you made the contract contingent upon certain repairs (based on the home inspection), make sure those repairs have been completed.

- *Settlement Statement* - At least one business day before settlement, you should receive a settlement statement (also referred to as a HUD-1 statement). This document will list all the costs you're required to pay at settlement. Review it carefully. If you find errors or items you don't understand, bring it up with your real estate agent, attorney or settlement agent. Don't let your questions go unanswered!

- *Certified Check* - In most cases, you will need to bring a certified check with you to settlement to cover all the closing costs. The amount of this check will be based on the settlement statement. Be sure to bring a photo ID with you as well.

Understanding the settlement process will help ensure a smoother home buying process. Be proactive about the items on this list. Don't just wait for them to happen -- make them happen.

Who Attends the Closing Process?

The participants at a real estate closing will differ from state to state and perhaps even county to county. The two participants you can count on being at the closing (or represented at the closing) are the buyer and the seller.

In addition to the buyer and the seller, there is typically a representative from the bank, the title company, and the real estate agent's office at the closing. In some states, like New York, there will also be attorneys for the buyer and the seller present at the closing.

The role of the seller is obvious. The role of the buyer is obvious. But what about the roles of the other players at the closing?

The Lender - The role of the lending institution is to ensure that the mortgage documents are properly signed and the funds are distributed. Some lenders will use the title company representative to handle this on their behalf, others will use a representative specifically from the bank, while other lending institutions may have attorneys handle their closings.

The primary focus of whoever is representing the bank is obviously to protect the interests of the bank. But the representative also wants to see the loan close.

Title Company Representative - The tile insurance company will have a representative at the closing to make sure all the terms and conditions (often referred to as exceptions) of the title policy are satisfied, and that the deed is properly executed.

The title insurance company will make sure all mortgages are paid off and there are no liens against the property. The person at the closing will also issue the official title insurance policy that protects the bank and the buyer.

Real Estate Agent(s) - The real estate agent(s) at the closing are primarily there to collect their commission, but they will also assist the buyer and the seller in completing the transaction. The real estate agent can prove helpful if any issues arise with adjustments or related issues that impact the transaction.

Real Estate Attorney(s) - If there are attorneys present, keep in mind that each attorney represents their client. Though everyone is working as a team to complete the transaction, it's still wise to know who has what interests at heart.

Who Runs the Show?

The bank representative and the title company representative will dictate most of the action at the closing, ensuring all documentation has been properly executed and the transaction was completed. The bank representative will also be the one dispersing the funds on behalf of the buyer to the seller.

Preparing Yourself for Closing Costs

Closing costs are the fees and adjustments owed at closing (or "settlement") by both the buyer and the seller. These costs can range from $3,000 to $8,000, depending on where you live. At the time I was writing this book, Maryland had the highest average closing costs (at $8,209), and Wisconsin had the lowest (at $3,738).

What's Makes Up These Costs?

Closing costs vary depending on where you live and what mortgage lender you choose. But closing costs often include fees for the following (this list is not all-inclusive):

- Loan origination
- Loan application
- Appraisal
- Document preparation
- Attorney's services
- Escrow agent's services
- Pest inspection
- Credit report / processing

Prior to closing day, your lender should give you a list of itemized closing costs associated with your loan. The list should be exhaustive, but sometimes it is not. Some of the most common items missing include: attorney fees (if any), tax adjustments, oil adjustments, title insurance gratuity, and other closing adjustments.

If you find any of these items missing from the closing cost estimate provided by your lender, ask your lender about them. Request a detailed list of ALL possible adjustments and fees you might incur.

Closing costs might be paid by the buyer or seller, depending on the particular cost and also the purchase agreement. For example, the seller will pay a sales tax or conveyance tax in most states. In some cases, the seller even pays the closing costs of the buyers. When the seller pays these closing costs, it is referred to as a seller's concession. In a slow / buyer's market, some sellers will offer to pay part of the buyer's closing costs, just to entice more buyers and sell the home faster.

The Seller's Concession

A seller's concession helps the buyers finance their closing costs. Basically, the closing costs are estimated in advance, and that amount is added to the sales price of the house. The seller then pays the closing costs of the buyer with these extra funds.

Here's an example. Let's say the purchase price of a home is $150,000, the mortgage amount is $135,000, and the estimated closing costs are $6,000. In that case, the seller's concession would adjust the figures in the contract to a sales price of $156,000 and a mortgage of $141,000. The extra $6,000 the seller earns would actually be used to pay the buyer's closing costs. Of course, this would need to be spelled out in the contract.

Financing Closing Costs

Some lenders let buyers finance closing costs without using the seller's concession. If you want to minimize your out-of-pocket expenses, speak to your lender about your options for financing your closing costs. Just keep in mind that you will be paying interest on this higher loan amount.

The key is to be informed and prepared. That means maintaining a list of anticipated closing costs and comparing it against the estimated costs prepared by your lender. Feel free to ask questions, and make sure you have the most accurate information possible so you can be prepared for the closing.

Most lenders give accurate estimates for closing costs. But there are some lenders who do a less accurate job, and there's always the possibility for human error. Rather than accepting the closing cost estimate at face value, you should dig deeper until you are confident the estimate you received encompasses all closing costs.

Tax Adjustments

The most significant expense commonly left off the list are tax adjustments. Tax adjustments can be hundreds or thousands of dollars. Make sure tax adjustments are factored into your closing costs estimate. Otherwise, you may be unprepared for the amount of funds do on closing day.

Handling Adjustments at Closing

Closing adjustments are credits and debits made during a real estate closing to cover a variety of expenses. At some real estate closings, adjustments can be extensive. So make sure you have a good handle on them prior to closing day.

Tax Adjustments at Closing - In most cases, the biggest adjustments made at real estate closings are tax adjustments. Tax adjustments occur when the buyer reimburses the seller for pre-paid taxes (property taxes paid that extend beyond the closing date).

Oil and Fuel Adjustments - Other adjustments include oil or fuel. If the seller is going to request an adjustment for oil or other fuel at the property, they are required to get a reading done that shows how much oil is left in the tank and what the prevailing rate is on that particular day. The buyer will then pay the seller for the oil they are leaving behind (for the benefit of the buyer).

Damage Adjustments - Some home buyers find that the house they are buying was damaged after they signed contracts. Maybe a window was broken, or a wall got damaged. During the final walk-through of the property, it's important to note such discrepancies so your real estate agent and/or lawyer can negotiate closing adjustments on your behalf.

Adjustments Add Up

When combined, the adjustments mentioned above can add up to thousands of dollars. A closing is never complete until all the paperwork is finalized, so don't be surprised if these adjustments get reworked several times as new information is discovered and recalculations are made.

Bring Your Checkbook

Chances are, you (as the buyer) will be writing checks at the closing. So you'll want to bring some blank checks for any adjustments or other fees that arise at closing. It's also a good idea to wait until all adjustments are finalized before you start writing checks.

Some buyers find that their real estate agent or attorney can handle all adjustments prior to the closing, so they are not calculated during the actual closing process. This is the ideal scenario, but you should still be prepared to write additional checks in case something was overlooked.

Conclusion

Adjustments are part of every real estate closing, so they shouldn't come as a surprise. Stay informed during the home buying process, and ask plenty of questions to determine what adjustments you should expect. That way, you can plan accordingly and have sufficient funds to cover everything on closing day.

Appendix - Home Buying Resources

Glossaries, online resources and more

Home Buying Glossary

This list is not all-inclusive, but is intended to give you a sound understanding of terms you'll likely encounter during the home-buying process.

A

A-Credit – A mortgage risk category / term used by lenders to describe a borrower with the best credit rating. Borrowers with this level of credit usually qualify for better loans at lower rates. For most lenders, the A-credit bracket is a FICO score of 720 or higher.

A-Minus -- A mortgage risk category between prime and sub-prime (but closer to prime). Also referred to as "A minus". Also referred to as Alt-A.

Agreement of Sale – A contract signed by buyer and seller stating the terms under which the home will be sold. Usually includes the sale price, who will pay what fees, etc. Also referred to as a contract or purchase agreement.

Amortization – Each time you make a mortgage payment, part of the payment will applied to the principal and part will be applied to the interest. Over time the interest portion of the payment will decrease (as the loan balance decreases), and the amount applied to principal will increases. In this fashion, the loan will be paid off (or amortized) in the specified time.

Amortization Schedule – A table or chart that shows how much of each payment will be applied to the loan's principal, and how much will be applied to the interest.

Annual Percentage Rate (APR) – The APR shows the cost of a mortgage loan by expressing it in terms of a yearly interest rate. The APR is often slightly higher than the published interest rate because it takes into account the financing of closing costs or pre-paid percentage points.

Application – The form used to apply for a mortgage loan. The mortgage application contains information about your income, assets, debts and more.

Appraisal – A professional appraiser's estimate of the market value of a property. Appraisals take into account the local market conditions and the characteristics of a property. They are required by most lenders.

Appreciation – An increase in a property's value due to market changes, home improvements, or other factors.

Assessed Value – The value placed on a home by city or county assessors that determines property taxes. Generally based on a percentage of the home's overall market value.

B

Balloon Loans – A type of loan where the regular monthly payments are followed by a lump sum or "balloon" payment of the total remaining balance.

C

Cap – The maximum amount an interest rate or monthly payment may increase, either at adjustment time or over the life of the mortgage. Adjustable rate mortgages (ARMs) usually have both annual and lifetime caps. Also known as a **Rate Cap**.

Cash Reserve – Cash that is sometimes required to be held in reserve in addition to the down payment and closing costs. The amount is determined by the lender.

Clear Title – A clear title is one with no "defects" (no liens on the property, etc.). Only properties with clear titles can be sold. Think of the expression: "You own it free and clear."

Closing – The official transfer of property ownership from seller to buyer. It usually happens in the form of a formal meeting between the buyer, seller, settlement agent, and the buyer's and seller's agents. At closing, the buyer will sign the mortgage, the seller will receive payment for the property, and the buyer and/or seller will pay the closing costs. Also referred to as **Settlement**.

Closing Costs – The total costs of completing the transfer of ownership of the property, other than the purchase price. Closing costs usually include fees for loan origination, home appraisal, survey and real estate agent's commission. They may also include prepayment of taxes and insurance, and real estate transfer taxes. Closing costs usually amount to about 2 to 4 percent of the purchase price of the home.

Comparative Market Analysis – A real estate evaluation that estimates the current market value of a home by comparing it with recently sold homes in the same area.

Contingency – Any condition that must be met before a contract becomes binding. For example, an agreement can be contingent on the sale of the buyer's current home.

Conventional Mortgage – Any mortgage that's not insured or guaranteed by the federal government.

Counter Offer – A response to a purchase offer that rejects all or part of the original offer but keeps the negotiations open in hopes of reaching an agreement.

Credit Bureau – A credit-reporting agency that gives financial information about potential borrowers to lenders. Currently, there are three companies that maintain national credit-reporting databases: Equifax, Experian, and Trans Union.

Credit Report – A report provided by credit bureaus containing information about a borrower's credit history. Basically, it's a report card of how you've paid your credit card debt and other loans over the years (as well as how much debt you currently have).

Credit Score – A computer-generated score used to determine how likely a person is to repay a loan. Your credit score is based on your credit report. Lenders use this score to analyze your credit report and to determine your credit worthiness.

D

Debt-to-Income Ratio – Also known as debt-to-earnings ratio. A ratio (expressed as a percentage) calculated by dividing gross monthly debt by gross monthly income. Debt-to-income is one of the key factors lenders will look at when considering your credit worthiness.

Deed – A written document that shows ownership of property. Includes the signatures of current owners and a legal description of the property. Also known as a **Title**.

Default – Failure to meet the legal obligations of a contract. In the case of home buying, failure to make the monthly payments on a mortgage.

Depreciation – A decrease in the value of property over time (as a result of market changes, wear and tear on the property, etc.).

Disclosures – Information provided about a property for sale – particularly information related to defects or problems. "Full disclosure" refers to the seller's responsibility to provide any and all information they know about the property.

Down Payment – The money paid by the buyer to the lender at the time of the closing. Because it's paid in advance, this portion of the purchase price is not part of the mortgage loan. Smaller down payments (those less than the standard 20 percent) usually require mortgage insurance.

E

Earnest Money – Money given by a buyer to a seller to show that the buyer is serious about purchasing the home. Earnest money becomes part of the down payment if the offer is accepted, gets returned to the buyer if the offer is rejected, or is forfeited if the buyer backs out of the deal.

Equity – The value of a property, usually calculated by subtracting the remaining amount owed on the mortgage from the fair market value of the property.

Escrow – Also "escrow account." Funds set aside and held by a neutral third party, usually for payment of taxes and insurance.

F

Fair Credit Reporting Act – A set of rules that governs the activities of credit bureaus and controls the release of confidential information by those bureaus.

Fair Housing Act – A law that prohibits discrimination during the home-buying process on the basis of race, color, national origin, religion, sex, familial status or disability.

Fannie Mae – The Federal National Mortgage Association, a tax-paying corporation created by the U.S. Congress that buys and sells conventional residential mortgages as well as those insured by FHA or guaranteed by VA. By purchasing mortgages, Fannie Mae increases the availability and affordability of home loans for low- and middle-income Americans.

FHA Mortgage – A mortgage insured by the Federal Housing Administration (FHA) of the United States Department of Housing and Urban Development (HUD). The loan is insured by the FHA/HUD, but it's actually provided by an approved lender.

The FHA's insurance encourages lenders to make loans to borrowers who may not otherwise qualify for a conventional mortgages. There are limits to the size of FHA loans, but they are usually enough to cover most moderately priced homes.

First Mortgage – The first mortgage is the primary lien against the property. In other words, the first mortgage has first claim in the event of default.

Fixed-Rate Mortgage – A mortgage with payments that stay the same during the entire life of the loan. The loan's interest rate is fixed and will not fluctuate with market changes.

Flood Insurance – Insurance required by lenders on homes located within a flood plain. This type of insurance protects homeowners against damage and losses incurred by a flood.

Foreclosure – The legal process that allows the lender to recover and sell a property after the owner has defaulted on the loan (failed to make mortgage payment). Sometimes referred to as **Repossession of Property**.

Freddie Mac – The Federal Home Loan Mortgage Corporation. A private corporation created by Congress to support the secondary mortgage market by purchasing residential mortgages, securitizing them, and selling them to investors. By purchasing mortgages, Freddie Mac increases the availability and affordability of home loans for low- and middle-income Americans. Similar to **Fannie Mae**, defined previously.

FSBO (For Sale by Owner) – A home being sold by the owner without the assistance of a seller's agent.

H

Home Inspection – A complete "top to bottom" inspection of a home's physical condition. Home inspections should be conducted by a professional, licensed home inspector and should cover all major systems and structural elements of the property. Home inspection fees are typically paid by the buyer.

Homeowner's Insurance – Insurance that protects the homeowner's property against damage from fire, storms and other hazards. Most lenders require homeowner's insurance. Also known as **Hazard Insurance**.

Homestead Credit – A state-sponsored property-tax credit program (only available in some states); reduces property taxes for eligible households. Ask your agent if your state offers such a program. Also known as **Homestead Exemption**.

L

Late Payment Charge – A penalty the homeowner pays when a mortgage payment is late. Late charges vary by state, type of loan, etc., but often run 5% of the payment amount (e.g., the late charge on a $1,000 payment might be $50).

Lien – A claim of money against a property. Example: a tax lien for unpaid property taxes. A lien is a defect, or "cloud," on the title and must be resolved before ownership of the home can be transferred.

Lock-In – A written guarantee from a lender that the buyer will receive a specific interest rate for a specific period of time. Also known as **Rate Lock** and **Rate Lock-In**.

M

Market Value – The amount that a seller may expect to obtain in the open market, based on current market conditions and recent comparable sales. An appraised value is an estimate of the current fair market value (see previous definition of "appraisal").

Mortgage – A financial agreement between a lender and a buyer in which the property is used as collateral for the loan. A mortgage gives the lender the right to collect payments on the loan (and to foreclose on the property if those payments are not made).

Mortgage Broker – An individual or company that offers loans to borrowers and is paid a commission for their services.

Mortgage Insurance – Insurance purchased by the buyer to protect the lender in the event of default. Mortgage insurance is usually required on loans with less than 20 percent down payment. The cost of mortgage insurance is usually rolled into the monthly mortgage payment. When mortgage insurance is obtained through a private company (not from the federal government), it's also known as **Private Mortgage Insurance** or **PMI**.

Mortgage Interest Deduction – A tax deduction based on the interest cost of a mortgage. Mortgage interest on a primary residence is usually fully tax-deductible.

Mortgage Note – A legal document that obligates the borrower to repay the loan (for a mortgage in this case).

Mortgagee – The lender in a mortgage agreement.

Mortgagor – The borrower in a mortgage agreement.

Multiple Listing Service (MLS) – A computerized database of virtually all the homes for sale in a specific area.

O

Origination Fee – A fee charged by the lender to cover the administrative costs of making the mortgage. This fee is paid during closing (or "settlement") and varies with the lender and type of loan. Origination fees of 1 to 2 percent of the mortgage are common.

Owner Financing – A purchase in which the seller acts as a lender, providing all or part of the financing for the buyer.

P

Payment Cap – A limit on how much an adjustable rate mortgage (ARM) payment may increase during the life of the loan.

PITI – Principal, interest, (property) taxes, and insurance. The typical components of a mortgage payment.

Planned Development – A neighborhood that is planned, developed and built as a single entity. Usually, the homes in a planned development bear certain features in common. Most planned developments also share common land or facilities that are managed by the homeowners' association or neighborhood association. Also known asa **Planned Unit Development** or **PUD.**

Points – Points are sometimes paid at closing as a way to lower the monthly payment interest rate. Paying points may be a wise option if you plan on living in the home for more than a few years. One point is equal to 1 percent of the loan amount (for example, two points on a $100,000 mortgage equals $2,000). Also known as **Discount Points**.

Pre-approval – The process of applying for a loan and gaining approval for a certain amount before having an actual purchase agreement.

Prepayment Penalty – A fee charged to a homeowner who repays a mortgage debt early (before the due date).

Principal – The actual amount of money borrowed, not counting interest. The part of the monthly payment that actually reduces the remaining balance of a mortgage.

Purchase Offer – A detailed, written document that makes an offer to purchase a property. The offer may be modified, or "amended," several times during the course of negotiations. When the offer is signed by all parties involved, it becomes a legally binding contract. Also known as the **Offer** or **Contract**.

Q

Qualifying Ratios – Guidelines used by lenders to determine if a borrower can qualify for a mortgage. The lender will consider the borrower's income and current debt, as well as the size of loan the borrower is trying to obtain.

R

Radon – A colorless, odorless radioactive gas that seeps up from the earth (as the result of the natural decay of uranium in the earth). Radon may leak into some homes and build up to unhealthy levels. For this reason, radon tests are often part of the home inspection process.

S

Second Mortgage – A mortgage obtained after another mortgage and subordinate to the first. "Subordinate" meaning that in the event of default, the lender of the second mortgage gets paid *after* the lender of the first mortgage. As a result of their "subordinate" nature, secondary mortgage loans are riskier for the lender and therefore bring a higher interest rate.

Settlement Statement – A document required by the Real Estate Settlement Procedures Act (RESPA). An itemized statement of charges that must be paid at closing or settlement. The buyer has the right to examine the settlement statement one day before the closing. Also known as a **Closing Statement** or a **HUD-1 Settlement Statement**.

Survey – A survey can refer to both a process and the document produced by that process. <u>The process</u> is conducted by a licensed surveyor (and is required by the lender) to confirm that the property boundaries – and features such as buildings, improvements and easements – are true and accurate as described in the deed. <u>The document</u> produced by a survey is a diagram showing legal boundaries, easements, encroachments, rights of way, etc.

T

Title – A written document that shows ownership of property. Includes the signatures of current owners and a legal description of the property. Also known as a **Deed**.

Title Defect – An outstanding claim on a property that prevents the legal sale of that property. Also known as a **Cloud** on the title. A title with defects is not a "clear" title.

Title Insurance – Insurance that protects the lender against claims that may arise in the event of disputes over property ownership. This charge is usually part of the closing costs.

Title Search – A review of public records and legal documents to ensure that the seller is the true, legal owner of the property (and that there are no unsettled claims or liens against the property).

Truth-in-Lending – A federal law requiring disclosure of the Annual Percentage Rate to home buyers shortly after they apply for the loan (usually within three days of loan application). It also requires the lender to fully disclose all terms and conditions of the loan. The information provided by the lender is referred to as the **Truth-in-Lending Statement**.

U

Underwriting – A critical step in obtaining a mortgage, underwriting is the lender's process of analyzing a loan application to determine the amount of risk involved in making the loan. It includes a comprehensive review of the borrower's credit history and a judgment of the property's real value.

W

Walk-Through – In the case of the "final walk-through," this is a final inspection of the property by the buyer and the buyer's agent. The final walk-through normally takes place a day or two before closing / settlement. The purpose of this walk-through is to ensure that any repairs agreed upon in advance have been made, and that no other issues have arisen.

Z

Zoning – The ability of local governments to control the use of land in a particular zone. For example, some areas may be designated for residential use and others for commercial use.

Home Buying Resources On the Web

The Internet has revolutionized the world of real estate. Home buyers have much more information, tools and resources at the their fingertips than ever before. As a result, home buyers are now empowered to do more for themselves than ever before. This book is a compilation of much of the information you'll find around the web, but it certainly is not all-inclusive. *No* home buying book is all-inclusive ... there's just too much information out there, and it changes too often.

So to help you round out your home buying education, I've created a list of helpful websites related to home buying, mortgages, credit, etc. These websites, combined with this book, will make you a home buying pro!

Finding a Home
When looking for a house to buy, use as many different sources as possible. Read your local newspaper. Keep an eye out for those "For Sale" signs. And of course, use the Internet. Here are some sites to help you with your search:

- www.Homes.com
- www.Realtor.com
- www.realestate.yahoo.com

You should also seek out the websites of real estate agents in your area. You can use Google to find them, simply by entering "homes for sale +your city name."

Mortgage Calculators
Online mortgage calculators are a quick way to determine the approximate monthly mortgage on a particular house, based on the price, the interest rate and the length of loan. Keep in mind these numbers don't account for closing costs and other variables. Still, they give you a pretty good idea as to where your comfort zone lies, based on monthly payments.

Always use more then one mortgage calculator, to verify the numbers they give you.

- www.mortgage-calc.com
- www.bankrate.com
- www.mortgage101.com/calculators
- www.interest.com
- www.homebuyinginstitute.com/calculators.php

Current Interest Rates
Interest rates are one of the ingredients that determine your total monthly payment. Here are some sites that will help you keep up with interest rates. As with everything else, it's wise to use several different sites to get an accurate overall picture.

- www.mortgage101.com/rates
- www.money.cnn.com/rates
- www.interest.com
- www.bankrate.com
- www.compareinterestrates.com

General Mortgage & Credit Information
We talked about how importance credit scores are to the home buying process. Here are some online resources related to credit scores, credit reports, etc.

- www.HomeBuyingInstitute.com/credit.php
- www.AnnualCreditReport.com
- www.Equifax.com
- www.TransUnion.com
- www.Experian.com
- www.MyFico.com

Improving Your Credit Score
We have carefully screened the articles that follow to ensure they offer solid advice on how to improve credit scores. So be sure to bookmark this page as a "one stop shop" for advice on improving your credit score.

"Improve Your Credit Score" - CNN Money
http://money.cnn.com/2002/02/15/debt/q_fivethings_creditscore/

"Tips for Boosting Your Credit Score" - Bankrate.com
http://www.bankrate.com/brm/news/credit-scoring/20040128a1.asp

"Improving Your FICO Credit Score" - MyFICO
http://www.myfico.com/CreditEducation/ImproveYourScore.aspx