

Buying A HOME

Leader's Guide

MoneyWIS\$E

A CONSUMER ACTION AND CAPITAL ONE PARTNERSHIP

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Introduction

Though the rewards of homeownership are many, buying a home for the first time can be challenging. This MoneyWi\$e Leader's Guide, created by the national non-profit organization Consumer Action and its Housing Information Project, in partnership with Capital One, will prepare you to teach hopeful homebuyers how to navigate the often complex home buying process with confidence.

The guide, which is part of a series of MoneyWi\$e publications on home buying, covers such topics as how to choose a real estate professional, how to qualify for a mortgage, and what is involved in the settlement (closing) process. It also explains unfamiliar terms and provides tips and suggestions that can help the purchase process go more smoothly.

The Buying a Home series also includes a multilingual companion brochure, "You Can Buy a Home" (available in Chinese, English, Korean, Spanish and Vietnamese); a teaching plan with suggested topics for classes and seminars; PowerPoint slides, and class activities.

For more about these materials, call Consumer Action at 800-999-7981, or visit our websites:

- **Consumer Action:** www.consumer-action.org
- **MoneyWi\$e:** www.money-wise.org
- **Housing Information Project:** www.housing-information.org

Preparing for Homeownership

I'm thinking about buying a home. What's my first step?

It's never too early to start planning. Start by asking yourself these questions:

- **What are my financial resources?** Figure out how much you have available for a down payment and how much you can afford to spend on housing each month. To do this, you might have to track your income and expenditures for a few months. If necessary, adjust your budget and step up savings to reach your goal.
- **What do I want to buy?** Think about the location, home size, and home type (single-family home, townhouse, condominium, etc.) you want and can afford. Visit open houses and view listings online to learn about your local housing market.

How can I figure out how much home I can afford?

You can use online calculators to determine how much home you can afford. That amount will depend on your income, debts, down payment and the mortgage interest rate you qualify for. (Good credit will get you a lower rate.) To find free online mortgage calculators, search online for “How much home can I afford,” or visit Fannie Mae (www.fanniemae.com) or BankRate (www.bankrate.com).

What is a down payment?

Your down payment is the percentage of the total cost of the home that you pay outright. Typically, buyers put 3% to 20% down and finance the rest with a mortgage. Some loan programs allow buyers to put nothing down.

What if I don't have a down payment?

Consider these possible sources of a down payment:

- **My Community Loan.** If you have limited savings, no credit history or nontraditional sources of income, this program offered through Fannie Mae lenders can help you buy a home. The program also helps public service employees and the disabled become homeowners. Visit the Fannie Mae website (www.fanniemae.com) and click on “Find a Lender.”

- **Retirement account loan.** You can borrow half of your fully vested balance in an employer-sponsored 401(k) plan and up to \$10,000 from an IRA (individual retirement account) without penalty. Find out what the tax consequences, if any, and repayment terms are before applying.
- **Second mortgage.** A “piggyback” mortgage is a second mortgage that covers your down payment. It usually features a higher interest rate than a first mortgage. A “silent second” mortgage requires no payments until you sell or refinance the home. A second mortgage may allow you to avoid paying private mortgage insurance (PMI). (See “Getting a Mortgage” to learn more about PMI.)
- **Down Payment Assistance Program (DAP).** Visit www.hud.gov/offices/hsg/sfh/np/sfhdap01.cfm for information about private non-profit funds available on Federal Housing Administration (FHA) loans. Recipients may be required to pay income tax on the down payment money; check with your tax preparer.
- **Housing Finance Agency** down payment program. Funds may be available through state Housing Finance Agencies working to increase homeownership in targeted communities. Find your state’s agency at the National Council of State Housing Agencies website (www.ncsha.org) or by calling 202-624-7710.
- **Veterans Administration (VA) loan.** Service people and veterans can qualify for a VA loan that requires no down payment and has low closing costs. Contact the U.S. Department of Veterans Affairs Loan Guaranty Service at 888-244-6711 to request VA Form 26-1880, Request for a Certificate of Eligibility for Home Loan Benefits, before applying. Or visit www.homeloans.va.gov/faqelig.htm to get the form and information online.
- **Private gifts and loans.** Gifts from relatives or friends are a possible source of down payment funds. However, down payment loans from individuals, even friends and family, can raise questions with lenders. Most lenders require you to submit a “gift letter” stating that the money does not need to be repaid. The donor may be asked to provide the lender with proof of the source of the funds.

How will I get a mortgage if my credit isn't perfect?

Your credit doesn't need to be perfect to get a mortgage, but good credit will improve your chances for loan approval, and will qualify you for a lower interest rate. Lenders rely on credit scores to determine their risk in making a loan. The most widely used scoring model is the FICO score, which is based on a 300-to-850-point scale. Many lenders like to see a score of at least 620.

As soon as you start planning to buy a home, order a free copy of your credit report from each of the three major credit bureaus. This will enable you to correct any errors. You'll also have time to improve your credit score, if necessary. (Paying your credit cards and other loans on time and keeping balances low are good ways to improve your credit.) Visit www.annualcreditreport.com or call 877-322-8228 to get your free credit reports.

Be sure to check your reports for errors again three to six months before applying for a loan.

How do I find a housing counselor?

It's a good idea to use a HUD-certified housing counseling agency for guidance in buying your first home. To find a counselor near you, visit HUD online at www.hud.gov and type "housing counseling" in the search field. Then find your state. You can also call 800-569-4287.

First-time homebuyers with low incomes can work with a local housing counselor through NeighborWorks America. Go to www.nw.org or call 800-438-5547 to find a nearby NeighborWorks affiliate. Local groups may offer free or low-cost home buying classes and down payment assistance.

The Affordable Housing Centers of America, a national non-profit organization, offers one-on-one mortgage counseling and first-time homebuyer classes for low and moderate income buyers. Go to www.ahcoa.org or call 888-409-3557.

Find the Right Loan

What should I look for in a loan?

It's a good idea to understand, and narrow down, your mortgage options before you need to apply for a loan. Though there are many loan products to choose from, they all fall into the general categories of fixed rate or adjustable rate. There are advantages to both—one guarantees that your interest rate will not change during the life of the loan, while the other typically offers a lower rate to start with and may fluctuate both up and down during the loan term. Which loan is right for you will depend on a number of factors, including how long you plan to stay in the property.

On any loan, ask:

- About fees—these can vary widely from lender to lender.
- If there are prepayment penalties if you refinance the loan.
- How long loan approval takes.

If you're considering an adjustable rate mortgage (ARM), make sure you understand:

- How frequently the rate can change.
- If there is an annual rate cap.
- If the rate can go down as well as up.

To compare current mortgage rates anonymously and for free among a number of lenders, try www.freeratesearch.com.

Don't jump at the first loan offer you get. Shop around. Be wary of "no cost, no fee" offers. Try to find a lender that participates in first-time homebuyer programs, which could reduce your interest rate, limit fees or help with a down payment. Check with local housing counselors and the city, county and state government where you plan to buy to see what programs are offered.

Should I apply for an FHA loan?

The FHA can be an excellent resource for first-time homebuyers. For example, the agency's "Good Neighbor Next Door" program allows

teachers, police and firefighters in certain revitalized neighborhoods to qualify for a no-down payment loan and a discount on the sale price.

If your bill payment record and credit history are not perfect, FHA-insured loans are easier to qualify for and usually allow a lower down payment. You may even be able to get a loan if you've been through bankruptcy. (You can apply two years from the date your bankruptcy is discharged.)

There are borrowing limits on FHA loans as well as upfront costs, and a 1.5% mortgage insurance premium that is paid monthly for five years. This premium still costs less than private mortgage insurance (PMI). Ask all lenders you contact if they offer FHA loans. Housing counselors can also direct you to FHA-approved lenders. (See "Preparing for Homeownership" for information on finding a counselor.)

What's a conforming loan?

A "conforming" loan fits within the size limits imposed by Fannie Mae and Freddie Mac, the nation's two largest mortgage investors. Loans that do not exceed the maximum set by Fannie Mae and Freddie Mac (currently \$417,000 but can go as high as \$729,750 in high cost areas) are conforming loans, and offer more competitive rates. Larger loans, called jumbo loans, carry a somewhat higher interest rate because they're harder to sell to a third party.

What are points?

A point (sometimes called pre-paid interest) equals 1% of the loan. On a \$100,000 loan, one point equals \$1,000. The more points you pay, the lower your interest rate will be, saving you money over the life of the loan. But paying points is not always advisable, particularly if you plan to sell the property within a few years.

What is the difference between being pre-qualified for a loan and being pre-approved?

"Pre-qualification" is a projection, or estimate, of how much of a loan you might qualify for. The actual loan amount you do qualify

for when you finally apply could be different due to factors such as a change in your income, debt, employment, or credit report.

“Pre-approval” is a firm commitment from a lender for a specific loan amount. The approval can be valid for as little as 30 and as much as 120 days or more, assuming no significant changes to your financial situation during that time.

In a competitive housing market, showing a buyer that you are pre-approved for a loan can give you an advantage over other prospective buyers who do not have financing lined up.

How do lenders decide the maximum mortgage amount for each applicant?

Lenders make this determination based on several factors, including your down payment, the market value of the home and how much you owe to other creditors. If possible, lower your debt before applying for a mortgage because the less you owe, the more you can borrow. Typically, lenders want your housing costs (mortgage, real estate taxes and insurance) to total no more than 28% of your gross (before tax) income. Lenders will usually limit your total debt (including car payments and credit card debt) to 36% of your income. This is called your debt-to-income ratio.

Because mortgage interest is tax deductible, homebuyers typically have to pay less income tax than they did before they bought. This situation means that many buyers can adjust their monthly withholding so that they get more money in their paycheck. Consult a tax professional for help calculating the tax benefits of homeownership and the proper withholding. Or visit www.irs.gov for more information.

Shopping for a Home

Should I use a real estate agent to help me shop for a home?

While it is possible to find a home without the help of a real estate agent, there are many advantages to working with a professional. An agent can provide insight into the local market, access the “multiple

listing service (MLS),” narrow down the many available homes to those that fit your needs and your budget, and guide you through the process and paperwork of making an offer and closing the purchase.

What is a buyer’s agent?

While it is common for a seller’s agent to handle a real estate transaction on behalf of the seller and the buyer, this is not always in the buyer’s best interest, since the seller’s agent has a duty to sell the home for the highest price possible.

A buyer’s agent works only for the buyer. However, your agent may work at an agency that serves sellers as well. If so, ask that you be told when you are being shown properties listed by that agency. A potential conflict of interest can be avoided by retaining a buyer’s agent through a company that serves only buyers, but it may be difficult to find such a company in certain parts of the country.

To find a good local agent, start with referrals from people you know. The National Association of Exclusive Buyer Agents website (www.naeba.org) allows you to “Find an Agent” by city and state. Once you’ve found an agent you want to work with, request the names of several references and get their feedback.

How is a buyer’s agent paid?

Most agents are paid out of the commission received from the seller. (Commissions, which are split between the buyer’s and seller’s agents, can be up to 7% of the sale price.)

Some buyer’s agents ask for an upfront retainer or service fee. Ideally, these fees should be credited against any commission your agent receives when you purchase a home.

Buyer’s agents often ask their clients to sign a contract that gives them the right to represent them exclusively. The contract may contain a clause that says you must pay the commission if the buyer’s agent is not paid by the seller or listing agency.

Do I need to hire an attorney?

You don't always need a lawyer to buy a home, but some states require an attorney to write real estate purchase/sales contracts. Lawyers prepare documents, hire the title search company and accompany you to the settlement (closing).

If you have building plans that require special approval or a zoning variance, be sure to get solid legal advice from a real estate attorney or local zoning professional.

Making a Purchase Offer

How do I make an offer?

Your agent will help you make a written offer that reflects the price you want to pay and the conditions (contingencies) you want to place on the sale. The seller may make a counter-offer. If and when you and the seller come to an agreement, the offer will become a legal contract (according to the laws of your state).

Contracts vary from state to state, but commonly include things like the price and deposit amount, a mortgage contingency, property disclosures, a home inspection contingency, and a closing date and location.

How much of a deposit should I put down?

An "earnest money deposit," often equaling 2% to 3% of the asking price, typically accompanies a purchase offer. The money should be deposited with a third party (put into escrow), such as a law firm or title company. Get a receipt and do not authorize release of the deposit until the sale is final.

What are contingencies?

Contingencies are conditions outlined in the contract that must be satisfied before the sale can be finalized. Some buyers make the sale contingent on obtaining a mortgage, selling their current home, or obtaining various home inspections. (It is not advisable to waive your right to a home inspection.) Sellers can reject your offer if they do not like your contingencies.

There are strict time limits attached to contingencies. For example, you may have only a few days to complete inspections and alert the seller to any problems that are uncovered. At that point, you can attempt to negotiate the cost of the repairs with the seller, or you can cancel the contract and get your deposit back. If you miss a deadline, you can no longer cancel the contract based on that contingency.

What is a home inspection?

A home inspector examines the property for problems such as leaks, structural weaknesses or failing components that might cost you a great deal of money to fix. The inspection should evaluate all major systems in the home (heating, cooling, plumbing and electrical) as well as the roof, foundation, basement and appliances. Home inspections are a protection for homebuyers—for \$300 to \$500 you could avoid thousands of dollars in future repairs. To find an inspector, ask your buyer's agent for a recommendation or contact the National Association of Certified Home Inspectors (www.nachi.org; 877 FIND-INS) or the American Society of Home Inspectors (www.ashi.org; 800-743-2744).

Sellers are required to disclose any defects or environmental hazards that they know of. If the seller knew about problems but did not reveal them, the buyer has grounds for a lawsuit.

Are there other necessary inspections?

Lenders in some states require a termite inspection. The test also looks for wood rot or water damage. You are entitled to a copy of the report.

Most lenders also require a real estate survey (a drawing of the parcel's property lines, structures, fences, retaining walls, driveways, public rights of way, etc.).

For water quality questions, contact the Environmental Protection Agency's (EPA) Safe Drinking Water Hotline at 800-426-4791. Go to www.epa.gov/epahome/wherelyoulive.htm and enter the home's ZIP code for local air, water quality and waste management information. Contact the state EPA office to check on asbestos, oil

or water contamination problems. To get free water and air pollution reports by county go to www.scorecard.org.

If you're buying an older home, consider testing for mold, lead or radon. Include a hazard contingency in your offer in case something of concern is found. This will give you a way out of the contract if you don't want to do the cleanup. You can also ask the seller to clean up the hazardous conditions, but the seller is not required to do this. For a checklist of what questions to ask to evaluate hazards, go to <http://epa.gov/ttn/atw/checklist.html>.

Government offices, such as health, building and zoning departments, may be able to provide additional information on the property.

What does homeowner's insurance cover?

Homeowner's insurance covers damage to your home and possessions, and your liability to other people who may be injured on your property. Make sure you understand if you are insured for a predetermined amount or if you are guaranteed full replacement cost of your damaged property.

If a pipe bursts you may have coverage, but if water seeps into your basement you will probably not be covered. Flood damage is usually not covered under a homeowner's policy. If you buy a home in a "special flood hazard area," you'll be required to get federal flood insurance. Enter your new address at www.floodsmart.gov to get FEMA's estimate of your new home's flood risk. Click on "What's Your Flood Risk?"

What is a CLUE report?

Comprehensive Loss Underwriting Exchange, or CLUE, reports reflect the loss history for a property. An insurer may refuse to issue a policy for the property you wish to buy based on prior insurance claims information contained in a CLUE report. Because lenders require homeowner's insurance, an inability to get coverage could prevent you from getting a mortgage.

When you enter into a contract to buy a home, you can ask your

real estate agent to get a report from the current property owner. The major issuer of CLUE reports is LexisNexis, one of the largest compilers and sellers of personal consumer data. To order a CLUE report on your own property, go online to <http://personalreports.lexisnexis.com> and click on Home Seller's Disclosure Report.

I'm buying a townhouse—are there certain questions I should ask?

If you're buying a condominium, a townhouse or even a home in certain developments, your property may be subject to homeowner's association (HOA) rules, fees and assessments, which will add to your monthly housing costs. Make sure you learn what your monthly dues cover (property taxes, trash collection, landscaping, etc.?) and what items you must pay for separately.

Ask for documentation on the financial health of the homeowner's association and have it reviewed by an attorney or another trustworthy and knowledgeable person. Does the association have ample cash reserves to handle sizeable repairs or maintenance of common areas? If not, you may be asked to dig into your pockets for a "special assessment." Ask how often the association has imposed special assessments for emergency repairs or legal challenges, and the cost of any major planned projects.

Getting a Mortgage

Won't it hurt my chances of getting a loan if I apply with several lenders?

No, it will not hurt your credit score if you do your shopping within a focused period of time, such as 30 days. This will make it clear to other lenders who review your credit file that you are comparing loans.

My down payment is less than 20%, so my lender requires me to pay private mortgage insurance (PMI). What is PMI?

PMI is insurance that buyers who make a down payment of less than 20% must pay for. The insurance protects the mortgage lender in case you default (fail to make payments) on your loan.

Do I have to pay PMI forever?

No. When you own at least 20% of the value of your home outright (this is your “equity”), you can cancel PMI. You can attain 20% equity by paying down the mortgage to 80%, or if your home appreciates in value.

Under the Homeowner’s Protection Act of 1998, your lender must automatically cancel PMI when you’ve paid down the mortgage to 78%. Otherwise, you may have to pay for an appraisal to prove your 20% equity before PMI will be cancelled.

Can I deduct PMI premiums from my taxes?

If your adjusted gross income is under \$100,000 (\$50,000 married filing separately), your PMI premiums are fully tax deductible. Above that amount, partial deductions are allowed for people with adjusted gross incomes of up to \$109,000 (\$54,000 married filing separately). Consult your tax preparer for more details.

How can I avoid PMI?

Make a 20% down payment. If available, a “piggyback” loan (second mortgage) may be obtained to cover some or all of your down payment. Typically, second mortgages (if available) are arranged with your primary lender’s approval at the same time as your first (80%) mortgage. Finance charges on piggyback loans are typically higher than those on a first mortgage, but may cost less than PMI. Before choosing one or the other, ask for a comparison of the costs and tax benefits (deductions) of PMI vs. a piggyback loan.

Who is responsible for the property appraisal?

Lenders hire appraisers to estimate the home’s value, but you pay the fee—usually around \$350 to \$500. An appraiser assesses the condition of the property and compares it to similar homes recently sold in the same area. You’re entitled to a copy of the appraisal before closing.

Lenders, mortgage brokers and real estate brokers have been known to pressure appraisers to overstate the value of a property. You don’t want to buy a home that is worth less than its appraised value—if

you needed to sell quickly, you could end up getting less than you owe. To avoid an inflated appraisal, ask your real estate agent for “comps,” information on recent comparable sales in the area.

What is a “Good Faith Estimate”?

When you apply for a mortgage, you must be given a Good Faith Estimate, a written itemization of approximate “closing” (settlement) costs. The estimate will include all the fees you are being charged in connection with the mortgage and the home purchase. The Good Faith Estimate is not a guarantee. Your rate and points, for example, are not set until you “lock in” with a lender.

Read all estimates closely. Use them to compare mortgage offers. Ask for an explanation of any fees you don’t understand.

How much are closing costs?

Closing costs can amount to 3% to 6% of the mortgage. On a \$200,000 mortgage, that is a cost of \$6,000-\$12,000.

How can I pay for closing costs?

Some loans, including FHA loans, allow you to roll your closing costs into your mortgage, which will add to the amount you are borrowing.

If you are buying your first home and you have an IRA (individual retirement account), you can withdraw up to \$10,000 to pay for closing costs without penalty for early withdrawal. But you will have to pay income taxes on those funds. Talk to your tax preparer before withdrawing money from your IRA.

In a slow real estate market, some sellers are willing to pay a portion of the buyer’s closing costs.

Finalizing Your Home Purchase (Closing)

How can I make sure the property hasn’t been changed since I agreed to buy it?

A day or two before closing, do a final “walk through” to be sure the home is in the same condition as when you agreed to buy it. Your

real estate agent will help you arrange this.

What is the HUD-1 Settlement Statement?

This statement, which you should receive at least one day before closing, itemizes all charges and credits on both sides of the real estate transaction. (The left side of the form lists the buyer's costs and payments.) The HUD-1 document shows the actual cost for each item, not just estimates. All lender's fees, broker's fees, attorney's and/or title company fees will be listed, as will all items paid outside of closing (POC), such as inspections, credit reports, and the appraisal. The earnest money deposit you made when you offered to buy the property will also appear.

What should I expect on the day of closing?

Arrive at the closing with a certified check (or cashier's check) for the final amount listed on your HUD-1 statement, some extra personal checks, and a pen with plenty of ink. You'll be signing a stack of documents, including a promissory note (your formal IOU) and a deed of trust (giving the lender the right to foreclose if the loan isn't repaid).

You'll also receive a "monthly payment" letter stating what you will owe each month in mortgage principal, interest, taxes and insurance (called "PITI"). If taxes and insurance are included in your payment (this is not always the case), the lender will keep these monthly payments in an "escrow account" until it is time to pay your property tax and homeowner's insurance bills.

Take your time and read all papers carefully before signing.

Does title insurance protect the lender or the homeowner?

Lender's title insurance protects the bank from liens (claims) against the title. It is a mandatory cost for the homebuyer taking out a mortgage.

A separate owner's title insurance policy is optional but highly recommended to ensure that your title to the property is free of liens or defects. It protects you against forged titles and title search errors, and it covers losses (up to the purchase price) if you have problems

transferring the title to a new owner. You pay the premium once, at closing, and the coverage lasts as long as you own the property. To find a local title company, visit www.alta.org/search/state.cfm and click on your state.

Understanding Your Rights

What laws are there to protect me when buying a home?

There are several federal laws designed to disclose the costs involved in buying a home:

- **The Truth in Lending Act (TILA)** requires lenders to disclose the annual percentage rate (APR), points and total cost of the loan over time.
- **The Homeownership and Equity Protection Act (HOEPA)** is part of TILA and is designed to stop unfair and deceptive practices by federal and state mortgage lenders on certain “high cost” home loans. This law applies to banks but not to mortgage brokers. The Federal Reserve Board has oversight over TILA and HOEPA. To file a complaint, go to www.federalreserve.gov/pubs/Complaints.
- **The Real Estate Settlement Procedures Act (RESPA)** requires that borrowers receive disclosures about fees throughout the mortgage process. Disclosure documents include the Good Faith Estimate, the HUD-1 Settlement Statement with actual closing costs, an escrow statement listing taxes and deposits held in reserve by the lender, and a servicing statement to notify you if your loan is sold. If there is a RESPA violation, your state attorney general or insurance commissioner is authorized to file a lawsuit. To file a complaint, contact the Office of RESPA Director, Room 9154, 451 7th St. SW, Washington, DC 20410.
- **The Fair Housing Act** prevents discrimination based on race, gender, religion, family status or handicap. Contact HUD’s Housing Discrimination Hotline at 800-669-9777 or mail your complaint to the Office of Fair Housing and Equal Opportunity, Department of Housing and Urban Development, Room 5204, 451 7th St. SW, Washington, DC 20410-2000. Once you file a complaint, HUD will try to reach an agreement or sue on your behalf through an administrative hearing or in district court. If

the violator is found guilty, you could be compensated for actual damages and pain and suffering. For discrimination news and housing counseling resources, go to www.fairhousing.com. Click on “Get Help Near You.”

Homebuyer Resources

Legal help. If you need the help of an attorney, search for a lawyer at the National Association of Consumer Advocates (www.nacanet.org) or FindLaw (www.realestate.findlaw.com). The Legal Services Corporation website (www.lsc.gov) allows you to search for local Legal Aid offices serving low-income individuals.

Background check. Verify that loan officers are licensed (or if any disciplinary actions have been filed) at the Nationwide Mortgage Licensing System and Registry (www.nmlsconsumeraccess.org).

Mortgage Professor (www.mtgprofessor.com). Jack Guttentag, a professor emeritus of finance from the Wharton School at the University of Pennsylvania, offers a lot of detailed mortgage information at this site, including the concept of “upfront brokers,” mortgage brokers who charge a fixed fee and disclose it upfront.

Freddie Mac (www.freddiemac.com). To find a closing-cost calculator that breaks down your costs, click on “Calculators and Tools,” then “Closing Costs.”

Fannie Mae (www.fanniemae.com). Look for the section titled “For Home Buyers & Homeowners” on the left side of the home page. Click on “Resources” for access to calculators and other tools to help you prepare for buying a home.

HomeSales.gov (www.homesales.gov). This site provides current information about single-family homes for sale by the U.S. Government. These previously owned homes are for sale by public auction or other method depending on the property.

HUD: Buying a Home (www.hud.gov/buying). The Department of Housing and Urban Development offers this step-by-step guide to buying a home, including web videos and lists of resources to help low and moderate income homebuyers.

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