CIRCULAR SERIES
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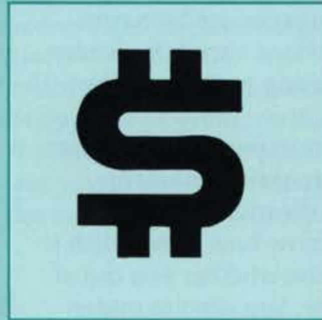
A1.3

Financing the Home



Council Notes **Volume 12, Number 1**

Building Research Council College of Fine and Applied Arts - University of Illinois

The purchase of a home is the largest single investment you make in a lifetime. Housing costs account for the largest single monthly expense in your budget. This circular can help you plan a realistic budget for purchasing a home. And, it will show you how to shop for a mortgage.

COSTS SHOULD FIT YOUR BUDGET

In the past, a house was a good hedge against inflation. You could deduct property tax and interest on the mortgage from federal income tax. Equity grew as you paid off the mortgage. One mortgage looked pretty much like any other. Most mortgages were fixed-rate, and interest rates were low.

Today, however, this has all changed. Today's buyers are finding that the many new kinds of mortgages can be confusing. Financing options vary from lender to lender, and housing costs are higher than in the past.

Buyers today must pay close attention to up-front costs, monthly payments, and the details of the mortgage agreement. You must know how to establish a budget to determine whether you can afford to buy a home. You need to understand the costs of home-ownership and the procedures involved in financing a home, including shopping and applying for a mortgage, types of mortgages, and closing on a loan.

HOW MUCH CAN YOU AFFORD?

Buying a house involves a thorough examination of your financial resources. Before starting to search for a house, you should have a rough idea how much you can afford to pay. This will save time and effort since you won't be tempted to look at houses you can't afford.

In the past, lenders used the following "rules of thumb" to determine how much buyers could afford:

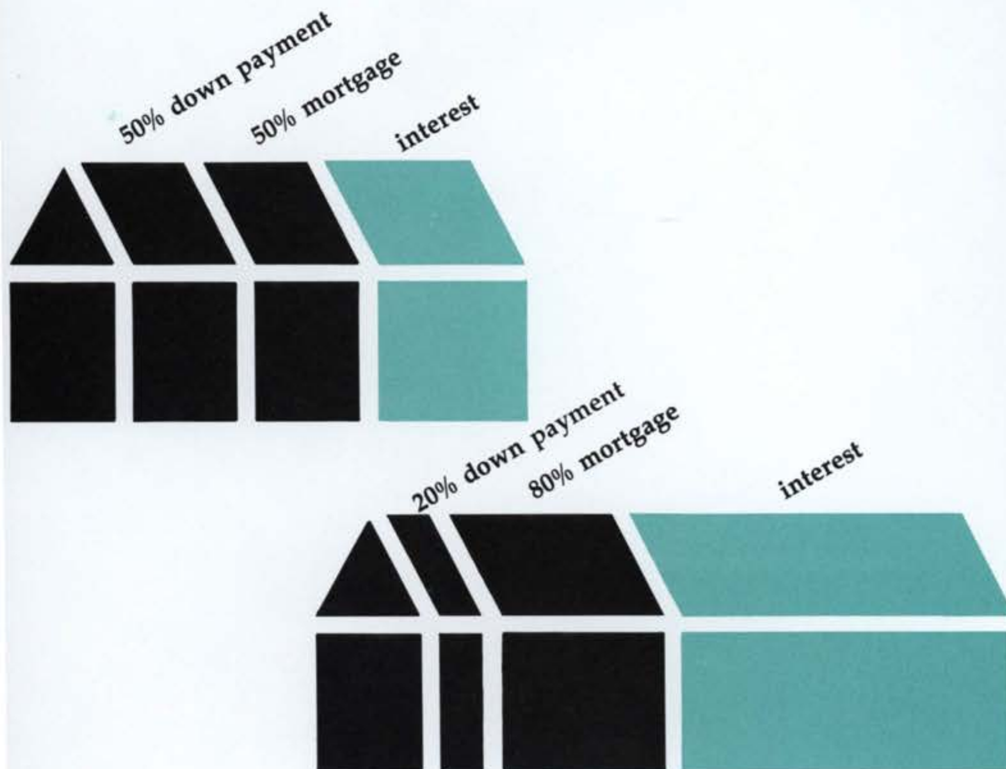
The purchase price of the house could not exceed two and a half times their annual income.

Monthly housing costs could not exceed 25 percent of net (after tax) monthly income.

However, these guidelines were conceived of years ago at a time when home prices, interest rates, and utility costs were comparatively low. They do not take into account family size, existing short- and long-term debt, amount of savings, equity in your present home, or today's varying interest rates. Thus, the conventional guidelines only provide a "ballpark figure" for estimating your borrowing capability.

The best way to determine how much to spend for housing is to compare your monthly income with monthly long-term obligations and expenses. Use the worksheet, "Evaluating Financial Resources," on pages 4 and 5 to determine how much money to invest in housing. Be honest with yourself. Do not commit more income than you can definitely count on. Exclude unreliable income from overtime employment.

You may be willing to make sacrifices in your entertainment, car, or clothing expenses to be able to buy the house you want. In the end, however, the lender



The size of your down payment makes a big difference in how much you pay over the life of your loan. You may be able to get a lower interest rate by putting more money down.

Housing costs are greater today than they were years ago. Mortgage payments are larger. Taxes, utilities, and other expenses add to the cost of housing, taking a larger portion of the consumer's dollar.

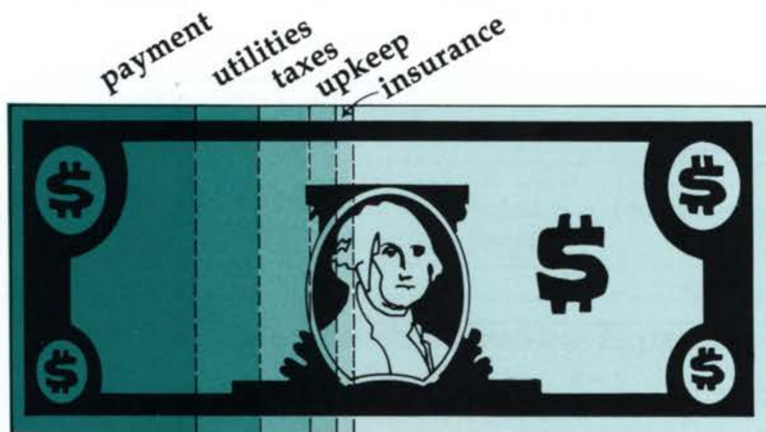
will determine the maximum amount you should commit to housing when you apply for a loan.

The lender is usually looking for two income ratios as they evaluate your loan application:

▲ A house payment not exceeding 25 to 28 percent of income. Included in this percentage is the money that will be spent for taxes and insurance. (You may hear some lenders call this PITI—principal, interest, taxes, and insurance.)

▲ Total obligations for the mortgage payment, taxes, insurance, and long-term debt not exceeding 33 to 36 percent of gross monthly income.

These ratios are established on the basis of the applicant's gross, verifiable monthly income. Your lender will ultimately want you to have your employer send a letter verifying your employment.



HOME OWNERSHIP COSTS

In addition to the monthly mortgage payment for principal and interest, there are other costs of home ownership.

Predictable Costs

Some of these predictable costs can be included in your monthly budget, but you must first know what they are.

Property Taxes. Tax rates on real property vary. Find out the rates from your local officials. Taxes are paid on the current value of the home. When a house is sold, the property tax may rise if you pay a great deal more than the previously assessed value.

Property Insurance. The lending institution holding the mortgage will require insurance in an amount sufficient to cover the loan. However, to protect the full value of your investment, you should consider purchasing insurance that provides the full replacement cost if the home is destroyed. Some insurance only provides a fixed dollar amount which may be insufficient to rebuild a badly damaged house.

Mortgage Insurance. Two types of mortgage insurance are available. One type pays the balance of the loan if the borrower dies. The second type protects the lender from loss if you fail to make payments. This insurance is required on loans where the down payment is less than 20% of the mortgage amount and may be required on any loan, depending on the lender.

Utilities. These include gas, electricity, water, sewer, and telephone. Obtaining utility bills from previous owners will help you estimate this expense.

Unexpected Expenses

Regular expenses are predictable. It's the unexpected expenses that cause trouble. You should budget a small amount every month to be set aside for emergencies.

Maintenance and Improvement. You should set aside 1 percent of the value of the house per year to cover maintenance. This figure can be higher for older homes.

Home Furnishings and Other Expenses. Appliances, carpeting, and furniture may add to your expenses. Also, add in fees for snow removal, trash collection, cable television, and condominium associations.

Moving Expenses. When moving into a new house, plan for any redecorating expenses as well as for the cost of the move itself. You may have expenses for getting your phone connected, and one-time service fees for other utility hook-ups.

HOW MUCH HOUSE WILL THIS BUY?

Having developed a budget, estimate the amount you can spend for a mortgage. The Payment Tables on page 6 show monthly payments for principal and interest. In addition, set aside money for

Evaluating Your Financial Resources

Step 1: Determine Net Monthly Income

Gross Monthly Income

- Gross base pay
  (all wages and salaries other
  than overtime) . . . . + $ ____________
- Net Profit
  (from business) . . . . + $ ____________
- Interest and dividends . . . . . . + $ ____________
- Other income . . . . + $ ____________

Total gross income (add) = $ ____________	+ $ ____________

Deductions

- Income tax
  (federal, state, and local) . . – $ ____________
- Social Security/retirement . . – $ ____________
- Insurance
  (life, health, property) . . . . . – $ ____________
- Other (charities, etc.) . . . . – $ ____________

Total deductions (add) = $ ____________	– $ ____________

1	Total take-home pay Subtract deductions from income = $ ____________	+ $ ____________

Step 2: Figure Long Term Monthly Obligations *(in excess of 11 months)*

- Installment payments on car,
  furniture . . . . $ ____________
- Other debt, over 11 months . . $ ____________

Total long-term debt (add) = $ ____________	+ $ ____________

2	Subtract long-term debt from total take-home pay. Bring forward the number from Step 1.	+ $ ____________

Step 3: Monthly Nonhousing Expenses

- Food, beverages (home and work) ....+ $ ____________
- Transportation/auto expenses + $ ____________
- Education ....+ $ ____________
- Medical/dental care ....+ $ ____________
- Clothing and grooming ......+ $ ____________
- Insurance (life and health) ...+ $ ____________
- Child care ....+ $ ____________
- Gifts and charity ....+ $ ____________
- Entertainment and recreation + $ ____________
- Savings ....+ $ ____________
- Other ....+ $ ____________

Total monthly non-housing expenses (add) = $ ____________ | – $ ____________

3 Subtract non-housing expenses from total of Step 2. | = $ ____________

Step 4: Estimate Monthly Housing Expenses

- Proposed mortgage payment + $ ____________
- Allowance for property taxes + $ ____________
- Allowance for utilities (heat, water, phone, electricity .... + $ ____________
- Allowance for maintenance, furnishings .... + $ ____________
- Allowance for insurance .... + $ ____________

4 Total monthly housing expenses (add) = $____________

Step 5: Compare

Compare estimated monthly housing expenses (Step 4) with income available (Step 3). If income available from Step 3 does not equal or exceed monthly housing expenses, then you must re-evaluate your budget and resources.

Total from Step 3 ____________ $\geq$ Total from Step 3 ____________

the down payment, taxes, insurance, utilities, maintenance, and improvement.

The budget allowance is not a "true" budget allowance, however, since owning a home can have significant tax advantages. An accountant can help you assess the tax benefits of home ownership.

Mortgage Loan Criteria

Even if you are convinced you can afford the house of your dreams, the lender makes the final decision. Each lending institution establishes its own guidelines. Lenders generally consider several factors before approving a loan.

Monthly Income. This is an obvious starting point, but it includes more than the breadwinner's paycheck. The spouse's paycheck must be added in by law. If a spouse plans to quit work, including that income in the loan application would be a mistake. Alimony, child support, part-time employment, and all other steady sources of income must be included.

If your income is low, but you are buying an energy-efficient home, your lender may be able to help you qualify for a loan anyway. Buyers can qualify through a federal program called the *Energy Addendum* financing program. The program allows an increase of 2 percent in the debt-to-income ratio that is used to determine a family's eligibility.

Employment. How long the borrower has had the same job is as important, from the lender's point of view, as is the type of work performed. Steady work and the likelihood of future increases in income are also important.

Credit. Above all, the lender wants to be convinced that the money borrowed will be paid back. The ability to repay a loan is best proven by past experience in doing so.

Debt and Net Worth. Most lenders set a limit of 36% of gross monthly income to be used for all installment debts (including PITI) lasting longer than 11 months.

Purchasing and Related Housing Costs. The borrower must have the money needed for the down payment and the closing costs.

The House. The lender is concerned about the age and condition of the house and the quality and character of the neighborhood. Is it a good investment? Could the lender sell the home for the amount of the loan if the buyer defaults? Lenders look at the long-range value of the home as they consider whether they should invest in the property.

Down Payment Sources. Lenders also want to know where you are getting the money for your down payment. You may have to prove the money came from a savings account or life insurance policy. Loans from relatives are considered part of your overall debt and are not allowed as part of a down payment, unless the relative is willing to co-sign the loan.

The payment tables give you the monthly payment for each $1,000 borrowed. To figure out how much per month your mortgage payments will be, multiply by the number of thousands you will borrow.

If the interest rate is 13%, and the loan lasts 25 years, you see that the monthly payment amount per $1,000 is $11.28. If you want to borrow $68,000, you would multiply 68×11.28=$767.04. This gives you the amount of the monthly payment.

Payment Tables

(Monthly payment for each $1,000 borrowed)

Int. Rate	5 yrs.	10 yrs.	15 yrs.	20 yrs.	25 yrs.	30 yrs.
8%	$20.28	$12.13	$9.56	$8.36	$7.72	$7.34
9%	$20.76	$12.67	$10.14	$9.00	$8.39	$8.05
10%	$21.25	$13.22	$10.75	$9.65	$9.09	$8.75
11%	21.74	$13.78	$11.37	$10.31	$9.80	$9.52
12%	$22.24	$14.35	$12.00	$11.01	$10.53	$10.29
13%	$22.75	$14.93	$12.65	$11.71	$11.28	$11.06
14%	$23.27	$16.13	$14.00	$13.17	$12.81	$12.64
15%	$23.79	$16.13	$14.00	$13.17	$12.81	$12.64
16%	$24.32	$16.75	$14.69	$13.91	$13.59	$13.45
17%	$24.85	$17.38	$15.39	$14.67	$14.38	$14.26
18%	$24.39	$18.02	$16.10	$15.43	$15.17	$15.07

STEPS IN HOME BUYING

After selecting a home, you will make a purchase offer and give the seller a goodwill deposit. This indicates you are serious about following through on the offer, and the seller is entitled to keep your money if you get cold feet and back out of the deal.

Signing A Contract

A *contract of sale* is the legal document which binds the seller and the buyer to an agreed-upon price. The contract includes all provisions important to both buyer and seller.

The contract should be drawn up or examined by an attorney familiar with local real estate. Make sure you understand every clause of the contract before you sign it.

This contract, or sales agreement, states the terms of the sale. It describes the property, the price, the date of closing, adjustments to be made at closing, special conditions of the sale, and furnishings or appliances included in the sale. Verbal agreements should be put in writing and included in the contract.

The goodwill deposit, or *earnest money*, is an amount adequate to demonstrate serious intent to buy. You may wish to state contingencies which will void the contract without the loss of the deposit. Failing to obtain financing is an example of such a contingency. Another contingency that is often specified is that the house receive a favorable inspection from a certified home inspector. (See Circular A1.1 *Inspecting the Home*.)

Your deposit is held in *escrow* by the broker or attorney until the closing, when it is applied to the down payment. The lender sets up an escrow account to hold your earnest money; you cannot take the money back without the lender's approval. Should you decide not to go through with the sale, although all terms of the purchase offer have been met, you forfeit the deposit to the seller.

If you are purchasing a new house, the contract should state that the builder promises to build a house, on a specific piece of land, by a certain date. (See Circular A2.0, *Hiring Designers & Builders*.)

Selecting A Mortgage

Most people cannot pay cash for a home. They make a cash down payment, ranging from 5 to 50 percent of the purchase price, and obtain a mortgage for the remainder. A *mortgage* is a legal agreement between the home purchaser and lender that pledges the buyer's property as security for the loan.

To determine whether a mortgage is acceptable, you should know several things that affect the overall cost of borrowing. These are the principal, the rate of interest, the repayment period, equity, the points, and other closing costs.

The *principal and interest* make up the monthly payment. The *principal* is the amount borrowed, or the amount of the loan, and represents the difference between the cost of the house and the down payment.

The *interest* is the charge made by the lending institution for lending the money, and is usually stated as an APR or *annual percentage rate*, such as 12.5 percent or 14 percent.

The *repayment period* is the number of years to repay the loan, such as 20 or 30 years. As you pay off principal, you build up *equity* or ownership. Your equity also increases if the value of the home increases. Building equity and reducing debt through payments of principal and interest is called *amortization*.

In considering mortgages, remember:

▲ The greater the down payment, the greater your equity in the property and the less you will have to borrow. The result is that your total interest costs drop. Also, a larger down payment lets the lender set a lower interest rate since the risk is reduced.

▲ Don't use all of your funds for a down payment, since money will be needed for closing costs and moving expenses.

▲ Conditions in the market affect interest rates. Shop for the best rate (there will be differences among lenders) since half a percent can make a great difference on a 20-year loan. Keep in mind, though, that the lowest rate doesn't automatically mean the best deal. Also, compare other costs lenders may charge when granting a mortgage.

▲ Since interest is paid only on the outstanding portion of the loan, earlier in the life of the mortgage, you pay more on the interest than on the principal. Later, it's the other way around.

Making a large down payment lowers the amount of interest paid over the life of the mortgage. You may also be able to get a lower interest rate.

The length of the repayment period affects the monthly payment and the total interest costs. A longer repayment period results in a smaller monthly payment but a higher total interest cost. Recently, 15-year fixed-rate mortgages have become more popular. While you quickly build up home equity, your monthly payments are higher.

Reading the Fine Print

Check to see if the mortgage has a *prepayment privilege* which allows the borrower to repay all or part of the mortgage in advance without penalty. A *due-on-sale clause* provides that the loan balance must be paid off if the home is sold.

The *Truth in Lending Act* requires that lenders disclose the *annual percentage rate* of interest, or APR, to borrowers. This statement also estimates the amount of interest paid on the principal over the lifetime of the loan. In many cases the interest paid on the loan will be greater than the original mortgage amount. Because the interest is such a large portion of the lifetime housing costs, be sure to compare overall interest charges before deciding which mortgage to accept.

The *Equal Credit Opportunity Act* makes it illegal for a person to be refused credit because of sex or marital status.

There are two other mortgage terms you should recognize. The *Acceleration Clause* refers to a provision in a mortgage that requires the unpaid balance of the loan to become due immediately if the regular mortgage payments are not made or if terms of the mortgage are not met. *Late charges* will be assessed if payments are not made on time.

FINANCING ALTERNATIVES

Until recently, most mortgages had fixed monthly payments (FRMs), a fixed interest rate, and full amortization (gradual debt reduction through monthly payments) over a period of 20 to 30 years. However, in the last 10 years, lenders have come up with a variety of financing alternatives that may help you buy a home you otherwise could not afford.

These new options include *bridge loans* that can give you financing to cover mortgage payments for 6 months to a year while you try to sell you old house. You can also ask about *shared equity* loans that let a relative or investor help you make the down payment. Some lenders will speed up the application procedures if you have borrowed mortgage money from them previously. This can be a big help if you move frequently.

Lenders are even discussing a new type of loan that would permit *negative amortization*. When negative amortization occurs, your monthly payments do not reduce the loan amount. Payments are all applied to paying interest on the loan. The size of the loan may even grow.

While these newer mortgage alternatives may involve some risks (and additional costs), they give buyers greater flexibility. Before making a decision on which kind of loan to use, make sure you read all the fine print in your loan agreement.

THE LANGUAGE OF LOANS

There are some other important terms to understand before you talk to your lender about mortgages.

A *conventional loan* is made strictly between you and a private lender with no other backing, such as government insurance or guarantee.

An *insured loan* is a loan insured by FHA, VA, FmHA or a private mortgage insurance company. Each of these government bodies guarantees the lender payment, even if the buyer defaults on the loan. There are significant differences between the programs.

An *assumable mortgage* is one in which the buyer takes over the payments on the seller's old mortgage and pays the seller the difference between the selling price and the remaining loan balance. (Not all mortgages are assumable and most new mortgages are written today with a nonassumable clause.)

A *second mortgage*, one in which the lender has secondary rights to the property, may be obtained to make up the difference on an assumption.

You will also hear lenders refer to *points*. One point is equal to 1 percent of the loan amount. Lenders may charge 1,2, or 3 points as an extra up-front cost–in addition to the down payment. The more points you pay, the lower your in-

terest rate will be. You may even be able to finance the points.

A *loan for land contract* is a sales contract that lets the seller retain title to the property until the buyer has paid the seller the full purchase price. The buyer makes the down payment and monthly payments to the seller with no involvement of the lending institution.

People who have owned their home for a long time, and who live in an area where home prices have risen rapidly, may find a *home equity loan* appealing. The lender obtains an appraisal of your home's current worth and will lend you the difference between the unpaid balance on your mortgage and the appraised value.

In reality, a home equity loan is similar to a second mortgage. It can significantly increase your monthly payments, a disadvantage if your existing mortgage payments are low.

Rent with option to buy enables the renter to buy time to obtain a down payment. In some cases part of the rent may be used as the down payment.

In financing a new home that has not yet been built, the lending institution often follows a formula allowing a certain percentage of the money to be loaned upon completion of each major "step" in construction. Make sure the loan will cover the essentials that may or may not be included in the contract price, such as drilling for a well or installing a septic tank.

LOAN OPTIONS

Before you decide on financing, evaluate the pros and cons of the different loan packages. Many lenders offer more than one package and will give you a choice. Interest rates vary, but they are generally tied to the current lending rate set by the Federal Reserve Bank. The loan rate will vary according to the *prime rate*, which is the rate at which the Federal Reserve makes money available to banks.

Fixed Rate (FRM)

With these loans, the interest rate and monthly payments remain constant for the life of the loan. You are protected from rising interest rates, but lenders charge higher interest rates. If interest rates fall, you'll have to refinance to take advantage of the lower rates. These loans are best for buyers on fixed incomes. You should also consider them when interest rates drop below 10%.

Adjustable Rate (ARM)

With ARMs, the interest rate or monthly payment is adjusted periodically to the market rate. Interest rates are usually lower than fixed-rate loans, so you need less income to qualify. If interest rates fall, the interest rate on the loan drops too, but if rates rise, your monthly payments will go up.

Interest rate adjustments can be made every 6 months to 3 years–it depends on the lender. The rate will be tied to either the Treasury Index or to another index, such as the Cost-of-Funds Index. Some lenders offer a conversion clause that allows you to convert the loan to a fixed-rate mortgage. These loans are good for first-time buyers with rising incomes.

Federal Housing Administration (FHA)

FHA loans charge below-market interest rates and have lower down payment requirements. The lenders charge points, and the loan may require more paper work. You will also have to pay an additional 1/2% interest to protect the lender from loss in case you default on the loan. Nevertheless, FHA loans are good for first-time buyers who may not have the 20% down payment lenders require.

Farmer's Home (FmHA)

The Farmer's Home Administration (FmHA) guarantees loans of clients in rural areas. While many rural homebuyers obtain FmHA guaranteed loans

through local banks, if the bank turns the buyer down, the buyer can apply directly to the FmHA district office. Thus, FmHA also functions as the lender of last resort. The loans work well for buyers with lower incomes in rural areas. However, if the buyer's income rises, FmHA has the right to require that loans be refinanced.

Veteran's Administration (VA)

The VA guarantees mortgages for qualified veterans and surviving spouses. They charge below-market interest rates and have lower down payment requirements. VA lenders usually charge points and take extra time for paper work. But the Veteran's Administration does not charge the buyer for guaranteeing the buyer's loan. Veterans who are first-time home buyers will appreciate the benefits of this program.

The mortgage type and interest rate make a big difference in your monthly payments. This chart shows the annual income needed to qualify for the loan and the amount of monthly payments.

Monthly Payments on a $100,000 Loan

Mortgage	Int.Rate	Monthly Pmt.	Annual Income
30-year Fixed rate	10.25%	$896	$43,000
15-year Fixed rate	10.00%	$1,075	$51,600
7-year Balloon	9.75%	$863	$41,400
ARM (1 year adj.)	8.44%	$773	$37,100
Rollover (10 year adj.)	10.41%	$905	$43,400
30-year Grad.pmt. (GPM)	*10.66%	$705	$33,800

*Actual loan rate; income and monthly payments based on first-year rate of 7.5%

Seller Financing

Sellers who do not need the full cash value of their property may also help finance the purchase. They can provide all or part of the loan, and they, not the bank, hold the deed of trust. If you fail to make your payments, the seller is entitled to reclaim the property. These loans are attractive for buyers who cannot qualify for other financing.

Sellers usually want to place a limit on the amount of time their money will be tied up. They may ask for a *balloon payment* in 3 to 5 years. This means the buyer must find another method of financing when the time period expires. If the buyers still cannot qualify for a loan, they risk losing the house. However, buyers with rising incomes who expect to move before the balloon payment is due or who plan to refinance may find balloon payments a better option than passing up the house they really want.

Blended (Wrap Around)

An existing assumable loan is combined with a new loan, resulting in an interest rate somewhere between the rate on the old loan and current market rate. This gives a lower interest rate and fixed monthly payments, but the seller, not the institution, holds the deed of trust. This type of loan is suitable for all buyers, but may not be available everywhere.

Graduated Payment (GPM)

Payments increase a set amount each year for the first 5 to 7 years, then level off. The loan requires less income to qualify, and you can plan ahead for increases. However, these loans cost more over their lifetime, and if the house is sold after the first few years, you may owe more than the original mortgage amount. First-time buyers with rising incomes (who don't expect to move soon) could find these loans attractive.

Growing Equity (GEM)

The monthly payment increases annually, but increases are applied to the loan principal. The loan term lasts half as long as other mortgages, and you can build equity sooner. On the down side, your income must keep pace with payment increases. This type of loan is good for buyers with rising incomes.

Shared Appreciation (SAM)

These loans allow the buyer and lender to share in any increase in the value of a property. Interest rates are below-market, and monthly payments are lower. If the home's value goes up, the total cost of the loan jumps. But if the home's value does not rise, you may still owe the lender for the projected increase. This might force you to refinance at higher

rates. The loan could help first-time buyers and buyers with lower incomes.

Renegotiable Rate (Roll-over)

The interest rate and monthly payments are constant for several years, but changes can occur at some specified time. If interest rates are higher at the time the loan rolls over, you could face higher monthly payments. However, since the time period is generally longer than the same time period in adjustable-rate mortgages, you do get greater stability in your payments. Buyers with rising incomes could consider roll-overs.

COMPARING MORTGAGES

Once the sales agreement is signed, the next step is to shop for financing. (Actually, it's a good idea to have done some preliminary checking to see if money is available and if you qualify, prior to making a purchase offer.) Some of the sources for obtaining a loan include savings and loans, commercial banks, savings banks, credit unions, mortgage bankers and companies, insurance companies, union trust funds, state government finance agencies, employers, and home-sellers.

There is a great distinction between the price of a house and its total cost. Total cost over the years is influenced by mortgage interest rates. A half-percent difference in interest rates adds up, over the length of a loan, to a sizeable amount of money. Don't be afraid to bargain.

When evaluating a loan, ask these questions:

- ▲ What is the required down payment?
- ▲ What is the monthly payment and interest rate expressed as the "annual percentage rate" or APR?
- ▲ How often can they change?
- ▲ Are there limits (caps) on the interest rate or monthly payment charges? How will the new interest rate or payments be calculated?
- ▲ What is the margin? This is the spread between the index used on an ARM and the borrower's new interest rate.
- ▲ What options are available to deal with changes in the interest rate (increase monthly payments or extend the term of the loan)?
- ▲ Could the amount you owe increase above the original loan (giving you a loan with negative amortization)?
- ▲ What is the length of the mortgage? Will you have to refinance the mortgage after a few years?
- ▲ Ask what the highest possible payment would be.
- ▲ Find out if the loan can be converted from an ARM to a fixed-rate loan in the future.
- ▲ Ask what the discount points and closing costs are going to be, and whether they can be included in your loan financing or whether you will have to pay for them at the time of closing.
- ▲ Check for prepayment penalties, call options, due-on-sale clauses, and any other penalties.

Finally, ask yourself if you are prepared to meet all contingencies that might occur over the life of the loan.

Applying for the Loan

After shopping around and finding a mortgage, the next step is to submit a loan application. If the application is approved, a letter of commitment will be sent outlining conditions of the mortgage and authorizing the go-ahead on the sale of the property. You will have to document your sources of income, credit card balances, and payments for other installment loans.

Once the lender gives you a letter of commitment, you are locked in to the loan rate stated on that letter. If the interest rate rises, you are protected from further increases; however, if rates fall slightly, you are not entitled to the lower rate.

Failure to make mortgage payments on time, as agreed to in the mortgage note, can lead to serious problems. If a payment is late, the mortgage is delinquent. If the payment is 30 days late, the mortgage is in default, and the lender may have the right to start foreclosure proceedings. If you believe you may have difficulty making payments on time, let the lender know of your problems. Usually, arrangements can be worked out with the lender.

THE CLOSING

The final step in the home buying process is the closing or settlement. This is a meeting between the buyer and seller, representatives of the lender, the real estate broker, and attorneys. The exchange of the title to the home takes place at this meeting when the seller passes the property deed to the buyer. In addition, all financial transactions involved in the sale are completed at the closing.

Closing a real estate transaction is a complex and costly process. Costs can often be reduced by negotiating with the seller to share costs. You should also compare attorneys' fees and lending fees.

Closing Costs

Settlement and closing costs vary from one lending institution to another. Among the reasons are differences in local real estate practices and loans, the possibility of splitting costs between the buyer and the seller, the type of mortgage obtained, and the efforts of the buyer to successfully "shop around" for lower closing costs.

The Real Estate Settlement Procedures Act (RESPA), a federal statute, helps protect the buyer at settlement. Lenders are required at the time a borrower applies for a loan to provide a good-faith estimate of the costs of settlement services and a copy of a booklet entitled *Settlement Costs and You!*

If you request it, the lender will give you a uniform settlement statement one business day before closing. Check the statement carefully for accuracy.

These are some of the expenses that will be figured into the final closing costs:

▲ Prorated property taxes (That portion of the taxes already paid by the seller must be reimbursed to the seller at closing);

▲ Title search and insurance fees (for examining the title to the property to verify clear ownership);

▲ Attorney's fees;

▲ Origination or application fee of the lending agency;

▲ Engineer's survey to establish exact property lines;

▲ Appraisal fees;

▲ Credit report fees;

▲ Points charged by a lending institution to increase profit on a mortgage. The lower the interest rate, the higher the number of points charged (one point equals one percent of the mortgage loan);

▲ Escrow fees paid to the lender to be held for taxes and insurance;

▲ Hazard homeowner's insurance premium;

▲ State and local transfer taxes;

▲ Interest may have to be prepaid on the mortgage from the date of settlement to the beginning of the period covered by the first monthly payment;

▲ Mortgage insurance premiums for private mortgage insurance if the loan requires it.

Your closing statement may also include fees such as notary and recording fees, revenue stamps, termite inspection, reserves for future recurring expenses such as hazard insurance and property taxes, and other incidental expenses. Any fee you are charged should be specified. Shop as carefully for financing as you did for the house.

Keep the following in mind:

▲ Don't use yesterday's assumptions about today's real estate market.

▲ The key is affordability. Consider your total housing costs, including loan payments (now and in the future), maintenance, property taxes, and anticipated income changes.

▲ Look into several sources of financing.

▲ Ask questions.

▲ Negotiate with the seller or lender. Better terms may be available than those initially offered.

▲ Seek legal advice throughout the home buying process.

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