

F I N A N C I N G

T H E H O M E



Small Homes Council-Building Research Council
University of Illinois at Urbana-Champaign



The purchase of a home is the largest single investment an individual or family makes in a lifetime. Housing costs account for the largest single monthly expense.

Traditionally, a house has been a good hedge against inflation. Property tax and interest on the mortgage could be deducted from federal income tax. Equity grew as the mortgage was paid off.

Until recently, one mortgage looked pretty much like any other. Most mortgages were fixed-rate. There was little variation in interest rates among lenders. Today, however, this has all changed.

Buying that "dream house" can often turn into a "nightmare," since most consumers have very little background or knowledge about financing this major expenditure. Consumers must know how to establish a budget to determine whether they can afford to buy a home. They 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.

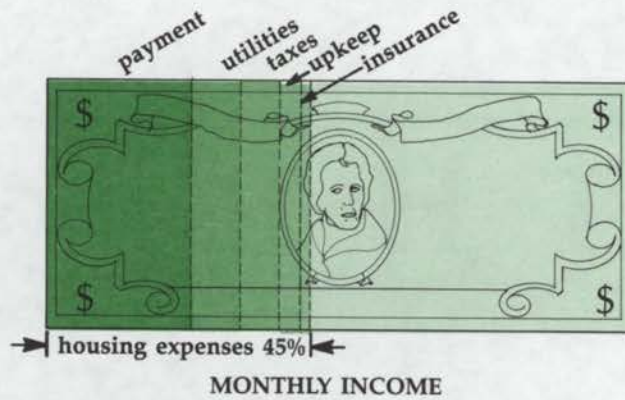
This circular presents general guidelines for financing a home. State laws and conditions vary, so that some modifications of the practices described on the following pages may be necessary.

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 help save time and effort since you won't be tempted to look at houses you can't afford.

For many years, potential buyers were given the following "rules of thumb" to use in determining how much they could afford:

- The purchase price of the house should not exceed two and a half times their annual income.
- Monthly housing costs should not exceed 25 percent of net (after tax) monthly income.



Housing costs today are greater 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.

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 a present home, or today's varying interest rates. Thus, the conventional guidelines only provide a "ballpark figure" for estimating borrowing capability.

The best way to determine how much to spend for housing is to compare monthly income with monthly long-term obligations and expenses. Use the worksheet, "Evaluating Financial Resources," as a guide 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 decide to spend a bit more to purchase a house with features you really like. Furniture, drapes, and rugs can be purchased as earning power increases.

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The maximum amount that should be spent on housing will be determined by the lender when the buyer applies for a loan. The lender is usually looking for two income ratios:

- A house payment not exceeding 25 to 28 percent of income.
- Total obligations for the mortgage payment, taxes, insurance, and utilities not exceeding 33 to 36 percent of income.

These ratios are established on the basis of the applicant's gross, verifiable monthly income.

HOME OWNERSHIP COSTS

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

Predictable Costs

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 will be influenced by the price you pay. You may pay higher taxes than the seller paid.

Property Insurance. The lending institution holding the mortgage will require insurance in an amount sufficient to cover the loan. Consider purchasing insurance that provides 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 due to payment default. This is required on all loans over 80% of the value of the property and may be required on any loan, depending on the lender.

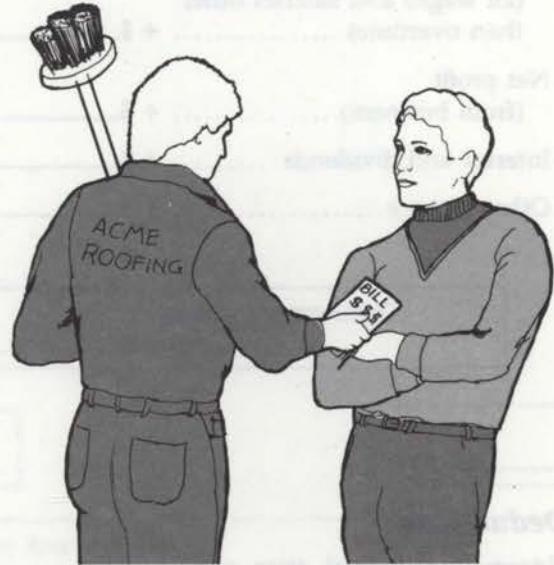
Utilities. These include gas, electricity, water, sewer and telephone. Obtaining utility bills from previous owners will help you estimate this expense.

Unexpected Expenses

Regular expenses are predictable. It's the unexpected expenses that cause trouble. Your budget should include a small amount set aside for emergencies.

Maintenance and Improvement. A traditional equation for determining annual costs of maintenance for single-family houses is equal to one percent of the value of the house. This figure can be higher for older homes.

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



Make sure you allow money in your budget for any repairs your home may require.

HOW MUCH HOUSE WILL THIS BUY?

Having developed a budget, estimate the amount you can spend for a mortgage. The Payment Tables show monthly payments for principal and interest. In addition, money for the down payment, taxes, insurance, utilities, maintenance, and improvements must be set aside.

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



Be sure to go over details of the contract and lending agreement with your attorney before signing.

Evaluating 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 and retirement.... \$ _____
- Insurance (life, health, other).... \$ _____
- 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 12 months)

- Installment payments on car,
furniture..... \$ _____
- Other..... \$ _____

Total long-term debts
(add) = \$ _____

- \$ _____

2 Subtract long-term debts from total take-home pay,
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 nonhousing
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 4 \$ _____

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	\$15.53	\$13.32	\$12.44	\$12.04	\$11.85
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

EXAMPLE

To figure out how much per month your mortgage payments will be, use the table to determine the payback period and the interest rate. Multiply by the number of thousands you will borrow.

Interest rate 13%

Payback period 25 years

Looking at the table, we see the payment amount per \$1,000 is \$11.28. We want to borrow \$68,000. Multiply:

$$68 \times 11.28 = \$767.04$$

This will be the amount of the monthly payment.

Mortgage Loan Criteria

Even if buyers are convinced they can afford the house of their dreams, the lender makes the final decision. Each lending institution establishes its own guidelines. However, lenders generally consider these 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.
- **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. A good credit rating is the best evidence of ability to repay a loan.

- **Debt and Net Worth.** Most lenders set a limit of 36% of gross monthly income to be used for all installment debts (including the house payment) lasting longer than six 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? The risk the lender takes involves assessing the long-range value of the home should it become the lender's property any time during the long period of repayment.

STEPS IN HOME BUYING

The Contract

After selecting a home, you will make a purchase offer and give the seller a goodwill deposit. 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 purchase, 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. The buyer 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.

The deposit is held in escrow by the broker or attorney until the closing, when it is applied to the down payment. 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 deliver to you, by a particular date, a specific model of house constructed on a specified plot of land. Construction specifications should also be included in the contract.

Selecting a Mortgage

Most people cannot pay cash for a home. They do 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, and equity.

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.

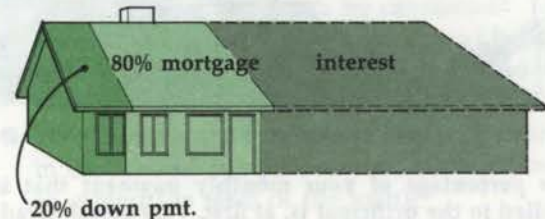
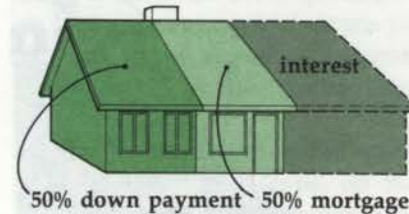
The interest is the charge made by the lending institution for lending the money, usually stated as an APR or "annual percentage rate", such as 12½ percent or 14 percent.

The repayment period is the number of years to repay the loan, such as 20 or 30 years.

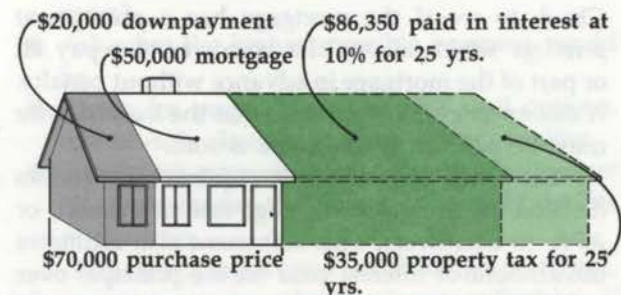
Gradually, as you pay off principal, you build up equity or ownership. Your equity also increases if the value of the home increases. This process of gradually obtaining equity and reducing debt through payments of principal and interest is called *amortization*.

In considering mortgages, remember:

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



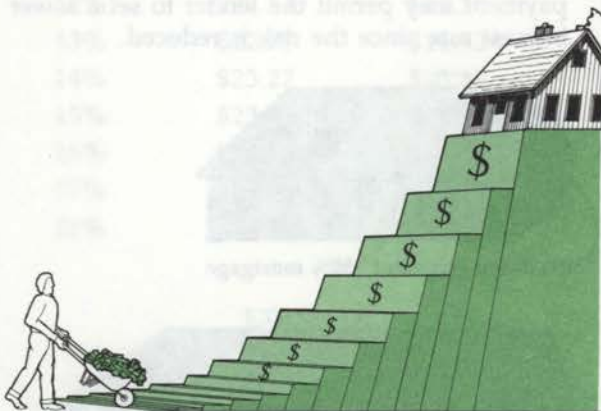
Making a larger down payment will lower the amount of interest paid over the life of the mortgage. You may also be able to get a lower interest rate.



Though interest and property taxes more than double the total cost of a house, these are both deductible from federal income tax and will lower your income tax substantially.

- However, 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 ½ 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.
- 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.



The percentage of your monthly payment that is applied to the principal is, at first, very small. Gradually, as you build equity, that percentage increases until the loan is finally paid off.

Read 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 package 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 (FRM's), a fixed interest rate, and full amortization (gradual debt reduction through monthly payments) over a period of 20 to 30 years. FRM's are harder to get today, because lenders are afraid of holding long-term, low-interest loans during a period of high inflation and rising interest rates. Instead, lenders have come up with a variety of financing alternatives that may help you buy a home you otherwise couldn't afford. These alternatives may involve some risks. The chart, "Home Mortgage Guide," briefly describes various financing alternatives, their advantages and disadvantages, and for whom they are most suitable.

Mortgage Terminology

There are some important terms to understand in conjunction with 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 bodies guarantees the lender payment, even if the buyer defaults on the loan. There are significant differences between the programs. The Veteran's Administration does not charge the buyer for guaranteeing the buyer's loan. With FHA there is a charge to the buyer for their guarantee. Private mortgage insurance companies usually add 1/2% to the loan rate to provide a guarantee against default. These types of mortgage insurance are generally required when the buyer is borrowing more than 80% of the loan.

Like the other agencies, 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. FmHA has the right to require that loans be refinanced when other financing becomes available.

Mortgage insurance is different from mortgage life insurance. Mortgage life insurance generally pays off the loan if one or both wage earners die. Because interest paid on a home loan is an important tax shelter for many people, paying off the mortgage at the time of death may not be advantageous. Regular term life insurance equal to the mortgage balance could be used to give survivors the option of paying off the mortgage if it were in their best interests.

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're not alone if you feel baffled by the number of new financing alternatives available. The "Home Mortgage Guide" explains the differences between them.

A *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.

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

In financing a home that is being constructed, 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.

Comparing Mortgage Alternatives

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, and homesellers.

There is a great difference 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 life of the 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 (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.
- 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.

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. The letter of commitment forms the basis for developing the mortgage agreement.

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.

HOME MORTGAGE GUIDE

Instrument	Advantages	Disadvantages	Suitable For
<p>Fixed Rate (FRM) Interest rate and monthly payments remain constant for the loan term.</p>	Protects against rising interest rates.	Lenders charge higher interest rate; must refinance to take advantage of decline in interest rates.	Buyers on fixed incomes.
<p>Buy-Down Seller and/or investor subsidizes mortgages by "buying down" interest rate for first few years.</p>	Lower interest rate initially, therefore, lower monthly payments; requires less income to qualify.	When subsidy expires payments could increase substantially, especially with unrealistically low interest rate buy-down.	Buyers with rising incomes; buyers who expect to move before subsidy ends.
<p>Owner Financing Seller helps with financing by providing all or part of the loan.</p>	Usually carries lower interest rate with lower monthly payments. Closing costs may be lower.	Seller, not institution, may hold deed of trust; if loan terms call for "balloon" payment, buyer must seek new financing (see below).	Buyers who cannot qualify for any other type of financing.
<p>Balloon Payments are amortized as though loan is for 30 years, but balance is due after much shorter period, usually 3 to 5 years.</p>	Lower initial interest rate; if interest rates have declined by the time balloon payment is due, buyer can secure less expensive financing.	Refinancing required; if interest rates have not declined, buyer risks losing his house if he cannot afford new payments.	Buyers with rising incomes; buyers who expect to move before balloon is due.
<p>Graduated Payment (GPM) Payments increase a set amount each year for the first five to seven years, at which time they remain constant for remaining term.</p>	Requires less income to qualify; buyer can plan ahead for increases in payments.	Loan costs more over entire term; must refinance to take advantage of decline in interest rates. If house is sold after first few years, payments may not have been large enough to cover interest.	First-time buyers; buyers with rising incomes.
<p>Adjustable (ARM) Interest rate or monthly payment adjusted periodically to market rate.</p>	Interest rate is usually lower initially, therefore monthly payment is lower and less income is needed to qualify; if interest rates decline, rate is adjusted downward with no need for refinancing.	Difficult to predict whether rates will rise or fall, therefore hard to plan for future payments; limits on increases could result in buyer owing more than originally borrowed (negative amortization); if house fails to appreciate at expected rate, borrower could owe more than house is worth.	First-time buyers; buyers with rising incomes; buyers who expect to move before adjustment period expires.
<p>No Interest (Zero Interest) Seller provides loan requiring large down payment but charges no interest on monthly payments.</p>	Term of loan is usually five years; entire monthly payment is applied toward loan principal; loan is less costly.	Requires down payment as large as 40 percent; seller sometimes charges premium above price charged buyers who take other type of loan; monthly payments usually larger.	Buyers with plenty of cash.

Instrument	Advantages	Disadvantages	Suitable For
<p>Blended (Wrap Around) Existing assumable loan combined with a new loan, resulting in an interest rate somewhere between rate on old loan and current market rate.</p>	<p>Lower interest rate; rate and monthly payment fixed for loan term.</p>	<p>Availability is restricted; seller, not institution, holds deed of trust.</p>	<p>All buyers.</p>
<p>Growing Equity (GEM) Monthly payment increases annually, but increase is applied to loan principal.</p>	<p>Loan term is about half of other mortgages; total cost is less; increases are predetermined; greater equity in the house sooner.</p>	<p>Buyer's income must be able to keep up with payment increases.</p>	<p>Buyers with rising incomes.</p>
<p>Shared Appreciation (SAM) Buyer and lender share in any increase in the value of a property.</p>	<p>Below-market interest rate and lower monthly payments.</p>	<p>If home appreciates greatly, total cost of loan jumps. If home fails to appreciate, projected increase in value may still be due, requiring refinancing at possibly higher rates.</p>	<p>First time buyers and buyers with lower incomes.</p>
<p>Renegotiable Rate (Rollover) Interest rate and monthly payments are constant for several years; changes possible thereafter.</p>	<p>Less frequent changes in interest rate offer some stability.</p>	<p>Renegotiable rate could be higher and present financial burden to homebuyer.</p>	<p>All home buyers, but especially those with rising incomes.</p>
<p>Federal Housing Administration (FHA) Insured by FHA, local lending institution provides money. Borrower pays 1/2 percent interest for FHA insurance.</p>	<p>Below market interest rates and lower down payment requirements.</p>	<p>"Points" usually charged. Extra time needed for paper work.</p>	<p>First-time home buyers.</p>
<p>Veteran's Administration (VA) Guarantees payment to qualified veterans and surviving spouses.</p>	<p>Below market interest rates and lower down payment requirements.</p>	<p>"Points" usually charged. Extra time needed for paper work.</p>	<p>Veterans who are first-time home buyers.</p>
<p>Farmer's Home Administration (FmHA) Persons in rural areas under 10,000 population who can't get credit elsewhere are eligible for loans for modest cost homes.</p>	<p>Interest rate and down payment vary according to family income.</p>	<p>If income is too high, family will not be eligible and may be required to re-finance.</p>	<p>Buyers with lower income in rural areas.</p>
<p>Federal Land Bank Designed for moderately priced single-family dwellings in towns under 2,500 population.</p>	<p>Interest rates which are adjustable may be lower depending on market conditions.</p>	<p>Substantial down payments usually required. Borrowers required to buy participation certificates in association equal to 5 percent of loan.</p>	<p>Buyers with large down payments living in rural areas.</p>

The Closing

The final step in the home buying process is the closing or settlement. This is usually a meeting between the buyer and seller, representatives of the lender, the real estate broker, and attorneys hired by any or all parties. At this meeting, the exchange of the title of the home takes place. This is accomplished 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. Study the following section carefully to gain a better understanding of the costs involved. These costs can often be reduced by comparison shopping. Don't stop when you've found the lowest interest rate. You may be able to save money by negotiating with the seller to share costs. You should also compare attorneys' fees and lending fees.

Closing costs. Settlement and closing costs vary in type and cost from state to state, from one locality to another, and even 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. At the time a borrower applies for a loan, lenders are required to provide a good-faith estimate of the costs of settlement services and a copy of a booklet entitled "Settlement Costs and You!"

If requested, a uniform settlement statement will be given to the borrower 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 or accrued must be reimbursed at closing.)

Title search and insurance fees for examining and transferring the title to the property to show clear ownership.

Attorney's fees

Origination or application fee of the lending agency.

Engineer's survey to establish exact property lines.

Credit report fees

Points charged by a lending institution to increase profit on a mortgage. One point equals one percent of the amount borrowed.

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

Hazard insurance premium on the property.

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 it is required on the buyer's loan.

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, 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.

For more information on current housing topics, subscribe to "Council Notes," a quarterly series from the University of Illinois Small Homes Council-Building Research Council.

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