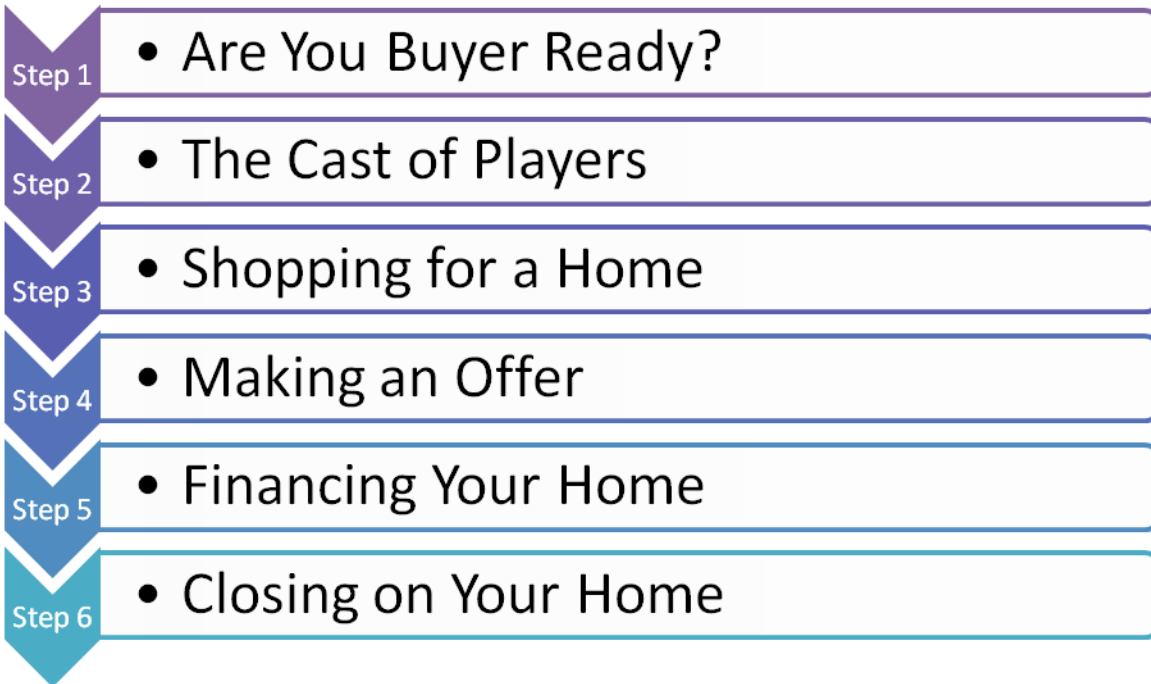


# BUYING A HOME



So you want to buy a home. That's great. I'd love to help you achieve your goal of homeownership, but first things first. Let's not put the cart before the horse.

First, we must find out if you can; if you are buyer-ready. Then we need to determine what types of financing options are available and suitable for your needs and individual circumstances. Once we know that, we can establish your buying parameters, including how much you qualify for (i.e., monthly housing payment and sale price range), where you want to live, what type of home you want (single family, duplex, townhouse, condo or co-op), and features you need and want in a home. Don't worry; we'll take this one step at a time. It's a process and I'm here to help you through it, step by step, from beginning to end.

You'll find a [Glossary of Terms](#) at the conclusion of this piece covering the terms you need to know.

## Step 1

# • Are You Buyer Ready?

### Get Pre-Qualified!

Prequalifying is a process lenders use to give you a quick evaluation of your credit-worthiness and the maximum loan amount for which you are likely to qualify. It is not a pre-approval (which requires careful review and analysis of your financial records), but rather a snapshot of your finances that gives you a ballpark figure to work with.

You need to get pre-qualified for a loan (unless you are one of the lucky ones who can pay cash for the full purchase price). What banks want to know before they will lend you money to buy a home is simple:

- Are you a good credit risk?
- Do you have a job or income to pay the mortgage?
- Do you have funds for a down payment and closing costs?
- Or will you need a gift, grant or loan for down payment and closing costs; or seller contribution to help out with your closing costs?

### How Much Can You Afford?

In general, experts say you can afford a home that costs about 2 ½ times your yearly income. However, different loan products and types have different guidelines for determining your maximum loan amount and housing payment. (See Step 5 Financing Your Home)

- **28/36 Ratios**

Lenders offering conventional loans (loans not backed by the government) don't want you to take out a loan you can't afford. Generally, the lender won't allow you to spend more than 28 percent of your gross income on home loan payments. Also, they usually won't allow you to pay more than 36 percent of your gross monthly income toward all your long-term debts combined, including your home loan payment, car and student loans, credit card payments, day-care costs, child support and alimony.

- **31/43 Ratios**

The federal government also guarantees certain loans made by private lenders. Uncle Sam want to encourage home ownership, so the Federal Housing Administration (FHA) offers relaxed guidelines that let people with higher debt ratios and smaller down payments qualify for loans. With an FHA loan you can spend a higher percentage of your income for housing and still get a loan. Your home payment may be as high as 31 percent of your income, and your monthly debt payments (including your home payment) can be as high as 43 percent of your income.

## What You Can Afford vs. Your Comfort Payment

Keep in mind that you may qualify for more than you feel comfortable paying. You don't need to spend as much as a loan officer says you can afford, but getting prequalified lets you know the maximum amount you can spend for a home payment. Don't feel pressured to over-extend yourself and become "house poor."

## Are You a Good Credit Risk?

Before a bank, mortgage company or credit union will lend you money to purchase a home, they are going to want to know if you are a good credit risk.

- **Have you paid your bills on time?** Your credit score may vary depending on if you always, sometimes, or never pay your bills on time.
- **How much outstanding debt do you have?** Many credit-scoring models evaluate the amount of debt you have compared to your credit limits. If you're actual debt is equal or near your credit limit, this will likely have a negative effect on your credit score.
- **How long have you had credit?** The longer you have had credit and proven your ability to pay the better your credit score.
- **How often do you apply for credit?** Many scoring models consider whether you have applied for credit recently by looking at inquiries on your credit report. However, your score will not be penalized if you're hunting for an auto loan or a mortgage within a short time frame.
- **Have you ever declared bankruptcy?** If you declared bankruptcy more than two years ago, you may still qualify for a loan. But, you will need to prove that you have since established good credit. To establish credit, use your credit cards and pay the bills on time. It is ironic, but true, that lenders would rather have you prove you can go into debt and pay it off on time, than see you pay everything in cash.
- **Have you had a property foreclosed upon or given deed-in-lieu thereof?** If you've had a foreclosure or given deed-in-lieu of foreclosure ("friendly foreclosure") in the past 3 to 7 years, you may still qualify for a loan. (See below Buying Again After a Foreclosure)
- **Have you had a successful short sale?** A short sale is one way to avoid foreclosure. If you owe more on the home than its value, your lender may agree to accept less than what is owed on the mortgage, allowing a "short" sale. Unlike a foreclosure or bankruptcy, it's not reported on a person's credit history and it's not a question asked on your loan application. (See below Buying Again After a Short Sale)

You will need a credit report to answer these questions. A lender or loan officer can pull your credit report for a small fee; so can a non-profit agency that provides counseling for first-time home-buyers.

## Do You Have Stable Employment or Income?

- You must have a steady income and your current or future employer will have to confirm the amount of your income and verify that they expect to employ you long term.
- If you are self-employed or paid on straight commission, you must verify that you've had a steady income for two to three years running. You must supply tax returns and profit/loss statements for these years.

## Buying Again After a Foreclosure

With certain restrictions, you may be eligible to buy another home in 5 years if the home was your primary residence. Without restrictions, the wait is 7 years.

If you are an investor and do not occupy the home, the wait to buy with a Fannie Mae insured loan is 7 years.

### **Buying Again After a Short Sale**

If your payments have never fallen behind 30 days late and the lender does not require that you pay back the loan, Fannie Mae guidelines may allow you to buy another home immediately. Finding a lender who will fund that kind of loan may be very difficult. If you are current on your mortgage for the 12 months preceding the short sale, you can qualify for an FHA loan immediately as well.

If your payments are in arrears yet a short sale is granted by your lender, you may qualify to buy another home with a Fannie-Mae backed mortgage within two years, regardless of whether the home is your primary residence. The wait for FHA is 3 years. However, lenders may make exceptions for borrowers in default at the time of short sale if the default was due to circumstances beyond the borrower's control (such as death of a primary wage earner, long term uninsured illness, etc.); and the credit report reflects satisfactory credit prior to the circumstances (beyond the borrower's control) that caused the default.

Borrowers who pursued a short sale agreement on their principal residence to take advantage of declining market conditions and purchase a similar or superior property within a reasonable commuting distance are not eligible for a new FHA insured mortgage.

## Step 2

# • The Cast of Players

You'll be working with several people on your journey to homeownership and surprise, surprise they all need to be compensated. Here's a quick rundown of the players you'll be working with in the home-buying process, including some you'll never meet face-to-face:

### **The Real Estate Broker/Agent:**

The agent's reimbursement is riding on the fact that you will purchase a home. The fees your real estate agent receives are often included in the purchase price of the home. An agent who lists a home for sale usually shares the agreed upon commission with the agent who brings in a buyer for the house. The commissions are usually a percentage of the sale price of the home, but could be a flat fee. As a buyer, you pay for the services of the real estate agents in the purchase price of the home (unless you have a different agreement with your agent where you compensate them for the time, effort and knowledge they bring to the transaction).

- There are different types of agents, and these agents have different interests. A seller's agent is loyal to the seller. This means the agent, and the company that agent is affiliated with, is representing the seller's interests in the transaction.
- A buyer's broker/agent is bound to you and must keep your best interests in mind. This means that the agent/company is representing your interests in the transaction.
- In some situations you may be working with a dual-agent. This means that the agent or agents are representing both the buyer and seller in the real estate transaction. This situation can only occur if you and the seller agree to allow the real estate agents to act as dual-agents. When acting as a dual agent, Minnesota law limits the information an agent may share with you. This law states "the agents/broker shall take no action that is detrimental to either side...".
- It is possible that you will work with a facilitator. This is an agent/broker who is not representing you or the seller in the transaction. They are simply carrying out the instructions of the parties in a legal manner.

### **The Loan Officer:**

You'll be meeting with a loan officer early in the process. The loan officer will help you determine how much you can afford based upon the lender's criteria and the type of loan that is best-suited for you. Loan officers will also be checking your employment and credit history. Remember, unlike a real estate agent/broker who may be representing you, a loan officer is looking out for the interests of the lender. The loan officer is required to disclose upfront the fees they will charge and when the fees will be charged (prior to closing or at closing). Lender credibility is also important to receiving a mortgage. Using an established lender will help guarantee a successful transaction. Your real estate agent is very familiar with mortgage lenders and the services they can provide. If you haven't selected a lender before you hire an agent, ask them for a referral.

### **The Loan Processor:**

Part of your closing costs will go to the loan processor. They double-check the work that the loan officer gathers. It is the loan processor's duty to determine if you're a good credit risk for the lender. They work closely with your loan officer, so you will probably meet them.

### **The Underwriter:**

The underwriter reviews the loan file, assesses the risks and gives the final stamp of approval for your loan. Their work is done behind the scenes so you'll never meet them.

### **The Appraiser:**

The loan officer will need an independent opinion of the value of the home you are buying. The appraiser will visit the home you want to buy, compare it to similar nearby homes that have recently sold, and determine its fair market value. The appraiser might determine that the real value of the home is higher or lower than the price you've offered to pay. While you pay for the appraisal, it's conducted so that the lender can feel comfortable that the property is worth what you agreed to pay. Remember, if for some reason you default on the loan, the lender wants to make sure the property has enough value to cover your loan balance.

When applying for a FHA or VA loan, you must use an appraiser certified by the FHA or VA (Veterans Administration), respectively.

### **The Home Inspector:**

It is up to you whether or not to hire a home inspector. Having a home inspected will help determine if there are any major problems with the property. If major problems are detected, you can use them as part of your negotiation in the purchase. Your agent can recommend one or more reputable inspection companies. (See [The Home Inspection](#))

### **The Closer:**

The closer's duty is to ensure that all parties sign and date all documents. A good closer will have plenty of chocolates available to help reduce the stress.

## Step 3

# • Shopping for a Home

At any one time, there are thousands of homes on the market for sale. How will you ever find "The One?" For starters, you will need to narrow down your search by deciding where you want to live (location) and what type of house you want (single-family homes vs. Condos and Townhouses). Then you will need to refine your search even further by determining your needs and wants in a home. And, you will need to be prepared to make some compromises.

### **Where Do You Want to Live? (Location/Neighborhoods)**

One of the most important things to consider when finding a home is the location. Here are some considerations:

#### **Traffic**

Visit the property at different times. If you visit at 11 o'clock in the morning, the street will probably be quiet. Go back around 5 o'clock in the evening or at other times to see what it is like then. Is the property next to a highway or main thoroughfare? If so, how noisy is it? Is the property next to railroad tracks or in a flight pattern? Be sure that you can handle the noise of these factors.

#### **Commuting**

You may discover that the further out of the city you go, the more home you can get for your money. If this is the case, and you work in the city, consider the commute. Is this something you can endure every day? It's a good idea to try out the commute, during your normal commute times to see how long the commute is when there is more traffic. Consider other destinations and how far you will be from the places you frequent most often. Remember, the longer your commute, the more you will be paying for fuel and auto maintenance.

#### **Community**

Check out the city's Chamber of Commerce and ask for a Resident's or Visitor's Guide, especially if you are new to the area. This will give you some insight as to area attractions, restaurants, events, and other interests happening in the community. Locate a copy of the city or community's newspaper and read about other community members' concerns. Talk with the city planning department or neighborhood organizations to find out about future developments and other issues (such as flood zones, airport noise zones). Ask the local police departments for crime statistics for your area (often this information can be found on the city's website).

#### **Schools**

If you have children, this is probably going to be the biggest deciding factor in choosing a home. Visit the schools; talk with the principal and teachers.

#### **Cultural and Religious Organizations**

Again, check the local newspaper for various organizations. Another good resource to utilize is the city phone book or check out the bulletin boards at the local grocery stores

and coffee shops for information.

Once you decide on a location, look at similar homes to familiarize yourself with home values and neighborhood characteristics. A fun way to view properties is by attending open houses. If you are working with an agent, be sure to disclose this information to the agent hosting the open house.

## **Deciding What You Want:**

### **Type of Home**

Deciding on the type of home you want to live in will help narrow down your search. Do you like the worry-free benefits of renting, where you don't have to do any yard or exterior maintenance? Then you may want to consider living in a townhouse or condo. Is having a yard and doing some housework something you desire? Then single-family homes are what you should be considering. Here are the most common types:

- Single-family (detached)
- Townhouse (attached or detached)
- Condominium
- Duplex
- Manufactured Housing

### **Style of Home**

Deciding on the style of home you want to live in will also help to narrow down your search. Here are the most common styles:

- Single Family Styles:
  - One Story (Rambler)
  - One ½ Stories
  - Two Stories
  - More Than Two Stories
  - Split-level (three level split, four or more level split, split entry or bi-level)
- Townhouse Styles:
  - Quad/4 Corners
  - Side by Side
  - Detached
- Condominium Styles:
  - High-Rise (4+ Levels)
  - Low-Rise (3- Levels)
  - Manor/Village
  - Two Unit
  - Converted Mansion
- Twin Home
- Duplex Styles:

- Side x Side
- Up and Down

Some people are drawn to certain architectural styles. Here are some of the most popular architectural styles in our area:

- Bungalow (can be One-Story or 1.5 Story with wood or stucco exterior)
- Tudor (typically 1.5 Story to 1.75 Story with stucco or brick exterior)
- Victorian (2-Story or 2+ Stories with either original wood exterior or replacement vinyl exterior)

### **Needs and Wants (Checklist)**

You've narrowed your home search by location and type of home. Now focus your lens a little closer and think about what space and amenities you'd like inside the walls. The following "needs and wants" checklist will help you focus on homes that meet your top priorities.

Start by identifying general needs:

- How many bedrooms?
- How many bathrooms?
- How much space or square feet?

Then think about the amenities you want:

- A fenced-in yard for the dog?
- A fireplace that really works?
- A formal dining room or an eat-in kitchen?
- Space for an office?
- A finished or finishable basement?
- An insulated garage?
- A porch or deck?
- A picture window with a pleasant view?
- Wood floors?
- Stall showers, not just bathtubs?

Decide which of the above are "needs" and which are "wants." List the features you must have in a home in your "needs" column. Then list your wants. This is your dream list. Wants are items you can live without or add later. List your "wants" from most to least important.

## Needs and Wants



List the features you must have in a home in your "needs" column. Then list your wants. This is your dream list. Wants are items you can live without or add later. List your "wants" from most important to least important.

FEATURES	NEEDS	WANTS	
		MOST	LEAST
Number of bedrooms			
Number of bathrooms			
Square feet			
Type of home (SF, Duplex, Condo, Townhouse, etc.)			
Style of home (rambler, split-level, 2-story, Tudor, Victorian, contemporary)			
Age of home			
Modern kitchen			
Fenced-in yard			
Fireplace (specify wood-burning vs. gas)			
Garage (How many stalls? Attached?)			
Porch, Deck or Balcony			
Windows (number, type, orientation)			
Wood floors			
Carpeting			
Heating System (forced air, hot water, gravity, etc.)			
Air conditioning (CA, wall, window)			
Basement			
Other			
Other			

## Step 4

# • Making an Offer

Some people decide to buy a home within seconds of walking in. Even the most well-informed home buyers can't ignore their hearts. Their strings are pulled the second they see the garden and the bay window overlooking it, the fireplace at the end of a cozy living room or family room, or the luxurious master bedroom and bathroom. I know it's difficult, but try to keep your emotions in check when you're bidding on a home. Your business savvy will have to ignore the tug of your heart strings to make a smart offer.

### How Much Should You Bid on a Home?

Money isn't the only consideration in home buying, though it usually appears near the top of the list! In making an offer, prioritize your needs. Is it important for you to pay the lowest price possible? Or is the ability to move in quickly your biggest concern? Your real estate agent can tell you what the typical difference is between asking prices and sale prices in your neighborhood. This will help you know what to expect.

Your offer or bid must be in writing. Most agents use the standard Minnesota Association of Realtors (MAR) Purchase Agreement forms. Your offer will include:

- The price you offer to pay and how you plan to finance the purchase.
- The time period you'll give the seller to accept or reject the bid.
- The date you want the sale to close and the date you want the seller to give you possession of the home.
- If it's a short sale, the date by which the Seller must obtain the necessary written short sale approval(s) from their lender(s).

### Bid High or Low?

You don't need to offer to pay what a seller is asking for a home. Home buying is a game of negotiations. When sellers first put their homes on the market, they may ask for more than they are willing to accept. Later, if the home hasn't sold, the seller may be desperate to sell and could price the home below market value.

The amount you offer depends on whether you think the asking price is high, low or in line with the market. Check the value of homes like the one you want to bid on. Ask your real estate agent to prepare a comparative market analysis (CMA).

Don't worry about insulting the seller by offering less than the asking price (unless it's a totally low-ball offer). On the other hand, you may decide to bid higher if the home buying market is hot and homes are selling quickly, or if you really want to buy a certain home.

### Understanding the Purchase Agreement

The purchase agreement is the major contract in home buying. It's what you submit when you bid on a home and it becomes a binding legal contract when accepted. If you change your mind about buying the home after the seller has accepted your offer, be prepared for a battle and the likelihood that you will forfeit your earnest money deposit. *The purchase agreement legally locks you into buying the home.* You'll probably have to pay hefty legal fees to try to get out of buying the home, and you may still be stuck with it in the end.

So read the purchase agreement thoroughly and ask questions if you don't understand something. A real estate agent may want to hurry you into signing it if another buyer is considering making an offer on the house you want to buy. Don't be pressured! On the other hand, if you wait too long you could lose it. *Understand the purchase agreement before you sign it!* You can also ask an attorney to review it before you sign it, but there will be a cost.

### **A Word About Contingencies**

Contingencies are your safety net. Contingencies are conditions, or "what if" provisions, that you add to your purchase agreement. Carefully consider under what circumstances you will or won't buy the house by attaching contingencies that can make the agreement null and void. A real estate agent or an attorney can help you write your contingencies. Make sure it reflects your understanding of the conditions under which you're willing to make the offer. Here are the most common contingency addendums to the standard MAR Purchase Agreement. For example, you might want to use contingencies to allow you to cancel the purchase if:

- You aren't accepted for a home loan. (This is covered by the Conventional, FHA and VA Financing Addendums.)
- The house has structural, mechanical or environmental defects that are discovered through your home inspection. (This is covered by the Inspection Contingency Addendum.)
- The house appraisal comes in lower than the price you offered to pay. (This is covered in the FHA and VA Financing Addendums; but this condition will need to be written into the Conventional Financing Addendum.)
- You can't sell your current house. (This is covered by the Contingency Addendum.)
- There are liens or other charges or claims on the property. (This is covered in standard MAR Purchase Agreement.)
- The Seller does not receive short sale approval within the allotted time. (This is covered in the Short Sale Contingency Addendum.)

### **The Home Inspection**

Once you buy a home, repairs can eat into your pocketbook, making the home of your dreams a "money pit." Homes can have wet basements, shaky foundations, rotting roofs and a multitude of other problems – even if they are relatively new. But a thorough home inspection before you buy can keep you from getting stuck with the bills.

#### **Invisible Enemies**

Unlike watermarks, some defects can be difficult to see. For example, radon (a gas emitted from the ground) has been discovered in dangerous levels in many Minnesota homes. A high level of radon may cause cancer. Not only is radon impossible to find without special detectors, it may be expensive to get rid of. Other potentially harmful "invisible enemies" include lead paint and asbestos.

#### **Isn't the Seller Required to Tell You About Problems?**

When a seller signs the standard Minnesota Association of REALTORS® purchase agreement, he or she is required to note only certain problems and environmental hazards, and state that certain mechanical systems are in working order. In other words, a seller doesn't have to disclose everything. Also, a seller may not always know a problem exists.

## **What Is a “Truth-in-Housing” Report?**

Some Minnesota cities require a Truth-in-Housing Report that tells you the condition of the home based on the city’s housing code standards. The report is completed by a licensed evaluator. Some cities have limited requirements to meet, so don’t rely on this report alone.

Most communities that have this ordinance do not require the seller to make repairs. The intent of the report is to provide prospective home buyers with thorough, accurate information to assist them in making a good decision about buying a home. When a Truth-in-Housing Report is required, the seller must provide the report to all prospective buyers at the time of the showing.

If you have questions about a Truth-in-Housing Report for a particular home, contact the evaluator or the city in which the home is located.

## **Should You Have a Home Inspection?**

Hiring a qualified inspector will protect you and help you feel confident about the condition of the home you’re buying. The home inspector you hire should identify any major plumbing, heating, electrical, structural, safety and environmental problems. If a home inspector identifies numerous minor or major maintenance items, you may be able to negotiate the final sales price of the home with the existing owner.

There are several ways to do an inspection. You can hire a professional inspector or contractor, or, if you’re knowledgeable about construction, inspect the home yourself.

## **Where Do You Find a Good Inspector?**

If you plan to hire a professional inspector, keep in mind they are not regulated by the state. Talk with friends and family about inspector’s they have used. Your real estate agent may also be able to suggest someone. You can also check the yellow pages under “Building Inspection Services” or “Inspection Service.”

However you find your inspector, make sure you ask if the inspection company has adopted the Standards of Practice and Code of Ethics of the American Society of Home Inspectors (ASHI), and if its inspectors are Certified Member of ASHI.

Here are some other things to discuss with prospective inspectors:

- What training and experience do you have?
- What items does the inspection cover? What doesn’t it cover?
- How do you define major problems? Any repair over \$500, \$1,000 or \$2,000.
- Do you stand behind the report, or is there a clause limiting your liability to the amount of the inspection fee?
- Have you ever written a report that caused a buyer to walk away from a sale?
- Do you carry professional liability insurance?

The price of home inspections varies considerably, so shop around.

## **What if the Property Doesn’t Pass Inspection?**

The FHA and VA require their own appraisal with minimum property standards and may ask the seller to make repairs as a condition of the sale. These are known as lender required “work orders.” But if a house does not pass a buyer’s independent inspection, the buyer may cancel the purchase agreement. Otherwise, the seller and the buyer

might have to negotiate who pays for the repairs.

## Arbitration

At the time you fill out the purchase agreement, you may have the opportunity to sign an **arbitration agreement**. You don't have to sign it. Signing or not signing won't affect your purchase agreement. You can agree to arbitrate later.

So what is arbitration? In simple terms, it's a system for settling out of court all differences or disputes about the physical condition of the property that arise after the closing. An arbitrator will hear all sides of an argument and make a decision. Sound appealing? It is to those who think court is just another word for "high legal fees." But that not always the case.

Disputes among buyers, sellers and agents are often simple misunderstandings that involve a limited amount of money. Maybe you thought the washer and dryer came with the house, but the sellers didn't think so. If you can't agree on a solution, you'll have to go to court, submit the dispute to arbitration, or use another dispute resolution process. However, if you sign an arbitration agreement, it is binding and you waive your rights to pursue any action in court.

The arbitration envisioned in the standard MAR arbitration agreement is a system that was developed by the National Center for Dispute Settlement (NCDS) and the Minnesota Association of Realtors® (MAR) to deal with real estate disputes among buyers, sellers, brokers and agents. NCDS arbitrators have backgrounds in building inspection, property management, engineering, the building trades, and other related fields. Arbitration hearings are usually held at the home site. Usually an arbitrator will pick a winner – the buyer, seller, broker or agent. Keep in mind that arbitrators aren't bound by legal rules. Make sure you study the pros and cons of arbitration closely before you sign any agreement.

If you don't sign the arbitration agreement you can often have your case resolved quickly and inexpensively in Conciliation Court or "Small Claims" Court. Currently, judges in Conciliation Court can decide cases involving disputes up to \$7,500 (this amount can change). If you would like more information on Conciliation Court, the Attorney General's Office offers a free publication entitled *Conciliation Court: a User's Guide to Small Claims Court*.

If you sign an arbitration agreement at the time you sign the purchase agreement, you will be committing yourself to a particular method of dispute resolution *before* you know what the dispute is about. And you will be giving up your right to go to court to assert specific legal rights you may have if you find yourself in a dispute. For this reason, you may want to consider waiting until a dispute arises and then choose a method of dispute resolution – whether that method is arbitration, mediation, Conciliation Court or District Court.

## Step 5

# • Financing Your Home

Unless you are a cash buyer, you'll need financing to purchase your home. There is no "ideal" loan for everyone. Perhaps that's why there are so many options. Much depends on your financial history, your situation today and your future.

Shop around for a lender. Lenders include: banks, savings & loans, credit unions, mortgage companies and public agencies (including cities). It's a good idea to talk to several. Compare interest rates and lender fees to make sure you get the best deal you can. Minnesota has hundreds of lenders to choose from and your real estate agent can refer you to several.

If you have a solid credit history, a good steady income, and the prospect for reliable income in the future, you should have no trouble qualifying for a loan.

The amount of the loan will depend on the size of your down payment and income minus fixed expenses. Chances are you'll choose from one of these types of loans: a conventional loan, a Federal Housing Administration (FHA) loan or a Veterans Administration (VA) loan (if you are a U.S. veteran). Any of these loans can be either a **fixed rate loan** or an **adjustable rate mortgage (ARM)** loan and can range in term from 10 to 30 years.

If you don't have a large nest egg for a down payment, or you haven't always paid your bills on time, don't panic. There are some options for people who have so-so credit records and there are mortgage programs especially for people with low incomes and first-time buyers. Talk to a lender about your financial situation and see if you might qualify for one of these special programs.

Here's a look at some of the various types of loans and the advantages and disadvantages of each. This should help you to determine the loan that is best-suited for you.

### **Fixed Rate vs. Adjustable Rate Mortgages (ARM)**

Just as their names imply, a fixed rate mortgage is a mortgage that locks you into one rate for the entire duration of the loan. Adjustable rate mortgages, or ARMs, will adjust according to an index of the U.S. Treasury. Please keep in mind that you always have the option of refinancing your home. In doing so, you can change the status of your rate.

#### **Advantages of Fixed Rate Loans**

- Certainty. You will always know what your rate is. There will be no wondering if your rate will rise.
- If the current interest rates are low, locking in at a fixed rate will ensure that when the rates begin to rise, you will continue to pay the low rate.

#### **Disadvantages of Fixed Rate Loans**

- Be careful if the current interest rates are high. If this is the case, taking out a fixed rate loan will mean that you will pay the high rate, even if the current rates begin to fall. (Keep in mind that you can refinance your loan to a lower interest rate if market rates go down, but you may have to pay for an appraisal and closing costs again.)

### **Advantages of ARMs**

- Typically, ARMs have a starting rate of 1 to 3 points lower than fixed rate mortgages.

### **Disadvantages of ARMs**

- Your ARM could rise quickly. If this is the case, you could end up paying much more than the current fixed mortgage rate within a short period of time.
- Most ARMs are not convertible, meaning you won't have the option to switch to a fixed rate mortgage to protect yourself from rising interest rates. Your only option to escape paying a rising interest rate would be to refinance. To refinance, you'll have to requalify and pay closing costs. If your home's value has declined and you owe more than its current value, you may not be able to refinance.
- ARMs include "exotic" mortgages such as "interest-only" or "negatively amortized" loans where the borrower does not pay down the principal of the loan for a certain period of time or where the amount owed actually *grows*! Once the borrower is responsible to pay off the principal they may be unable to afford their payment.

### **Federal Housing Administration (FHA) Loans**

The U.S. Department of Housing and Urban Development (HUD) guarantees loans for low- to moderate-income homebuyers. These loans are backed by the Federal Housing Administration (FHA). FHA loans are very popular for first-time homebuyers in Minnesota. If you qualify for an FHA loan, you will need to pay for an FHA appraiser to determine the value of the property. You will also need to pay for mortgage insurance.

#### **Advantages of FHA Loans**

- You can make a lower down payment; the minimum required is 3 ½%.
- It is possible to qualify even if you have substantial long-term debt. The FHA will allow you to pay 43 percent of your income toward long-term debt. This includes your mortgage payment. (You may not be comfortable with such a large debt load, however.)
- If you take out an ARM FHA loan, the rate will only move 1 point per year.

#### **Disadvantages of FHA Loans**

- You must pay an upfront mortgage insurance premium (MIP), which is equal to 1% of the loan amount on a 30-year term. You can pay this fee as part of your monthly loan payment.
- In addition, you must pay a monthly mortgage insurance premium (MIP) on a 30-year term, which is equal to .90% on homes with a loan-to-value (LTV) above 95% and .85% on homes with a LTV of 95% and below.

### **Veterans Administration (VA) Loans**

These are available to people who have served in the military for a certain length of time. To see if you qualify, call 651-296-2562 or 1-800-827-1000. Surviving spouses are also eligible for VA loans.

#### **Advantages of VA Loans**

- You can borrow the entire purchase price of the home. No down payment is required.

## Disadvantages of VA Loans

- You must pay a funding fee, which is 2% for veterans or those on active duty and 2 ¾% for those serving in the National Guard or reservists. You can pay this fee as part of your monthly loan payment.

## Assumable Mortgages

FHA, VA and a few conventional loans are assumable. This means a buyer can take over the seller's loan and make the payments that were negotiated by the seller several years ago. You might not have to go through the qualification process to assume some conventional loans. But the FHA and VA loans may make you meet their qualification standards.

Aside from the possibility of easy qualification, the advantages of assuming a loan have all but dried up in a time of low interest rates. Assumable mortgages may carry higher interest rates than those currently available, but they will generally have lower closing costs.

## Purchase-Rehab Loans

A purchase-rehab loan allows you to borrow additional money to repair and improve the home you are buying. If you are buying a home in need of repairs or improvements, and many of the foreclosed homes on the market today fall into this category, this may be the best option for you unless you have deep pockets (cash reserves). The most common purchase-rehab loan is FHA's 203 (k) mortgage but some lenders offer conventional purchase-rehab mortgages. Most purchase-rehab loans are limited to owner-occupant borrowers and can be used for one-to-four unit dwellings. Here are some of the benefits and limitations of purchase-rehab loans. This is a general overview and much of the information will vary by lender and loan product.

- **Purchase Agreement**

Before you submit a purchase agreement, it's important to have an idea of what work needs to be done and how much it will cost. Most lenders allow your rehab cost of \$5,000 - \$35,000. Be sure you can cancel the purchase agreement if the rehab costs end up being higher than you expect. Also make sure you request enough time to complete inspections and get estimates from contractors.

- **Lender Walk-Through**

Most lenders conduct a walk-through. The purpose of the walk-through is to identify what rehab work needs to be done to make the property livable and safe. **Any rehab work identified by the lender must be completed.** Structural repairs, major remodeling/renovation and luxury improvements are generally not allowed with rehab loans.

- **Contractor Bids (estimates)**

Once you and your lender decide what rehab work will be done, you are responsible for getting at least two estimates from licensed contractors. The lender reviews and approves the contractor and estimate. **Rehab work must be done by a licensed contractor.**

- **Property Appraisal**

Once the lender approves the contractor and the estimate, they will have the property appraised. This is done to determine the "after-rehab value" of the home, taking into account the cost of the work.

- **Rehabilitation Timeline**

Generally rehab work has to begin 30 days after closing and be completed within six

months. ***You are responsible for paying your mortgage while the rehab work is being done.*** Also, consider your living arrangements and if you are going to be able to live in the home while the rehab work is being done.

Completed rehab work is generally inspected by the lender before the contractor is paid. Both you and the lender are required to approve payments to the contractor. Only approve payments if you are satisfied with the work.

### **Beware of Abusive and Predatory Lending**

Predatory lenders take advantage of people in difficult financial situations. They will exploit those who have a lack of financial knowledge, which is why it is easy for first-time buyers to fall victim to them. Be cautious and wary of offers with the following:

- **High Interest Rates and Fees**

Some loans will contain hidden fees. Most fees are negotiable. Be knowledgeable of what your lender charges. Ask them up front for a list of their fees.

- **Small Monthly Payments with a Large Balloon Payment at the End of the Loan Period**

Sometimes lenders will stretch out the payments so that your initial loan payments are small enough to afford. However, stretching out the payments on your loan may result in large unaffordable payments later on which can force you into obtaining another high interest loan to make final payment or selling your home. It is important to know what your payments will be over the life of the loan.

- **Inflated Appraisals**

Remember that appraisals are only estimates of the property's worth. For instance, suppose you get a \$200,000 loan based on an inflated appraisal. You will be held responsible to pay the \$200,000 back in full even if your home only sells for \$160,000. Whether you are a first-time homebuyer or looking to refinance, be careful of appraisals that overstate the value of your property.

- **High Loan-To-Value**

Be extremely cautious of lenders or brokers who encourage you to borrow more than 80 percent of your home's value. A high loan-to-value ratio puts both your home and your financial record at great risk.

- **Adjustable Rate Mortgages (ARMs)**

As opposed to a fixed rate loan, the interest rate on ARMs fluctuates according to the market. Watch out for ARMs with tempting low introductory rates. Just because you can afford mortgage payments at the present interest rate doesn't mean that you will be able to do so if the interest rate rises.

- **Prepayment Penalties**

These are fees designed to penalize consumers from paying off some or their entire loan early. Facing prepayment penalties, consumers may stay locked into high interest rate loans because it would be too expensive to pay the penalty.

Minnesota law requires lenders to disclose these types of penalties at the time of application. The penalty can only be up to two percent of the unpaid principal or 60 days interest on the unpaid principal, whichever is less. A penalty cannot be imposed beyond 42 months of the loan, or upon the payoff of the loan as a result of the sale of the property.

## **Mortgage Insurance**

Depending on your loan type and the amount of your down payment, you may be required to purchase mortgage insurance.

If you made less than a 20% down payment on a conventional loan, you will need to purchase Private Mortgage Insurance (PMI), which is paid monthly. Once you gain 20% of your equity, then you may be released from this insurance.

If you have an FHA loan, you will need to pay an upfront and a monthly mortgage insurance premium (MIP). You cannot cancel your MIP under Minnesota law.

## **Property Appraisal**

To approve your loan, your lender will require a property appraisal to ensure that the amount of the loan is appropriate for the condition of the property. An appraisal is an estimate of the property's fair market value.

## **Homeowner's Insurance**

Another requirement of the lender will be that you have the property insured. This also insures their investment in the property. Be sure to shop around to avoid overpaying. Keep in mind that an insurance company will not only look at the current condition of the home, but they will also look at any past claims on the property, along with any past claims that you have made on any other properties. Depending on the location of the property (meaning county, city, and zip code), you may pay a higher premium. The insurer will also look at your age, if you have children and if you have any pets. A cost-saving tip is to use the same insurance company that the previous homeowner used or the same insurance company that insures your automobile.

## **Title Insurance**

The title insurance policy you will be required to pay for at closing protects the lender in case the legal title of the property isn't clear. It doesn't protect you; therefore, you may want to buy an owner's title insurance policy, too. Some events that could result in an unclear title would be if a spouse wasn't living in the property at the time of sale, then later decides they want to claim it, or if the property was left to another party in a will.

## **Escrow**

Your lender may require you to escrow monthly payments for things such as insurance and real estate taxes. The amount of these expenses will be included in your monthly mortgage payments.

## Step 6

# • Closing on Your Home

If you are like a lot of buyers, you thought this day would never come. Remember, there is a lot to get done before you close. Documents have to be filed. The property title has to be examined. Your contingencies must be met. And, most importantly, your loan must be approved. Once you get to the closing, your closing agent will ask you to sign the biggest stack of papers you've ever seen. No need to panic. This section provides a quick guide to closing that will help you every step of the way, from a few things you'll need to do to prepare for your closing, to what will happen at your closing, followed by a few more things you'll need to do after you close.

### Getting Ready for the Closing

- Keep in contact with your lender to see if the lender needs any more information. If you are approved for a loan you'll either get a **commitment letter** or a phone call from your lender explaining the terms of the loan.
- Choose and pay for one year of homeowner's insurance. You'll need to complete this task at least a week before your closing.
- Make sure you have a closing agent (or closer) lined up to help with the closing. Your real estate agent or loan officer may suggest a closer; however, you are free to choose your own. (Some closings have both a seller's and a buyer's closing agent.)
- Request a copy of the HUD-1 Settlement Statement from your closer one business day before closing. The HUD-1 form contains a list of all of your closing costs. Compare it to the good faith estimate of closing costs your loan officer gave you when you applied for the loan.
- Contact your closing agent or real estate agent with questions or problems concerning the listed fees. Ask about any fees that don't match those listed in your good faith estimate. But understand that some minor differences will appear. That's because certain fees are based on the amount of the loan and the value of the property you end up with. They can only be nailed down when your loan is approved. These include:
  - Title insurance premiums.
  - Loan origination fee.
  - Homeowner's insurance premiums.
  - Mortgage insurance premiums.
  - Property taxes.
  - Mortgage registration tax.
- Inspect the property just prior to closing. Your real estate agent will arrange for your pre-closing final walk-thru to make sure your home is the same condition it was when you wrote your offer and that any required repairs have been completed.

## Closing Checklist

Are you ready to close on your home? Bring your calculator to the closing and make sure there are no mathematical errors. Use this checklist to make sure you have all your "docs" in a row.

- Purchase agreement signed and accepted by seller.
- All contingencies met.
- Mortgage loan approved.
- Home appraisal completed.
- Title search done.

### What Should You Bring to the Closing?

- Your homeowner's insurance binder and a receipt showing this has been paid.
- A photo ID.
- Your addresses for the last 10 years.

### What Will You Sign?

- A promissory note that states you'll make monthly mortgage payments on a loan amount at a certain interest rate for a specified time period.
- The mortgage that says the bank can take the property if you do not make payments as agreed.
- And so many other papers it will make your head swim! But don't worry; the closer will explain all the forms as you go along.

### What Will You Pay?

You will need a cashier's check to pay:

- The balance of your down payment. (Subtract the **earnest money** you paid in "good faith" when you made your offer on the home.)
- Unpaid closing costs. While you will have paid for an appraisal and credit report before closing, other fees will be due on the date you close. Refer to your HUD-1 Settlement Statement to see what you still owe.
- Escrow funds.

### What Does the Seller Give You?

- A signed deed transferring ownership to you.
- Bill of sale for personal property.
- Other documents specified by your purchase agreement.
- The keys and garage door opener.

### What Does the Closer Give You?

- Instructions for homesteading the property.
- The Abstract of Title, if your property is Abstract (as opposed to Torrens). It's important to store it in a safe place as you don't want the dog to eat it (such as a safety security box).
- If you purchased an Owner's Title Insurance Policy, the closer will send you this

document about a month or so after the closing. Make sure to put it with your other closing documents; as you'll need it when you go to sell the property.

### **After the Closing**

Congratulations! Now, you're a Homeowner. What else will you need to do?

- Take your deed and Social Security number to the courthouse to file for homestead tax status.
- Put the utilities in your name.
- Start packing and reserve a moving van, if required.
- Move into your new home at the time you and the seller agreed upon and wrote into the purchase agreement.
- File a change of address form with the post office so that your mail will be forwarded to your new address.
- Start a special home improvement and emergency savings account. Like it or not, like our bodies, homes are in a constant state of decline. Things will break and will need to be repaired or replaced. Get used to it! Better yet, be prepared for it!

If you'd like more information on buying a home, the Attorney General's office offers a free publication entitled ***The Home Buyer's Handbook***. It's available for download at this [website](#).

Additional information on [Home-buying services and counseling](#) is provided under **Housing Resources**.

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*Mavrik Realty is not engaged in the practice of law nor gives legal advice. It is strongly recommended that you seek appropriate professional counsel regarding your rights and responsibilities as a homebuyer and homeowner.*

Glossary. Terms you need to know.

**Abstract of Title:** A condensed history or summary of all transactions affecting a particular tract of land.

**Addenda (Addendum, singular):** These are supplemental documents that are part of a purchase agreement.

**Adjustable Rate Mortgage, ARM:** A loan where the interest rate adjusts to current rates during the duration of the loan.

**Annual Percentage Rate, APR:** The cost of the loan, including the interest rate, points, origination fee and other charges.

**Arbitration Agreement:** When a seller and buyer agree to settle all disputes about the property out of court. If both parties sign, they agree to have an independent arbitrator decide disputes.

**Assessments:** When a city makes improvements to city property, homeowners must pay for these improvements through their city taxes.

**Association Dues:** Payments condominiums and townhouse owners make for upkeep and management of shared property; *typically paid monthly directly to the homeowners association and not included in your monthly loan payment.*

**Assumable:** A loan that a buyer can arrange to take over from the seller.

**Bill of Sale:** Receipt of Personal Property received in a real estate transaction.

**Buyer's Broker:** An agent who works on behalf of the buyer.

**Clear Title:** One which is not encumbered or burdened with defects.

**Closing Costs:** These are costs involved in transferring ownership of a home that the buyer must pay at the time of closing in addition to the down payment: including points, mortgage insurance premium, homeowners insurance, prepayments for property taxes, etc.

**Commitment Letter:** A letter from your lender showing qualification of a loan and listings the terms.

**Condominium:** A system of individual fee ownership of units in a multi-unit structure, combined with joint ownership of common areas of the structure and land.

**Contingency:** A clause that is added to a purchase agreement stating that certain terms be met within a specified time frame for the purchase agreement to remain valid.

**Contract for Deed:** An owner offering the buyer financing, and the buyer makes monthly installments to the owner.

**Conventional Loan:** Loans without government involvement or backing.

**Cooperative:** A residential multi-unit building owned by and operated for the benefit of persons living within.

**Credit Score:** The rating a credit reporting agency gives you based on your credit history.

**Deed:** A written document by which the ownership of land is transferred from one person to another.

**Default:** Failure to make loan payments when they are due.

**Down Payment:** An up-front payment made on a home.

**Earnest Money:** "Good faith" money usually paid to the agent when you make an offer on a home. If the offer is approved, the money is counted toward payment on the property. If the offer is denied, the money is returned to the buyer.

**Easement:** An interest in land owned by another that entitles its holder to a specific limited use, such as laying a sewer, putting up electric power lines, or crossing the property in the case of a shared driveway.

**Equity:** The portion of the home's value that you own, free and clear of any mortgage or lien.

**Encroachment:** A fixture, such as a house, wall or fence, which intrudes upon another's property.

**Escrow:** Money paid in addition to the monthly mortgage payment this is used toward paying property taxes and insurance.

**FHA Loans:** Home loans made through a private lender that are insured against loss by the Federal Housing Administration. FHA loans have loan down payments (currently 3.5%) and allow you to borrow a larger amount than you would be allowed to borrow in a conventional loan.

**For Sale By Owner ("FSBO"):** FSBO, pronounced "fisbo" is a home that is offered for sale by the owner without the benefit of a real estate professional.

**Fixed Rate Loan:** A loan with a constant interest rate over the term of the loan.

**Good Faith Estimate:** The disclosure form on which your lender estimates all closing costs. A lender must give you this form within three days after you apply for a loan.

**Gross Income:** Your income before you pay taxes.

**HUD-1 Form:** A settlement statement listing of all the closing costs. The U.S. Department of Housing and Urban Development (HUD) requires that a closer make this statement available to a buyer one business day before the closing.

**Homeowner's Insurance:** Also called hazard insurance. Insurance which home buyers must purchase to protect the investment they and their lender have in the home.

**Homestead Tax Credit:** Tax credit given for property that is owner-occupied.

**Interest:** Lender's charge for a loan.

**Joint Tenancy:** Where two or more persons hold real estate jointly for life, the survivors to take the interest of the one who dies.

**Judgment:** A decree of a court. "In practice this is a lien or charge upon the lands of the debtor resulting from the Court's award of money to a creditor." (See Judgment Lien)

**Judgment Lien:** The charge upon the lands of a debtor resulting from the decree of a court properly entered in the judgment docket.

**Lender's Title Insurance Policy:** A form of title insurance policy that you pay to protect the lender from claims on the property title. This form does not provide protection for the owner.

**Lien:** A hold, a claim or charge allowed a creditor upon the lands of a debtor. "Some examples are mortgage liens, judgment liens, mechanic's liens."

**Loan Origination Fees:** Fees you pay your lender for handling and processing your loan application.

**Loan Processing:** A lender's analysis of your ability to qualify for a loan. The analysis involves weighing your income, credit report and financial records against the value of the home you want to buy.

**Lock-In Agreement:** An agreement you make with your lender to guarantee you the

interest rate your lender quotes for your loan. You can lock in a rate when you apply for a loan or at any time before the closing.

**Long-Term Debt:** Any debt you will continue to owe on for six months or more.

**Marketable Title:** A good title about which there is no fair or reasonable doubt.

**Mechanic's Lien:** A lien allowed by statute to contractors, laborers and material-men on buildings, or other structures upon which work has been performed or materials supplied.

**Mortgage:** An instrument used to encumber land as security for a debt.

**Mortgagee:** A designation for the mortgage lender on lands.

**Mortgagor:** A designation for the mortgage borrower on lands.

**Mortgage Discount Points:** Prepaid interest on a loan. One point equals 1 percent of your total loan

**Mortgage Insurance Premium, MIP:** Insurance that a lender is required to pay on for an FHA loan.

**Multiple Listing Service, MLS:** A service that real estate agents subscribe to that lists home for sale and homes that have sold by neighborhood, price and features.

**Owner's Title Insurance Policy:** A policy of title insurance which insures a named owner against loss by reason of defects, liens and encumbrances or lack of marketability of the title. The company issuing the policy also agrees to defend covered claims made against the title. (This is optional coverage; but highly encouraged.)

**PITI:** The monthly loan payment which includes "Principal, Interest, Taxes and Insurance."

**Prepayment Penalty:** A penalty fee assigned for early payoff on a loan.

**Prime Mortgage:** The highest grade of mortgage that you qualify for, also called Grade "A."

**Principal:** The total amount you are borrowing to pay for a home. This is usually the purchase price minus the down payment.

**Private Mortgage Insurance, PMI:** If you make less than a 20% down payment on a conventional loan, you will be required to pay for this insurance.

**Property Tax Adjustment:** Reimbursement to the seller for taxes already paid for the year.

**Purchase Agreement:** A legally binding agreement between the buyer and seller that lists the terms and conditions of the sale of the property, including all addendums and contingencies.

**Real Property:** Land and that which is affixed to it.

**Registered Land:** See Torrens Title.

**Re-Issue Credit:** Savings on the cost of title insurance for using the same title company that the previous owner used. Because the company is "re-issuing" the insurance, it can offer a lower rate.

**Sub-Prime Mortgage:** A grade "B" or lower loan that has a higher interest rate than a prime mortgage; *usually because the borrower is a higher risk.*

**Subagent:** A seller's agent who may bring a potential buyer to a home, but owes their duties/loyalty to the seller.

**Tenancy in Common:** An estate or interest in land held by two or more people each having equal rights of possession and enjoyment but without any right of survivorship between the owners.

**Title:** The evidence or right which a person has to the ownership and possession of land.

**Title Defect:** Any legal right held by others to claim property or to make demands upon the owner.

**Title Insurance:** Insurance against loss or damage resulting from defects or failure of title to a particular parcel of real property. (See Lender's Policy and Owner's Policy)

**Title Search:** An examination of public records, laws and court decisions to disclose the current facts regarding ownership of real estate.

**Truth-In Housing Inspection Report:** An inspection that the seller pays for that discloses the condition of the house.

**Truth-In Lending Disclosure Statement:** A statement from your lender stating all fees and costs of a loan using the annual percentage rate (APR).

**Underwriting:** Risk analysis conducted by a lender to decide whether or not to approve you for a loan.

**VA Loan:** Low-interest, no down payment loans available to those who have served in the U.S. Military. VA loans are guaranteed by the Department of Veterans Affairs against loss to the lender, and made through a private lender.