

The Educated Home Buyer

A guide to buying and financing your next home

Published by The Educated Home Buyer, Inc.

The Educated Home Buyer™

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Welcome

Congratulations on making one of the most important financial decisions of your life. Owning a home beats paying off someone else's mortgage and certainly will give you a greater feeling of financial security. If you already own a home, moving up is almost always beneficial.

If you are like most people, you don't purchase real estate very often. Next to your retirement plan, your home is probably your biggest investment. So it's not hard to understand why buying a home is such a stressful experience. During the ten years I spent in the real estate industry, I saw people who experienced so much tension over the thought of buying a home that they just gave up on the idea. Others let their emotions get the best of them and as a result made some poor decisions that I am sure they later regretted (and paid for).

Most of the stress these people felt was a direct result of their lack of understanding of the process. If you don't understand how something works, or know where to turn for information, you can't be comfortable and make good decisions. On top of this, I found that many real estate agents and mortgage lenders did very little to educate home buyers. Many of these professionals work on commission and therefore need to make quick sales to survive. Unfortunately, when you work in this type of environment, it's sometimes easier just to assure someone "that's the way it works" rather than to spend time explaining why things happen the way they do or the various options the person might have. Again, due to the fact that this is a commission-based business, some real estate agents and lenders don't want buyers to be educated. In this way, buying a home can sometimes be like buying a car - the transaction is shrouded with mystery. I wrote this guide in an attempt to take the mystery out of the home buying process.

How To Use This Guide

I have organized this guide into five sections. Each section represents one part of the process of buying a home. Follow the details outlined in each of these steps - in order - and I promise you that the whole process will make more sense and become a lot less stressful whether you are purchasing your first home or your fifth home. The highlights of this guide are the "keys" that I have included everywhere you see the key symbol in the margin.

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Pay close attention to these concepts, in many cases keys are pieces of information that real estate agents and mortgage lenders will not ordinarily share with you. Keys are things that I learned over my ten years in the industry. I tried to share them with my clients and even today find myself sharing them with friends, relatives, co-workers or anyone else that I might happen to run into who is in the process of buying a home. I reached a point where I decided that I should compile these pieces of information into an easily understandable guide that would be useful to both the first time homebuyer and the move up buyer. Keys help you make better decisions, get better terms on your mortgage, and generally allow you to feel comfortable with the home buying transaction.

In addition to the key icons, you will also find references to specific pages on my website, www.educatedhomebuyer.com, where you can find resources that will help you progress through the home buying process. The best part is that most of these services are FREE to HOME BUYERS. Remember to visit <http://www.educatedhomebuyer.com> periodically as you search for your home. I'll also email you periodically with more important information that you should have before you buy a home (but don't worry, your email address will never be sold or shared with anyone).

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Thanks for purchasing The Educated Home Buyer. Please feel free to direct any comments or questions to customerservice@educatedhomebuyer.com. I will answer as many emails as volume permits. I am not an attorney or a licensed real estate agent, therefore I cannot respond to requests for legal advice. **Purchasing a home could be the largest financial transaction that you ever enter in to; IF YOU ARE AT ALL IN DOUBT AT ANY POINT IN THE PROCESS, SEEK LEGAL ADVICE.**

Mortgage Loan Preapproval

Please pay close attention to the title of this section. The title is "Mortgage PreApproval" not "Mortgage PreQualification." There is a big difference. A mortgage prequalification generally consists of a meeting with a loan originator who will ask you various questions about your finances and then make a determination of your purchasing power on the spot. This is certainly better than nothing, but it really just amounts to one person's guess of how much of a loan you will qualify for. Unless you know the loan originator, you have no way of knowing if he or she has any experience in the mortgage industry (it might be their first day on the job). Even an experienced loan originator will frequently have difficulty predicting how much loan you will qualify for without completing a preapproval.

A mortgage preapproval is an actual mortgage loan approval less the house. You will submit all the necessary documentation and your loan will be reviewed by a loan underwriter – many lenders today use **automated underwriting** and can literally preapprove you on the spot if you meet certain criteria including a good credit score. What's a credit score? A credit score is a three digit number calculated by applying a formula that takes into consideration your credit history, amount of credit you have, job time, how long you stay at one particular address, and a number of other factors. More and more lenders are automating their loan approval process and relying on credit scores rather than an actual person looking at your credit report. This is one of the reasons why it is extremely important for you to know what your credit score is (you'll learn about the other reason later).

TO GET YOUR CREDIT SCORE RIGHT NOW GO TO
WWW.EDUCATEDHOMEBUYER.COM/CREDITCENTER.HTM

It's important to know your credit score before you apply for a mortgage preapproval.

Once you have a mortgage preapproval, all that needs to be added to complete the transaction is an appraisal of the home. A lender has committed to giving you a loan for a specified amount of money in writing. A mortgage preapproval will typically have an expiration date and be subject to your financial situation remaining exactly the same (i.e. you do not obtain a new car loan or switch jobs). Many lenders will give you the option to lock in an interest rate for a limited time at the time of preapproval. If you are working with one that doesn't, make sure you understand what you need to do to lock in an interest rate when you find a home.

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When I was a loan originator, it was pretty rare when I prequalified a person and could say with absolute certainty that the proposed mortgage would be approved. Usually there were just too many uncertainties. For example, the person I was prequalifying might mention that they had some late payments on a car loan a year ago or so. Without obtaining a full mortgage credit report, it was impossible to determine if there was more than one late payment, if this person was really talking about a year ago or 3 months ago, or if the payments were even actually late at all. Many sellers require proof that a potential buyer is preapproved and therefore capable of purchasing their home before they accept an offer. In some cases, the seller wants this assurance before they even let you see the home.

Obtaining a mortgage preapproval before you begin looking for a home is not only a good idea, it is almost required. The biggest benefit of obtaining the mortgage preapproval: You are now free to shop for your dream home without worrying about whether or not you will get the financing for it. You will also avoid getting your heart set on a home that you cannot possibly finance.

Choosing a Mortgage Lender

It used to be so easy. Walk into the bank where you kept your savings, let the friendly branch manager know that you just bought a house and before you knew it, your loan papers were ready. Unfortunately, when you make loans based on personal relationships rather than the borrower's ability to make payments, disaster is bound to follow- and it did. Many of today's standardized mortgage loan guidelines are a direct result of the savings and loan crisis that took place a while back. Although many of the bad loans that caused this crisis were secured by commercial real estate, residential real estate was also involved. Today, regardless of where you obtain your mortgage, the guidelines are very similar if not identical. Most lenders want to originate only loans that they can easily sell so that they don't have capital tied up. In order to do this, their loans have to be originated based on standard guidelines and practices. Even lenders who are not concerned about selling their mortgages are still subject to regulations (especially if they are operating as a bank) that allow loan origination only within certain parameters. Therefore, there is probably no one lender in your area that will make loans that other lenders will not. Mortgage brokers and mortgage bankers may originate a number of different kinds of loans and as such may be able to make a loan a bank cannot; however all of these loans are still done within certain standard guidelines.

Shopping for a mortgage can be a lot like shopping for a car. One dealer might offer a better price on the car of your choice, but won't give you a fair price on your trade in. Another dealer might offer rebates or below market financing. Mortgage lenders often attempt to attract borrowers by offering what appear to be low interest rates. Just as in shopping for a car, it is important to look at the whole deal when shopping for a mortgage. The amount of closing costs paid, even if they are financed, is just as important as the interest rate you get. The profit for a mortgage lender is determined in the same way a car dealer's profit is: the more they can get you to pay, the more money they make. Before you begin searching for a lender for your mortgage preapproval, it is important to understand the differences between the various types of mortgage lenders.

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TYPES OF LENDERS

The mortgage industry today is comprised of three types of lenders.

Mortgage Bankers generally only originate mortgages - no car loans, signature loans, etc. "Bank" appears in many mortgage banking company names, but these companies are not banks - they don't take deposits. Your loan is immediately sold after closing because these companies usually provide funds for your loan from a credit line that they maintain (since they don't have deposits to lend out). After closing, the idea is to immediately sell your loan to pay down their credit line so that they have funds for someone else's loan. This fact alone should not concern you, once you sign your mortgage papers, the terms remain the same regardless of who owns the loan.

A mortgage company's profit comes from collecting fees and a gain on the sale of the mortgage. A mortgage company may obtain a commitment from an investor to buy your loan at the time they give you loan approval. At this time, the investor will also agree to pay a certain price for the loan, based on the interest rate. For example, an investor may agree to pay a mortgage company \$99,000 for a \$100,000 loan @ 7.5%. To break even, the mortgage company has to collect 1 point (or one percent of the mortgage amount) to make up for the \$1,000 loss they incur in selling the loan. They may offer you a rate of 7.5% with two points. The extra point they collect becomes their profit. Mortgage companies earn a profit on "no point" loans because they receive a premium from the investor. The same mortgage banker may offer you 8% with no points because an investor is willing to buy your \$100,000 mortgage for \$101,000. Many mortgage bankers have underwriting authority - they actually make the decision on your loan approval. Because of this, a mortgage banker may have more control over the timing of your loan approval than a mortgage broker and may be able to work with you to resolve minor obstacles.

Mortgage brokers operate in much the same manner as mortgage bankers with one exception - they do not have credit lines and do not use their own funds for your loan for even a short time. In most cases, you will see the actual lender or investor's name on all of your loan documents since the lender is actually supplying the funds for your loan from day one.



The fact that mortgage brokers do not fund your loan has resulted in legislation that offers you a tremendous advantage when shopping for a mortgage. Mortgage brokers are required to disclose all of their fees and income, including any premiums the actual lender/investor is paying them – mortgage bankers may not be required to provide you with these disclosures because they are using their own funds for the loan. The end result is that the borrower can clearly see what the “wholesale” price is on the loan and how much the mortgage broker is earning for originating the loan. Mortgage brokers typically deal with huge national lenders who earn their living by packaging blocks of mortgages together and selling them to institutional investors. These national lenders will then handle the servicing of the loan – payment collection, paying property taxes, handling payoffs, etc. The national lender charges the institutional investor a monthly fee for servicing these mortgages. Because these fees represent a monthly recurring income stream, most national lenders are more interested in the servicing income than making money from the sale of the loan. Servicing

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fees are tiny (.25% - .50% of the payment amount) so volume is very important. Because of this, some larger national lenders will actually take a loss on the loan origination (offer a rate/points structure that is less than the investor will purchase the mortgage for) in order to stimulate loan production and in turn build up servicing income.

A good mortgage broker knows which of his national lenders fall into this category. In this situation, the mortgage broker can add a reasonable fee to the wholesale price and the result will still be a rate/points structure that is very attractive to you. Of course, some mortgage brokers will take advantage of this situation and add more profit in for themselves. By paying close attention to the fee disclosures, you will be able to recognize this and potentially negotiate a better deal. In general, you should expect your mortgage broker to earn about 1% of your loan amount; but this fee may be 2% or so on loans under \$100,000 and potentially under 1% for large loan amounts (\$250,000+). This is a general guideline only, if you have a complicated financial situation, your mortgage broker will spend more time on your loan application and deserves to be compensated for it.

Although the disclosure laws make using a mortgage broker advantageous, as in any other financial transaction, be careful who you are dealing with. Mortgage brokers tend to be smaller companies. Regardless of whether they work for a mortgage broker or mortgage banker, **many loan originators are paid by revenue sharing- they split the fees or premium on your loan with the company. Most loan originators are able to set their own rate structures. They know what the lender or investor is offering and quote you a rate based on the profit they want to make.** This structure results in a lot of temptation. Unscrupulous loan originators will quote you a rate that is too good to pass up just to get you committed to them. They have no intention of honoring this rate because in many cases it represents a loan that would be closed with no profit. Instead, they will tell you that the lender would not honor the rate lock or they will delay processing your loan and as a result your rate lock will expire. By the time you reach this point it will probably be too late to go anywhere else and you will have to accept whatever rates they choose to offer you. Before you commit to any lender, make a call to your local Better Business Bureau and make sure that any rate lock commitment the lender makes is in writing. Your real estate agent will also be able to tell you which mortgage brokers to avoid. Most mortgage brokers are reputable and typically work with dozens of lenders. Because of these relationships, they can find a loan that is ideal for your situation. A mortgage broker has worked with these lenders many times and in some cases even knows the personalities of the loan underwriters. Therefore, even though many mortgage brokers do not have underwriting authority (they don't make the decision on your loan), they can direct your loan to the lender who is most likely to approve it quickly.

Banks, savings and loans, and large national mortgage companies have a different motive in originating mortgages. Although some of these institutions operate like mortgage bankers, selling off all mortgages they originate so as not to tie up capital, many "keep" the mortgages they originate. As described above, "keep" is an inaccurate term in that even if you are paying the same bank or mortgage company that originated your loan, in reality they probably do not actually still own your mortgage. They will combine your mortgage with other mortgages into "pools" which are then sold as securities. Servicing rights are

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retained and provide an ongoing fee income stream. Many of these institutions offer loans both directly to the public and through mortgage companies. So why not just go directly to the source? Wouldn't this always result in a better rate? Not necessarily - for two reasons. First, the rates that these institutions make available to mortgage brokers are almost always better than the rates that are offered to the public. Mortgage brokers have to make a living like everyone else and therefore need to be able to add a reasonable fee to the mortgage and remain competitive. Banks, savings and loans, and large national mortgage companies incur costs to offer mortgages directly to the public (office space/overhead, loan originator and processor salaries, advertising, etc.) and therefore need to add to the rates to cover these costs. However, with the growth of the Internet this is changing. **By offering mortgages through a web site, a large lender can minimize origination costs** - all of its staff can be centralized and productivity can be much higher. **The lender can potentially offer you a better rate without losing money.** However this brings me to the second reason why going directly to a larger lender does not always result in the best deal. A large national lender will typically have thousands of loans in process at any given time. By applying directly with that lender you may be offered a slightly better deal, but you become loan # 13,453. As you can imagine, it may be hard to get attention if there are any problems or even if you need any explanation of part of the process. **If you choose to lock in your interest rate, you will have a certain amount of time to get your loan processed and closed. In order to meet this deadline (you may also have a seller imposed closing date due to their need for funds) you need to have the full cooperation and attention of the lender.** Again, if you are one of 1,000 loans that a loan processor is working on, it may be hard to get his or her attention. A mortgage broker may represent a significant piece of a lender's volume and therefore will almost always get better response than you can as an individual. Most mortgage brokers and bankers process their own loans (assemble documentation, order credit reports and appraisals, etc.) and as such have a great deal of control over the length of time it takes to get your loan approved. However, if the bank, savings and loan, or large national lender is interested in quickly increasing their loan volume at the time that you are buying your home, you may end up with a better deal with this type of lender. If you are within qualifying guidelines and have at least 3 or 4 weeks to complete the loan application process, consider a bank or large national lender.

Closing Costs

Now that you know the differences between the 3 different types of lenders, you might be wondering how to compare the loan terms that you are offered by different lenders. Of course, the obvious comparison is the interest rate itself on the loan. However, it is important to also compare closing costs from one lender to another. Higher closing costs could mean an effective interest rate that is .50% higher (or more) than the rate you think you are paying. One good indicator of the true cost of your loan is the APR or annual percentage rate - that second rate you always see on your loan papers and never really understood. Basically, the APR is calculated by taking into consideration the effect of some of the closing costs that you are paying to get your loan. The more closing costs involved, the higher the APR. All lenders are required to disclose the APR twice - at the time you apply for the loan and again at the loan closing. Pay attention to this number, it will only change if closing costs or your actual interest rate changes.

In order to compare lenders, it is important to have at least a basic understanding of what closing costs mean:

LOAN ORIGINATION FEE

Many lenders, especially mortgage brokers, may charge an origination fee. This is the mortgage company's fee for securing financing for you. This fee varies from lender to lender and is (or should be) negotiable but be reasonable. If you have had a rocky employment history that requires a lot of work to document or have numerous late payments on your credit report, you should expect to compensate the lender for the additional work that is required to secure your loan approval. However, if you are very creditworthy and provide all the necessary documentation at the time of the loan application, it is not unreasonable to ask the lender to accept a lower origination fee. Loan origination fees are generally a % of the mortgage amount; usually between .5% and 2% - depending on the applicant and mortgage amount. These fees go straight to the mortgage company.

LOAN DISCOUNT (POINTS)

Points can be defined as simply the cost of obtaining a certain interest rate. **A point is 1% of the mortgage amount (not the sale price or appraised value).** The more points you pay the lower the rate on your mortgage loan. Most lenders will also offer no point interest rate options. Which is the best option for you? An easy calculation will provide you with the answer to this question: Take the dollar amount of the points you are paying and divide by the difference in payment between the zero point option and the option you are considering. The result will be the breakeven point in months. If you anticipate being in the home at least this long, pay the points; otherwise choose the no point option.

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Mortgage Amount/Rate	Payment	Points
\$100,000 mortgage @ 8.00%	\$733.76	0
\$100,000 mortgage @ 7.50%	\$699.21	\$2,500 (2 1/2)
Difference	\$34.55	\$2,500

Points Payback Period = \$2,500 divided by \$34.55/month = 72 months = 6 years

In this example, if you saved the amount that your payment was lowered every month, it would take 6 years to pay back your original investment in points. If you remain in the home more than six years, the \$34.55 becomes a gain. If you do not stay in the home at least six years, you have not even recouped your initial investment. Don't always choose the lowest rate (which always comes along with the most points). If you have any reason to believe that you may not be in this house for more than 5-7 years, you may end up on the short end of the stick.

APPRAISAL FEE & CREDIT REPORT FEE (APPLICATION FEE)

When you apply for a mortgage loan, many lenders will ask for an application fee. Some will ask you to pay the cost of a credit report only on a preapproval, others will offer free preapprovals. When you are applying for the actual mortgage loan, the application fee is usually paid up front in order to cover the cost of obtaining an appraisal (by a professional appraiser) of your home and the cost of obtaining a credit report. A mortgage credit report is a detailed report in which all information is verified and generally costs about \$50. Most credit bureaus now send you a copy at the same time they provide the lender a copy. Since you are paying for it, you are also entitled to a copy of the appraisal (by law). **Beware of lenders who do not apply your application fee to the cost of the appraisal and credit report or attempt to collect other fees at the time of the loan application.** Not only is this a bad business practice, it is also illegal in most cases. Just as you wouldn't pay a contractor up front for a bathroom remodeling job, don't pay closing costs up front (pay only the application fee, if required and make sure that it will be applied to the cost of your appraisal and credit report). Don't choose a lender for your preapproval just because they'll do it for free – the cost of a credit report is far less than what you'll pay if you end up with a loan with a high interest rate or excessive closing costs.

CREDIT REPORT: \$15 - \$75

APPRAISAL: \$200 - \$600 (MULTIFAMILY PROPERTIES COULD BE MORE)

Estimate only, your cost may differ based on your location

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PROCESSING FEE, UNDERWRITING FEE, WIRE TRANSFER FEE, FUNDING FEE

These fees can represent the lender passing his overhead costs on to you. You should refuse to pay these fees unless you are dealing with a mortgage broker and these fees are being sent directly to the investor (you can verify this by checking the settlement provider listed on your settlement statement at closing).

If you were purchasing a car, you wouldn't expect the car dealer to charge you an office support fee or a fee for processing the check you write for the down payment, so why would you pay a mortgage lender's overhead? In some cases, these fees can simply amount to more loan origination fee (profit) in disguise.

LOAN PROCESSING FEE: \$100 - \$250

UNDERWRITING FEE: \$150 - \$250

WIRE TRANSFER FEE: \$15 - \$50 (Actual bank fee for a wire transfer usually about \$15)

FUNDING FEE: \$200 - \$300 (Should include wire transfer fees or courier fees)

Estimate only, your cost may differ based on your location

DOCUMENT PREPARATION FEE, TAX SERVICE FEE, FLOOD CERTIFICATION, SURVEY

These fees are generally collected for services that are provided by third parties (again you can verify this by checking the settlement provider listed on your settlement statement at closing). Many lenders, especially brokers, will contract with a third party to prepare documents for your loan closing. These parties expect to be compensated for the work they do, so a document preparation fee paid to a third party is a legitimate charge. Tax service fees, flood certifications and surveys are also almost always provided by third parties. **As you collect closing cost estimates from a number of lenders, you will probably begin to understand what reasonable charges are for these services in your area.**

You can also ask your real estate agent to give you an idea of what to expect.

DOCUMENT PREPARATION FEE: \$100 - \$250

TAX SERVICE FEE: UNDER \$100

FLOOD CERTIFICATION FEE: \$25 or less

SURVEY: \$150 - \$300

Estimate only, your cost may differ based on your location

TITLE INSURANCE, EPA ENDORSEMENT, TITLE INSURANCE BINDER

Your lender will require title insurance. However, the lender's title policy insures the lender's interest in the collateral for the loan (your home) against loss due to title defects that were not discovered at the time of the sale – it offers no protection for the homeowner. Make sure you get an owner's policy (most title agencies will provide this automatically).

An owner's title insurance policy protects your equity against title defects up to the face amount of the title policy, not just to the amount of your mortgage.

Although the chances of someone challenging your interest are slim, if it does happen you could stand to lose one of your largest investments - your home. How could this happen? Isn't the title checked carefully before closing? A title exam, which is basically an in depth

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investigation of the property including rightful owners, liens, easements, restrictions is completed before closing but isn't foolproof. For example, one of the previous owners could have been married and potentially his or her spouse (who had an interest in the property based on the marriage) did not sign the deed when the property was transferred three owners back. It may be difficult to detect this within the confines of a standard title exam. The previous owner's spouse technically still has an interest in the property and could attempt to claim it from you at any time. The typical title insurance policy will provide for payment of this claim if it is legitimate. Other potential risks that are covered under most title policies:

someone impersonating the seller or other persons formerly in title executes the deed

forged deeds, releases and other documents relating to the transfer of title

deeds executed by minors or incompetent persons

invalid deeds delivered after the death of the grantor (previous owner)

fraud

invalid documents executed under expired power of attorney

An experienced title agent could probably give you a couple dozen more situations in which title insurance will save your investment.

TITLE INSURANCE : USUALLY % OF PURCHASE PRICE (example \$3 per \$1000 of coverage or .3%)

EPA ENDORSEMENT: \$75 - \$100

TITLE INSURANCE BINDER: \$50 - \$100

Estimate only, your cost may differ based on your location. Title insurance cost can be very dependent on your state.

SETTLEMENT OR CLOSING FEE

Because this is such a large transaction, you will need a neutral third party to administer the closing and make sure everything goes according to purchase agreement. **The escrow agent** can be someone at the title agency or possibly an attorney. This person is responsible for making sure that title transfers into your name. It is the escrow agent's responsibility to get the seller the proceeds of the sale. The escrow agent will make sure any mortgages that the seller had are paid. This person will also make sure that all provisions of the contract are accounted for. For example, if the seller of your property has agreed to repairs, the escrow agent will most certainly have you sign a statement that the repairs were done to your satisfaction before title will transfer. The settlement fee is typically split between the buyer and the seller.

SETTLEMENT OR CLOSING FEE: \$250 - \$350 (BUYER'S HALF OF TOTAL COST)

Estimate only, your cost may differ based on your location

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**ITEMS REQUIRED BY LENDER TO BE PAID IN ADVANCE,
RESERVES DEPOSITED WITH THE LENDER**

If your lender is paying your property taxes and/or hazard insurance (included in your mortgage payment), you will have an escrow account with the lender for this purpose. If your lender requires private mortgage insurance, this will also become part of your escrow account. Depending on when your transaction is closing, you will need enough money in your escrow account so that when the next property tax bill comes to the lender, there are sufficient funds to pay it. Private mortgage insurance and hazard insurance is paid in advance. Typically, your first annual private mortgage insurance premium is due at closing (in many cases it can be financed) and your first hazard insurance premium is paid to your insurance agent (before closing, you will need to provide the escrow agent with the policy before title transfer). The lender may require a couple of months worth of these premiums to start off your escrow account as you may not make your first mortgage payment for well over a month after closing. The reason for the seemingly long period of time before your first mortgage payment is due is that mortgage interest is typically paid in arrears or after the fact. Your March 1st mortgage payment pays February's interest. Therefore, if title transfers January 15th, your first payment will be due March 1st because a February 1st due date would pay interest for all of January----15 days longer than you actually owned the house. Because your March 1st payment pays only interest for February, you still owe the lender interest from January 15th through January 30th. You will have to pay this interest at closing. I have seen mortgages with due dates that prepay interest – you pay interest before its actually due. Your March 1st payment is paying March's interest, not February's. What's the difference? You are losing the use of your money for a month, every month for the life of the loan. This could have the same effect as paying the late charge every month. **If you run across a mortgage loan with a favorable rate that has you paying interest in advance, do the math. It could be a much less favorable deal that it appears to be.**

How to Choose a Lender

In choosing a lender, evaluate both the interest rate options that are offered and the closing costs that come with these options.

If your credit and employment histories are good and you have 3 weeks or so to get your loan approved, consider all types of lenders.

If you don't have this much time, a mortgage broker or mortgage banker may be able to get your loan processed faster.

If you have some credit problems or an unstable employment history, you will probably be better off with a mortgage broker who can present your application to a number of different lenders.

It is important to know your **credit score** before you start shopping for a mortgage. The Coalition for Responsible Lending, a North Carolina based consumer group, recently released a report with their estimate of the amount of interest that borrowers overpaid due to their mortgage rates being higher than the amount of risk that they represented (meaning a

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borrower who qualified for the best rate was offered and accepted a higher rate) – the figure was an astounding \$2.9 Billion. To put this number in perspective, if the average borrower has a \$100,000 loan balance and pays a rate that is 1.5% higher than is justified for his credit history, then at any given time about 2,000,000 borrowers may fall into this category. How does this happen? An unscrupulous lender will tell you that you have had a few credit problems and that because of this, he could only get you a mortgage with an interest rate that is higher than the going market rate (and he gets a big premium on the loan due to the high rate). Borrowers with credit scores of 640 and higher are generally eligible for conventional financing and the best rates. Borrowers with credit scores below 640 usually need a **subprime mortgage, but can still shop for the best rate for their situation.**

TO GET YOUR CREDIT SCORE RIGHT NOW GO TO
WWW.EDUCATEDHOMEBUYER.COM/CREDITCENTER.HTM

Subprime Mortgages



Subprime mortgages have become very popular in just over the past few years. You have probably seen the ads – “When your bank says no, We say yes!” Subprime lenders will make loans to people with fair to poor credit histories, nonverifiable income, or high debt ratios – at an interest rate that is 1% - 5% higher than the going market rate. Some subprime lenders will lend you more than your home is worth (typically this requires good credit and is a refinance as opposed to a purchase). **If you have difficulty obtaining a standard mortgage at current market rates and know that your credit score is low (less than 640) or you have some other type of qualifying problem, by all means consider a subprime mortgage – many lenders, especially mortgage brokers, offer both.** Many people that I dealt with who had a less than sparkling financial history with would not even consider this option due to the higher interest rate. Instead of making a mortgage payment that might be \$75/month higher than they expected, building equity in their own home, and saving on their income taxes, they chose to continue renting and paying off someone else’s mortgage. I know what you are thinking, it never make any sense to me either. What makes this scenario even more confusing is that **with a good payment history and no further problems, you can typically refinance into a conventional mortgage within a couple of years.** In fact, your lender will probably call and offer you this option.

Although some subprime lenders will quote you extremely high rates that come with lots of points, don't be fooled into thinking that this is the market. The Coalition for Responsible Lending's study also showed that excessive fees collected upfront (like lots of points) were part of \$6.2 Billion in annual borrower overcharges. Most subprime rate/point combinations are similar to standard conventional rate/point combinations - only 1% -5% higher depending on the credit or income problems you might have. There is no reason you should be paying 5 points on a subprime loan unless you have extreme credit problems such as a foreclosure or recent bankruptcy. Subprime mortgages are graded in a range from A- to D, A- being the closest to qualifying for a standard conventional loan and D being extreme credit problems (the lender might be refinancing your home to save you from foreclosure). What grade your loan receives is generally a matter of your loan originator's and/or lender's opinion, but find this out as soon as possible. If you know that you are

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trying to obtain a B loan for example, you can do some rate shopping and make sure you are getting a reasonable rate based on your situation. At the very least, letting the loan originator know what your credit score is up front will help you get an accurate rate quote for your situation.

Shopping for a Mortgage

Most people simply pick up the phone, call a number of lenders and ask what their rates are. This is certainly a fine way to get an idea of what the going mortgage rates are, but this isn't going to get you the best rate possible.

As I mentioned earlier, shopping for a mortgage is a lot like shopping for a car – including the negotiating part. You wouldn't expect to get the best deal possible by calling a number of car dealers and just asking for the price of a certain model would you? Of course not. Don't do this when you shop for a mortgage either. Let the loan originator know that you are well qualified (or at least know your standing if you have had some credit problems), are speaking to other lenders and are going to act quickly. Most loan originators work on a commission basis, have some flexibility in terms of what rates and terms they offer, and will negotiate with a borrower who has already done most of their work for them. Even if a lender won't lock in a rate at the time of your preapproval, it's in your best interest to apply for a preapproval with a lender who offers favorable rates so you won't have to look for another lender when you find a home.

Here's an example of how your conversation with an originator might go:

ORIGINATOR: Good morning, ABC Lending, how can I help you?

YOU: I was wondering what the best rate is that you are offering today on a 30 year fixed rate \$100,000 mortgage with no points and a 30 day lock. My credit score is 740, I've been on my job 5 years, and I have 20% down which is currently on deposit in my bank account.

From the start, you've let the originator know that you understand qualifying, know what product you want, and are prepared for a loan application (which means less work for him).

ORIGINATOR: Well let me see, our 30 year no point rate is 7.75%

YOU: What would the APR be?

You may also want to ask what the total amount of closing costs is---but if the APR is fairly high (meaning an APR that is >.25% higher than the quoted rate on zero point loans), you'll immediately know that the closing costs probably include an origination fee or some other cost that could potentially be waived. If the originator can't or won't give you the APR, move on.

ORIGINATOR: The APR is 7.99%

YOU: Hmm, can you give me all of your closing costs?

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Here's where the negotiating starts. By asking for all of the closing costs you are looking to get the originator to ask you what you think of the rate – if he does this it is your signal that there is some room for negotiation.

ORIGINATOR: (after giving you the closing costs and assuming that they are reasonable) Are we competitive? Would you like to schedule a loan application?

YOU: I don't know, you aren't any better than any other lender that I've talked to but I'd really like to take care of this today. Is it possible for you to get me a 7.50% and waive the loan processing fee? If I could get that rate, I'd go with you and make my loan application today if you could fit me in.

Your goal is really an 1/8%, but ask for more than you'll accept just like you would when negotiating on a car. Don't think an 1/8% makes a difference? An 1/8% means \$3070 on a \$100,000 30 year loan.

ORIGINATOR: We couldn't possibly go that low on a 30 year mortgage, the market isn't there.

YOU: OK, thank you. Here's my name and phone number in case you can figure out a way to get me this rate. Have a nice day.

In many cases the originator can get you the 7.625% rate and still make a decent commission on the loan. If you don't get a call back in 15 minutes or so, call another lender and try again. This technique works best with a mortgage company but you might be surprised how flexible some banks can be too.

Of course this means that you may have to talk to a number of lenders before you apply for a loan. This takes a lot of time and can get aggravating if you get involved in a game of voicemail tag.

Not many of us have time to make phone calls all day so I'm happy to say that I've found a great FREE service that helps you avoid all of this. You fill out one short loan application that is sent to four lenders. These lenders then call you and best of all, COMPETE FOR YOUR BUSINESS.

TO USE THIS SERVICE, GO TO:
WWW.EDUCATEDHOMEBUYER.COM/APPLYONCE.HTM

If you haven't found a house yet and are applying for a mortgage preapproval, you could still use this script in order to identify a lender who will work with you to get the best rate. At the time of your preapproval you should make an agreement with the originator on how much profit there will be in the loan – for example, you might agree that the mortgage company will make a 1% spread. This is important because if your rate isn't locked at the time of the preapproval, you will most likely be looking at a different set of rates by the time you find a house and without this agreement, you'll have to start negotiating all over again. Once you make this agreement with the loan originator, let him or her know that you will ask to see the mortgage company's rate lock sheet for your loan to prove that they are living up to the agreement (or you'll find another lender).

Making the Loan Application

The more prepared you are for your loan application, the better your chances of being approved.

NOW that you know how to choose a lender, you are ready to make the application for your mortgage preapproval. Most lenders will work around your schedule, so allow at least an hour and a half for the loan application so that you can ask questions and really be certain that the loan originator understands your finances. **The time that it takes to process your loan application and in some cases, your chances of being approved, are largely determined by how prepared you are when you complete your loan application.** Instead of thinking of yourself as the lender's client, think of your relationship with the lender as a business partnership. Your responsibility in this partnership is to document every part of your financial life and paint a picture for your loan originator. Your lender's part of this partnership is of course to secure financing for you at the most favorable rate possible. Without your cooperation, in many cases this is not possible. Prepare for the loan application by assembling the following information:

EMPLOYMENT

Mortgage loan underwriting guidelines typically require the verification of two years worth of employment or income if you happen to be self-employed. Your income is determined by one of the following (adjusted to a monthly figure):

Hourly wage

Annual salary

Base salary + average commission amount

Average commission amount (if you work on straight commission)

The net income from your tax returns if you are self-employed

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To document your employment history, bring your last two years W-2s and your last 30 days worth of paystubs (2 if you get paid every other week, 4 if you get paid weekly). If you have had more than a couple of jobs over the past few years or have a gap in your employment history, assemble a written explanation (my company was downsizing and as a result I was unemployed for 2 months but ended up finding an even better position making more money). Overtime will be included as part of your income if it is consistent. In other words can you show a definite pattern of overtime over at least the past couple of years even if it is seasonal? For example, if you work at the North Pole, you probably work 40 hours a week up until about August at which time you start working 55 to 60 hours a week consistently. If you have worked at the North Pole for at least two years and worked the same way both years, the loan underwriter would calculate the average amount of overtime hours you worked during the year, multiply by the overtime rate, divide by 12 months and add to your monthly income. In the same manner, if you did not get paid for overtime but have received a \$4800 bonus every year for the last 3 years, you would get credit for an additional \$400/month income over and above your salary. In most cases if overtime or bonuses are necessary for you to qualify for the loan, your employer will be asked to state in writing that the probability of the overtime or bonus continuing is high. Check on your company policy before making the loan application, some companies refuse to comment on this, others will almost guarantee overtime or bonuses. Depending on what you do for a living, this factor alone could make a big difference in how much loan you qualify for.

If you are self-employed, compile at least two years worth of tax returns (3 or 4 is even better) and construct a profit and loss statement for the current year. If there have been significant fluctuations in your income (up one year, down the next, up the following) write a detailed explanation of what is happening with your business. Include documentation if possible (i.e. copies of contracts with your customers, documentation from the collection agency that worked on your company's bad debt). If you haven't been self-employed at least two years, you may have trouble getting a mortgage loan – it is difficult to establish a pattern of income when only one year's worth of data exists. Your income is the NET profit that shows on your tax returns, not the GROSS revenue. If the restaurant you own does \$2000 a week in business, obviously your income is not \$100,000 a year. You have expenses that come out of the \$100,000 – food costs, cooks and waitresses to pay, insurance, rent, advertising, etc. Your income is what is left after you pay all of your expenses (regardless of what business you are in). Make sense? I can't count the number of self-employed people that applied for loans with me who were 100% convinced that their income was the total amount that their business took in – don't make this same mistake. Also don't make the mistake of hiding all or part of your income from Uncle Sam. Because income tax returns are the only sure way of documenting income for the self-employed, if you don't pay taxes on it, don't expect to buy a house with it. Again, I had numerous self-employed people tell me that they made much more than what showed on their tax returns. If I had only signed up with the IRS paid informant program, I would be a very wealthy man at this point. Please remember income tax evasion is illegal. If you refuse to pay the government what you owe them, why would you expect the lender to believe that you will pay them? On top of that how is the lender supposed to verify this hidden income that the government doesn't even know about?

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DOWN PAYMENT / CLOSING COSTS

Depending on the type of mortgage that you are applying for, you will have to show that you have adequate funds for the down payment and/or closing costs. In most cases, you will also have to show that you have at least a couple of months worth of house payments left after you take care of the down payment and closing costs. Acceptable sources of funds include:

Your Bank Account

Mutual Funds

Gifts (in most cases the source of the funds will also be verified)

Stocks

Proceeds of other Real Estate or stocks that you have sold

Loans on 401Ks or real estate that you own (generally the only two ways you can borrow money for the down payment/closing costs)

Documentation is the key in this part of the loan application. Gaps in your employment history require an explanation from you – these explanations can't always be backed up with documentation. **Some type of documentation is always available to show where your funds came from.** Banks and mutual funds are required to send statements, you receive a proceeds statement when you sell stocks, inheritance payments are based on wills, etc. The lender needs this documentation to be sure that you have not borrowed all or part of the funds you need for closing (which conceivably could make it impossible for you to make both your down payment loan payments and your mortgage payments). The lender also needs to make sure that you have put at least some of your own money into the transaction (and therefore have the feeling that you have something to lose). **Assemble at least three months worth of statements from the account or accounts that contain the funds you intend to use for closing.**

CREDIT

You should bring a statement or loan payment book for every loan that you currently have including credit cards to your loan application. Included in this category are credit cards that you pay off every month - bring your last statement for these as well. In addition to getting your credit score, **it is a very good idea to have a credit report run before you make your loan application, preferably a merged report. (To get your merged credit report right now go to www.educatedhomebuyer.com/creditcenter.htm)** A merged report represents information from more than one credit bureau and most closely represents an actual mortgage loan credit report. This will allow you to be prepared. The lender will ask you for a written explanation of every late payment that shows up on your credit report. One-time occurrences on smaller accounts such as credit cards are not usually a big problem, but still require a written explanation. Be honest- I misplaced my credit card

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statement and didn't realize that I hadn't paid until the next statement came is the truth and a perfectly valid explanation. If you misplace all your credit card statements every month, it's an entirely different matter. Late payments on larger loans, especially late payments in the last twelve months, usually require a good written explanation and documentation. You might explain a late payment that shows on your car loan by saying that bank cashed your check and credited the wrong loan account. This explanation would be accompanied by a letter from the bank apologizing for the error or at the very least a copy of your letter to the bank asking them to correct the problem. Again, be honest with your explanations. You may also want to explain why you will never be in a situation where you will be forced to make late payments again (I lost my job and didn't have any savings to rely on, since then I have always made sure that my savings account contained at least 3 months of salary).

Your lender should complete your mortgage preapproval in about a week, maybe faster if you provided all the documentation that I have suggested. **You should receive written verification of your preapproval including any conditions.** In the interest of time, the underwriter will often give you a conditional loan commitment. This means that your loan is approved subject to the receipt of some documentation or subject to some other condition being satisfied. It is in your best interest to eliminate all of these conditions as quickly as you can. You will not be able to close on your home until you satisfy all conditions regardless of how minor they might appear to be. Some sellers may not be satisfied with a loan approval that is subject to a number of conditions, so don't wait until closing to take care of any loan approval conditions that you might have.

Some lenders may also give you the option to lock in an interest rate at this point (not all lenders will do this as your exact actual loan amount is unknown until you purchase a home). In other words, you would be guaranteed a certain interest rate and point combination regardless of what happens in the market. In many cases, if rates go down, you may not be able to take advantage of this (however, if rates go up, you are protected). There are a number of different rate lock variations – for example some lenders will let you relock your rate once if rates go down, but might charge a fee. It is in your best interest to find out whether interest rates are expected to go up or down, but don't waste too much time attempting to predict interest rate movements. If you are offered a chance to lock in a rate at this point and are comfortable with the expected payment, go ahead with the rate lock. Even professional mortgage bond traders cannot predict exactly what interest rates are going to do – there is no way you are going to do this and in attempting to do so you will most definitely drive yourself nuts.

Finding Your Home

Now comes the exciting part - finding your home! But where do you start? You now know how much you can afford; you have a preapproved mortgage loan. You may have a general idea where you want to live and what style of home would best fit your lifestyle. In order to organize your thoughts, consider the following:

Factor to Consider	Reasons
How close is your new home to your workplace?	Adding even ½ hour to your daily commute can make your dream home seem a lot less desirable
How close will your family and friends be?	In some cases, it is a good thing to be farther from family, but generally if you are used to jumping in the car and arriving at a friend's home within 15 minutes or so think about this factor
Do you have children? Will you have older relatives living with you? Pets? Hobbies?	Your lifestyle will largely determine the style of home that you will be most comfortable in.
Proximity to interstates, main roads, shopping	How long will it take you to get to the grocery store or the nearest Wal-Mart/Kmart?
Schools, Recreational Activities, Overall Appearance of the City	A city with a budget problem has no choice but to cut spending on services- eventually this will lower property values
How much room do you need?	If you definitely need 4 bedrooms or an eat-in kitchen, you may be limited to certain areas based on what you can afford
Instinct	As with many other things in life, trust that voice instead of you and don't dismiss first impressions. The last time we were out looking for homes, before we even got to the kitchen, my wife told me that she felt that "this was our house." Of course, you would not base your decision solely on instinct, but it can clearly tell you that it is time to start really analyzing a property.

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Choosing a Real Estate Agent

Been driving around looking at open houses or calling on ads you see in the newspaper? Does it seem like you're not finding anything even close to what you are looking for?

The first rule for home buyers is: **Always use a real estate agent.** In most cases, buyers pay their real estate agent nothing -the seller pays a commission that is shared by the agent that listed the property for sale and by the agent who brought the buyer. A good real estate agent can quickly locate all homes that are currently for sale that might appeal to your taste and wallet. A real estate agent can also help you with both negotiating your offer and getting a mortgage.

Many people choose a real estate agent based simply on a relationship. Your co-worker's mother is a real estate agent, so of course you would use her when you buy your home. One real estate agent is just as good as any other, right? Wrong. **When you chose a real estate agent you are choosing someone to help you with one of the biggest financial transactions of your life. Don't make this choice based on who they know or strictly because they seem nice.** During my 10+ years in the business I had experiences with agents who treated buyers as if they were a close friend or even part of their family. I also had experiences with real estate agents whose only concern was their commission check and how quickly it was going to land in their wallet. In most cases, the agents who genuinely cared about their customers also had a good understanding of home buying process - they cared enough about the quality of service that they provided to take the time to educate themselves. Talk to a number of real estate agents before you choose one.

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Include your co-worker's mother in this group but base your decision on her skill level not on the size of her family. Find out how long an agent has been licensed and how many home sales he or she has participated in. Get to know the agent a little, you need to feel comfortable with this person. Make sure the agent you choose knows the city or areas that you are interested in. Ask for references. **One common misconception is that the top producing real estate agent is always the best choice.** This is not always true, especially as a buyer. A top producer is probably very good at closing sales and satisfying home sellers, but may not necessarily be as good at satisfying homebuyers. Ask for references. Top producers are busy people and may be difficult to reach unless they have built their business around their clients instead of around their commission checks. Some top producers have one or more assistants who can be a terrific, easily accessible resource for their clients.

Don't eliminate an agent just because they are part time. Many part time agents who have been in the business for a few years are very knowledgeable. Others may be new to the business but may have help from the office broker, who is typically the owner of the

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real estate agency. Of course this could be an ideal arrangement, but then the broker's personality and motivation also become part of the decision. Some part timers are supplementing their income. Others are retired from their career jobs and choose to stay active by selling real estate. The advantage of working with a part time agent is that typically he is not depending on the commission from your home purchase to buy his groceries. As a result, you probably won't get as much pressure to buy. A part time agent may be able to devote more time to you – in fact you may be the only client he is working with.

Some buyers, especially first time buyers, often need a little push. A good agent knows when a push is appropriate. Not so good agents will begin pushing you from your very first meeting.

By now I am sure you have noticed that I haven't clearly defined the perfect agent for you. This is because choosing an agent is at least partially a personal decision based on your instinct. **Make sure the agent you choose is knowledgeable and can clearly explain real estate concepts to you.** If you feel that you are educating the agent by relating some of the things you have learned in this guide, move on. A good real estate agent will not only understand the entire home purchase process; he or she will also be able to give you advice based on your personal situation. This is something that I cannot do within the confines of this guide or my web site.

When you have made a choice, stick with that agent. Real estate agents generally work on a commission only basis. If your real estate agent is not directly involved when you make an offer on a home, in most cases they will receive nothing - regardless of how many homes they have taken you to or how much time they have spent with you. It is in your best interest to respect this. If your agent knows that you will walk into any open house you see or look at homes with other agents, naturally you will not have their full attention. You will probably also experience more pressure to buy because the agent may feel that they have a limited number of chances to sell you a home and in turn earn a living. Most real estate agencies are members of the local multiple listing service (another question to ask during your interview stage). **The multiple listing service gives an agent member access to all homes that are listed. Therefore any agent can sell just about any home that is for sale, regardless of whether their company has listed the property (their sign is in the front yard) or some other company has listed the property.** You do not have to call the listing agent to see the home, your agent can arrange for this. The listing agent and your agent then split the commission that the seller pays.

You may choose an agent and then realize that you made a mistake. Let the agent know that you intend to work with someone else. Obviously this will not be a particularly pleasant phone call, but it will be worse if you let the agent continue to believe that you are working with them. The agent may spend a great deal of time searching for a home for you only to find out that you have been working with someone else for the past three weeks. That will result in a very unpleasant situation.

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In a limited number of cases you may find a home through another channel. For example, your friend's grandfather passed away 3 months ago and left a house for them to sell which turns out to be your dream home. If this happens, let your agent know as soon as possible. Again please remember that this person is working on commission and therefore their time is precious. Most agents will be understanding. You may feel bad in this situation but you can still compensate your agent by referring business to them (assuming you were happy with their service). Be on the lookout for friends, relatives, neighbors, co-workers who mention that they are considering a home purchase. It takes very little effort to pass along an agent's business card and relate your good experience. Since most real estate agents spend at least 50% of their time looking for business, your agent will appreciate this. You will also feel better about the situation.

SEARCHING FOR A HOME

To begin your search, have your real estate agent provide you with a list of homes available in your price range and homes that have sold in the general area that you have decided on. Drive by these homes. You will probably be able to eliminate at least 50% of the homes currently listed for sale based on exterior appearance alone. As a rule, I found that the exterior appearance of a home is indicative of the interior and overall condition. If the shutters are falling off and there is no landscaping, chances are good that the kitchen floor is 25 years old and the pipes under the bathroom sink have been leaking for six months. If the listing form your real estate agent gives you has an indication of the amount of time the home has been on the market, pay attention to this as well. There is only one reason a home has been on the market for a long period of time – price. You might think that condition or location could also keep a home from selling, but remember that anything can be sold at the right price. If a home in deplorable condition in a \$150,000 neighborhood is offered for sale at \$100,000, chances are pretty good that someone will buy it with the intention of fixing it up and making a profit. If this same house is offered at \$140,000 it won't sell for a long period of time, if at all.

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FOR SALE BY OWNER

Some homeowners choose to offer their home for sale without using a real estate agent in order to save on the cost of commission. Although you should not ignore these homes in your search, in some cases the for sale by owner home will be overpriced. Usually the owner does not have the benefit of a professional price opinion and determines the sale price using the limited amount of neighborhood sale price knowledge they might have (the Smiths sold their house for \$172,000 so ours has to be worth at least \$190,000). In many cases, emotions get in the way. Some homeowners add a premium to their sale price in an attempt to make up for all the memories they are leaving behind. Others add the dollar value of all improvements they have made over the past years to their sale price. Obviously, improvements add value to a home, but usually not dollar for dollar. Replacing a furnace may cost \$5,000, but buyers expect every home to have a functioning furnace so this improvement doesn't add \$5,000 to the value of the home (however, having a brand new furnace may make the home more appealing than a home that has a 25 year old furnace). A real estate agent can usually add logic to a situation like this and get the seller to offer the home at a reasonable price. If you choose to purchase a for sale by owner home, you will probably not have the assistance of your real estate agent unless the owner has agreed to compensate the agent in some way. You will have to negotiate the contract and follow the closing yourself which will probably mean obtaining the services of an attorney. This could result in expense that goes beyond your available funds.

On the other hand, home sale data is becoming more easily accessible and therefore a home seller who has chosen not to use a real estate agent may have the property reasonably priced. Don't ignore for sale by owner homes, but make sure that you analyze them based on the steps outlined in the next section.

Making the Offer to Purchase

After an exhaustive search and just when you were ready to give up, you find the perfect home. Better still, you can afford it (at least according to your lender). Now what?

The first step is to determine the market price range of the home. Some buyers that I worked with determined their offer price by subtracting 10% or 15% from the listing price, regardless of the property they were looking at. They wanted to see "how low the seller would go." Don't play this game, it results in a lot of wasted time and could cost you the home you really want. Many sellers will become angry when you submit a "low-ball" offer (especially when their listing price is representative of the market and reasonable). I have seen cases where the seller refuses to counteroffer in a situation like this and even goes so far as to tell the real estate agents that he doesn't want to deal with this buyer (which is his right as long as he is not violating any discrimination law). Making this kind of offer also makes it difficult for your real estate agent to close the deal. Your agent doesn't have data to validate your offer and therefore cannot defend it. Your agent immediately becomes the enemy in the eyes of the seller. Even if he comes back the next day with a reasonable offer, he may receive a counteroffer just out of spite.

Of course, if your data says that the listing price is too high, this is a completely different situation. Your agent will have something to back up your price and can reasonably explain it to the seller. If they refuse to listen, it might be better to move on to another home anyway.

At this point, although your real estate agent will be a great resource in providing you with data, you do not have to rely on him or her to determine your offer price. Ask your real estate agent to pretend that they are listing the home and compile comparable sale data for you. Many agents will do this automatically. There are also a number of online resources available to help you compile this data. Take advantage



<http://www.educatedhomebuyer.com/>

You don't have to rely completely on your real estate agent when trying to determine the market value of a house

of these resources.

TO GET A DETAILED PROPERTY VALUE REPORT GO TO
WWW.EDUCATEDHOMEBUYER.COM/HOMEPRICE.HTM

Your agent may make judgement calls on which comparable sales to provide you with and in turn skew your data. Of course the agent has a lot more experience in choosing good comparable sales, but let them explain why a comparable sale is not a good choice rather than just not showing it to you. There may be some situations in which you have a difference of opinion with your agent that affects your offer. This is also the point in your relationship where even the most ethical agent will be tempted to eliminate a comparable sale (on the low side) so that the offer will be easier to close. Believe me, this is very easy to justify when you are staring down the barrel of a \$2500 commission check, regardless of who you are or what you are about. Accessing independent data sources will keep this from happening.

This data should be assembled in two different directions. **First do a search of the immediate area around the home you are making the offer on (same development, 3 or 4 streets in either direction, etc).** Compile all the data you can on any property that has sold in the last year. The real estate market tends to fluctuate based on economic conditions (most notably interest rates) so comparable sales that are over a year old probably won't help much. As you are compiling this data do not eliminate colonials because the home you are considering is a ranch. The idea here is to get a good feel for the price range in the area that the home is located in. You want to make sure that the price you offer is within this range. **Next, do a search of a larger area, but limit the data to sales that involve properties that are similar to the home you are making the offer on.** If you are buying a Ranch, search for sold Ranches - usually you want to limit the search to the same city that the house is located in. As I mentioned in the last section, city services and reputation do have a lot of influence on market values. Compare the features that your proposed home has with homes that have sold. If you are lucky enough to come up with a good number of comparable sales, you will probably be able to determine how at least a few features affect market value. For example, you may notice that homes with 4 bedrooms sell for \$20,000 more than homes with 3 bedrooms. Professional appraisers are skilled at assigning values to various features of properties and they basically use the same technique that you are using. As you complete this process, you will be narrowing the price range in which to make your offer. Don't try to determine an exact price, even professional appraisers are guessing at this.

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The top 5 factors that adversely affect the value of a house

As you are looking at how certain features affect the market value of your comparable sales, you might notice a few factors that dramatically affect the ultimate sales price. According to a state-licensed (Ohio) appraiser, here are the top 5 factors that adversely affect the value of a house:

Major defects - Some people watch a couple of episodes of “This Old House” and think they are ready to do foundation work themselves. An appraiser has to consider what it would cost to get a licensed contractor to correct any major defect and factor that cost into his opinion of the market value – and you should too. This doesn’t mean that you should never buy a house with defects---it means that you should buy it at a price that would allow you to hire a contractor to do any repairs and still not have more than the market value of the home invested.

TO FIND A QUALIFIED CONTRACTOR IN YOUR AREA GO TO
WWW.EDUCATEDHOMEBUYER.COM/FINDCONTRACTOR.HTM

Proximity to Noise or Other Nuisance – a nearby airport, highway, factory or railroad tracks might not be obvious at the time you are looking at the house. Having one of these “nuisances” as a neighbor will do nothing but keep the value of a home down.

No basement – especially on a street of houses that all have basements. Of course, this depends on what part of the country you are in. In some parts of the country, you won’t find any homes with basements.

2 bedrooms or less – no matter where you are, one or two bedroom homes can be real tough to market. Even empty nesters desire 3 or more bedrooms, for guests, hobbies and a number of other uses.

City – Tax rates, schools, police and fire service are just a few ways that cities which are close geographically can be miles apart when it comes to value. If you end up looking at comparable sales in other cities, you’ll probably see this very clearly. Avoid buying a home in a city with a poor reputation just because it saves you a little money – you’ll be very disappointed when you go to sell the home and find that the appreciation isn’t what you expected.

Once you have your price range, determine your offer price based on the following factors:

The market - Is there a shortage of homes for sale in this price range? If so, your offer should probably be on the high side of this price range.

Condition - Is this home in particularly good condition? Did it appeal to you right away (if so it will appeal to other buyers that might come along as well)? If so, make a good offer quickly - before someone else does.

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Can you meet the seller's closing requirements? For example, the seller might be building a home. If you agree to extend closing 90 days (to coincide with the completion of their new home) you may be able to offer a slightly lower price than the buyer who absolutely insists on closing in 20 days.

Your emotions - While many people will advise you not to let your emotions get in the way of purchasing a home, don't forget that this is the place you are going to live. You are going to eat Thanksgiving dinner here, your children are going to grow up here and most of your memories are going to include some piece of this place. If you feel very strongly about this property and you know there are other buyers bidding on it, don't worry about bidding a little higher than logic would otherwise allow - unless you have reason to believe that you will only be in the home for a short period of time. Real estate values typically at least keep pace with inflation, so even if you pay slightly more than a home is worth initially, you should be able to sell the home in 4 to 5 years without losing anything. One factor to keep in mind in this situation is that your lender will appraise the home. The appraised value is important in that it will affect the amount of mortgage the lender is willing to give you for the property --- particularly if you have no down payment or a minimal down payment. If you offer the seller an amount that is way off the market value, you may not be able to secure financing on the home. However, do not completely depend on the lender's appraisal. Don't forget that the market value of a home = the amount someone is willing to pay for it. If an appraiser can substantiate your high bid price, you may get financing for the home but you may not necessarily be able to find another buyer who shares your opinion regarding the value of the home. Because of this, it's important for you to understand the real value of the house so that you know where you stand after you close the deal.

HOME INSPECTIONS

I strongly recommend including a clause in your offer that allows for a home inspection and gives you the right to cancel your offer based on the results. Your real estate agent or attorney can help with this.

You can then either hire a professional home inspector or have someone that you know who is knowledgeable inspect the home. In either case, the following areas should be checked:

*foundation- is it solid, does grade of the property allow for drainage away from the house, are there any cracks or other signs of failure

*electrical- adequate for the home and systems (i.e. central air)

*plumbing- adequate water pressure, any leaks or potential problems

*roof- any leaks (attic should be inspected), how long until replacement, insulated

*furnace- operating properly, how long until replacement

*windows- operating properly, provide adequate insulation

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Most real estate agents will be able to refer you to one or more professional home inspectors. **When using one of these home inspectors, remember that they probably depend on referrals from real estate agents to survive.** Real estate agents are generally not happy when a purchase is cancelled based on a bad report by a home inspector. In fact, they may be so unhappy that they stop referring buyers to this home inspector, even if his report was justified. They may also relate their experience to every other agent in their office. Although the home inspector is being paid by you and therefore certainly owes you an honest and fair evaluation of the property, keep in mind where their business comes from. The home inspector may play both sides of the fence -- he may point out a potential problem but downplay it so that you do not back out of the purchase.

Before you hire a home inspector, ask if the following information will be provided:

Estimated remaining life of major repair items: furnace, central air, roof, windows, hot water tank, plumbing, driveway and other concrete

Estimate of cost of any defect found (a range is fine, remember the inspector is usually not a contractor)

Are all electrical outlets tested? GFI outlets tested?

Is a water pressure check done at all faucets?

Does the inspector test carbon monoxide levels near the furnace?

Will the inspector give you an opinion on how well the home is insulated?

In most cases, home inspectors are not required to be licensed or certified in any way. It is important to check an inspector's credentials - there should be some construction/technical experience there. If you ask around and look around enough, you will probably be able to locate someone who is in the construction industry (maybe works for a builder) and moonlights as a home inspector. This is the ideal situation - usually this person is very knowledgeable and because doing home inspections is not their main source of income, they are probably not as concerned with the referral aspect.

Regardless of who does your home inspection, read all materials that you are provided with very carefully. I have never seen a home inspection report that makes any kind of guarantee regarding the condition of the property and you should not expect to see this. I have run across quite a few homebuyers who believed that because they had a home inspection done that some kind of warranty existed. A good home inspector will identify most potential problems but cannot guarantee the home's condition. Sellers can conceal defects, some problems may not be easily identified within the scope of a normal home inspection and the severity of many defects is a matter of opinion. In order to provide you with an absolute guarantee of a home's condition, the home inspector would have to spend a considerable amount of time at the property and have a number of tests done which would result in a home inspection fee that would certainly be in the thousands, if not the tens of thousands.

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Obviously, most people would not go to this expense for a guarantee and rightly so. Building codes and construction guidelines generally prevent serious problems. **Most homeowners who I know that have had problems noticed these problems when they purchased the home, but did not get a professional opinion as to the severity of the problem before they purchased the home.** If there are cracks in the basement walls, pay the cost of an inspection by a structural engineer before you go through with the purchase of the home (or ask the seller to split it with you). Even if there is no sign of water in the basement, these cracks could be the start of a serious problem that could cost you tens of thousands of dollars in the future. Investing a couple hundred dollars today to avoid this situation is well worth it. Other potentially major problems require a professional opinion as well.

SO THAT YOU DON'T HAVE TO RELY ON YOUR REAL ESTATE AGENT TO
FIND A HOME INSPECTOR, USE THE FREE HOME INSPECTOR LOCATOR
SERVICE THAT I FOUND
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WRITING THE OFFER

I am not an attorney or a licensed real estate agent, so I cannot review the contents of a standard real estate purchase agreement. However, most purchase agreements that I have seen are very straightforward and easy to understand. Make sure that you understand every aspect of a purchase agreement before you sign it. If you are unclear about any part of the purchase agreement, consult an attorney. It is a good idea to review a copy of a standard real estate purchase agreement before you start looking for a home so that you know what to expect when the time comes to make an offer on a property.

It is also important to understand the relationships involved in the transaction before you even get started. If your real estate agent is splitting the commission with the listing agent (and therefore being paid by the seller) his ultimate legal responsibility might be to the seller. This could mean that if you tell the agent that you are willing to pay \$5,000 more than the offer you are making, the agent must share this information with the seller.

Typically once you have decided that you are interested in a particular piece of property, you will sit down with your real estate agent and complete a written offer to purchase. Some agents may present the seller with verbal offers in order to try to arrive at a mutually acceptable price before the offer is put into writing, but this never really seemed too effective to me. As a seller, a written offer is definitely a serious offer. In some cases, a seller may be able to agree to a price verbally and then change their mind. Once both parties sign the offer, it becomes a contract and both parties are bound to it. Take the time to put any offer in writing. In most cases, you will also be asked for earnest money when you complete the offer to purchase. Earnest money is basically just a deposit to show that you are serious and should not scare you. However, keep in mind that if you change your mind after your offer is accepted by the seller, you may lose this money.

Your offer will usually be presented to the sellers of the property in person and as soon as possible. The sellers have the option to accept the offer as written, reject the offer or counteroffer - that is propose a higher price or different terms. In the case of a counteroffer, you will then have the opportunity to accept it, reject it or propose your own counteroffer. Conceivably, the offer could go back and forth a number of times before an agreement is reached. However, in practice if the offer goes back and forth two or three times without an agreement being reached, one of the parties will probably give up and look for another house or buyer.

Closing

Your insurance agent will ask you to pay the first year's premium of your homeowner's policy up front, before closing

Once your offer has been accepted and your home inspection is completed, you should notify your lender. An appraisal of the property that you have purchased will have to be completed. **If you have not already done so, now is the time to lock in an interest rate.** Depending on how long it has been since your preapproval was processed, your lender may have to update the loan documentation. You will also have to secure property insurance. In most cases, your insurance agent will ask you to pay the first year's premium before he will provide you with the actual policy. You will need the policy in order to close the sale - your lender needs to be certain that their collateral is adequately protected. This is also a good time to either get life insurance or upgrade your current coverage.

I found a great FREE service that is very similar to the mortgage lender service that I told you about earlier - you fill out one information sheet and it goes to a number of agents who all compete for your business. It couldn't be easier to get the best deal on homeowner's insurance.

I've put a page up on my website so that you can take advantage of this service too!

WWW.EDUCATEDHOMEBUYER.COM/INSURANCEQUOTE.HTM

At some point, either before or during your closing, you might be offered mortgage credit life or mortgage disability or some other form of credit insurance. While I believe in insurance, my advice is to stay away from any kind of credit insurance – the products I have seen were not good values when compared to standard insurance products. For example, most mortgage life policies only cover your mortgage balance – which means your coverage gets lower and lower as time goes by. The cost of this type of insurance is usually higher than standard term life insurance with a benefit that stays the same over time. If you are interested in protecting your mortgage balance either with life insurance or disability insurance use the service I mentioned above to get a quote on a product that is not tied to your loan.

Depending on where you live, closings are handled in two different manners. In some areas, a meeting will be scheduled to facilitate the closing. Typically, the real estate agents, buyers, sellers, title company and any attorneys involved will be present. All papers are signed and funds are collected. The deed is taken to the courthouse for recording immediately following this meeting. In other areas, an escrow agent (who usually works

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for the title company) will accumulate all the necessary signatures and funds without necessarily bringing all parties together at one time. When the escrow agent has compiled all the necessary documentation and funds, they will have the deed filed. All real estate contracts that I have seen include a clause that specifies when the buyer is to take possession of the property from the seller. In most cases, the buyer will give the seller at least a few days to vacate the property after title transfer. If the seller has agreed to make any repairs to the property as part of the contract, make sure that you personally inspect these items before closing. Obviously, if the seller hasn't kept up their end of the bargain, you probably have grounds to pursue them legally. However, it is much easier to hold up the closing until the repairs are completed than it is to file a lawsuit against someone.

It is always a good idea to review your documents before you sit down with the escrow agent to sign them. At the very least, you should get copies of your settlement statement (it may be an estimate if the escrow agent is missing information), your mortgage note and any waivers that you are expected to sign (i.e. accepting repairs that the sellers have completed). Make certain that you are getting the mortgage rate and terms that you were expecting and that closing costs are in line with the original estimate that you received from the lender. Reviewing these documents before the actual closing gives you the opportunity to work out any problems without holding up the closing. You are also more likely to notice any changes or errors when you are not under pressure.

Also make sure that arrangements have been made for delivery of the keys (or pick up by you). I was involved in a number of sales where no specific arrangements had been made beforehand and the buyers ended up locked out of the house for a day or so while their real estate agent tracked down the seller and got the keys.

Congratulations! You made it through the process!

After closing, you should receive your recorded deed (showing title transfer to your name) and your mortgage insurance policy. Be patient these documents may take weeks to reach you.

Enjoy your home. Please feel free to contact us at The Educated Home Buyer with any questions or comments you might have.

Email: customerservice@educatedhomebuyer.com

<http://www.educatedhomebuyer.com/>

Web Page Reference

www.educatedhomebuyer.com/creditcenter.htm

Credit Reports from all 3 Major Credit Bureaus and Credit Scores Available

www.educatedhomebuyer.com/applyonce.htm

Fill out one short loan application that is sent to four lenders who compete for your business – a FREE service

www.educatedhomebuyer.com/findagent.htm

The fastest, easiest way to find a qualified real estate agent in your area – a FREE service

www.educatedhomebuyer.com/homeinspector.htm

The fastest, easiest way to find a qualified home inspector in your area – a FREE service

www.educatedhomebuyer.com/homeprice.htm

Low cost, detailed property reports. Includes Neighborhood Demographic Profile, Nearby Home Owners Report, School Report and Local Area Business Report.

www.educatedhomebuyer.com/insurancequote.htm

The fastest, easiest way to find the best deal on homeowners or any other type of insurance – a FREE service

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<http://www.educatedhomebuyer.com/>

www.educatedhomebuyer.com/findcontractor.htm

Find a qualified home improvement contractor in your area – a FREE service

Other great homebuyer sites:

Fannie Mae - Helping Americans achieve the dream of homeownership....

Fannie Mae provides financial products and services that increase the availability and affordability of housing for low-, moderate- and middle-income Americans....

<http://www.fanniemae.com>

Loan Guaranty Homepage...

Information on the Home Loan Program Am I Eligible for a VA Loan? Property Management Construction and Valuation Lenders & Servicers Contact VA Loan Guaranty Service Forms Loan Guaranty HomePage VB...

<http://www.homeloans.va.gov>

The Coalition...

The Coalition Principles State Reform Federal Reform Citigroup-Associates Links to Other Organizations New Info News Clips What is Predatory Lending? Reports Victims' Stories Predatory Lending costs ...

<http://www.responsiblelending.org>

ABC's of Real Estate consumer guide...

The ABC's of Real Estate provides mortgage and real estate consumer advice, information, and resources to residential home buyers and sellers....

<http://www.realestateabc.com>

Real estate search engine - HomeResearcher.com...

Comprehensive directory of links to real estate, home mortgage loans, home improvement and home furnishing....

<http://www.homeresearcher.com>

REALTOR.com: Real estate listings, homes for sale, home loans, home buying...

REALTOR.com: find real estate listings on homes for sale, condos, and townhouses, as well as home loans, home buying help and REALTORS®." meta name="Keywords" content="National Association o...

<http://www.realtor.com>

Home Buyer's Checklist

- Check Credit Score and Credit Report. Take care of any problems or errors.
- Identify a Lender with Favorable Terms for Your Situation.
- Apply for Mortgage PreApproval.
- Get Written Confirmation of Mortgage PreApproval.
- Identify the Areas you are Interested in and Can Afford.
- Find a Real Estate Agent.
- Find a Home.
- Make a Written Offer, Seller Accepts Offer.
- Get Home Inspection Done.
- Contact Lender to Have Appraisal Done and Lock in Interest Rate (if not locked at the time of the PreApproval).
- Find Home Insurance.
- Ask Closing Agent to Send You copies of Closing Papers 2-3 days before Signing.
- Make Sure the Seller Has Done Everything They Agreed to Do (i.e. repairs).
- Sign Closing Papers and Get Keys From Seller.

