HOME BUYING 101

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The Mortgage Process

Buying a home is one of life's most exciting experiences. The following practical information will help prepare you before you begin the home buying process and guide you while you are in the midst of it. We hope it helps you feel informed and comfortable about the entire home buying process.

Prequalification

As a prospective homebuyer, you will need to schedule a prequalification session. Your mortgage loan officer will discuss the following four things: the payment amount you can afford, various financing options, down payment requirements, and closing costs involved in obtaining a mortgage loan.

1. The payment amount you can afford: The size of the mortgage loan you qualify for is based on your income and current debts.

   A mortgage payment has four components:

   - The principal – the amount of your monthly payment that reduces the outstanding balance of your original amount borrowed.
   - The interest – the cost for borrowing the money
   - The property taxes – the amount you owe each month for property taxes
   - The hazard insurance – the insurance that protects the homeowner and lender against physical damage to the property like fire, wind, hail, etc.
   - Private Mortgage Insurance (PMI) is an insurance you may also need if your down payment is less than 20%. This is typically added to your monthly loan payment.

   Can you afford to buy the home of your dreams? A good guideline to follow is that your monthly housing expense should not exceed 30 percent of your gross monthly income.

2. Financing options: Mortgages fall into two broad categories: fixed-rate and adjustable-rate (ARM):

   - Fixed-rate mortgage – the interest rate remains the same throughout the length of the loan, whether that be a 10, 15, 20, 30 or 40 year loan. The big plus of a fixed-rate mortgage is that you know your monthly payments won't change.
   - Adjustable-rate mortgage (ARM) – the interest rate varies over the term of the loan. The starting adjustable-rate is usually lower than the fixed-rate option, but can increase or decrease a certain amount at specific intervals, such as once a year. The main advantage of an ARM is that you'll start out with a lower interest rate, and therefore smaller mortgage payments. This lower rate may make it possible for you to qualify for a larger loan amount than you could get from a fixed-rate mortgage. Some people also like ARM's if they know they won't be in their home for more than five years.

The Mortgage Process (continued)

3. **Down payment**: A partial payment on a purchase. This payment is typically a small portion of the total purchase price, and reduces the amount of the purchase that must be financed. When buying a home, a typical down payment requirement could range from 5% to 20% of the purchase price.

4. **Closing costs:** You will be given an estimate of how much your closing costs will be before you actually close on the mortgage loan. Your lender will provide you with a Good Faith Estimate of Closing Costs. As with the down payment, closing costs are due in full on the day of the closing

Preapproval

Prospective homebuyers who are beginning to shop for a home may obtain a preapproved loan. The scheduled appointment will normally take about one hour. You will probably need the following documentation:

- Tax returns including W-2's for the last 3 years
- Pay stubs covering the last 30 days
- A list of assets and liabilities
- Employer's names and addresses for the last 2 years
- Residence addresses for the last 3 years

The preapproval is good for a limited time. When the prospective homebuyer has found a home to purchase, an appraisal is completed and full loan approval is obtained.

Application

The application process is identical to the preapproval process above, except the prospective homebuyer has a signed purchase agreement or contract from the seller. This should be supplied along with the other required documents listed in the preapproval process above.

Underwriting

When all the information on the application has been verified and the property appraisal has been completed, the loan file is sent to an underwriter. If the loan is approved, title work will be ordered in preparation to close. If the loan is denied, other available options can be explored.

Closing

A closing is a 30-minute appointment with the borrower(s), seller(s), realtors, closing agent, and mortgage loan officer to finalize the mortgage transaction. At least one week prior to the closing, borrower(s) should provide the information concerning their homeowners insurance coverage to their lender. A cashier's check for down payment and closing costs, payable to the title company, must be brought to closing.

Home Equity

Equity is the difference between what your home is worth and how much you owe on your mortgage. You can turn this equity into usable funds by taking out a home equity loan. You can use this equity for:

- New or used vehicle purchases
- College expenses
- Home Improvements
- Or anything at all!

In most cases, the interest on a Home Equity Loan or Line of Credit is tax deductible. Consult your tax advisor about your specific situation.

Determining Equity

To determine the equity you may have available, you can use either your property tax statement or a current appraisal.

Value of your home	$
x 90% (.90)	= $

Taking the figure above, subtract any existing 1st mortgage balance.

Figure from above	$
Balance owing on home	- $
Remainder	= $

When does it make sense to refinance?

Good reasons to refinance include getting a lower interest rate, shortening the term of the mortgage to build equity faster, lowering monthly payments or switching from an adjustable rate to a fixed-rate mortgage.

Even if you just secured a new mortgage recently, it might make sense to refinance. Homeowners should consider refinancing if, in the long run, it will save them money.

To determine if it will save you money, calculate your break-even point. You can calculate it by dividing the mortgage fees by the monthly savings. The answer you get tells you how many months it will take for you to break even.

If you plan on retiring in the house, strongly consider refinancing. If you plan to sell within two or three years, it may be unwise to refinance.

Monthly savings from refinancing:	$100 a month
Closing costs:	$3,000
Break-even point:	30 months

$100 / $3,000 = 30 months

Important Mortgage Terms

Adjustable-rate - a mortgage having an interest rate that can change at designated intervals, based on a financial index. Also called an ARM.

Amortization - the gradual reduction of the principal of a mortgage by scheduled installment payments.

Amortization Schedule - a schedule that shows the portions of each payment that are applied to interest and to principal. It also shows the loan balance remaining after each payment.

Annual Percentage Rate (APR) - a rate that reflects the actual annual cost of a loan, incorporating the loan interest rate, private mortgage insurance, points, and fees.

Appraisal - a professional assessment of the market value of a property.

Appraisal Fee - the lender has the home you are purchasing appraised to determine whether the value of the property is sufficient to secure the loan.

Appreciation - increase in value of a property.

Assessed Value - the value placed on a property by local officials for taxation purposes (may or may not equal appraised value).

Closing - the legal procedure in which the transfer of property becomes final. *Also called settlement.*

Closing Costs - costs incurred by the buyer and seller in transferring ownership of a property.

Closing Fee - this fee is paid to the closing agent.

Closing Statement - a statement showing the various closing costs and recording which party paid these costs. Also called settlement statement.

Conventional Mortgage - any mortgage that is not insured or guaranteed by the federal government.

Credit Report - a report of an individual's credit history prepared by a credit bureau and used by a lender to determine a loan applicant's creditworthiness.

Credit Score - a three-digit number that lenders use to objectively measure your credit-worthiness — how likely you are to pay back a loan on time.

Deed - the legal document conveying title to a property.

Default - to fail to make mortgage payments on a timely basis or to comply with other mortgage conditions.

Delinquency - failure to make a loan payment on time.

Down Payment - the part of the purchase price of a home which the buyer pays in cash up front; not included in the loan.

Earnest Money - a deposit given to the seller by the buyer when submitting an offer to show serious intent about buying a property.

Equity - the difference between the market value of a property and the owner's outstanding mortgage balance; measures the degree of ownership.

Escrow - the holding of documents and money (such as a deposit) by a neutral third party prior to closing. Also an account held by the lender into which a homeowner pays money for taxes and insurance.

Escrow Reserves - reserves are required if the lender will be paying your property taxes and hazard insurance to set up your escrow account.

Fannie Mae (FNMA) - an acronym for the Federal National Mortgage Association. Fannie Mae purchases mortgage loans originated by local lenders and sets guidelines that lenders must follow to qualify prospective borrowers.

Fixed-rate - a mortgage in which the interest rate does not change during the entire life of the loan.

Flood Certification Fee - used to determine if the property is in a flood hazard area and needs flood insurance coverage.

Flood Insurance - insurance that will be required if a property is in a federally designated flood hazard area.

Freddie Mac (FHLMC) - an acronym for the Federal Home Loan Mortgage Corporation. Another of the major purchasers from local lenders. See also Fannie Mae.

Good Faith Estimate - a written estimate of closing costs provided by the lender within three days after someone applies for a loan.

Hazard Insurance - insurance to protect the homeowner and lender against physical damage to property from fire, wind, vandalism, and other hazards.

Home Equity Loan - a loan based on and secured by the borrower's equity in his or her home.

Homeowner's Insurance - an insurance policy that combines hazard insurance and liability coverage.

Interest - the cost for borrowing money.

Lender's Title Insurance - protects the lender if any title problems turn up that the title search and examination didn't find.

Loan Discount - also referred to as points. Fee paid to lower your mortgage interest rate. One point equals 1% of the mortgage amount. For example, on a $70,000 loan, one point is worth $700.

Loan-to-value ratio (LTV) - the ratio between the amount of the mortgage and the total value of the property.

Lock-in Rate - an interest rate the lender guarantees to the borrower provided the mortgage is closed within a certain time period.

Mortgage - a legal document that pledges a property to the lender as security for payment of a debt.

Mortgage Note - a legal document obligating a borrower to repay a loan at a stated interest rate during a specified time period.

Mortgagee - the lender in a mortgage agreement.

Mortgagor - the borrower in a mortgage agreement.

Origination Fee - a fee paid to a lender for processing a loan application, stated as a percentage of the mortgage amount, or points. Due at closing.

Plat Drawing - Assures that the property and all buildings are within the property lines.

Points - a one-time charge by the lender to increase the yield of a loan. Equal to 1% of the loan amount and paid at closing.

Preapproval - the process of formally applying for the mortgage. The lender determines that you are eligible for a mortgage of a certain amount.

Prequalification - the process of determining how much money a prospective homebuyer will be eligible to borrow before a loan is applied for.

Principal - the amount originally borrowed. Also that amount of the monthly mortgage payment that reduces the outstanding balance of a mortgage.

Private Mortgage Insurance (PMI) - insurance provided by a nongovernmental insurer to protect a lender against loss if a borrower defaults. Usually required if down payment is less than 20% of the purchase price.

Processing Fee - this fee covers the cost of preparing closing documents.

Purchase and Sale Agreement - a legal document requiring the buyer to buy and the seller to sell, under specified terms and conditions.

Rate Lock - the amount of time that a lender will guarantee a loan's interest rate. Once the interest rate is locked on a loan, the lender will guarantee that rate for a certain period of time, usually for 30, 45 or 60 days.

Recording Fee - this covers the cost of recording the mortgage at the county recorder's office.

Refinancing - the process of obtaining a new mortgage, usually at a lower rate and sometimes at a shorter term, to repay and replace an existing mortgage.

Tax Service Fee - this fee covers the cost of monitoring and paying your real estate taxes and insurance.

Term of a Mortgage - the length of time you are given to repay a loan.

Title Insurance - insurance to protect the lender (lender's policy) or the buyer (buyer's policy) against loss arising from disputes over property ownership.

Title Search - a detailed examination of the title records to ensure that the seller of a property is the legal owner and that there are no liens or other claims outstanding.

Truth in Lending - a federal law that requires lenders to fully disclose, in writing, the terms and conditions of a mortgage, including the APR and other charges.

Underwriting - the process of evaluating a loan application to determine the lender's risk.

Home Buying 101

The majority of the information contained in this book is from NEFE (National Endowment For Financial Education). However, some of the information is based on the opinions of Capital Credit Union.

EQUAL HOUSING LENDER

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