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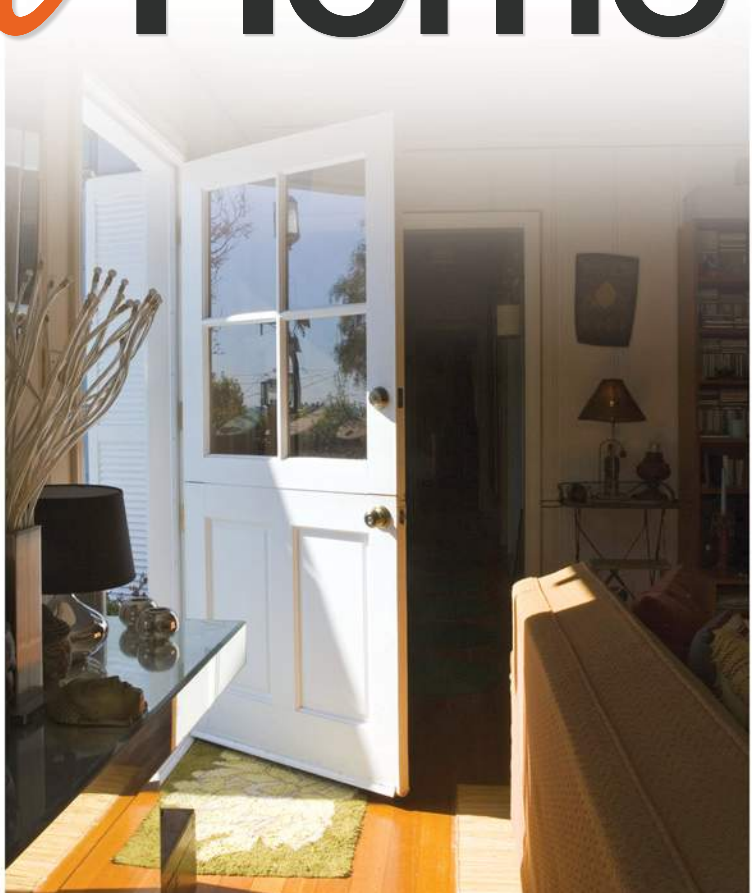
Nolo's Essential Guide to Buying Your First Home



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Ilona Bray, J.D.
Alayna Schroeder, J.D.
& Marcia Stewart

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LAW for ALL

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We believe accurate, plain-English legal information should help you solve many of your own legal problems. But this text is not a substitute for personalized advice from a knowledgeable lawyer. If you want the help of a trained professional—and we'll always point out situations in which we think that's a good idea—consult an attorney licensed to practice in your state.

Acknowledgments

This book was a 100% team effort and couldn't have been written without the advice, stories, and ideas of real estate experts and homebuyers from around the United States. First and foremost, we thank the members of our advisory board, who spent countless hours reviewing chapters, explaining local practices, and sharing the best and worst memories from their professional experiences.

Special thanks to the late **Broderick Perkins,** a real estate journalist based in San Jose, California, who reviewed and contributed to every chapter of this book's early editions.

Our other invaluable sages included:

- **Nancy Atwood,** real estate broker with ZipRealty in Framingham, Massachusetts (www.ziprealty.com)
- **Amy Bach, J.D.,** consumer advocate and Executive Director and cofounder of United Policyholders, a national nonprofit (www.uphelp.org), based in San Francisco, California
- **Timothy Burke**, founder and CEO of National Family Mortgage (www.nationalfamilymortgage.com), based in Waltham, Massachusetts
- **Alicia Champagne,** real estate attorney (www.champagneandmarchand.com), short sale negotiator, and Realtor education teacher in Wilmington, Massachusetts
- **Marjo Diehl,** Mortgage Adviser at RPM Mortgage in Alamo, California (www.rpm-mtg.com)
- **Sandy Gadow,** expert on real estate closing and escrow, and best-selling author of *The Complete Guide to Your Real Estate Closing* (www.escrowhelp.com)
- **Kenneth Goldstein,** Boston-area attorney with the law firm of Goldstein & Herndon, LLP (www.brooklinelaw.com), and Chairman of the Board of Selectman of the Town of Brookline, Massachusetts
- **Paul Grucza,** Director of Education and Client Engagement for The CWD Group, Inc. AAMC® in Seattle, Washington (www.cwdgroup.com)
- **Richard Leshnower,** New York-based real estate attorney
- **Paul A. Rude,** professional inspector and owner of Summer Street Inspections, in Berkeley, California (www.summerinspect.com)

- **Bert Sperling,** city and neighborhood expert and author in Portland, Oregon, and founder of www.bestplaces.net
- **Daniel Stea,** broker/owner/attorney at Stea Realty Group in Berkeley, California (www.stearealtygroup.com)
- **Fred Steingold,** attorney and author in Ann Arbor, Michigan (many of his books on small business and other legal matters can be found on www.nolo.com)
- **Russell Straub,** founder, President, and Chief Executive Officer of LoanBright, a mortgage marketing service based in Evergreen, Colorado (see www.loanbright.com and www.compareinterestrates.com)
- **Tara Waggoner, MBA,** real estate broker and Market Manager at Redfin in Houston, Texas (www.redfin.com).

A number of other experts provided additional advice—you'll see many of them quoted in this book. They include Neil Binder, New York real estate investment expert (www.bellmarc.com); Elisabeth DeMarse, CEO and president at TheStreet, Inc., and New York-based real estate industry expert (www.demarseco.com); Kartar Diamond (www.fengshuisolutions.net); Debbie Ostrow Essex, child and family therapist based in Berkeley, California; Stephen Fishman, attorney and Nolo author; Joanna Hirsch, real estate agent with Pacific Union in Oakland, California (jhirsch@pacunion.com); Joel Kinney, attorney with Fort Point Legal in Boston, Massachusetts (fortpoint.me); Annemarie Devine Kurpinsky, associate with George Devine, Realtor®; Pat Lashinsky, former President, ZipRealty; Jeff Lipes, Vice President at Rockville Bank in Hartford, Connecticut; Maxine Mackle, Connecticut Realtor® (www.halstead.com); Paul MacLean, retired home inspector in Austin, Texas; Mark Nash, Associate Broker with Coldwell Banker, who serves the Chicago, Evanston, Skokie, and Wilmette areas of Illinois (www.marknashrealtor.com), and author of *1001 Tips for Buying & Selling a Home*; Carol Neil, independent broker and Realtor® in Berkeley, California (www.pacificunion.com); Fiore Pignataro, Realtor® with Windermere Realty in Seattle, Washington (www.windermere.com); Lorri Lee Ragan, formerly of the American Land Title Association (www.alta.org); Mary Randolph, attorney and author; Frank Rathbun, Vice President of Communications, Community Associations Institute (www.caionline.org); Ira Serkes, Berkeley Realtor® with Pacific Union (www.berkeleyhomes.com); Viviane M. Shammas, attorney and real estate broker

in Ann Arbor, Michigan (www.vivianeshammas.com); Debbie Stevens, Oregon real estate agent (www.ramsayrealty.com); Rich Stim, attorney and Nolo author; Craig Venezia, real estate author (www.craigvenezia.com); and Loretta Worters, Vice President of Communications for the Insurance Information Institute.

No amount of advice can substitute for a personal story, so we'd also like to thank the many homebuyers who shared the good, the bad, and the ugly of their own experiences or told us what they'd like from this book, including Amy Blumenberg, Laurie Briggs, Dave and Danielle Burge, Karen Cabot, Linda Chou, Jennifer Cleary, Jaleh Doane, Phil Esra, Lisa Guerin, Gabrielle Hecht, Pat Jenkins, Ellie Kania, Justin and Tamara Kennerly, Chris and Libby Kurz, Talia Leyva, Willow Liroff, Meggan O'Connell, Evan and Tammy Ohs, Leny and Frank Riebli, Leah Scheibe, Diane Sherman, Bruce Sievers, Luan Stauss, Tom and Heather Tewksbury, Catherine Topping, Josh and Gillian Viers, Julie and Malachi Weng-Gutierrez, and Kyung Yu.

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Big thanks to our colleagues in the editorial department, who supported us through the (long) process of writing this comprehensive (and yet fun!) text. Kudos to Susan Putney in Nolo's Production Department who took a challenging compilation of information and turned it into a beautifully designed book.

Thanks also to Nolo founder Jake Warner, who championed this book idea for many years.

Our basements may be cluttered, our gardens may need weeding, and our floors may need a good scrubbing—but we love our homes. Thanks to the people who helped us get there—professionals (some who taught us what to do, others who taught us what not to do!) and our families, who share the joy of homeownership with us.

About the Authors

Ilona Bray is an attorney, author, and legal editor at Nolo. Her other real estate books include *The Essential Guide for First-Time Homeowners* and *Selling Your Home: Nolo's Essential Guide*. Her working background includes solo practice, nonprofit, and corporate stints. She sold her first home at a profit—despite being in the middle of a real estate downturn—and bought a larger home. Her fantasy house would be a Greene & Greene mansion of the same style (like the Gamble House in Pasadena), with a large sun porch and lots of surrounding trees.

Alayna Schroeder is an attorney whose legal experience has included everything from work at a corporate law firm to editing and writing to a stint in the Peace Corps. According to *Sacramento Magazine*, her first home, which she shared with her husband, twin babies, and a Bolivian-born dog, Luna, was in one of the Sacramento area's ten Great Neighborhoods—a fact Alayna tried to remember as she redid the aging plaster and desperately searched for adequate closet space into which to stuff modern-day baby gear. Alayna's idea of a fantasy house is always changing, but she'd settle for an A-frame in the woods with a lake view, big deck, and gourmet kitchen.

Marcia Stewart is the author or editor of many Nolo real estate books, including the best-selling *Every Landlord's Legal Guide*. Years ago, she found the perfect "starter" house in one of her favorite neighborhoods. As her family started to grow, so did the house, with a new second story and deck. Most recently she (finally!) remodelled her 1950s kitchen. Her fantasy house would be a Queen Anne Victorian with a home theater and a beautiful garden and pool.

Table of Contents

Your Homebuying Companion

Buying your first house may be one of the first certifiably grown-up things you ever do. And no matter how ready you feel, taking a major step like this—particularly one where there are so many zeros on the price tag—can make you want to just close your eyes and *get it over with*.

But if you're going to invest your time and money, you want to make sure you don't find just any house—you find the *right* house, at the *right* price, with the *right* loan. A house you're happy to stay in for a long time, no matter what the market does. To do that, you need a lot of information.

This book is full of nuts-and-bolts information about the homebuying process. But it's also got anecdotes and advice that we hope will remind you to enjoy this exciting, if sometimes frustrating or nerve-wracking process. Keep in mind what you're aiming for: your own home, where you're free to pound nails in the wall, get a cat, or paint your bedroom any color you want, without asking the landlord!

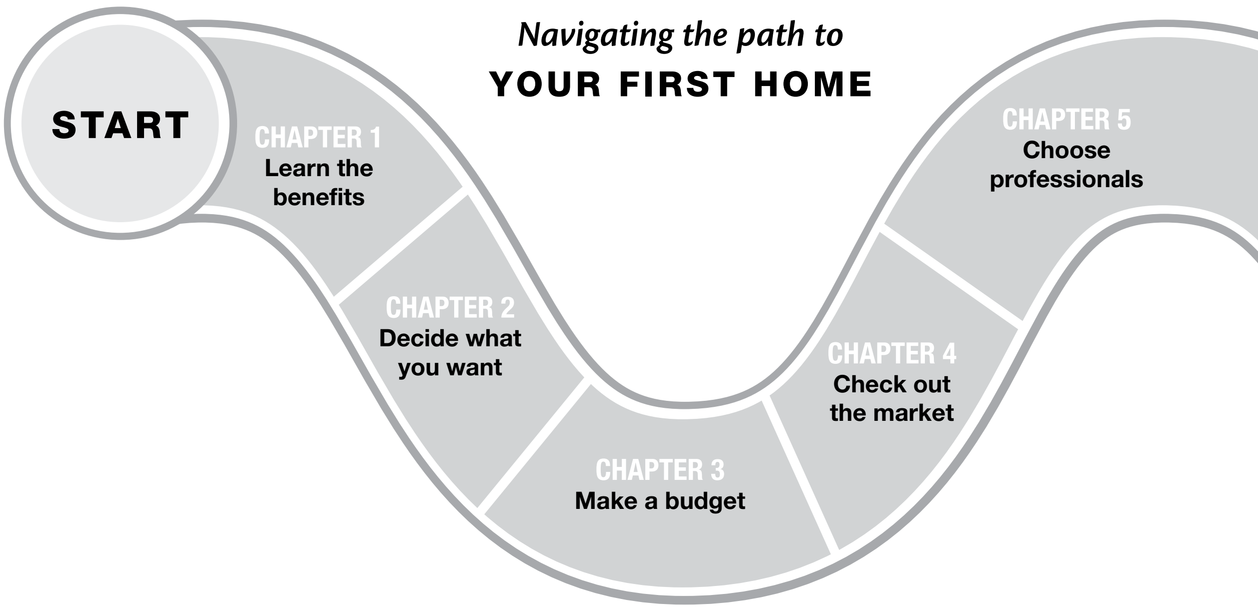
By the time you've read the key information here (don't worry, you won't have to read every chapter or every section), you'll truly be ready. We'll show you how to:

- choose the appropriate house in the best possible neighborhood, whether it's an old bungalow on a tree-lined street, a condo in the city center, or a custom-built home in a new development
- narrow in on a realistic price range based on your budget, and strategize ways to afford more
- select from a variety of financing options, from a 30-year fixed rate mortgage (like the one Mom and Dad got) to a private loan from a relative or friend
- pick a great real estate agent, mortgage broker, home inspector, and other professionals
- negotiate and sign an agreement to buy a house (find out what's important in all that fine print)

- wrap up your financing, get inspections, and take care of other last tasks, and finally
- close the deal, arrange your move, and settle into your new home.

You're going to benefit from the expertise of a team of 14 advisers from around the country who have reviewed this book and added the kinds of insights you usually get only in personal conversations. For instance, you'll meet a mortgage broker who explains why you should avoid oral loan preapprovals; a real estate agent who cautions against dressing too well at open houses (it can hurt your negotiating position); a closing expert with straightforward advice on why you should care about things like "easements" and title insurance; and a lawyer who suggests how to save on attorney's fees.

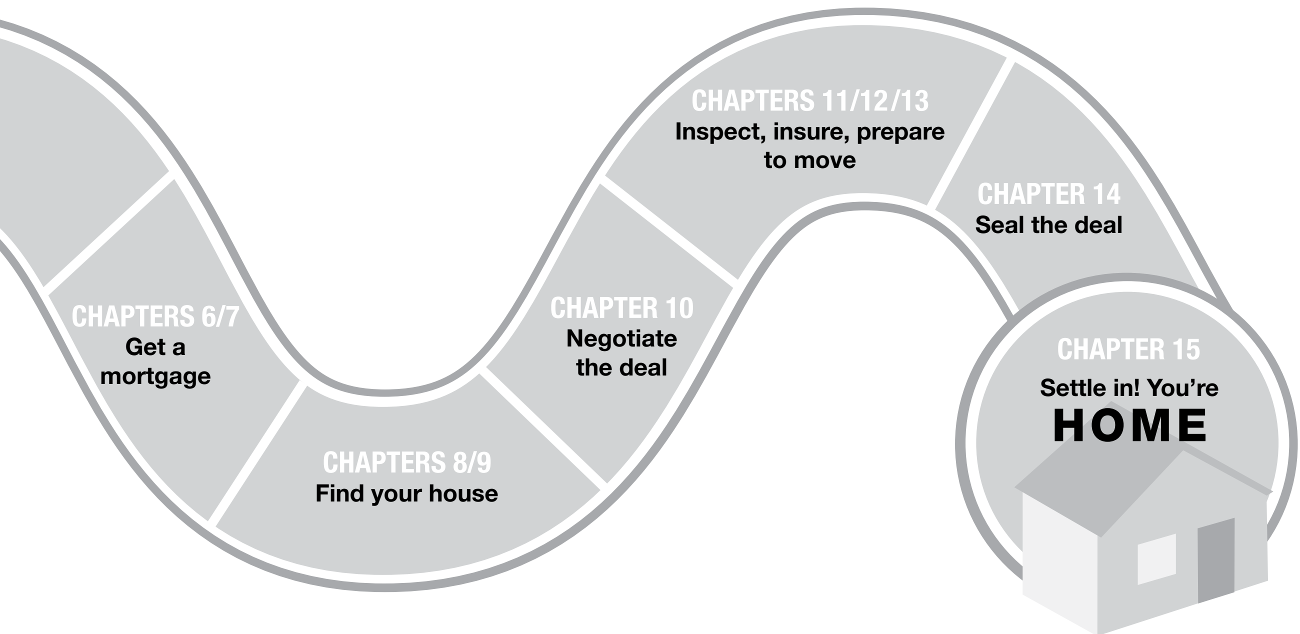
With this book comes special access to electronic materials on Nolo's website. There you'll find a Homebuyer's Toolkit with over two dozen forms, checklists, and letters to help keep you organized and on track during every stage of the process. Whether it's a "Dream List" that prompts you to set out your priorities, checklists to carry when you tour a house or condo, or a set of interview questions for potential real estate agents, you'll find it there. And as a bonus, it includes MP3s with interviews of several of our advisers, plus this book's authors, who share their insights.



The three authors of this book, Ilona, Alayna, and Marcia, bring not only years of legal and real estate expertise, but also different first-time homebuying perspectives of our own. One of us bought with a 15-year mortgage, (since paid off) so she had no house payments when it came time to pay her son's college tuition. Another bought with the help of family members and now has probably the lowest mortgage payment on the block in one of the city's up-and-coming neighborhoods. And the third bought a modest starter home with a hybrid adjustable rate mortgage, fixed it up, and managed to ride out the down market until she could sell.

Our varied experiences help us understand that everyone has different objectives when buying and special challenges when buying for the first time. You may just be looking for a place—any place—to get started, you may want the challenge of a fixer-upper, or you might need the convenience of a low-maintenance condo. We know that you might be doing this alone, with your spouse or partner, or even with a friend. No matter who you are or what your goals and objectives may be, we hope you recognize yourself in some of the stories and experiences reflected in this book.

So hang on tight—to this book, that is. It will be your companion, providing advice, information, and inspiration all along the path to your new front door.



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www.nolo.com/back-of-book/HTBH.html

And if you notice a useful sample form in this book, such as a letter or checklist, you'll have access to a digital version via the same companion page. You'll find other useful information on that page, too, such as podcast interviews with the authors and some of the advisers you'll get to know in this book. See the appendix for a full list of forms and podcasts on Nolo's website.

CHAPTER 1

What's So Great About Buying a House?

Meet Your Adviser

Daniel Stea, broker/owner/attorney at Stea Realty Group, in Berkeley, California (www.stearealtygroup.com).

What he does "I spend a great deal of my day simply talking with buyers and sellers, as well as evaluating properties for them. We're always running 'comps.' Prospective buyers want to make sure they're not paying too much; sellers want to make sure they're not asking too little. We're always looking at what other properties recently sold for, since that's a key indication of where the market is currently at. Sure, many websites will give you real estate 'comparables,' but these are generally based on the average price per square foot of other properties that have recently sold. But it takes a human who has actually walked through all of those properties to start adding and subtracting for various attributes such as location, condition, schools, and so on. That's one of the values of what brokers bring to the table and why their services will always be in demand."

First house "It was an adorable English Tudor in the Oakland hills, which I bought for $190,000. Built in 1927, it was full of character—and had a $90,000 pest report and leaked like a sieve. The original roof was still there, with multiple subsequent roofs layered right over it. It was a memorable home! I lived there for five years, completely rehabilitated it, and then sold it when Oakland real estate was finally coming around and moved to a home closer to my office in Berkeley."

Fantasy house

"I'm not sure it exists! Like most of our clients, I'd love to have a place that's highly walkable to everything urban. But I'd also like a view of the San Francisco Bay, which is tough to get unless you're a considerable distance up the hills. Only a few homes exist in that sweet spot in between. And they obtain multiple offers and sell for a premium price in the current market. Style-wise, I see something to appreciate in almost every type of house: from the old ones that need a lot of work to the modern ones with walls of glass and high ceilings, many of which have more character than they are given credit for."

Likes best about his work

"Finding that we can bring clarity to people's confusion. Homebuyers show up full of questions, wondering things like, 'What is the process?' and 'How much should we offer?' We educate them about the market and the process and give them the tools they need to feel empowered. Once they feel confident, we're ready to begin shopping."

Top tip for first-time homebuyers

"Be patient. A lot of people come to us in a panic, saying, for example, 'We just got into town, we don't want to waste our precious money on these exorbitant rents, and we need to buy something right away.' But the process will go much smoother if you give yourself some time—ideally, six months to a year—to get to know the market, walk the neighborhoods, and learn about the homebuying process. In fact, if you're relocating here from Washington, DC, New York, or Boston, like many of our clients have, I'd say rent first! It's very difficult to come into a new city for a month and know where you want to live. Begin working with a Realtor® long before you're ready to make your first purchase offer. We earn the same commission whether our buyers purchase now or in a year—and it's important for them to be pleased with the home they select so that they'll refer us to their family, friends and coworkers."

Picking up a book on homebuying for some light reading? We're guessing not. If you're reading this, you're probably seriously interested in buying a house. But before we launch into how, let's explore why—just in case you've got any lingering doubts about whether it's a good idea. This chapter will preview some of the primary financial and personal benefits to buying a home (and you'll find details on many of the subjects covered, such as tax benefits, in later chapters). Then we'll talk about some common myths and fears, and how to get over them.

Best thing I ever did

Buy my first home. Although Leah was happy with her rental place, she says, "I wanted a place that I could call my own, with a backyard for my cats, and space for an office so I could work at home full time. After three weeks of looking, I found it! And after a year, some of the best parts of homeownership are things I wasn't even expecting—like having already gotten to know more neighbors than I did during a whole six years in my apartment. Plus, although I've never thought of myself as domestic, I've had a surge of interest in decorating—I put up Roman blinds, have been picking out paint colors, and just bought my first Christmas tree!"

Investment Value: Get What You Pay For ... And Then Some

You've probably heard people talk about real estate as a great investment. But what exactly do you get out of the deal? Well, a few things: You'll build equity instead of spending cash on rent, you gain immediate benefits (a place to live!), and you'll eventually have full ownership of an asset that—at least over the long term—has a good chance of appreciating in value.

Leverage

Buying a home is one of those rare instances where you can control a very large and potentially appreciating asset with a comparatively small initial cash investment (your down payment). Better yet, notes adviser Daniel Stea, "You're using the proverbial 'OPM' (other people's money) for the balance of the investment, and that money is being lent to you at comparatively low cost given the historically low interest rates we've experienced these past few years. Yet you get to enjoy the appreciation on the full value of the investment, not just your cash component. It almost doesn't seem right!"

Equity, Baby

Over time, as you patiently pay your mortgage, two things may start happening—your principal loan balance will go down, and the house's market value may go up. Both of these mean that you're accruing *equity*. Equity is the difference between the market value of a house (what it's currently worth) and the claims against it (what you have left to pay on any mortgages or loans you've taken out against it). You'd be hard-pressed to find another investment where you can borrow a large amount of money, pay a modest interest rate, and reap every bit of the gain yourself.

> **EXAMPLE:** Hugo buys a home for $300,000 with a $60,000 down payment (20%) and a $240,000 mortgage. If the market value of the house is $300,000, Hugo's current equity in the home is $60,000 (market value minus mortgage debt). A few years later, Hugo has reduced the principal on the mortgage by $5,000, to $235,000. Meanwhile, the house's value has risen to $310,000. Hugo now has $75,000 in equity: ($310,000 minus $235,000). That's $15,000 more than he originally invested.

Of course recent history has shown that the value of a property doesn't always increase: It can also decrease, sometimes dramatically. Fortunately, houses rarely drop in value permanently. And after some precipitous value drops in the early 2000s, home appreciation in 2013 was running at an average of around 12%, according to the S&P/Case Shiller Home Price indexes.

It Beats Paying Rent

A good chunk of the money you'll use to finance your home is money you're already spending anyway, on rent. When you buy a house, that cash is actually going into your investment.

You Can Live in Your Investment

Some people like to call a mortgage a forced savings plan, because it makes you sock a little cash away every month in the form of a mortgage payment—money you will, with any luck, get back when you sell the place. On the other hand, you might call it a smart investment plan, because it gives you both a roof over your head *and* a way to convert your cash into a potentially appreciating asset.

You Can Borrow on Your Investment

Eventually, as your equity in your home builds, you can borrow against it at relatively low interest rates, using a home equity loan or a HELOC (home equity line of credit). These are also commonly referred to as "second mortgages."

The interest rates on these tend to be higher than on primary mortgages, but lower than on the typical credit card. The money borrowed can be used for any number of purposes, such as home improvements, college tuition, or a car. Better yet, if you use the money for home improvements, the interest is tax deductible, up to $1 million.

Of course, there are risks—if you default and your house goes into foreclosure, the lender is second in line to be paid from the proceeds of the sale of your house, after the primary mortgage holder.

My, You're Looking Creditworthy!

We hear so much about people who ruined their credit score by getting foreclosed on that it's hard to remember the reverse side of the picture: A mortgage is seen as "good debt." When you successfully pay it down, credit-reporting companies view that as a sign that you're responsible and able to handle a large loan.

"This can do wonders for your credit rating," says adviser Daniel Stea. "It makes you a much better credit risk (statistically speaking), which becomes especially useful if you decide to apply for an auto loan, small-business loan, student loan for your kid's college tuition, and so on."

That House Is *Yours*

One benefit to buying a house is kind of obvious ... you're becoming a home*owner*, and when the loan is paid off, you won't have to pay for a place to live. You could keep renting the same place you're in now for 50 years, and at the end of that time you'll still have to pay monthly rent checks to your landlord.

Tax Breaks: Benefits From Uncle Sam

You'll get to claim various federal tax deductions and credits for home-related expenses. These can add up to some serious savings.

Tax Deductions Versus Tax Credits

Be careful not to confuse a tax deduction with its more valuable cousin, a tax credit. A tax deduction is an amount you subtract from your gross income (all the money you earned during the year) to figure out how much of your income is subject to tax. For example, if your gross income is $80,000, and you have a $2,000 tax deduction, your taxable income is reduced to $78,000.

A tax credit, by contrast, is a dollar-for-dollar reduction in your tax liability. If your taxable income is $80,000, and you qualify for a $2,000 tax credit, your taxable income is still $80,000, but you get to reduce the amount of tax you ultimately owe by $2,000.

Tax Credits

As a new homeowner, you may be entitled to certain tax credits.

- **Tax credit for first-time homebuyers.** At the time this book went to print, all the tax credits for first-time homebuyers had expired—but keep an eye on the news and www.irs.gov for anything new that might come along.

- **Tax credits for energy-efficiency.** A tax credit good through 2016 lets you claim 30% of the cost of installing geothermal heat pumps, small wind turbines, fuel cells, or solar energy systems. For more information, visit www.energystar.gov (search for "tax credit").

Mortgage Interest

One of the biggest deductions will be the interest you pay on your home mortgage (available for mortgages of up to $1 million for individuals and married couples filing jointly and $500,000 for marrieds filing separately). This one's particularly advantageous during the first few years of a fixed rate mortgage, when most of your payment will be put toward interest.

Other Tax-Deductible Expenses

You can also deduct certain other expenses, such as:

- **Property taxes.** While the amount varies between states and localities, most people pay around 1% of the home's value each year in state property tax. This amount is deductible from your federal taxes if you itemize.
- **Points.** Points are additional and usually optional fees paid when you buy your mortgage (you get a reduced interest rate in return). They're tax-deductible in the year you pay them.
- **Interest on a home improvement loan.** If you take out a loan to make improvements that increase your home's value, prolong its life, or adapt its use—for example, by adding a deck or a new bathroom—you can deduct the interest on that loan, with no limit. But you can't deduct interest on loans used to make normal repairs, such as repainting the kitchen or fixing a broken window.
- **Interest on home equity debt.** Sometimes you can deduct interest on a home equity loan even if the money isn't used to buy, build, or improve your home—for example, if you use it toward a child's college tuition or family medical bills. The deduction is limited to a maximum loan amount or the total fair market value of the home less other mortgages. The maximum loan amount is $100,000 for an individual or married couple filing jointly and $50,000 if married but filing separately.

- **Home office expenses.** If you use part of your home exclusively and regularly for a home-based business, you may be able to deduct a portion of the related expenses—including the costs of some home repairs, or even things like landscaping if your home's appearance will be important to visiting clients.
- **Moving costs.** If you move because of a new job that's more than 50 miles from your current residence, you may be able to deduct your moving expenses.
- **Prepayment penalties.** Although we advise against getting a mortgage with a prepayment penalty (as discussed in Chapter 6), if you do, and then you make a prepayment, the penalty you pay will be tax-deductible.

Itemizing Your Deductions

To take advantage of house-related tax deductions, you'll need to *itemize* your tax deductions, rather than take the standard deduction (for 2014 tax returns, $6,200 for individuals and $12,400 for marrieds filing jointly). The true tax savings comes in the difference between your tax liability when you take the standard deduction and your tax liability when you itemize. Itemizing involves a step up from the good old 1040EZ, but it's not all that complicated. To make it worthwhile, your itemized deductions should exceed the standard deduction. With the high price of real estate, it's not usually too hard to outpace the standard deduction with deductible homeowner costs, not to mention other deductible expenses like donations to your favorite charity.

> **EXAMPLE:** Let's say you get a $200,000 fixed rate loan at 4% interest in 2014. You're looking at paying nearly $8,000 the first year in interest alone. That doesn't count property taxes, points on the mortgage, or any other tax-deductible expenses.
>
> If you're single, the standard deduction is $6,200. But if you itemize your deductions, you could deduct the $8,000 in interest payments instead. By itemizing even this one deduction, almost $2,000 less of your income will be taxed.

TIP

Keep good records. You'll be able to reap the benefits of itemizing your deductions only if you know about them and are prepared to prove them to the IRS—all of them, not just the house-related ones. Keep a file of receipts for the more common deductions, such as unreimbursed business expenses (office equipment and travel); educational expenses (tuition and books); charitable contributions; and unreimbursed medical expenses. Consider getting help from a tax professional—even your meeting might be tax-deductible!

CHECK IT OUT

Go straight to the source. See IRS Publication 530, *Tax Information for Homeowners*, available at www.irs.gov. This publication will give you more detailed information about the tax benefits of buying a home.

Capital Gains Tax Relief When You Sell

While it may be too soon for you to imagine selling your first home, another important benefit is available if and when you do. Thanks to the Taxpayer Relief Act of 1997, you don't pay capital gains tax (usually 15%) on the first $250,000 you make on the place. Double that to $500,000 if you're married and filing jointly, or to $250,000 per person if you co-own the place.

To qualify, you must (with a few exceptions) have lived in the home two out of the previous five years before selling. Many first-time buyers use this tax break to move from modest starter homes to roomier homes that cost more.

Personality and Pizzazz: Your Home Is Your Castle

If you've always been a renter, you know the drill: Things stay the way they were when you moved in. White walls stay white, ugly carpeting stays ugly, and the funky bathroom light fixture stays funky.

When it's your home, you get to make your mark. There's just no way to quantify the psychological advantage of personalizing your space. Even people who've never taken an interest in home decorating, repair, or gardening find themselves hooked on the creativity and self-expression possible with home projects.

No More Landlord: Say Goodbye to Renting

Expressing your personality isn't the only advantage to leaving rental living behind. Say goodbye to things like waiting around for things to get fixed, wondering whether the landlord will raise your rent or kick you out anytime soon, and being surprised by landlords who stop by at their own convenience.

Even reasonable landlords who make prompt and thorough repairs and never raise the rent can pull surprises or sell the property. Owning your own house reduces the stress and uncertainty of renting. You're in charge of when you move on, who comes in the front door and when, and what gets done to the place. While that means you've got some extra responsibilities, you've definitely got some extra security and benefits, too.

The Future's So... Expensive!

If you pay $1,000 in monthly rent now, approximately how much will you be paying in 40 years, assuming average inflation (4% per year) and no rent control?

a. $2,500 b. $3,400 c. $4,800

d. None of the above, because I'll own a home.

Answer: c or d.

Best thing I ever did

Make monthly payments to myself, not the landlord. At age 25, Talia had only toyed with the idea of buying a house—she'd thought that, despite her full-time job, it was financially impossible. But then her landlord raised the rent. Talia says, "I looked into loan options—and to my surprise, I qualified. Within two months, I bought a converted first-floor apartment with a little patio, in a safe neighborhood. I love not having to share a washer and dryer with other people anymore. But even better is the feeling of independence of having my own place: Because I'm building equity, I like to think

I'm making those mortgage checks to myself—and they're not that much higher than my rent checks were, plus I can claim some significant tax deductions."

You Can Do It … If You Want To

Are you still on the fence about homebuying? Some people just don't feel ready to take the plunge. Below are a list of common "I can't do it because …" excuses. Don't get us wrong: Not every excuse is a *bad* excuse. You just need to know whether yours are based on solid facts rather than plain old fear.

"But … I Like Renting"

Maybe you're thinking, *I really love my apartment* or, *I'm getting such a good deal*. But even if your current rent seems cheap, cheap is never as good as free. Yes, we're aware that buying a house isn't free. But at some point, you won't be paying a mortgage anymore. That will *never* be true if you rent.

CHECK IT OUT

Run your own numbers. These calculators compare the costs of renting and buying:

- www.nytimes.com (search for "Is it better to buy or rent?")
- www.nolo.com/legal-calculators (click "Should I rent or buy?").

While you'll need to guess how much you'll spend on a home to use these calculators, the result will at least give you a rough comparison. Revisit the calculators after you've looked at Chapters 3 and 6 (covering the financial details of buying a house).

All that being said, renting might be best in the following situations:

- **You plan on moving from the area within the next few years.** Buying is a long-term strategy, with significant up-front costs. Plus, it's easier to move out of a rental than a home you own—selling is almost as complicated as buying.

- **You need flexibility.** Buying is best for people whose lives are fairly stable. If your first priority is being able to quit your job any time a friend proposes a round-the-world sailing trip, maybe homeownership will feel more like a trap than a positive step. (Then again, we've met travelers who've sublet their house and supported their travels with the rent payments!)
- **You expect your income to decrease soon.** If you're planning to return to school or quit your 9 to 5 to pursue an acting career, you might not want to lock yourself into a mortgage. Still, you may be a potential homebuyer if you can afford something more modest within your anticipated future income or can pay the mortgage by co-owning the property or taking in renters.
- **It will cost you far more to buy than to rent.** Run those numbers, using calculators like the ones listed above. In a few markets, you can still rent for less than you can buy—even after you factor in tax deductions and inflation. If that's the case, you might be better off renting and investing elsewhere—or simply renting a bigger and better place than you could hope to buy.

"But ... I Can't Afford It"

Maybe your main reservation about buying a home is that you simply can't afford one. Scraping together a 20% down payment can be no small task when you've already got your plate full with your current bills. Or perhaps you're afraid you won't qualify for the gigantic loan you'll need or won't be able to pay it once you get it.

Best thing we ever did

Focus on the spaghetti. Caryn and her husband Alec were stretching to their financial limits to buy a house, and Caryn says, "We were nervous, but our agent told us, 'You'll just need to eat spaghetti for about a year, and then things will even out.' For some reason, that image stuck in my head, and I thought, okay, I can handle eating spaghetti for a while. In fact, that's about the way it worked. The first year, we depleted our savings, not only with the house closing but with repainting and buying furniture. Now we've settled in, and owning a home doesn't feel like such a big load on our shoulders anymore."

If you're trying to get a down payment together and finding your efforts frustrated, don't lose heart. There are alternatives: For example, you may be able to augment your down payment with a loan from a family member, or even enter into a cobuying arrangement with a friend.

As for the mortgage payment, people who think they can't afford it often focus only on the big number—the five-, six-, or even seven-digit figure that says what a house is going to cost. But a mortgage allows you to spread that number out over a big portion of your life.

Finally, let's not forget that the first home you buy isn't necessarily going to be the one you'll live in forever. By remaining flexible, and starting with a not-quite-perfect house, you can break into the housing market. That's why they call it a "starter" house—it's only the beginning. The equity that you accrue may very well help you get into that next place.

Small Can Be Beautiful

If you think living in a small space means you'll be cramped, uncomfortable, and aesthetically disappointed, check out www.apartmenttherapy.com. Under "Tours," your secret voyeur can look at tiny spaces other people have transformed into fabulous homes. Be inspired!

"But ... I'm Single"

Some people are reluctant to buy a house because they're single now, but hope to be part of a couple before long. But did you know that nearly one-fifth of homebuyers today are single women? Obviously they have figured out that there's no secret rule that says only couples get to buy houses.

Best thing I ever did

Invest in my present as well as my future. Real estate agent Joanna knows about not wanting to buy a house as a single woman—she's seen it in many of her clients. But, says Joanna, "The problem with waiting to do something the traditional way is, what do you lose during that waiting period? I was in my early 30s and ready to have a place of my own. Plus, it makes sense to spend the money and get a tax write-off rather than pour it into rent. This isn't to say that buying alone wasn't stressful—I stretched financially to make it work. But since buying, my house has gone up in value."

Maybe you're worried that you'll have to move as soon as you meet Mr. or Ms. Right. While that admittedly is possible, it's also possible that in the meantime, the increased value of your place will help, not hinder, your happily-ever-after. If the value of your home increases and you pay down the mortgage, the two of you will have equity you can use to buy a place together. Besides—a house that's perfect for one may accommodate two just fine.

Best thing we ever did

Combine our homes. Hannah says, "I was a young professional and *very* single when I bought a condo. Two years later, I met Chad, who also owned a small home. Before I knew it, we were married and living in the house, renting out the condo. Then we had kids, and the house was just too small. We sold my place and Chad's, using the equity to buy a house big enough to accommodate our kids. It's nice to have a place that we chose together, with our family in mind."

"But… It's Too Much Responsibility!"

For some, the idea of owning a home just seems like too much to handle. Admittedly, renting is much simpler than owning. You write a rent check, and you're covered for the month. And in many rental arrangements, you can leave with just a month's notice—perfect for those with wanderlust.

Telling yourself that renting doesn't involve responsibility isn't really true, though. After all, what happens if you don't pay the rent? You get evicted—and then where do you go? Back to Mom and Dad's? Most people would rather do whatever it takes to make that monthly payment happen.

So if you've already lived away from home, you're familiar with what's needed to make monthly payments and handle monthly finances. Of course, when you buy you'll have other responsibilities, like taking care of your yard or doing repairs, but you're in charge of prioritizing what happens when. If you decide you don't want to repair the creaky stairwell until you've redone your kitchen cabinets, that's up to you.

"But... Maybe Prices Will Go Down!"

Trying to time the real estate market? Timing is definitely important, but it's not easy to get in to the market at the perfect moment. Even experienced real estate pundits get it wrong. If prices look to be stable and you're just waiting until you can afford to get in, that's one thing. But if you're trying to out-clever the real estate market, you're likely to find that by the time you notice a trend everyone else will have, too; and prices may jump up before you know it.

So if you've watched your local market and economic news carefully, and have a solid sense of what's ahead, perhaps waiting for a price drop makes sense. But don't put your life on hold. That's particularly true if you're getting married, having a baby, moving into a retirement home, or doing something else that comes with its own timing demands.

"But ... I'm Still Scared!"

Buying a home may seem overwhelming, even if you've always wanted to do it. The process is unfamiliar, there's a lot of money at stake, and you may fear getting swept up into buying a place you don't even like or that will drop in value. But fear shouldn't stop you from realizing your homebuying dreams. To help calm the butterflies, take constructive steps such as these:

- **Know your strengths and weaknesses going in.** Then find ways to address them, for example with self-education or by hiring professionals.
- **Learn what you can expect from professionals.** Understand what real estate agents, mortgage brokers, home inspectors, and other professionals do, and put them to work for you, saving time and money.
- **Observe your local real estate market.** We'll show you how to research the trends in your area, in order to reassure yourself that you're not buying an asset that may drop in value, and has long-term appreciation potential.
- **Understand the process.** Read up on all steps of the homebuying process now, so that you won't be confused—or need to do any late-night remedial study—when the process kicks into high gear.
- **Get organized.** Use all the worksheets and checklists in the Homebuyer's Toolkit on the Nolo website to stay on top of key

tasks, such as choosing a real estate agent or inspector or pulling together financial papers for the lender.

This book will help you accomplish all those goals. It will tell you where you are at every step, so that you can breathe, get your bearings, and proceed with confidence. Get the facts, and you'll be ready.

What's Next?

Once you've decided you're ready to buy, it's time to figure out what's important to you. In the next chapter, we'll discuss how to examine and settle on your priorities regarding types of houses and neighborhoods.

CHAPTER 2

What Do You Want? Figuring Out Your Homebuying Needs

Meet Your Adviser

Paul Grucza, CMCA, AMS, PCAM, a community association expert and educator, author, and association strategist located in Seattle, Washington.

What he does With 30-plus years of real estate-related experience (including as a licensed real estate salesperson and property manager), Paul is now an active lecturer and consultant, and faculty member for (and past President of) the Community Associations Institute (CAI, at www.caionline.org). CAI provides nationwide training, guidance, and resources to the volunteer homeowners who govern community associations. Paul received CAI's 1999–2000 "Educator of the Year" award. He established and hosted an award-winning community association issues television program for the Dallas-Fort Worth market which is viewed by well over one million people per week. He's also the Director of Education and Client Engagement for The CWD Group, Inc. AAMC® in Seattle, Washington (www.cwdgroup.com), which provides professional management and consultant services for a variety of condominiums and planned communities.

First house "It was an absolutely rundown but gorgeous Mission-style bungalow built around 1922, in one of the first incorporated subdivisions outside Buffalo, New York. The house was the builder's model for that subdivision, so it had all the features, including inlaid floors, woodwork, and leaded glass. I spent the next 11 or so years lovingly restoring it—regrouting the bathroom tile, refinishing the woodwork, rebronzing the heat duct covers, replacing the modernized light fixtures through a restoration company, and much more. It turned out to be the most beautiful home I've ever owned."

Fantasy house

"My true fantasy house would be a comfortably sized home situated on a bluff that overlooks Puget Sound and the mountains. Living in Seattle affords the opportunity to evaluate lots of wonderful properties, but since working with an architect, my fantasy will become a 'fantasy retirement home,' one that meets the need for view and accessibility. A redo of a midcentury rambler would be nice, but a built-from-the-ground-up is not bad, either."

Likes best about his work

"My daily interaction with a wide variety of people. Solving homeowner issues. Training and speaking to a variety of groups. They include homeowners, developers, service professionals, managers, and board members. This brings me more joy than anything—and after nearly 33 years, I'd better enjoy my work!"

Top tip for first-time homebuyers

"Regardless of the type of property you're looking for—whether a house, a condo, a cabin, a doublewide, or whatever—leave your emotions at home. Look at the property and its practical application in your life, and at what it will cost to turn it into your home."

You know you're ready to buy but are probably wondering, "Where do I start?" There's a lot to think about, like what kind of home or neighborhood you want, and what features you can't *possibly* live without. This chapter will help you:

- identify neighborhood characteristics that fit your personality and that maximize house-resale value
- understand how your lifestyle and plans should play into your choice of house
- learn the benefits and drawbacks of different types of properties (single-family houses, condominiums, or co-ops, plus new or old places), and finally
- create a Dream List, describing and organizing your priorities, to use when house shopping.

Later chapters will teach you how to do the looking, how to figure out whether you can afford what you want, and what to do once you've found a place. For now, focus on organizing your thoughts and priorities.

Know Your Ideal Neighborhood: Why Location Matters

If you're a lifetime renter, you've probably always thought about location in the short term, knowing you could move at the end of your lease. Buying is different: You're committing yourself to a location for at least a few years. And you'll probably feel a sense of investment in your community that you didn't before. So get serious about identifying your location preferences, then make sure these preferences won't mean buying a house with low resale prospects.

Neighborhood Features for Daily Living

Not everyone wants the same features in a neighborhood, and you're the one who's got to live there. Before letting anyone else tell you what the best neighborhoods are, consider your preferences and priorities regarding:

- **Character and community.** For some, the uniformity of well-planned developments is pleasing; others enjoy the variety of older, one-of-a-kind homes. Visualize your ideal neighborhood, whether it features trees and parks or restaurants and bars.
- **Safety.** While most everyone prefers less crime, safety often comes with a trade-off. For example, a rural neighborhood might be safe, but a city's resources and nightlife will be very far away.
- **Resources and accessibility.** Think where the important places and resources in your life are, like your workplace, child's school or day care, grocery stores, health care providers, public transportation or major roadways, cultural amenities, and more. How much time are you willing to spend traveling to those places?
- **Schools.** If you're planning on sending children to public schools, the quality of nearby schools will be important.
- **Zoning and other restrictions on owners.** If you want the freedom to remodel your home, you'll have to be in an area that allows that. Or, if you appreciate community uniformity, you'll like living somewhere that limits the changes owners can make to their houses or property.

They Call That a House?

You won't believe what people live in! Here are a few creative houses:

- The Golden Pyramid House in Wadsworth, Illinois: The largest 24-karat gold-plated object ever created.
- The Shoe House in Hellam, Pennsylvania: Just what it sounds like—in the shape of a work boot, made of light-colored stucco and featuring shoe-themed stained-glass windows in every room.
- A live-in water tower in Sunset Beach, California: from the 1940s, converted to a three-story house.

This isn't a complete list, and you should think about features that are unique to your needs. For example, adviser Bert Sperling notes, "If you're lucky enough to be a stay-at-home parent, you may find yourself lonely during the day if you have to travel a considerable distance to find some community for you and your youngsters."

Neighborhood Features That Boost Resale Value

When it comes to the long-term value of your home, location really *does* matter. If you have a desirable piece of property that's also in a desirable location, more people will want to buy it. That keeps its value relatively high compared to nearby homes in less sought-after locations (which people may buy partly because they can't afford anything else).

Not surprisingly, many of the features that attract first-time homebuyers boost resale value, like high-quality schools, low crime rates, convenient amenities, and neighborhood character and community.

Another major factor affecting resale value is conformity. Buying a house that's much bigger than the houses around it is usually a bad idea. That house will appreciate at a slower rate, because buyers drawn to a neighborhood of smaller homes won't be able to afford the larger home, and buyers drawn to larger homes won't be drawn to that neighborhood. And if a house is just too unique—because the owner has customized it too much—it's going to stick out like a sore thumb.

Finally, try to get an idea of whether a neighborhood is up and coming. You can tell by looking at whether there seems to be a lot of remodeling, new landscaping, or trendy-looking shops. Bert Sperling adds, "If you read the signs correctly, you could get in on the ground floor of the next hot new neighborhood."

Know Yourself: How Your Lifestyle, Plans, and Values Affect Your House Priorities

Later in this chapter, we'll show you how to prepare a Dream List to help you find the right house. Before making your list, reflect on what you want the house for. (To live in, duh, we got that.) Although it may be hard to imagine where your life will be in a few years, do your best to consider:

- **Who is going to live in the home?** You may be on your own now, but in the future, might you bring in a roommate, significant other, child, elderly parent, or pet? If so, factor this into your priorities for things like number of bedrooms, quality of the school district, number of floors, or availability of outdoor space.

- **What do you plan to do in the home?** If you plan to work at home, spend a lot of time in the kitchen, or entertain frequently, plan adequate space for that. Conversely, consider whether you really need to spend extra for a huge gourmet kitchen if you eat takeout every night.
- **What does your lifestyle require?** If you travel for business, you might want the convenience of a condo with easy airport access. Or if you're into nightlife, you might want to be able to stroll home and crash at 2 a.m.
- **How do you like to spend your time at home?** Do you love the idea of remodeling an old home or creating a beautiful garden? Are you scared to death of anything that hints at the word "handy"? If you'd rather be throwing a cocktail party than mowing the lawn, the big house in the suburbs may not really be right for you.

Best thing I ever did

Look for a house with scope for my artistic side. A graphic designer and yoga teacher, Diane had wanted to buy a house for years—but knew it would be a financial challenge. She says, "I scraped together enough to buy a small cottage, with a disastrous backyard—and I turned it into my art project. I painted those white walls celery green, brick red, and tan. I spent all winter pulling weeds, then put in flagstone and flowers. And eventually I sold it for a large profit—enough to buy a duplex, so now I'm a property investor!"

"Where *Could* I Be in Five Years?"

Instead of planning where you think you'll be in five years, why not play "Where *could* I be in five years?" Try it with a friend or partner over a glass of wine, or while walking in the park. You'll have to be a little realistic—do you *really* think you'll win the lottery?—but optimistic, too. You may see yourself finding a better job in another city, or having your first baby. Imagining the possibilities can help you not only define your housebuying objectives, but see how those goals fit into your life's priorities.

Know Your Ideal House: Old Bungalows, New Condos, and More

You probably have a vision in your mind of the house you want, whether it's a cozy cottage with fruit trees; an elegant brick townhouse with no yard; or a modern, glass-enclosed loft with views of the city. For an overview of your options, read on. (And when you're reading the bios of our advisers in this book, take a peek at their fantasy houses!)

> *Isn't my house classic? The columns date all the way back to 1972.*
>
> Cher, *Clueless*

Of course, where you live will play a huge role in what you can buy. For example, in Chicago or New York City, you may be looking at apartments in high-rise buildings, while in less urban areas, most of the homes may be single-story ranch houses or newly built homes within developments.

Would You Like Land With That? Single-Family Houses

You wouldn't think we'd have to define "house," would you? But since a number of different house types are available, let's be clear about what each one is. Technically speaking, a "house" is a detached, single-family dwelling. When you own a house, you own both the structure and the property that it sits on, all by yourself. Your house won't be attached to the next one, and you won't be cursing an upstairs neighbor for stumbling across the floor at 3 a.m.

Even if you know you want a house, however, an important question remains—new or previously lived in? Each has its own benefits and headaches.

CHECK IT OUT

Interested in house styles? To decide whether you prefer a "Colonial," a "Victorian," or an "Italian Renaissance," look online at sites such as:

- www.architecture.about.com (click "Home Styles")

- www.oldhouses.com (click "Old House Style Guide")
- www.wikipedia.org (search for "List of house styles").

Old (or Not-So-New) Houses: Benefits and Drawbacks

If you're in an uber-urban area or your price range dictates it, older houses may be all that are available to you. Or you may just prefer a touch of historical charm. Either way, you'll get all these benefits:

- **Affordability.** Older homes tend to cost less to purchase than new, customized homes. (Though this isn't a universal rule—in large cities, where the majority of new building is far outside the city, it can be the reverse.)
- **Established neighborhood.** Instead of looking at mounds of dirt while perusing architectural drawings, you'll be able to get a feel for the neighborhood by taking a stroll.
- **Established landscaping.** You're not likely to find a tree-lined street, or a wisteria arbor over your front gate, in a new development.
- **Construction.** Older homes are often built with high-quality materials such as thick beams, solid-wood doors, and heavy fixtures.
- **Character.** Crown molding and built-in cabinetry are just a few of the fun features found in older homes—but rarely in newer homes.

There are also drawbacks to previously loved homes, including:

- **Lower resale value.** Older homes, on average, sell for less than their newer counterparts.
- **Replacement costs.** The years take a toll on appliances, water heaters, and roofs—and replacing them isn't cheap.
- **Efficiency.** Older houses tend to be less energy efficient than newer ones.
- **Style.** Although you can probably switch out the former owner's unique style choices (like magenta bathroom tile), it may require a fair amount of sweat equity (meaning *your* sweat builds equity).
- **Layout.** Older houses were built for another era … an era before plasma screen TVs and home offices. Rooms may be smaller and laid out differently than you'd like, with too few electrical outlets.

Of course, not every used home is *old*. If you buy one that was built only a few years ago, some of the drawbacks described above will be eliminated. Likewise, you'll lose some of the benefits.

Newly Built Houses: Benefits and Drawbacks

Well over half a million new homes are built in the United States each year, often in planned communities or developments. (Of course, you can always buy a piece of land and build a custom home—but that's a different book, with its own unique set of issues.) No surprise—buying a new home has unique benefits, including:

- **It's mine! It's new!** A new house is a blank slate, clean and virtually untouched.
- **It's custom-built.** Although most builders offer a limited choice of floor plans, you usually get to define details like paint colors, flooring, and fixtures (though good taste comes at a price).
- **Suited to modern tastes and needs.** New houses are built for today's lifestyles and trends, so you'll be able to find features like induction cooktops, a mud room, and lots of natural light. Also, you shouldn't have to worry about replacing a water heater or roof anytime soon.
- **Livin' green.** New houses tend to be more energy efficient than older homes, so per square foot, you'll probably spend less money on things like heating and cooling costs. And with some searching, you might find a "green builder" who uses environmentally friendly building techniques and materials (see the U.S. Green Building Council's website at www.usgbc.org).
- **Community uniformity and planning.** Many new homes are built in planned unit developments (PUDs). Like condominiums, PUDs often have rules to maintain neighborhood aesthetics, and amenities like swimming pools and community centers.

But buying new also has these drawbacks:

- **It costs HOW much?** New houses are generally worth more, but their cost mounts quickly as you customize them to your wishes. Developers often offer unique financing alternatives (discussed in Chapter 7), which may make a new house purchase more affordable.
- **Who's this guy?!** You might have to deal with the developer's salesperson or representative, without the benefit of your own real

estate agent to protect you. If you hope to use an agent, be sure to bring him or her along on your first visit—otherwise, you may lose your chance.

- **Not time-tested.** While it's exciting to get a brand-new home, you'll be the first to discover whether all the lights work, the dishwasher runs, the water heater heats, and more.
- **It will be done *when?!*** Developers don't always finish houses when they expect to, and often don't compensate purchasers for the delay. Instead, the fine print may release them of liability. Worse yet, financially unstable builders have been known to go bankrupt before the houses are finished at all, or before adding amenities such as a golf course or swimming pool.
- **More rules?** As we'll discuss when we get to condos, some PUDs require all owners to live by a set of written rules. Short of selling, there's often little you can do to get out of these rules if you don't like them.

Sharing the Joy, Sharing the Pain: Condos and Other Common Interest Properties

Maybe a traditional house isn't for you—perhaps it's out of your price range, you're looking to avoid all the maintenance, or you want to live in an area that just doesn't have many regular houses. In that case, you may want to consider an alternative, like a condominium ("condo") or co-op.

These types of properties are often referred to as common interest developments (CIDs), because they involve shared ownership or responsibility for common areas like hallways, recreation rooms, or playgrounds. How a place looks physically doesn't really make a difference—any of these three might look like an apartment, flat, loft, or townhouse; old or new; in the city or the country. (Detached houses in PUDs count too, but since we've already covered those, we won't include them in this section.)

Are you picturing yourself out on the roof with a hammer, doing your share for the common good? Don't worry, you won't likely be asked to perform repairs or fix elevators. But you *will* have to become a member of a community association, which makes sure those things are done. Your monthly membership fee (formally called a "maintenance assessment" or "regular assessment") will help keep common areas in good shape and provide a cash reserve for unanticipated or larger projects like replacing a roof. If you want to actively participate in the association, you can attend meetings and voice your opinion—or even get yourself elected to the board of directors. If you don't, you just write the check and hope the more active owners are like-minded.

There are three types of community associations: planned community associations (for PUDs, detached family homes, and townhouses), condominium associations, and co-op associations. We'll point out any significant differences among them as we go.

TIP

What the association leaders do. Though every CID homeowner must join the community association, the board of directors handles the day-to-day work and decision making, such as coordinating repairs and collective services like trash pickup; managing amenities such as swimming pools, playgrounds, and tennis courts; preparing annual budgets; and conducting meetings.

Condominiums: Benefits and Drawbacks

When you buy a condo, you buy the interior space of your home. Your walls, ceiling, and floors define your boundaries instead of fences and sidewalks. Everything in the common space—be it stairwells, swimming pools, sidewalks, or gardens—the whole community owns together and is financially responsible for. Some of the benefits of condo life include:

- **Affordability.** A condo often costs less to buy than a house (although in major metropolitan or resort areas, the opposite is sometimes true). Maintaining a condo can also be less expensive, since costs that otherwise might be duplicated—like landscaping, roofing, and some insurance—are shared.
- **Convenience.** If you aren't into maintenance, you'll appreciate that the condo association—particularly in a larger community—is likely to hire a management company to take care of the landscaping and common areas. You may also get valuable on-site amenities like a gym or pool.

- **Community.** Because you're all part of the same community association, you'll get the opportunity to know your neighbors, whether you wish to or not.

Every rose has its thorns. Some of the drawbacks to condo living include:

- **Rules, rules, rules.** You'll be subject to a document called the master deed or Declaration of Covenants, Conditions, and Restrictions (CC&Rs). This sets forth not only rules for the community association board to follow, but rules governing all owners. You'll be told what you can do in the common space, and even what you can do with or in your own unit from the color of your curtains or blinds to the type of flowers you can plant.
- **Buy for less, sell for less.** Condos generally appreciate at a slower rate than houses. And some have gotten into serious financial trouble in recent years, leaving homeowners unable to sell at all.
- **Privacy.** Since you'll be sharing common areas and usually walls or ceilings, too, you'll be giving up some privacy. Also, if having a large outdoor space to garden, entertain, or keep a pet is important, you might be frustrated by the outdoor spaces, which are usually either miniscule or communal.

Diet-Time for Fido?

What kinds of things do CC&Rs limit? Common examples are:

- whether you can have a pet, and if so, its maximum height or weight
- whether you'll get a parking space, or whether your guests can park in the lot
- whether you can change the color of your curtains or paint the outside of your unit
- the location or appearance of things like your mailbox, clothesline, satellite dish, flags, and wreaths
- how long visitors can stay with you
- whether you can rent your unit to someone else, and
- whether you can smoke in your unit.

- **You share all costs, whether you want to or not.** It may be frustrating to see your monthly membership dues spent on things you never use, like the swimming pool. And if you're the kind of person who can live without a repair until you have spare cash, tough luck—you'll be forced to pay your share on the association's schedule, sometimes in excess of your regular fees. If you get behind on paying your assessments, your condo association may have the power to foreclose on you (even if you're up to date on your mortgage)!
- **It can cost more than you expect.** In addition to your monthly membership or maintenance assessments (which can themselves be several hundred dollars), you may have to pay additional fees called "special assessments." These are one-time fees collected for major purchases the association can't afford to make with its current reserves (for example, to replace the roof). Do your research: In recent years, with many new buildings not fully occupied, the few owners in some CIDs have found their special assessments very high.

TIP

Size matters in condo developments. Your experience will be a lot different in a Boca Raton megaplex than in a Brooklyn brownstone. In a building with fewer units, you may find the rules less constricting—but you may also be more responsible for day-to-day operations and costs.

Townhouses and Duplexes: Benefits and Drawbacks

One compromise between a single-family dwelling and a traditional condo is a townhouse. Townhouses are usually built in rows and share at least one common wall (also called "row houses"). Like single-family houses, each townhouse owner has title to the building and the land it sits on. Like condos, townhouses may share some common areas, governed by a community association (but unlike condos, the community association usually owns the common area).

Just be sure, when you start househunting, to find out for sure what type of property you're looking at. If a careless ad or agent calls a property a townhouse, but it's really a condo, you'd own a little less personally (because the land isn't yours, nor is the outside of your unit) and should pay less accordingly.

Co-ops: Benefits and Drawbacks

Co-ops sound so glamorous, don't they? But what are they, other than swanky apartments in New York City for the rich and famous?

Like condos, co-ops (short for housing cooperatives) are defined by their ownership structure. When you own a house or condo, you own a piece of physical property. When you own a co-op, however, you own shares in a corporation. The corporation, in turn, owns the building you live in, and you get a proprietary lease to live in a specific unit within the building. The lease allows you to live there as long as you own your shares and spells out any restrictions on your use of the unit.

As with any corporation, your shares also give you voting rights. Shareholders elect the board of directors, who make most of the decisions and manage daily operations or hire staff to do so. The shareholders pay a monthly "maintenance fee" to cover these and other costs. Usually, the more desirable the unit a shareholder has, the higher the maintenance fee.

Celebrities Who've Owned Co-ops

Among the big names who've made a co-op home (or maybe one of their homes) are Glenn Close, Jimmy Fallon, Chloe Sevigny, Sean Combs (a.k.a. Diddy), Matthew Perry, and Kelis.

Because of your limited ownership and other financial issues (discussed in Chapter 6), co-ops are sometimes difficult for the average first-time homebuyer to afford. The limitations also mean that co-ops tend to be quite slow to appreciate in value.

Factory Made: Modular and Manufactured Homes

Buying a prefabricated home no longer means living in an insubstantial-looking box. In fact, it's a creative possibility and a growing trend. Modern, multistory dwellings, now known as "modular homes," are built in blocks in factories and transported to properties, where they're fully assembled to comply with local building codes. If you decide to buy a property and build a home on it, a modular home might be a relatively low-cost option.

However, you'll have to consider additional expenses like transporting the home; getting the proper permits and access to utilities and sewer lines; hiring professionals for installations; and adding features like landscaping, driveways, or fences. A local contractor may be able to give you a brief overview of the costs, players, and timeline.

CHECK IT OUT

Check out modular homes styles, from the traditional to the ultra-modern, at:

- www.modularcenter.com
- www.houseplans.com
- www.linwoodhomes.com.

Another low-cost option is the manufactured house, once commonly referred to as a mobile home. These too have come a long way. Manufactured homes comply with federal building standards but aren't constricted by local or state building codes.

Manufactured homes are typically transported to communities of other, similar homes, and the owners lease the land the homes sit on. If the lease is terminated or the land is sold, the owners can be required to leave and take their homes with them. Since a lot of the value of a home is in the land, these homes tend to *lose* value over time, and moving one may cost more than it's worth. Manufactured homes are often more difficult to finance, too. The bottom line is that they're low-cost options to more permanent properties but don't usually offer the same equity-building advantages.

Million-Dollar Mobile Homes?

Yes, you'll find them in Malibu: Even the rich and famous (like Minnie Driver) sometimes retreat to manufactured home communities.

Putting It All Together: Your Dream List

Now it's time to fill out what we call your "Dream List." This is a handy worksheet where you'll write down your "must haves," such as number of bedrooms, size or type of house, neighborhood, maximum price, and anything else you consider a minimum requirement in a home, such as a garden. There's also space for you to note your "would likes," features you'd prefer but could live without or possibly add later (such as a deck).

Of course, expressing your preferences doesn't mean you'll *get* all of them. But later, when you're out househunting, carrying a copy of your Dream List will help make sure you keep your priorities straight.

The Dream List also includes a section for things you absolutely won't accept, under any condition, such as a dark kitchen with few windows. You might need this reminder one day, when you find a house that's perfect in every other respect.

> *Ooh! I forgot about the washer and dryer! I've been dreaming about that my whole New York life!*
>
> Carrie, *Sex and the City*

TIP

Check in with your partner. If you're buying the house with another person, make sure you assess your priorities and complete the Dream List *together*. It won't help to make a list of priorities, only to find out they're in direct conflict with your fellow buyer's.

Best thing I ever did

Put my practical needs as a single woman first. Hope thought she was looking for a cute Craftsman with wainscoting, high ceilings, and a yard. "In fact," she says, "I almost bought a house that fit my supposed ideal. But at the last minute, I realized it wasn't going to work. My work hours don't leave time for home maintenance, and my safety was an issue in that neighborhood. So I switched gears and bought a late '80s townhouse with a drive-in garage with direct access to the house, in a nicer neighborhood. It's architecturally boring, but I'm comfortable there, the homeowners' association deals with most of the maintenance, and I haven't had a moment's regret."

ONLINE TOOLKIT

The "Dream List" can be found in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.) A filled-in sample is shown below.

Dream List

Address: 43 Belvedere Road, Oakland, CA **Date visited:** March 3, 20xx

Contact: Tom Macht, Hills Realty, 510-555-3479

General Features	Must Have	Would Like	This House
Type (house, condo, etc.) or Style (Colonial, loft, etc.)	Single-family house in good shape with few stairs from the street	Ranch style or layout with bedroom on 1st floor, accessible for elderly parents	80 years old, but seemingly in great shape. Two-story. Den on first floor could be used as guest room.
Upper price limit	$900,000	$ 750,000	$ 850,000 list price
Age above/below	Less than 75 years old	Less than 50 years old	80 years old
Min. square footage	1,500	2,000	1,750
Min. lot size	2,500 square ft.	3,500 square ft.	3,000 square ft.
Number of bedrooms	3	4	3 (plus den that could double as guest room)
Number of bathrooms	2 full baths	3 full baths	2.5 (half-bath off of kitchen and full bath in master bedroom)
___ car garage	1-car garage	Large attached 2-car garage	No garage
Parking	Driveway parking, not on an incline	Same	Driveway parking close to house, level surface
Fireplace	Not a deal breaker	A gas fireplace	Nonworking fireplace
Flooring	Hardwood, at least in living room and dining room	Hardwood floors in good shape, in entire house	Hardwood floors in living room and dining room, but covered by wall-to-wall carpet. Floors need refinishing.
Other	Good separation from neighbors' houses	Lots of privacy, especially in backyard	Houses are fairly close, but trees provide some privacy on 1st floor

Dream List, continued			
Floor Plan	**Must Have**	**Would Like**	**This House**
Formal living/ dining	Separate living and dining rooms	Large living room for entertaining.	Small living and dining rooms, open on to each other
Great room	Don't care	Don't care	No
Number of floors	2	1	2 (short flight of stairs)
Basement/attic	Clean, dry basement for storage; no flooding problems	Large finished basement for kids' playroom plus storage, half-bath	Basement in good shape; could be divided into kids' play space and storage area. No bathroom.
Other			
Kitchen	**Must Have**	**Would Like**	**This House**
The basics	Large sunny kitchen, lots of counter space and storage	Gourmet kitchen with beautiful cabinets, walk-in pantry, natural lighting plus recessed lighting, hardwood floors	Decent-size kitchen, good light, adequate storage. Cabinets need resurfacing. Linoleum floor will need replacing. Lighting fixtures outdated.
Dishwasher	Built-in dishwasher	Same	Only portable dishwasher, but could add a built-in one
Other appliances	Gas stove, large refrigerator in good shape	New stainless steel appliances, including commercial stove	Refrigerator and oven don't match, but are only a few years old.
Eat-in	Space for small table for four, or breakfast counter	Breakfast nook opening on to deck	Breakfast nook! Now to add the deck …
Other			

Dream List, continued			
Other Rooms	**Must Have**	**Would Like**	**This House**
Laundry	Washing machine and dryer	Separate laundry room on 1st floor, with space to hang clothes and iron	Washing machine and dryer in basement. Bare bones.
Family	Space for kids to hang out, separate from living room	Large finished playroom in basement	No separate play-room, but kids' rooms are large, and extra space in basement.
Den/study	A room suited for office, with space for two desks, bookcases, and file cabinets	Two separate offices with built-in bookcases would be fantastic!	Den on first floor could double as guest room/ office. Master bedroom nook could be made into small office.
Other			
Outside	**Must Have**	**Would Like**	**This House**
Deck/patio	Sunny deck off of kitchen or ability to easily add one	Large deck plus patio in garden	Small deck off of second floor master bedroom; would be easy to build deck off kitchen.
Garden	Sunny yard for garden	Established garden, fruit trees, good soil, underground watering system. Mainly sunny, with a few shade trees.	Back yard needs work. A few rose bushes and succulents, but potential. Completely open (no shade). No drip system.
Fenced yard	Yes—need for dog	Beautiful hardwood fence and large secure backyard	Fence in bad shape. Will need to replace, or fill in some areas with holes.
Pool/hot tub	Not necessary	Not necessary	No
Other			

Dream List, continued			
Structure	**Must Have**	**Would Like**	**This House**
Central heat/air	Central heat	Central heat and AC	Central heat
Insulation	Throughout house and attic	Throughout house and attic	Only attic is insulated
Upgraded plumbing	A must	Copper plumbing	Not sure about the material, but plumbing, water pressure, etc. seem fine.
Other			
Storage	**Must Have**	**Would Like**	**This House**
The basics	Good storage a must in entryway, bedrooms, kitchen, basement, bathrooms, and other rooms.	Custom built-in closets in all rooms, lots of shelves, drawers, cupboards (especially in kitchen)	Adequate coat closet in entryway. All closets need updating, except for large walk-in closet in master bedroom.
Linen closet	Linen closet near bathroom	2 large linen closets, 1 near bedrooms, other bath	Small linen closet on 2nd floor only, outside of bathroom
Other			
Convenience	**Must Have**	**Would Like**	**This House**
Work within ____ miles/minutes	1 hour tops by car	15 minutes by car (one can dream)	30-minute drive to City (45-60 minutes in rush hour). Alternative = good public transport
Church/place of worship within ____ miles/minutes	N/A	N/A	N/A
Other			

Dream List, continued

Neighborhood	Must Have	Would Like	This House
Quiet street	Residential area; no speeding cars, walking distance to grocery, other shops.	Same	Street a little noisy (dog next door), basically okay. Only a few blocks to lake and great shopping area!
Safe neighborhood	A must!	Same	Seems safe; need to talk with neighbors, check crime stats.
Good schools	A must!	Lake Hills school district, schools within walking distance	Lake Hills school district! Elementary school is short (15-minute) walk from home.
Rules/restrictions	N/A (we don't want to live in community association)	N/A	N/A
Community association fees	N/A	N/A	N/A
Accessible public transport	Short walk or drive to BART, and close bus stop	Short walk or drive to BART. Bus stop at corner	10-minute drive to BART, bus stop a 5-minute walk
Other			

Absolute No Ways Under Any Condition

Bad schools, high-crime area, fixer-upper.

Notes

This house is definitely a possibility—especially because of schools and location. We may be able to get it for less than list price—enough to cover some changes we'd like, such as refinishing/replacing floors, resurfacing kitchen cabinets, adding a built-in dishwasher, repairing backyard fence. May even be able to swing adding a deck off the kitchen!

Dream List Directions

This Dream List includes the more common features found in many homes, but you can add others to this list (perhaps a must-have hillside location with a view) or delete some features. Add as many details as you want in the left-hand column ("General Features"). At the end of the Dream List, there's a section for those things you absolutely will not accept, under any condition. There's also a section at the end for notes, such as comments about a particular house or neighborhood—something you want to be sure to remember, such as a quiet location at the end of a cul de sac.

Fill in the "Must Have" column with your minimum requirements and the "Would Like" column with features you'd prefer but could live without. For example, for the "Number of Bedrooms" feature, you might write "3" in the "Must Have" column and "4" in the "Would Like" column. In some cases, you'll add additional information: For example, you might put a checkmark indicating that a house meets your upper price limit, and then note the actual price of the house. If a "Must Have" can be added when you move in, such as a deck or second bathroom, you can also note this.

If you fill out the left columns of the Dream List now and print more copies, you can use this sheet over and over again. Each time you visit a house, simply write in the address and note how it compares in the right-hand column ("This House"). Save copies for homes that seem like good possibilities.

What's Next?

Now that you know what features you're looking for, it's time to figure out whether you can afford them all. In Chapter 3, we'll explain how a lender is going to evaluate your finances and what you should do to evaluate them yourself.

CHAPTER

3

Does This Mean I Have to Balance My Checkbook? Figuring Out What You Can Afford

Meet Your Adviser

Russell Straub, a former mortgage broker and founder, President, and Chief Executive Officer of LoanBright, a mortgage marketing service based in Evergreen, Colorado, whose services involve two websites, www.loanbright.com and www.compareinterestrates.com.

What he does Helps LoanBright serve its goal of giving homeowners a convenient way to find the right mortgage company as well as a loan with favorable terms. Homebuyers visit the company's website, compare interestrates.com, enter some basic information, receive a list of lenders or brokers and available loan terms, and consent to being contacted. At the other end of the transaction, LoanBright helps mortgage brokers (particularly sole proprietors or independent ones) meet these potential clients.

First house "It was a condo in Boston, a 350-square-foot studio—big enough for me, by myself. I bought it during a run-up in real estate prices—at the peak, as it turned out! I was working as a manufacturing engineer and didn't know a thing about real estate. I chose my mortgage broker because she lived two floors up from me in my apartment building, but she managed to shepherd me through. Although the 1980s real estate crash hit not long afterward, I held onto the place. In fact, even though I now live in Colorado, I still own the condo and rent it out, and it has since tripled or quadrupled in value."

Fantasy house "Right on the ski slopes at Vail. I already spend some time there, but not enough. If you've been there, you know the style I'd like—wood, European looking, with a wood-shake tile roof, ski in/ski out."

Likes best about his work

"My short commute from home is great. Also, I like how each of us at LoanBright brings something different to the table, with varying interests and viewpoints, which we can combine into something new. I'm also conscious of the fact that we have the ability to change the lives of the solo or small-business mortgage and loan brokers whom we consider our primary customers. Many of them are honestly struggling—some are single moms—and it's a competitive business, with more people doing the jobs than there are transactions. We're trying to do the right thing for them. It's also satisfying to be able to help homebuyers get competitive loan quotes, potentially saving them thousands of dollars on their new mortgage."

Top tip for first-time homebuyers

"Do your homework. Read about the process, ask your questions, and talk to more than one broker and lender. It can take a while to get the hang of it. But I read a survey recently saying that consumers booking a hotel room online spend an average of one hour or more selecting a hotel. If homebuyers would spend a proportionate amount of time researching their prospective purchase and mortgage, they'd come out way ahead. But I've met many who spent less than an hour getting educated about buying a home!"

ONLINE TOOLKIT

For more tips from Russell Straub, check out his audio interview on the Nolo website. (See the appendix for the link.)

Up to this point, we've been able to focus on the fun stuff—finding out all the great reasons to buy a house and imagining what the new place will look like. Now it's time to take a step into the world of finances—nothing that will require an accounting degree, fortunately. You may be wondering why we're even bringing up boring financial stuff before you've started seriously househunting. That's what a mortgage broker is for, isn't it?

But wouldn't it be horrible to put an offer on a house and begin shopping for a loan, only to discover that you couldn't qualify for the amount you needed or the terms you expected? Even worse, what if you were able to get a loan, but discovered after moving into your new home that you'd borrowed more than you could handle—at least, without moonlighting?

Don't Play the Multiplication Game

You may have heard of a formula where you multiply your household's gross annual income by two and a half to find out how much you can afford to spend. This may be fun and easy, but it won't help you draw realistic conclusions. It fails to factor in important things like how much debt you currently have, the terms of your mortgage, or how much you already have saved for a down payment. If you really want to guess how much you can spend before reading this chapter, you're better off using a reliable online affordability calculator like the one at www.nolo.com/legal-calculators.

Getting familiar with your finances before there's a prospective property in sight—even if you just sit down for an hour or two—will show you how much you can realistically afford to spend and prepare you to choose the best possible loan. This chapter will help you by:

- explaining the costs of purchasing a house
- demystifying the process mortgage lenders use to decide how much you can borrow
- providing simple ways to calculate what you can *really* afford based on your lifestyle and finances
- showing you how to boost your financial profile, and

- explaining what it means to get preapproved for a loan and why you should do so.

If you've already found a place and are trying to figure out how to pay for it, don't skip this chapter. A quick look at your finances will still help you decide whether your prospective home's cost is within your budget and whether you're likely to get the loan terms you're counting on.

Beyond the Purchase Price: The Costs of Buying and Owning a Home

Buying a house means some new expenses beyond the purchase price. A first-time homebuyer should plan to drop some cash for:

- the down payment
- the loan principal, loan interest, taxes, and insurance
- up-front costs, mostly to close the deal, and
- recurring ownership costs.

The exact amounts of these expenses depend on you, the house you buy and where you buy it, and the type of mortgage you get. But even if you can't predict exact amounts, understanding these expenses and what drives them will save you some sticker shock.

Do We *Have* to Talk About Money?

We know, all this talk about numbers makes watching a a file download seem fascinating. But if you pay just half a percent more than you could have if you'd done some research—say, 4.5% instead of 4.0%, on a 30-year, fixed-rate mortgage for $200,000—you could end up paying almost $21,000 more in interest over the life of the loan.

Down Payment

You may be plunking down a hefty chunk of change, in the form of a down payment, to buy your home. Down payments are traditionally calculated as a percentage of the purchase price. Although most lenders tightened lending practices after the 2007/2008 financial crisis and began requiring down payments of 20%, many are relaxing standards once again. If you have excellent credit, you should be able to qualify for a mortgage with between 5% and 10% down.

Tick, Tick, Tick

Finding the house you want to buy might not take as long as you think. According to a 2008 survey by the National Association of Realtors®, the typical homebuyer spent 12 weeks searching before settling on a house.

Nevertheless, there are many benefits to making a large down payment:

- **No PMI.** If you pay 20% of your purchase price, you don't have to pay private mortgage insurance, or PMI, which lenders routinely require of homebuyers who borrow more than 80% of the home's value, to protect the lender if you default.
- **Smaller monthly mortgage payments.** If you borrow less money, you'll have less to pay back, leaving you more cash for other things.
- **Less interest overall.** If you borrow less, you'll owe less in total interest. For example, if you got a 30-year, fixed rate loan for $200,000 and paid 4.0% interest, you'd pay approximately $143,735 in interest over the life of the loan. But you'd pay only about $114,989 over the life of a $160,000 loan with the same terms. The bank would get over $28,746 more in interest just because you didn't put $40,000 down at the beginning.
- **It's like money in the bank.** No matter what the market does, putting cash into your home is a low-risk way to use it.
- **Lower interest rate.** Borrowers who take out mortgages for more than a certain amount ($417,000 in most places in 2014, but higher in high-cost areas such as Alaska and Hawaii—up to $625,500 in 2014—and can change annually) get what are called "jumbo" loans, with higher interest rates. If making a down payment will lower your loan to below that amount, your interest rate will probably drop, too. Likewise, if you're a borrower with poor credit, you might be able to obtain better loan terms if you fork over more cash at the beginning—the lender figures you've got more incentive to keep paying if you stand to lose your down payment when the lender forecloses.

Where Will I Get Down Payment Money?

If you're interested in making a down payment but haven't saved the cash, here are some alternative sources:

- **A gift or loan from family or friends.** If you have a loved one with available cash, you may be able to get a low-interest loan, or even a gift. Nearly one third of first-time homebuyers get help from friends and family—either as a gift or a loan—for the down payment. However, you'll need to keep an eye on your lender's rules regarding the source of your down payment. Adviser Russell Straub notes, "If one gets an FHA mortgage, there are no restrictions on the amount or percentage of the gift so long as it comes from a blood relative. If one gets a conventional mortgage and the gift is for less than 20% of the purchase price, however, the borrower(s) must make at least 5% of the down payment from their own funds, and the gift(s) must be from a blood relative."
- **Withdrawal from your IRA.** You can withdraw up to $10,000, penalty-free, from an individual retirement account (IRA) to purchase (or build) your first home. Your spouse or cobuyer can do the same. For more information, see IRS Publication 590, *Individual Retirement Arrangements (IRAs)*, available at www.irs.gov.
- **Borrow from your 401(k).** Check with your employer or plan administrator about whether you can borrow from your 401(k) plan. Also ask how much you can borrow (usually, $50,000 at most). But be warned: Lenders will factor the monthly 401(k) loan repayment amount into your mortgage qualification ratio. For more information, see IRS Publication 575, *Pension and Annuity Income*, available at www.irs.gov.
- **Current assets.** If you have other investments, like stocks or bonds, consider cashing them out—but be sure to factor in the taxes you'll owe. You may be also able to sell an asset like a car or valuable musical instrument.
- **Don't have a big wedding!** Okay, we're half joking here. But you wouldn't believe the number of couples we've met who said that, in retrospect, they wish they'd kept the wedding small and put that money toward a house.

Best thing we ever did

Make a 30% down payment. According to Nigel, "When Olivia and I decided to buy a house together, we were earning nonprofit salaries (low). But our parents were excited to see us settle down and gave us generous gifts. Between that and emptying our savings account, we had about 30% to put down—which convinced the seller to choose our bid from among the many others, because we'd obviously have no trouble financing the rest. Now we have absurdly low monthly payments—less than we'd be paying in rent—and the house has appreciated in value. Also, we're in a position to help our parents out financially, if they need it."

Principal, Interest, Taxes, and Insurance

Ever heard of PITI (pronounced "pity")? It stands for principal, interest, taxes, and insurance, all of which must be factored into your homebuying plans. Here's the breakdown on these expense items:

- **Principal.** The amount you borrow from the lender and must pay back, month by month.
- **Interest.** A percentage of the overall borrowed amount that the lender charges you to use its money. The exact rate varies widely.
- **Property taxes.** Taxes vary by state and sometimes by local area, but expect to pay somewhere around 1% of the house purchase price each year, if the place you live fits the national average.
- **Insurance.** Coverage for theft, fire, and other damage to the property (required by your lender) and usually for your liability to people injured on your property or by you. Average rates run upwards of $600 per year, and over $1,000 annually in many locations. Private mortgage insurance or PMI also factors in here. If a homebuyer puts down less than 20%, the annual PMI cost can range from ½% to 1.5% of the loan amount.

Worst states for property taxes?

The five with highest rates nationwide are: #1: New Jersey, #2 Illinois, #3 New Hampshire, #4 Wisconsin, and #5 Texas.

It makes sense that these four items have their own acronym, PITI, because for some homebuyers (usually those whose down payment is less than 20%), all four must be paid straight to the mortgage lender each month. The lender turns around and pays the appropriate party. The lender's rationale is that if you don't pay these bills (or your mortgage) and the lender gets the property, it doesn't want to get stuck with your tax or insurance bill, too.

TIP

PITI is paid differently when you buy a condo or co-op. Instead of paying the lender, you may have to pay your community association or co-op board for your portion of the mortgage and real estate taxes (on a co-op), or for insurance on the jointly owned parts of the property (on either a condo or a co-op).

Added together, your total PITI may come to a lot more than your current monthly rent. That makes owning a home look like an expensive proposition. But it's not an apples-to-apples comparison. First, remember that your mortgage payments typically reduce your loan principal, so your payment is building equity, not just going into a black hole. Second, your interest payments and property taxes are tax-deductible.

> EXAMPLE: Mieko and Lyle buy a house for $250,000, putting down $25,000 and financing the remainder with a 30-year fixed rate mortgage at 4%. Not only are their monthly mortgage payments $1,074 a month, but the mortgage lender also collects $450 each month to pay their homeowners' insurance and annual property taxes, for a total monthly payment of $1,524. The money for the tax and insurance bills is held in an escrow account, which the lender draws on to pay the bills when due. At the end of the first year, Mieko and Lyle will be able to deduct about $11,328 from their taxable income: $2,400 for property taxes and about $8,928 for interest paid on the mortgage.

Up-Front Costs

Until now, we've been talking about costs associated with the house itself. But you'll also have to spend some pretty serious cash at the beginning to make the sale happen. (Sort of like paying first and last month's rent.) Particularly if you're trying to save up for a decent-sized down payment, you'll need to plan for the following additional up-front costs:

- **Closing costs.** An array of miscellaneous and sometimes aggravating charges—for everything from couriers to loan points (discussed below) to insurance premiums—are lumped into a category called "closing costs." These vary across the country, but are usually 2% to 5% of the house purchase price.
- **Points.** Borrowers sometimes agree to pay a "loan origination fee" or "points" to obtain a specific loan. Each point is 1% of the loan principal (so one point on a $100,000 loan is $1,000). Paying points can lower your interest rate, so you pay less in the long term. But you'll probably need to pay the cash up front (although with some FHA loans, points can be amortized into your loan—meaning added on, with interest accruing).
- **Moving costs.** How high these will go depends on how far you're moving, how much stuff you have, and whether you use a professional moving company.
- **Service setup costs.** You may have to pay fees to set up cable, a security system, high-speed Internet, and similar services in your new home.
- **Emergency fund.** It's a good idea (and sometimes a lender requirement) to have a couple months' worth of PITI payments saved, in case something goes unexpectedly awry.
- **Remodeling costs.** If you buy a fixer-upper or a planned remodel, you might need thousands of dollars in cash early on, just to make the place livable. Estimate high for these expenses—they're almost always more than anyone expected.

Recurring Costs

Yes, there's more. Whether new or old, your house will need regular maintenance—gutters cleaned and trees trimmed regularly, a paint job every few years, new appliances when the old ones die, and so on. If you buy in a common interest development, your own maintenance costs may go down, but you'll have to pay monthly dues and sometimes special assessments for unanticipated projects like resurfacing a damaged parking lot. While not part of your PITI, all of these expenses will affect your monthly cash flow.

TIP

Adjust your deductions. Once you know the details of your mortgage, work with a financial professional to change your withholdings to account for your lower tax liability, freeing up more money for other expenses.

Spend Much? How Lenders Use Your Debt-to-Income Ratio

Once you understand what you'll be paying for, and that you'll probably need a mortgage to make it happen, the obvious question is, how much can you borrow? To know that, you need to understand how lenders think. Just as you're trying to get the best loan, lenders are looking for the best borrowers.

Without knowing you personally, lenders need some criteria to figure out how risky it is to lend you money. If you make your payments, they'll turn a profit, either in interest or by selling your loan on the secondary market (more on that in Chapter 6). If you don't, they'll have to chase you down for the cash or sell the property to try to get it.

One of the criteria that lenders use is the comparison between your income and your debt load, called your "debt-to-income" ratio. They also look at your track record for paying previous debts, or your credit history, discussed below.

The concept of "debt-to-income ratio" isn't as complicated as it sounds. The lender simply looks at your household's gross monthly income, then makes sure that your combined minimum debt payments—for your PITI (including any community association fees), credit card, car, student loan, personal loan, 401(k) loan, and others—don't eat up more than a certain percentage of that amount. The idea is to make sure you have enough cash left over for your mortgage payment.

Maximum Acceptable Ratios: The 28% and 36% Rules

How high can your debt-to-income ratio go? Traditionally, lenders have said that your PITI payment shouldn't exceed 28% of your gross monthly income. This is sometimes called the "front-end" ratio. Also, your overall debt shouldn't exceed 36% of your gross income (also called the "back-end" ratio). (Your gross monthly income means the amount you earn before taxes and other monthly withdrawals, plus income from all other sources, like royalties, interest, alimony, or investments.)

EXAMPLE: Fernando and Luz have a gross annual income of $90,000 ($7,500 per month) and a moderate amount of existing debt. If they plan to spend 28% of their gross monthly income on PITI, they'll pay $2,100 each month. Assuming they spend about $300 of that on taxes and insurance, they can borrow about $375,000 using a 30-year, fixed rate loan at 4% interest.

Khanh and May also have a gross annual income of $90,000, but they're debt-free. So, depending on the size of their down payment, they may qualify for a loan using slightly more than 28% of their gross monthly income on PITI. In an extreme case, they could qualify to allocate up to 36% of their gross monthly income on PITI. Spending the same on taxes and insurance, they can borrow about $500,000 using a 30-year, fixed rate loan at 4% interest. With the same income but a higher debt-to-income ratio, Khanh and May can spend a lot more money on a house than Fernando and Luz.

CHECK IT OUT

Ready to run some numbers? Online affordability calculators show how a traditional lender will use your debt-to-income ratio to set your maximum monthly mortgage payment. Find such calculators at www.nolo.com/legal-calculators, www.hsh.com, www.bankrate.com, and www.interest.com. Make sure any calculator you use factors in the amount of your down payment, your income and your debts, and your estimated taxes and insurance.

Calculating Your Own Debt-to-Income Ratios

All you need to figure out your own debt-to-income ratios is your combined gross monthly income figure plus that of anyone buying with you. This will tell you approximately what a lender will say you can afford to spend each month on a mortgage payment. See the sample Debt-to-Income Ratio Worksheet below.

ONLINE TOOLKIT

You'll find a blank version of the "Debt-to-Income Ratio Worksheet" in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.)

Sample Debt-to-Income Ratio Worksheet

Gross monthly income:	$2,000	
Gross monthly income × 0.28	$560	Maximum monthly PITI payment
Gross monthly income × 0.36	$720	Maximum monthly debt overall

Blasts From the Past: How Your Credit History Factors In

Aside from your available income, your lender's main preoccupation will be with your credit history. Most lenders want to know whom they'll be competing with to get your monthly dollars, how much you're borrowing from those various sources, and how good you've been about paying money back in the past. You've probably undergone credit history checks before, like when you applied for a car loan or rented a new apartment.

> **Managing Your Money Is So Easy!**
>
> *You just use your credit cards! You pay your American Express with your Discover, your Discover with your Visa, your Visa with your MasterCard. Before they catch up with you, you're buried in a glorious crypt in Bel-Air!*
>
> Camilla, character on TV series *The Naked Truth*

Credit reporting bureaus exist to keep track of your borrowing habits. The three major companies are Equifax (www.equifax.com), Experian (www.experian.com), and TransUnion (www.transunion.com). They use a formula compiled by the Fair Isaac Corporation to calculate your "FICO" score (which we'll call your "credit score"; but beware when you see this term other places, because anyone can compile a number and call it a "credit" score).

In 2012, FICO introduced something called the FICO Mortgage Score. Some lenders may use this instead of, or in addition to, your regular FICO score. The goal of the FICO Mortgage Score is to capture more information than does the regular FICO score, such as your history of child support payments, rental payments, and more (all gleaned from public records).

How Lenders Use Credit Scores

Lenders use your credit score to decide whether to lend you money and, if so, how much and on what terms. If you'll be financing your home jointly with others, the lender will look at each person's credit score. Unfortunately, that means that if one of you has a low score, it will probably affect the terms of the loan offered to all of you. If any of you has serious skeletons in the financial closet, either clear out the closet, reconsider the joint purchase, or get creative with your financing strategies.

Getting Your Own Credit Report and Score

The best way to know exactly what prospective lenders will be looking at is to look at it yourself first. Federal law requires each of the three major consumer reporting companies (named above) to provide you with a free copy of your credit report once every 12 months.

CHECK IT OUT

The only authorized source for free credit reports: Go to www.annualcreditreport.com. Other websites may advertise a "free report" but try to sell you something in the process. This site also links you directly to the websites for the big three reporting bureaus.

Lessons learned the hard way

Being financially responsible left me with no credit history! When Willow decided to buy her first house, she didn't expect her lack of debt to create a problem. Willow explains, "I'd worked my way through school and taken out a student loan that I'd paid off almost immediately. And I'd always used a debit card instead of a credit card. As a result, I had to jump through all sorts of extra hoops, providing a letter from my old landlord showing that I paid the rent on time; showing records of my payments of phone bills, cable bills; and even having my parents add my name to their credit card account. (That last strategy worked faster than I expected—within one month, my credit score was the same as theirs.) Here I thought I'd been so good at controlling my finances, yet I discovered I'd been completely naïve when it came to creating a record of debt payments."

It's a good idea to ask all three agencies for your credit report. They sometimes have different information, and your lender may be looking at all three reports. You can do this simultaneously, but it means that you won't be able to get another free report from any of them for another full year.

Federal law doesn't require the agencies to give you your credit *score*, which is different from your report. You'll probably have to pay extra to get the score (unless you live in a state like California that requires that consumers be given their scores for free when getting a mortgage). You can get your credit score either from the individual consumer reporting company websites or by going to www.myfico.com.

What Your Credit Score Means

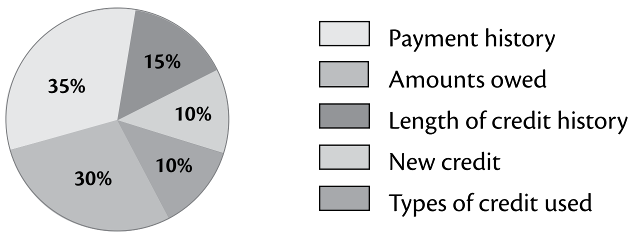
When you get your credit score, it will be a number somewhere between 300 and 850—the higher the better. If your score is above 720, it's considered pretty strong. Most people are in the 600s or 700s. A higher number tells the lender you pay your debts on time, have limited sources of revolving credit, and have an established record of using credit prudently, making you a good credit risk. A lower number (below around 620 for conventional mortgages and 580 for FHA mortgages) means you look more risky—perhaps because you have enough revolving credit that if you maxed it all out you couldn't pay all your bills plus a mortgage; you've missed payments in the past; or you've never used any credit source, so the lender doesn't know what to make of you.

A low score will make it difficult to find a willing lender. And any lender you do find will expect you to pay more for that privilege of borrowing, probably in the form of higher interest. (If your credit is less than perfect, you may be able to clean it up, as we'll discuss below.)

CHECK IT OUT

What makes up a FICO score? It includes your payment history (35% of the score), how much you currently owe (30%), how long you've been a borrower (15%), whether you have any new credit accounts (10%), and the types of credit you use (10%). To learn more, go to www.myfico.com, a Fair Isaac website for consumers.

What Makes Up Your Credit Score



Understanding Your Credit Report

Get ready: Your credit report may go on for *literally* pages and pages. Focus on making sure the most critical information is mistake-free, particularly these bits of data:

- **Name, Social Security Number, and addresses.** Especially if your name is a common one, you may have multiple aliases. And an address you don't recognize may mean someone with the same name is incorrectly listed on your report.

- **Creditors.** Make sure you actually borrowed money from the creditors that appear, and that the amounts borrowed are accurate. Keep in mind that some types of loans, like student loans, can be sold or transferred. In that case, all creditors that have held the loan will appear, but the pretransferred or sold accounts should no longer be designated "open."
- **Open credit lines.** Make sure any lines of credit you've closed are no longer shown as open. Different reporting companies use different terminology, so if you're not sure, call to clarify.
- **Collections and judgments.** Make sure any collections actions or judgments are reflected accurately.
- **Late payments.** These notations will usually indicate a late payment of 30, 60, or 90 days. Make sure they're accurate.

Correcting Credit Errors

Credit reporting mistakes happen frequently. Inaccuracies in the report affect your score, and if your score drops, so does the likelihood of you getting the best possible loan. You'll want to spot and correct any errors before a lender sees your report, not after you've applied for a loan and been rejected.

All manner of mistakes are possible—from bits of credit history that aren't yours to a false claim that you paid a bill late. To correct such errors, contact the reporting agency in writing. If all three agencies misreported the information, you'll have to contact all three. Each agency may have a different procedure and forms to use for disputing the report. When you discuss issues over the phone, make sure to document conversations, including the date and name of the person you spoke with. Finally, if you have any documentation that supports your claim, send a copy with an explanatory cover letter.

The credit reporting agency has 30 days to investigate your complaint and give you its findings. If it can't verify that its version of events is correct, the agency is supposed to remove the information from your file. If it won't, you have the right to place a statement in your file giving your version of what happened.

Sometimes you can also work directly with your current and former creditors to correct inaccuracies or solve problems. If you're willing to pay the disputed amount, or the creditor is willing to settle for a lesser amount—which it sometimes is—the creditor may also agree to clear the item from your credit history. Likewise if you have proof of an error, it may be faster to go directly through the creditor than to correct it through the reporting bureau.

CHECK IT OUT

Need help patching up your credit? See *Credit Repair*, by Attorney Margaret Reiter and Robin Leonard, J.D. (Nolo). It offers plain-English explanations and over 30 forms and letters to help you negotiate with creditors, get positive information added to your credit record, and build a financial cushion. Also, the Debt Management section of Nolo.com includes dozens of useful articles on credit repair.

Repairing Your Credit

Rome wasn't built in a day, and credit history can't be repaired in one, either. If you or a coborrower have a poor credit history, Fair Isaac suggests you start cleaning it up six to 12 months before applying for a loan. If your credit history is really messy, it may take even longer.

But here's some good news: Even if you have a long, ugly credit history, your score will be weighted in favor of your latest performance. Turn over a new leaf by following these strategies:

- **Pay on time from now on.** Don't miss due dates for credit cards and other bills. Setting up automatic payment plans can help, and your lender may reduce your interest rate in return.
- **Pay the worst first.** Start by paying off high-interest debt, like on credit cards. Also, keep your balances low on revolving lines of credit. Don't just move the debt around—that won't fool the credit scorers, nor will it free up cash for a mortgage payment.
- **Don't cancel credit cards.** Paying a balance down to zero but keeping the card active is typically much better for your credit score than actually cancelling the card.

TIP

Check out FHA-backed loans. Some low down payment federal loan programs are less strict about credit background. See Chapter 7 for details.

What's Your Monthly Budget? Understanding Your Finances

Now that you've seen what lenders look at to decide how much you can spend, it's time to think about what *you* believe you can spend. The point is to avoid taking on so much debt that you lose sleep or have to give up sushi for ramen noodles.

Lessons learned the hard way

Should've budgeted for furniture! According to adviser and real estate broker Tara Waggoner (whom you'll meet in Chapter 15), "I know a couple who, for the first nine months living in their first home, literally had almost no furniture beyond a card table and a futon. They'd rented a much smaller place before. In working out their budget, they forgot to take into account that they'd have to furnish all the rooms that they were so excited about in their new home: a media room, an office, and five bedrooms (they had kids). They laugh about it now."

In fact, if you look closer at that debt-to-income ratio, you'll realize that it has a built-in problem. It's based on your *gross* income—the amount you theoretically make before your paycheck gets eaten by taxes and other withdrawals. Your mortgage payment could, depending on your lifestyle, end up exceeding what actually remains.

The easiest way to understand your current spending and savings pattern is to do a budget worksheet. You can do this using either special budgeting software, a spreadsheet like *Excel*, or with old-fashioned pencil and paper. List all your expenses, including food, entertainment, clothing, transportation and car-related expenses, health and dental care, child and pet care, student loans, and utilities. Hold onto your receipts, and if you use an ATM card or make electronic payments, look at your bank statement to see where it's all going each month. Include automatic monthly withdrawals on your budget worksheet—for your DSL line, online DVD rentals, or gym membership. Of course, you can leave your current rent and any rental-related expenses out of your calculations.

CHECK IT OUT

These websites have free budget worksheets you can print and fill out, or budgeting software to purchase:

- www.mint.com
- www.vertex42.com
- www.planabudget.com
- www.quicken.intuit.com.

Next, compare your monthly expense total to your monthly net income —what comes home, not what you make before taxes and the rest. The difference between that take-home pay and your expenses is the amount of disposable income that you can use for new-house-related expenses.

CAUTION

Self-employed? Expect some frustration in qualifying for a loan. Lenders typically require you to have been self-employed for at least two years, and calculate self-employment income based on an average of the most recent 24 months. So, for example, if you've been self-employed for only 14 months, your income—no matter how high—may be excluded for loan qualification purposes. Similarly, if your first 12 months' self-employment income was only $12,000 but the next 12 months yielded $120,000, your 24-month average would be only $5,500 per month.

Most people try to modify their spending habits if their disposable income isn't enough to cover the PITI. Having all your expenses in front of you helps you decide where to make such cuts. It also prepares you to draw the line if a lender or mortgage broker encourages you to pay more than your true budget allows. Remember, the lender mainly cares that you can pay back the money you borrow—not that you do it while living the life you want. If Pilates classes or Friday happy hours are important to you, then stick by your own budget and plan.

CAUTION

Not to scare you, but… Fred Steingold, an attorney-adviser whom you'll meet in Chapter 5, thought you should know just how deeply a lender can dip into your finances if you ultimately fail to make payments on your mortgage. "The U.S. is divided into 'recourse states' (the majority) and 'nonrecourse states,' explains Steingold. "In a recourse state, if the value of the home drops and you stop making mortgage payments, the lender may not only sell the home in a foreclosure sale, but also hit you with a deficiency judgment for the remainder of the mortgage debt." In other words, the lender can go after assets of yours other than the house securing the mortgage. To find out your state's law on this, go to www.nolo.com and search for, "State Foreclosure Laws."

Getting Creative: Tips for Overcoming Financial Roadblocks

After running the numbers, you may feel that you can't afford a decent house, or maybe any house. But no matter your financial woes, there are steps you can take to ease them, including:

- **Reduce your debt.** This will free up cash for monthly house payments and reduce your debt-to-income ratio.
- **Make a new budget.** Revise your monthly budget, keeping your homebuying goals in mind. If you have targets, you're more likely to control your spending habits to meet them.
- **Reduce spending.** You may be able to get a roommate until you're ready to buy a place, apply an expected work bonus toward your fund, go back to basic cable, or shop more at thrift shops. Check out local freecycle groups (www.freecycle.org) for free items.
- **Borrow from a nontraditional source.** Consider different and creative options for borrowing money, from your family to the seller of the house you buy. For details, see Chapter 7.
- **Get a buying partner.** Perhaps you know someone who has cash and would be interested in jointly owning a property. Keep in mind that owning together doesn't have to mean living together, or even owning equal shares.

- **Cash out other investments.** Consider cashing out money invested in stocks, bonds, mutual funds, or other property to come up with a down payment, thus also reducing your monthly payment.
- **Sell an asset to raise down payment cash or reduce monthly spending.** Adviser Russell Straub explains, "I've frequently encountered homebuyers with high-end cars and huge car-loan payments. They often either had equity in the car or were paying so much per month on the car loan that it made their back-end ratio (the 36% ratio) too high. By selling the car (and maybe replacing it with a more modest vehicle or using public transport, car-sharing with a service like Zipcar, or ride-sharing with Uber or Lyft), they were able to qualify for a bigger house payment."
- **Consider other home types, sizes, conditions, or locations.** Remember that condominiums are often cheaper than houses and old houses are generally cheaper than new.
- **Wait.** If you expect prices and interest rates to remain stable, your income to increase, and to save more money, you might delay your house purchase. With increased income, you may be able to borrow more; with an increased down payment, you may not need more.

The Power of Paper: Getting Preapproved for a Loan

Knowing what house-related costs will be laid at your feet, roughly how much a lender will let you borrow, and how much you'll really want to spend based on your income, lifestyle, and other factors, you can think about getting *preapproved* for a loan. Preapproval means you get a letter from a bank or lender committing to lend you a certain amount. It's often expressed as a monthly amount, because interest rates may vary, but the amount you can afford to pay each month does not.

CAUTION

Preapproval is not a guarantee. The bank hasn't really fully processed your request, and will place several conditions on your final approval. In fact, you'll need to comply with a host of requests for information. Lenders have become more prone to declining final approval than ever before, so be prepared. But it still helps you….

Preapproval does two important things: It gives you some certainty that you can afford the houses you're considering, and it makes you more attractive to sellers. You'll know exactly how much you can borrow, and sellers will know that if you've put an offer on their place, you can actually (subject to the bank's final approval) come through with the cash.

TIP

You don't need to use the lender that preapproves you. It would make matters easier if you did, but there's no need to feel bound. You (or your mortgage broker) might find a better deal by the time you've chosen a house.

Why Preapproval Is Better Than Prequalification

You may have heard of loan *prequalification*, but don't confuse it with preapproval. When you get prequalified, you give a lender some basic information about your income and debts, and the lender estimates what you'll likely be able to borrow. But the lender doesn't commit to lending you that money, so prequalification mainly helps you ballpark the price range you should be looking at and readjust your expectations if need be.

Prequalification certainly won't wow any sellers. On the plus side, prequalification is free and easy to do (in person, over the phone, or on the Internet).

Preapproval is a different story. It will actually cost you a little money (in the $30–$40 range), because the lender will check your credit history. (This cost may be negotiable.) But preapproval will also give you more—a written commitment to lend you money. Don't accept a verbal preapproval.

Of course, the lender will attach a few conditions to that commitment. If, for example, you lose your job, the bargain is off. And make sure your preapproval letter doesn't contain too many conditions. For example, if the letter conditions the loan on a credit check, it means the lender hasn't really done its homework, and you're not really preapproved.

What You Need to Show for Preapproval

To get preapproved, you'll need to provide the lender with some financial data. This is actually a blessing in disguise—it's all stuff you'll need to dig up to get a loan anyway, and it's about the last thing you'll want to be thinking about later, when you've found a place to buy and are juggling other tasks.

Here's what you'll need to pull together and photocopy. If you're buying with someone else, both of you will need to give the lender every item on the list.

- pay stubs for the last 30 days
- two years' W-2s and potentially two years of personal and business tax returns
- proof of other income
- proof of other assets (such as stocks or pension funds)
- three months of bank records (all pages) for every account you have
- source of your down payment (for example, bank records from you and anyone gifting you money)
- names, addresses, and phone numbers of employers for the last two years
- names, addresses, and phone numbers of landlords for the last two years
- information about your current debts, including account numbers, monthly payment amounts, and so on
- other records and documents.

ONLINE TOOLKIT

Use the "Financial Information for Lenders" checklist in the Homebuyer's Toolkit Nolo website. (See the appendix for the link.) It will help you keep track of all the items listed above, which you'll need for loan preapproval (and later, final loan approval).

You'll also need to fill out an application—if you're working with a mortgage broker, you'll probably get help with it, and can draw much of the information straight from the documents listed above. The lender will ask you for additional information once you've selected a property—that is, if you use that lender. If you switch lenders, you'll have to give the new one the whole works. The additional material includes:

- a property appraisal (you'll have to pay for that, usually about $300–$400—the lender will set it up once you've selected a property), and
- proof that you've obtained homeowners' insurance.

Where to Go for Preapproval

Your options for getting preapproved include working with a mortgage broker, going directly to a local bank or institutional lender, or using an Internet aggregator—a website that compiles loan information from a lot of different lenders into one place. For more on how to research mortgages, see Chapter 6.

If you haven't yet found a mortgage broker, there's no harm in going straight to a lender for preapproval. First, make sure the lender is willing to do two things: give you the up-front letter stating that you're preapproved up to a certain amount, and then give you another letter later, when you actually bid on a home. This second letter will reflect a preapproval amount equal to the amount you're offering to pay for the property. The second letter is important because when you give a preapproval to a seller, the seller doesn't need to know that you can afford to pay more. That kind of revelation can hurt your bargaining position.

Preapproval is usually a quick process. If documents are transmitted electronically, you could be preapproved within hours. At its longest, it should take only a few days.

CAUTION

If you change plans and, instead of a single-family home, decide to buy a condo, townhouse, or other home within an association, tell your lender ASAP. As adviser Paul Grucza explains, "I've seen people lose their ability to get a mortgage because either the lender forgot to factor in the regular and special assessments owing on this type of property, or the buyer forgot to mention them. This can be enough to push buyers right over the margin, so that they no longer qualify for a mortgage in the amount they were preapproved for."

What's Next?

Confident that you're not going to break your personal bank or end up without a home loan, you can now start checking out the housing market. We'll show you how in Chapter 4.

CHAPTER 4

Stepping Out: What's on the Market and at What Price


Brett Patterson

Meet Your Adviser

Bert Sperling, a city and neighborhood expert based in Portland, Oregon. He's the founder of www.bestplaces.net and author of *Cities Ranked & Rated* (Wiley) and *The Best Places to Raise Your Family* (Wiley). *The New York Times* wrote a profile about Bert titled simply (and accurately) "The Guy Who Picks the Best Places To Live."

What he does For nearly 30 years, Bert has been helping people find their own best place to live, work, play, and retire. As the foremost creator of popular best-places studies, he's in constant contact with the national media, and regularly publishes his latest findings. His creative yet useful research topics cover everything from the best cities for dating to the worst ones for migraine headaches.

First house "It was a 1920s Craftsman bungalow in Portland, Oregon. My wife found the house and said, 'We're buying it'—and she was absolutely right, it was a wonderful deal and a great place to raise our two sons. Affording it was a stretch, especially because interest rates were high, but we were tired of renting and were able to assume the seller's mortgage. We loved the neighborhood—only five minutes from downtown and close to shops, restaurants, and bus lines. I'm a big fan of urban neighborhoods."

Fantasy house "We've already found it! It's a cedar-shingled, Northwest coastal style place in Depot Bay, Oregon. The house is right on the rocks overlooking the ocean—a wonderful getaway, though ocean living is a bigger challenge than many people realize. We're under constant assault by the weather, with winds over 100 miles per hour. One of our requirements was high-speed Internet service so we can stay at the beach house for extended time periods and still keep up on our writing and research."

Likes best about his work

"I tell people I've got the best job in the world. It's wonderful to see all the differences in where people live and establish homes, and to be able to share their stories with others. I really believe there's no worst place to live. Every place is someone's home and has things that mean a lot to them, even though some aspects of living there might be challenging."

Top tip for first-time homebuyers

"Start by figuring out what type of homebuyer you are. For example, are you a 'money is no object, because I'll live here forever'; an 'I don't care about resale, I just want to find a good fit for my family'; or an 'I've got to find a fixer-upper if this is going to work' type? Most of us have to watch how much we spend, so think about the long term, don't get in over your head, and don't buy the best place on the block."

Visualizing your perfect nest, and calculating what your budget will allow, was important. But now it's time to step out and see what the market really has to offer—before you turn into a serious house shopper, and possibly even before you find a real estate agent. This background work may take only a few weeks. Or, says adviser Bert Sperling, such research "can be so much fun that you'll want to take a year or more exploring new places and seeing how they might fit your lifestyle." In any case, your efforts will be so worth it, helping you to know when to leap at a house and what price to offer. You'll want to:

- get a feel for the communities where you might want to live (if you don't already know)
- look at the houses already on the market, possibly including houses in developments, still under construction
- research the prices other sellers have recently paid for houses like the one you want, and
- gauge whether the local market is kinder to buyers or to sellers.

TIP

Eager to skip all this and just start shopping? It's possible to check out the market and keep your eye out for your dream house simultaneously—but it's harder. Without a sense of the market, you may waste your time, for example rushing to turn in a too-low bid in a hot market. Or you might waste your money, for example by bidding too high in a cool market. Give yourself time to explore and be open to changing your mind about what you want.

What's the Buzz? Checking Out Neighborhoods From Your Chair

Use the tips below to help you either find the right neighborhood for you, confirm your feelings about one you've already chosen, or open your mind to new possibilities. We'll start with the tasks you can accomplish online or by phone, then discuss visiting in person in a later section.

Where Do You Begin?

Most people have a good idea of where they want to live, sometimes right down to the street. But if you're moving from far away, you may not know your new town's uptown from its downtown, much less the names of the neighborhoods. And even if you're already a local, there are probably places on your map you haven't explored.

Starting with a blank slate lets you play tourist in your new hometown- (or neighborhood)-to-be and begin making friends and contacts. Here are some effective strategies:

- **Talk to friends, colleagues, and relatives about where they live.** Ask what they like best and least about the area—you're sure to uncover some surprises.
- **Out-of-towners: Start with whatever or whoever drew you to that town.** If it's a new job, ask your employer for staff contacts who'd be willing to share their experiences. The best people to talk to are those who've moved from far away themselves.
- **Look into where like-minded folks congregate.** Perhaps you have a particular interest or hobby, such as knitting, photography, cooking, or music. Contact some related shops or businesses (or "like" on Facebook) to find out about the local scene. Their owners or employees can share insights on where things are happening and how to join in.
- **Check websites of local real estate agents.** Many include detailed community and neighborhood information. Even if you haven't hired an agent yet, you can call one and ask for information—the agent will probably jump at the chance to display knowledge to a potential client. Most agents know a lot about different neighborhoods, or at least about one neighborhood, since many of them specialize.

What's the Neighborhood Like?

One of your biggest questions will be the character of your prospective neighborhood. Is it a place where you walk to get tapas or drive to pick up cheeseburgers? Will the local hotspot be a sports bar or a blues bar?

TIP

What about your neighbor's beliefs? Adviser Bert Sperling notes, "Perhaps the two biggest definers of local feel are things we've been told to avoid in polite conversation—religion and politics. Variety may be the spice of life, but you're going to find it very difficult to feel comfortable in your new town or neighborhood if you're the only person with a particular point of view. Do some research to find out which way a place is leaning."

Community character is one of the hardest issues to research (especially if you're completely new to the area), but these resources will get you started:

- **www.streetadvisor.com.** Search based on various filters (prices, personality, things to do, and so on) or enter a street address and see how the locals describe their area, whether it's seeing racoons at night or getting heckled by crackheads. You can also ask questions.
- **Official website of the city or county where you are house-hunting.** These typically provide welcoming information for new residents, such as demographics, crime statistics, and contact information for police departments, post offices, public libraries, hospitals, parks and recreation centers, and more.
- **Sperling's Best Places.** This website, at www.bestplaces.net, is known for its "best of" lists. Its studies will tell you the best and worst towns for everything from affordable housing to getting a good night's sleep. The site also gives statistical information, by zip code. You can find out the percentage of your neighbors who vote Democrat or Republican or are affiliated with a particular religion, the cost of living, climate, local home characteristics, and more.
- **www.neighborhoodscout.com.** This relatively new site's search tool provides reports on neighborhood residents' ethnicity, wealth, educational background, and other characteristics.
- **City-data.com.** This site compiles scads of information about specific cities and neighborhoods (cost of living, home prices, and local transportation and amenities, attractions, history of natural disasters, and news stories). Photos, too!

- **Foursquare.com and Yelp.com.** Even if you check out only the reviews on restaurants or nightlife, you'll start getting a good sense of the neighborhood. But there's much more to be found, including neighborhood reviews on Yelp.
- **Neighborhood-specific Facebook pages, Twitter accounts, or websites.** These are usually set up to alert locals to events happening nearby.
- **Wikipedia.** Don't forget this popular site, which may offer interesting information on a city's or locality's history, geography, demographics, arts, education, and resources.
- **your own, custom search.** One of the best tactics is to use an Internet search engine (like Google, Yahoo, or Bing). Says Bert Sperling, "Here's your chance to play detective and sift through all the clues to find your perfect new home. Just enter the name of any place (such as 'Oak Park, Chicago') and stand back as the search engine presents page after page of incredibly useful insights, opinions, and facts that you won't find any other way. There are blogs, message boards, forums, and specialized websites, all curated and cataloged by the search engines, which would be nearly impossible to discover by any other means."

How Safe Is It?

If you're planning to live in your new home for a long time, make sure you feel secure there. Bert Sperling notes, "Smaller cities tend to have lower crime rates than large ones; that's part of the tradeoff you make for being part of a vibrant urban scene. Still, crime in large cities is often centered in certain areas, which you can avoid." Crime statistics for cities are available at www.city-data.com. For an estimate of neighborhood crime risk, check out www.bestplaces.net, which offers crime-risk indices down to the zip code level.

The most accurate source for neighborhood crime stats is from the local police department. Most larger cities put local crime reports online, often on a city map. "Pay attention to the categories of the reported crimes," advises Bert Sperling. "An occasional car break-in may be tolerable, but not gunfire."

Best thing I ever did

Not assume an okay-looking neighborhood had low crime. Before buying her first house, Talia says, "I came close to buying a place in another neighborhood. It had looked fine when I was driving around. But my agent suggested I contact the local police station. I did and discovered that because this neighborhood was surrounded by areas where crime was much higher, it actually got its own share of break-ins and assaults. The crime rate was too high for me to feel comfortable living alone. I shifted focus to another area, where I now live and feel safe."

Safest Cities in the U.S.

These cities had the fewest violent crimes per capita, according to *Business Insider*:

1. Irvine, California
2. Fremont, California
3. Plano, Texas
4. Madison, Wisconsin
5. Irving, Texas
6. Scottsdale, Arizona
7. Boise, Idaho
8. Henderson, Nevada
9. Chandler, Arizona
10. Chula Vista, California

One crime issue that's easier to research online concerns registered sex offenders. Nearly every state has passed a law, usually called "Megan's Law" (after a young victim of abduction and sexual assault), requiring state governments to distribute information about sex offenders living in different communities. Many states have websites giving offenders' addresses (an easy way to access these is via www.parentsformeganslaw.org). Search for "Megan's Law" and the name of your state. But take the information you find with a grain of salt—not all of these websites are regularly updated, and some contain inaccuracies or misleading information.

Will the Services You Need Be Nearby?

The existence or proximity of schools, parks, shopping, and more could make or break your neighborhood decision. Fortunately, finding these is a relatively straightforward research task, with such websites as:

- **www.walkscore.com.** Shows the proximity of local restaurants, shops, schools, and other amenities and calculates the time it takes to get there by walking, biking, or using mass transit. Also delivers a "Walk Score" for each neighborhood or city.

- **www.google.com.** To estimate your commute time and distance, go to Google Maps, enter your work address and an address from the neighborhood where you might live, and receive an estimate for various commuting options.
- **www.yelp.com.** Use Yelp to find nearby restaurants and businesses, and check out their reviews.
- **www.usnews.com/best-hospitals.** This is an annual report called "America's Best Hospitals," supported by *U.S. News & World Report*. Also check out "Hospital Compare," with fact and statistics about all U.S. hospitals, presented by Medicare.gov.

Is It Zoned for How You Want to Use It?

After liberating yourself from your landlord's rules, you might be less than excited to discover that the home business you'd always dreamed of starting is prohibited, or that you can't turn the garage into an in-law cottage or add a second story. Local zoning rules or other city regulations (even criminal laws) are usually to blame. It's also worth knowing what general uses the neighbors are allowed.

First, find out from the municipal planning and building department what zoning category each neighborhood you're interested in falls into. A classification called single-family residential is the norm. But some neighborhoods with ordinary houses might actually be zoned for multifamily residential, transitional, or a mixed use such as residential plus commercial. One of these other classifications might be good for you. For example if a home business is in your plans, mixed commercial and residential might be perfect. But these alternate classifications can also be a problem, particularly when it comes to your neighbors' future plans.

It's the Law!?

There's probably a story behind these:

- University City, Missouri: You're not allowed to have a garage sale in your front yard.
- In Boston, you can't permit manure in your home. It's okay in your stable, but "no more than two (2) cords" of it at a time. (Let's hope Bostonians know how much a "cord" is.)
- Boulder, Colorado: You can't put indoor furniture outdoors in your yard.

Multifamily zoning, for example, might mean the house next door could be replaced with an apartment building.

Also realize that zoning ordinances usually deal with more than how the property can be used. They typically dictate the allowable square footage of a home and sometimes how tall it can be and where it can be placed on the property. A home may have to be set back a certain distance from the street and be a certain distance away from neighboring homes. This can affect your plans to add an extra room or deck.

Research the zoning and other municipal rules further—ideally with the help of your real estate agent or attorney—if any of the following are true:

- **You intend to operate a home business.** In an area zoned residential, take a careful look at the local rules—they don't always give a clear thumbs up or down. Some, for example, prohibit home businesses in general but allow exceptions, such as for writers, artists, accountants, consultants, and other businesses that are unlikely to cause noise or traffic problems. Even then, a city ordinance may prohibit you from employing anyone on-site who doesn't actually live in your home. To find out local rules that may apply to your business, contact the planning or zoning department for the city or county you plan to live. Finally, If you're buying a condo, co-op, or similar property, be sure to check any restrictions on home businesses. Also talk to other local home-business owners about the restrictions, and whether their neighbors have raised any fuss.

RESOURCE

Planning on starting a home business? Check out the articles on home businesses in the Business Formation and Taxes sections of Nolo.com. And for detailed information, including more tips on zoning, see the Nolo books *Legal Guide for Starting & Running a Small Business*, by Fred Steingold (or the *Women's Small Business Start-Up Kit*, by Peri Pakroo). Also check out *Home Business Tax Deductions: Keep What You Earn*, by Stephen Fishman (Nolo), which discusses issues like when you can deduct general home maintenance.

- **You plan to remodel the house or garage or add other structures (even a fence, pool, or child's tree house).** Rules for changing an existing house can be notoriously sticky and require permits. Local view ordinances may restrict your ability to add a second story. You might talk to a local architect in advance—they're used to dealing with, or getting around, the rules.
- **You plan to park a boat, RV, or large vehicle in your driveway.** Some city planners have decided this doesn't look so good.
- **The house has historic landmark status, or looks like it should.** Once a house is so designated, any remodeling—even basic things like a new paint job—may be subject to rules on style and color. Still, owning a historic home can be personally satisfying and offer high resale value if you restore it.
- **You plan to cut down a large tree.** Yes, your landscaping may be a topic of separate regulation, excluding shrubs and flowers.
- **You have any other special plans for the property.** Local rules are limited only by the imagination of the local government. Bizarre ones sometimes pop up in response to one homeowner's inappropriate actions, like having put up too many holiday lights.
- **Vacant lots are widespread in the neighborhood, or you see a lot of new construction.** You'll want to know what might legally be built there.
- **You plan on keeping any farm animals such as roosters or a goat.** They may well be prohibited.

If you're thinking of raising chickens in your backyard, check out BackYardChickens.com, which includes everything from links to local laws to reviews of different types of breeds. Citychicken.com also collects local laws. Or, If you're planning on becoming an amateur beekeeper, know that some cities prohibit bees, while others allow them if immediate neighbors provide written permission. One place to start your search is the Apiary Inspectors of America website, www.apiaryinspectors.org.

Which celebrities keep chickens?

The likes of Barbra Streisand, Tori Spelling, John Cleese, Reese Witherspoon, Jennifer Aniston, and Rachel Weisz are reported to share their properties with feathered, egg-laying friends.

Is It a Planned Community, With Restrictions on Homeowners?

If you move into a community interest development (CID), you may find your choice of house paint colors limited to white, white, or white—and that's just for starters. The homeowners' associations that oversee such communities often regulate how individual homeowners are expected to treat and use their property (such as fence style in a detached house or curtain color in a condo or co-op). A home located in a traditional subdivision consisting of lots may also be controlled by subdivision restrictions.

For now, just realize that these sorts of restrictions exist, and plan to research them further if you look at a CID.

How Good Are the Local Schools?

If you have children, or plan to, then the quality of the local school district is probably high on your list. But even if you don't plan on children, you should be concerned with school quality, because the *next* family that buys your home might want children. And they'll pay more if the local schools are great.

To get statistical information about how schools perform in your state, check your department of education website, usually accessible from your state's main Web page. Other good online resources include:

- **www.greatschools.org,** a national, independent nonprofit organization, it helps parents choose schools and support their children's education, and provides ratings and comments by parents.
- **www.education.com.** Presenting information and statistics about local schools, with ratings and parent reviews.

Best thing I ever did

Visit local public schools. Violet says of her family's move from Connecticut to Pennsylvania, "Our criteria for choosing a neighborhood were: school district, school district, and school district. We'd heard there were two excellent districts close to my husband's new job. So I took my son and daughter to visit the principals and teachers and watch classrooms in action. The school in one of the neighborhoods had great classroom morale, lots of activities, and ethnic diversity. Wouldn't you know it, the houses in that neighborhood were mostly million-dollar-plus McMansions. But we found a fixer-upper we could afford. It was worth the hard work to make it livable—the kids love their school."

See for Yourself: Driving Through Neighborhoods

You can tell a lot about an area by cruising through it, most likely by car. When you get a real estate agent, he or she will also drive you around, but it's good to go on your own first, free to explore the seedier spots. You may find yourself thinking, "I could live here," or "Get me out, fast."

First, open an online map, and locate the areas where you might like to live. Do yourself a favor and print out some of the maps, so they're easier to consult while you're driving around. And, you can make notes for later reference. Pay special attention to places on the map you've never been that are close to or within your highlighted area. Then systematically drive up and down the streets, imagining yourself living there. (The character of a neighborhood can change in the space of a city block, or right after a natural divider such as a freeway, park, or large housing complex.)

Look beyond the houses and think about whether the local features fit your lifestyle—would you, in fact, walk to the bus stop, garden in the front yard, or jog at the local track? Focus on questions like:

- **How well are the homes maintained?** Neat homes and yards are signs that homeowners feel invested in their properties.
- **Who's around?** You can tell a lot about a neighborhood by who's out and about, whether it's children on bicycles or post partiers walking to breakfast joints on Saturday morning.
- **How's the traffic?** Are people driving sanely or zooming around with music blasting? Does the major street leading to the neighborhood become a noisy parking lot during rush hour?
- **What types of local businesses are there?** Franchise chains, funky coffee shops, and upscale restaurants could become your favorite hangouts—or you could be in for frustration if your favorite cuisine is nowhere to be found or there's no dry cleaner nearby.

- **Look for indicators of future growth.** Is there a light rail line being built nearby? Are there bike lanes, or nearby transit stops? "These transportation alternatives are very much in demand right now," notes Bert Sperling. Also look for new "infill" housing, small apartment buildings, and mixed-use structures (with shops on the bottom, apartments above.) Sperling adds, "These are all bets that smart investors are placing on the growth of an area."
- **Check the signs.** Literally. If you see lots of "For Sale" signs, it *could* mean people are moving out, and you'd want to know why—a new factory or mini-mall being built nearby? A surge in crime? You'll either have a greater chance of snagging a bargain, or you may decide to look elsewhere. On the other hand, a lot of homes for sale could also mean the neighborhood is hot, hot, hot!

If you like what you see, you might even add another color highlighter to the map, showing your favorite streets (useful for cross-referencing with later home sale ads). You're guaranteed to find a surprise or two.

Lesson learned the hard way

The grill's going every night! Barry is a vegetarian, while his girlfriend Ann is not. After a long search, the couple found an adorable house near a commercial street dominated by Korean restaurants. Barry says, "We carefully had the house inspected and talked to the neighbors about safety. But we'd visited the house only in daylight. Our first evening after we moved in, we noticed a cloud of aromatic smoke coming from a nearby Korean barbecue. I was horrified, and Ann started mischievously suggesting sneaking out for a bite. We love the house, but it took awhile to get used to the permanently barbecue-scented night air."

On Foot: Talking to the Natives

There's probably no better way to find out what a certain neighborhood is like than talking to people who already live there. Pick a day when you're feeling relaxed (preferably not open-house day). Then walk around, paying attention to smells and sounds. (Cocooned in your car, you might not notice odors coming from a nearby brewery, airplane or freeway noise, the buzzing from a local generator, or rowdiness at a nearby commercial strip.)

Talking to people in neighborhoods still under construction is obviously harder—but it may be possible if you're not the first to buy. Or, you can look in surrounding developments to get a general feel.

Look for people out gardening, or walking their dogs. It might feel funny to strike up a conversation with a stranger, but complimenting said garden or dog is a pretty reliable conversation starter. Explain that you're thinking of buying, and ask questions like:

- What do you like most and least about this area?
- Which streets are considered the best to live on?
- Do you feel okay about walking outside at night?
- Do you have kids? Do they go to public school here?
- Are there any changes planned that will make the neighborhood better or worse (such as a new development, changed policing system, or pending school initiative)?
- What kind of person would be happiest living here?

ONLINE TOOLKIT

Use the "Questions for Talking With Locals" worksheet in the Homebuyer's Toolkit on the Nolo website. It includes the questions above, as well as space for your notes. (See the appendix for the link.)

Coffee shops and local restaurants are also good places to meet people, including the business owners. And even on open-house days, you can meet a lot of locals and talk to real estate agents about community issues (though the agents won't be offering up much negative information).

Sunrise, Sunset: Getting Day and Night Perspectives

There's a reason open houses are usually scheduled on Sunday afternoons: The sun is high in the sky, the neighborhood is quiet, and no one's working. Life couldn't be better! To plug back into reality, though, try visiting a neighborhood at different times of the day or week. In neighborhoods with lots of local schools, it can sound like a parade is passing weekdays around 3:00—and then the insanely bright floodlights at the football field click on after dark. Neighborhoods located in lovely little gulches or valleys may seem dull by early afternoon, when they lose their daily dose of sunshine. And late at night, if you see more tough-looking characters hanging out on street corners than dog walkers, you might want to recheck those crime stats.

Best thing we ever did

Drive through the neighborhood at night. Sam and Kari were looking to buy a place at a time when the market was crazy and their options limited. According to Sam, "When we saw a nice, affordable house right on the border of a good neighborhood, we were so excited! On a whim, we drove back later that night. There was a whole other side to that neighborhood: Cars slowly cruised by blaring music, and loud groups loitered around, drinking and smoking. Seeing our bewildered looks, an elderly neighbor asked whether we were lost, then advised us, 'Don't buy here; it's not safe. I'd get out if I could.' We took her advice and are so glad we took that evening drive."

Got Houses? Finding Out What's Locally Available

By now, you've probably narrowed down your search to specific neighborhoods. So, you're probably curious about what's for sale there right this minute. It's the easiest research task you'll ever take on, thanks to widely available advertisements, in:

- **Realtor.com.** This is the granddaddy: the MLS database of homes for sale kept by Realtors® nationwide, and once guarded as closely as the Coca-Cola™ recipe. Now you can usually access it—or selected portions of it—for free on various websites. Start with the National Association of Realtor's (NAR) website, www.realtor.com. It also offers an app, with a direct feed to current listings. Or, try searching for "MLS" and the name of your state or city. (The homes won't change much, but the formatting will.)
- **Trulia.com.** This well-designed search engine offers attractive features like the ability to search by type of home (such as single-family or

condo), to limit your search to foreclosures or houses where the seller has already reduced the price, and (under "Local Info"), colorful maps that show you average list prices by zip code. Trulia also offers an app (www.trulia.com/mobile), which allows you to quickly locate nearby homes for sale and open houses.

- **Zillow.com.** The website offers extensive listings of homes for sale, including FSBOs and foreclosures. And with its award-winning mobile app (www.zillow.com/iphone), you can not only pull up a map that shows homes for sale near your exact location, but save your favorites and sign up for notifications of when new listings hit the market or old listings drop their prices.

TIP

The farther you get from the original MLS, the greater the possibility for inaccuracies. Although many websites draw from the MLS, they're not always as quick to update listings—for example, when a sale is pending. So you may fall in love with a home on-screen only to discover that it's no longer available.

- **Real estate sections of city or community newspapers.** City papers often have online classifieds, but don't forget tiny community papers—they sometimes have the best classifieds, because they're devoted to a limited geographical area.

ONLINE TOOLKIT

Wondering what FB, HDWD, or S.S. Kit means? You must be reading a paid-by-the-word ad. For some deciphering help, check out the "Common Real Estate Abbreviations" list in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.)

- **The Owners Network at www.owners.com.** These homes (so-called "FSBOs") are being sold without help from real estate agents, so they may not appear in the MLS. Also try www.forsalebyowner.com. For more on buying a FSBO, see Chapter 9.
- **Websites sponsored by local real estate brokers.** Some brokers provide photos, neighborhood information, and advice. Try local Re/Max

Realtor®'s websites, for example. Or, just enter a search phrase such as, "Chicago real estate," and you'll find all the big real estate firms and many smaller ones specializing in the local area.

- **Looking for a newly built home?** Check out www.move.com (by the National Association of Home Builders), where you can refine your search with criteria such as "Green Features" or "Pool." Also worth checking are www.newhomesource.com (with extensive information on custom, "build-on-your-lot" builders) and www.americanhomeguides.com. It's best to search all three sites; each gives different results.

And you can always do a general search, such as "houses for sale in Ithaca, New York," to make sure you haven't missed anything.

How Much Did That One Go For? Researching "Comparable" Sales

All the houses you see advertised come with a price tag—but the price may have little to do with reality. How much a buyer actually pays will probably vary from the list price, up or down, by thousands or even tens of thousands of dollars. In a cool market, many sellers have an inflated idea of what their house is worth, and it eventually sells for less. In hot markets, some sellers set an artificially low list price in hopes of attracting a large pool of potential buyers, which results in outrageously high bids.

There's no sense in choosing—or eliminating—a neighborhood or area based on price until you find out how much houses there are *really* selling for. (Later, such knowledge will ensure you don't pay too much or offer too little for a particular house.)

Look at final sale prices of houses comparable to the type you're interested in, or "comps." The most accurate comps come from houses that sold recently (preferably within the last six months) within the same general area (around six blocks) and with the same basic features as the house you hope to buy (like number of bedrooms, square footage, garage, neighborhood, lot size, general condition and construction quality, and landscaping).

You'll never find two exactly comparable houses, so do your best to take a sort of average. Your agent, once you're working with one, will also be able to give you this type of information, with even more recent data. And when you're ready to bid on a particular house, the agent may draft up a report on the comps. But for quick and dirty comp data, use the websites listed below.

CHECK IT OUT

Here's where to get comparable sales data. A number of free online services track the prices that homes sold for. Two cautions apply, however: One, the listings and estimates may be out of date, or just plain out of whack, since they're generated by a computer, not a person. Two, beware of signing up to be contacted by an agent.

- www.zillow.com (under "Homes," click "Recent Home Sales")
- www.trulia.com (under "Buy" click "Recently Sold Homes" and enter search information such as a zip code or a neighborhood name and city).

EXAMPLE: Paul and Leslie want to buy a three-bedroom house in Ardmore, Pennsylvania. They take the address of one such local home and pop it into one of the websites above. The closest matches are a three-bedroom, one-bath house that sold for $250,000 three months ago; a three-bedroom, 1½-bath house that sold for $275,000 five months ago; and a three-bedroom, one-bath that sold for $228,000 six months ago. Without looking at the actual houses, they project that they'll need to pay somewhere in the mid- to high-$200,000s for the house they want. They might also posit that prices are rising, that the house currently for sale may be overpriced, or that adding a one-half bath can measurably raise the value of a house. Unfortunately, websites don't tell you about details such as house style, condition, landscaping, or charm. As Paul and Leslie start visiting actual houses and working with a knowledgeable agent, they'll have a chance to sharpen their understanding of local house values.

Eventually, your knowledge of sale prices will turn you into a sort of amateur appraiser and help you decide on the appropriate price for houses you're looking at. Don't discount the value of your own research and intuition: House values depend partly on buyers' subjective responses to them, and you're a buyer. Placing an exact market value on a house is an inexact science, though appraisers, real estate agents, and sellers do their best to come close.

Hot or Cold? Take the Market's Temp

To figure out home values, you also need to know whether you're in a market that's primarily hot or cold (or balanced somewhere in between). At local open houses, do you have to wait in line just to squeeze up the stairs, or do you find yourself all alone with a chatty seller's agent? When talking with friends and neighbors about homebuying, do they tell stories of how being outbid on houses drove them to couples' counseling, or how they're plotting how to get a bargain from a seller whose house has languished on the market for weeks? These are just a few of the more extreme indicators of whether the local—emphasis on the word "local"—housing market is hot or cold.

A hot market means there are more buyers than sellers, or not enough houses on the market to satisfy demand. As soon as a house is listed for sale, it's snapped up, and sellers can be inflexible about the price and buyers' other negotiating requests. In the hottest markets, sellers may pit you against other buyers competing to offer the highest price, the shortest closing period, and the smoothest transaction.

A cold market means there are more sellers than buyers, and houses may remain on the market for months at a time, waiting for a buyer. If, as happened a few years back, this is coupled with a major economic downturn, foreclosures can flood the market and bring down prices. This gives the buyer leverage when negotiating, because the longer a seller has waited, the more desperate he or she may be to unload the place. Meanwhile, sellers know that you have other options.

TIP

Markets can be lukewarm or mixed, too. As Realtor® Mark Nash notes, "Hot and cold is a generalization. For example, in some markets, starter single-family homes could be hot, and penthouse condos could be cold."

The urgency of your house search, and your approach to sellers, will all be shaped by knowing whether you're in a market that's hot, cold, transitional, or balanced in the middle. It's not hard to figure out the basic "hot or cold?" question—as long as you focus in at the neighborhood level and aren't fooled by general headlines. The more difficult part is to gauge where the market is going—a market can move up or down in a matter of weeks.

The housing market can be affected by the local and national economy, mortgage interest rates, the availability and cost of housing (including rentals), the supply of and demand for homes (which can vary by time of year), and more. Scads of real estate commentators make their living trying to predict what's next, but none know for sure. Nor do they specialize in the corner of the world you're looking at, which might have its own mini hot and cold regions.

You'll develop a sense of where your local market is going once you start seriously househunting. If, after several weeks, you find yourself able to predict the asking prices of newly offered homes, the market is probably pretty stable. If, on the other hand, you notice open house or "price reduced" signs on houses you looked at a few weeks ago, the market is probably plateauing or cooling. And if you've been outbid on a house or two and notice that the list prices of similar houses seem to be inching out of your range, the market is heating up and you'll need to act quickly. A real estate agent can also tell you about trends, based the increasing number of listings in their MLS database and the average time that houses stay on the market.

TIP

Don't put your life on hold trying to predict the future. For every person who waited for the market to drop and got a good price, there's another one who watched it pass them by. Just find a house you want at a price that's fair and affordable at the time. If you're planning to stay there for more than a few years, you'll weather any downturns.

Lesson learned the hard way

Waiting for the downturn that never came. Eva, an artist, says, "At one point, I thought I'd never marry and decided to buy my own house. I began looking, accompanied by my dad, who'd offered to pitch in on the down payment. But every time I found a place I liked, my dad said, 'That's way too much, prices will come down soon.' He said that first about houses in the $200,000 range. Then I watched as similar houses started selling for $300,000, then $400,000. I bought a tiny place soon after, which fortunately has since risen in value. But it kills me that I could have had it for much less a couple years earlier—or could have had a bigger house that would fit my, guess what, husband and new baby!"

Just Looking: The Open House Tour

Visiting open houses—where sellers throw the doors open to just about any interested party—is educational, free, and fun. For now, don't look only at houses that are smack dab in your price range. By looking at too-expensive and too-cheap houses, you'll get a feel for what various house features—like another bedroom or an updated kitchen—are worth.

As you visit open houses, compare their features to your Dream List, to get a sense of which items will or won't be easy to find. Now's a good time to refine your list, too, if you realize that "a fenced yard would be great," or "I can't live next to an apartment complex."

Remember, unless you're ready to read the rest of the chapters and ramp up your activities in a hurry, don't fall in love with a house yet. You're still getting to know what's out there. In later chapters, we'll discuss how to take a hard look at a particular house—evaluate its physical condition, whether it's priced appropriately, and whether it meets your long- and short-term needs—as well as how to prepare an appropriate offer.

If a house really does look perfect, and you can't resist, at least heed this final warning: Don't sign anything on the spot. You may meet an oh-so-friendly agent who says, "I can write up your offer, no problem!" That agent represents the seller, whose interests, including getting the highest price and the most advantageous terms, will be put first. Go home, take a deep breath, look at later chapters of this book, and do some quick shopping for a buyer's agent—if you really want to buy that house.

Best thing we ever did

Just start looking. Fiona was more convinced than her girlfriend that they could handle the financial commitment of a house. Fiona says, "Even after we'd done our research, had a mortgage broker evaluate our finances, and asked our parents to pitch in on a down payment, she resisted going to open houses. According to her stressed-out logic, we weren't *really* ready, so it was a waste of everyone's time. Finally I got her out looking, and it was great—seeing open houses suddenly made the process fun. Of course, it was also a reality check, since we realized we could afford less than we'd thought. But we ended up finding a wonderful house, with great neighbors."

Nothing to Look at Yet? Finding Your Dream Development

If you're thinking of buying a newly built home, your community-to-be may look like a large sandbox. But that doesn't mean you can't do advance research. Your most important task will be to choose the best-quality developer before you go any further. Why? Well, as with any other product, different house manufacturers make different quality products, or have different track records for reliability. You don't even want to go near a house built by a developer at the low end of the quality spectrum, or who's teetering on the edge of bankruptcy, no matter how affordable it seems.

Figure out which developers are working in your area, which are worth buying from, and whether they offer the types of houses you want. To find developers, use the websites listed under "Got Houses? Finding Out What's Locally Available," above. Then use the following tips to research them:

- **Talk to people.** This includes others who have purchased from a particular developer, local contractors, real estate professionals, appraisers, and city planning staff. Don't stop until you've gathered information about each local builder's reputation from a variety of sources.
- **Ask tough questions of the developer and others.** You'll want to find out how long the developer has been in business; how well funded the business is; whether it's ever been sued and for what; and the

credentials of the developer, its employees, and contractors. Don't just take the developer's word for it—double-check with your state's licensing board and the local building office.

- **Search online.** To hear feedback from other consumers, try searching Internet blogs, local newspaper websites, and homeowner-run websites such as HomeOwners for Better Building (www.hobb.org). Also search for local news stories about the builder or developer to see whether complaints have arisen about the quality of the homes or other sensitive issues.
- **Call your local Better Business Bureau.** It's often the first place that people turn to with complaints about local developers.

What's Next?

You've hopefully gotten a sense of which neighborhoods not only have a character you like, but offer the safety, schools, or other amenities you need. You've also gotten a sense of the local market and whether it offers houses you might want at a price you can afford. You're almost ready to do some serious house shopping. But first, let's figure out who's going to help you do it.

CHAPTER 5

Select Your Players: The Real Estate Team

Meet Your Adviser

Fred S. Steingold, an attorney and author based in Ann Arbor, Michigan.

What he does Fred's legal expertise includes real estate and business matters. He has helped hundreds of homebuyers with key tasks like drafting and reviewing sales contracts, checking title insurance commitments, and looking over closing documents. Fred is a coauthor of the Nolo book *Negotiate the Best Lease for Your Business* and the author of several other Nolo books.

First house "An 1,100-square-foot ranch house in an Ann Arbor subdivision, with just enough room for our two young children. I fondly remember sitting on the back porch during long summer evenings and walking to nearby University of Michigan football games on crisp autumn afternoons. But I don't miss the small size of that house, and the crank-open windows with gears that were always getting stripped."

Fantasy house "Any house designed by Sarah Susanka would be fun to live in. She's an architect in Minnesota and the author of a series of books on not-so-big houses—they're sparkling gems with alcoves, woodwork, and interesting lighting. She knows how people want to live." (Note to readers: Check out Sarah's work at www.notsobighouse.com.)

Likes best about his work

"The range of people I get to work with. My first-time homebuyer clients are always so excited—and often more than a little nervous. I like walking them through the process and helping them overcome problems with the seller, the lender, and sometimes with their own real estate agent. Once in while, a purchase is about to fall apart over some knotty detail, and I can come up with a creative solution to save it. It's all part of helping these (usually) young buyers move up in the world."

Top tip for first-time homebuyers

"You're probably expecting me to give law-related advice, but I'd say have a thorough inspection! Most us don't know how to spot a potentially leaky basement or roof, or other expensive problems. But an experienced inspector can give you a heads up so you can opt out of the deal or have repairs made on the seller's dime. And if you're having a house built for you, make sure to learn about the builder's reputation. You'll be extremely frustrated if the new house isn't ready until eight months after the promised date—or if you have to chase the builder to get postclosing warranty work done."

Buying a first home is a complex process, and there's no reason to do it alone. You can bring together a team of experts who've seen it all before (many times!). They'll not only help you understand what you need to do but also perform key tasks themselves. Your real estate team should likely include:

- a real estate agent, who will help you find, negotiate for, and complete the purchase of your home
- a mortgage broker or banker, who will help locate the best financing
- a real estate attorney (in several but not all states), who will make sure the deal is properly and fairly drafted and that the seller has good title
- a home inspector, who will examine the property's condition for defects, and
- a closing or escrow agent, who will help ensure that the transfer happens smoothly and on time.

Unlike a sports team, these players may not work together directly. But even if they never meet, they share a common goal: to help you purchase your house on the best possible terms. Still, you're the boss (and the checkbook), so you'll want to be confident about your players and their abilities. In this chapter, we'll explain each person's role and how to select top players.

Your Team Captain: The Real Estate Agent

Your real estate agent has the broadest role of any team member: You'll work together from start to finish.

Who Real Estate Agents Are

You've probably heard different names—broker, agent, or Realtor®—used to describe real estate agents. These convey different levels of experience, training, and knowledge.

- **Agents.** A "real estate agent" is the most generic of the choices. Agents must be licensed in the state where they work. This usually means completing 30 to 90 hours of classroom instruction, passing an exam, and renewing their licenses every one or two years.

- **Brokers.** A real estate broker is, in most states, one step up from an agent. Brokers have more real-estate-related education and experience. In many real estate agencies (also referred to as "brokerages"), the buyer works with an agent on a daily basis, but the agent is supervised by a broker. If the buyer has problems the agent can't resolve, the broker will handle them. In smaller, independent agencies, the buyer may work directly with a broker. When we use the term "real estate agent," we're referring to both agents and brokers. And in fact, some states blend the terms, allowing all real estate agents to call themselves brokers. In Washington State, for example, an agent who has met the basic qualifications is called a "designated broker," as distinguished from the more elevated "managing broker." Arizona and Oregon make the distinction between brokers and principal brokers. Other states may call the junior brokers associate brokers or something else. Bottom line: Ask any agent you might hire for the details on his or her licensing designation and check your state's department of real estate licensing for confirmation and more information.
- **Realtors®.** Over half of all licensed agents are members of the National Association of Realtors® (NAR), a trade association. NAR members can use the designation "Realtor®." They must comply with the NAR's standards of practice and Code of Ethics. Membership also suggests that the agent is up-to-date on real estate issues (because NAR provides training, member newsletters, and other resources) and has a network of contacts through the organization.

Real Estate Agents on the Silver Screen

- Annette Bening plays Carolyn Burnham in *American Beauty.*
- Jack Lemmon, Kevin Spacey, Alan Arkin, and Ed Harris play competing agents in *Glengarry Glen Ross.*
- Julianne Moore plays Marlene Craven in *The Hand That Rocks the Cradle.*
- Craig T. Nelson plays Steven Freeling in *Poltergeist.*
- Silvia Miles played a real estate agent in *Wall Street.*

Realtors® may also have advanced designations/certifications through the NAR and its affiliate organizations. You're particularly interested in the Accredited Buyer Representative (ABR) or Accredited Buyer Representative Manager (ABRM) designations, given to Realtors® or brokers specializing in representing buyers.

What Your Agent Does for You

Your real estate agent is your team captain, answering to you but coordinating other players and handling multiple tasks. Expect your agent to:

- **Suggest neighborhoods.** Although this book helps you look for the right neighborhood, your agent should be able to pinpoint possible locations. Ideally, your agent will live in or around the area you're interested in and give you an insider's perspective.
- **Show you comparable sales data.** To help you gauge the market value of any house you're interested in, your agent should compile a written report (called a comparative market analysis, or CMA) of comparable properties ("comps") that sold in the last three to six months. (If prepared by a broker, the same report may be called a "broker's price opinion," or BPO.)
- **Find prospective homes that meet your needs.** You'll tell your agent how much you want to spend, what physical characteristics are important to you, and what type of neighborhood you're looking for. A good agent will search for properties that meet your criteria and show them to you as soon as they're available. Any competent agent knows that this task may take one day or one year—in either case, the agent will patiently help you find what you're looking for.
- **Walk through prospective properties with you.** Your agent will actually take you to look at properties, too. Your agent acts as another set of eyes, helping you think about practicalities (like whether the house provides enough storage space or has an impractical floor plan), and spotting potential problems (like a water stain on the ceiling indicating a possible leaky roof, or an old plumbing system in a sparkling new kitchen). The agent might also suggest easy-to-make improvements, such as converting an unused nook into a home office space. The agent will coordinate a second and even third showing, if needed.

- **Draft a written offer and negotiate the sale.** In the majority of states, your agent will help you draft an offer or other written statement that includes your offer price and terms. In other states, a lawyer would do this. (The offer process will be discussed in detail in Chapter 10.) The agent will also ensure you receive any legally required disclosures about the physical condition of the property. After your offer is accepted, the agent will act as an intermediary between you and the seller, negotiating over issues that come up, such as repair needs identified by your home inspector. Adviser Daniel Stea urges, "Make sure your agent has the ability and commitment to negotiate the best price on your behalf. Too many are so eager to get into contract or to move the deal to the next step that they push less hard than they could have."

Who's the typical Realtor®?

According to the National Association of Realtors®, most of its agent members:

- earn about $47,000 per year
- have been in the field for about 12 years, and
- are approximately 56 years old.

- **Explain the process.** Your agent should (beginning at your first meeting) be able to summarize the process of and timeline for searching for homes, writing an offer, finding and applying for financing, opening escrow, checking title, obtaining homeowners' insurance, removing contingencies, and closing the deal.
- **Open escrow.** Your agent should open escrow for you (help begin the process of finalizing your purchase) or give you recommendations for a reputable escrow or closing company or real estate attorney (depending on what state you're buying in). (In some states, however, the seller customarily chooses the escrow or closing company.)
- **Manage day-to-day activities leading up to the closing.** Once your offer is accepted, you have a lot to accomplish before the deal is finalized, such as scheduling home inspections, lining up financing, and getting insurance. Your agent should guide you through each step, either handling the tasks directly or working with the appropriate professionals. Your agent should also be present for major events like inspections, the appraisal, the final walk-through, and the

closing. And if your sales contract contains contingency clauses, your agent can help make sure that you comply with the deadlines for contingency removals.

Will You See More of the Agent or an Assistant?

Experienced, busy agents will often be serving a number of clients simultaneously. They may not, for instance be available to walk through a home with you on a moment's notice. Such agents may work with a team of fellow agents or assistants and ask one of them to step in for matters such as this—then return to your side for important matters such as negotiations.

Should you be worried about getting "pushed off" onto an assistant? As with many things, it depends on the quality of the agent. An excellent agent will have a well-trained team, every member of which you can trust to give you the help you need. You should perhaps be just as worried about hiring an inexperienced agent who has all the time in the world to help you.

Still, when establishing your relationship with the agent, it's worth asking who exactly you'll be working with and how accessible you can expect your agent to be.

Make Sure Your Real Estate Agent Plays for You

Real estate agents make a living representing one of two parties: the buyer or the seller. Since most agents have several clients at a time, they often represent both types in different transactions, sometimes selling houses for sellers, other times helping buyers purchase houses.

Usually, this isn't a problem unless the agent simply takes on too many clients and gets stretched thin between competing tasks. However, it can become one when the agent who is selling a house for one client has—or takes on—another client who wants to *buy* it. Then the agent could act as a "dual agent."

This frequently results when a prospective buyer visits an open house, expresses interest, and the seller's listing agent says, "Don't worry that you don't have an agent yet, I'll write the deal up for you." Adviser and realtor®

Daniel Stea says, "Buyers too often fall for this, thinking it might save them money—which it likely won't—or because the listing agent implies that the buyers might have a better shot at getting their offer accepted this way. In reality, the listing agent may simply be attempting to generate a second commission by representing the buyer." In rare cases, the selling agent may even claim that you have to use that agent's services, because he or she found you first!

You can imagine the potential problems when one agent represents two parties with opposite interests: While the buyer wants to buy the place for as little as possible, the seller wants to sell for as much as possible. Back when dual agency was more common, many buyers who'd told their agents that they were willing to pay more for a house than they'd offered were appalled when their agents turned around and told the sellers that exact information.

Real-Estate Fiction

- *Death by Real Estate*, by Maggie MacLeod (Daybreak Publishing): Barb Parker is a mystery-solving real estate agent.
- *Closing Costs*, by Seth Margolis (St. Martin's Press): Five couples try to survive the cutthroat Manhattan real estate market.
- *Good Faith*, by Jane Smiley (Anchor): A divorced real estate agent is lured into a development deal by a newcomer to his small town.

These days, if an agent wants to represent both sides, most states require that the agent get written consent from both parties. But it's not a good idea to consent to this. You want someone who is on your team all the way. Your safest bet is to get your own, buyer's, agent—one contractually bound to represent only you (though your agent must still be fair and honest with the seller).

One good way to find out whether your agent will ever be a dual agent is to ask, before hiring, "Will you ever represent me in a dual agency?" Only work with agents who say "no." If you become interested in a property listed by that agent, he or she can help you find another agent to complete the deal.

In a similar situation called a designated agency, you're represented by one agent, and the seller is represented by another agent who works in the same brokerage. In states where designated agency is allowed, all parties must normally agree to it in writing. The risk of divided loyalties is much less than with a dual agency. Still, you'll want to be confident that your agent is trustworthy and be careful about what you disclose.

Finally, on the other side of the table sits the seller's agent, often called the "listing agent." The seller's agent is hired by the seller. While the seller's agent is ethically and even legally bound to be fair and honest toward you, this agent focuses on representing the seller's best interests. You want the seller's agent to remain where he or she belongs—on the other side of the table.

How Real Estate Agents Are Paid

After hearing about what a good agent can do for you, you may start mentally calculating whether you can fit one into your budget. The good news is, your agent is one person in this process you *won't* have to hand money to. The seller ordinarily pays the entire commission (averaging 5% to 6%), which is split between the seller's agent and yours (usually, 2½% to 3% each). You do end up indirectly paying for your agent's services, though, because the seller will probably factor the cost of paying both agents into the purchase price of the home.

Some people will tell you that agents are mainly out to make buckets of money, by maximizing their commission and minimizing the amount of time they spend with you. They caution you that agents will show you only properties above your price range, push you to offer too much, or rush you into a purchase.

It's true that the more you spend, the higher the agent's commission goes. However, to say that agents are solely motivated by money is an overgeneralization—in fact, it's often not in the agent's own interests to behave this way. If, for example, you're pushed to offer an extra $10,000 on a home, and then don't qualify for the mortgage, the agent will have wasted a lot of time. Or what if you pay the extra $10,000, then feel the agent trapped you into it? You'll never use that agent again and will tell your friends not to, either. Neither prospect will appeal to the professional, experienced agent you'll be choosing—not to mention the fact that an extra $10,000 on the sales price adds up to only about $150 in increased commission.

To avoid a possible misunderstanding about how your agent gets paid, make sure there's a written agreement between the two of you. This should spell out the extent of the agent's expected services and your financial obligations, and deal with other matters such as whether you'll go to mediation in the event of a dispute. No need to sign this immediately—many agents will wait until you're ready to submit your first offer (at which time such an agreement is required in some states and by some real estate companies). Before signing this agreement, however, it's not good form to give more than one agent the impression that you've chosen him or her to help you find and buy a home!

Using an Agent When Buying a Newly Constructed House

When buying a new house from a developer, or having one built for you, you can be represented by your own real estate agent. However, the agent usually needs to be with you on your very first visit or the developer won't allow the agent to collect the commission or referral fee.

Developers usually have salespeople, paid by and loyal to the developer, who they'd prefer to have you use for the tasks your agent would normally handle, such as drawing up written agreements. Of course, these usually favor the developer, for example, limiting the developer's responsibility for shoddy work or late completion. It's worth bringing your own agent to advocate on your behalf and help you negotiate a fair deal.

However, if you're represented by an outside agent, the developer may, as a way of recouping part of the commission or referral fee (particularly in a hot market), be less flexible about price or less willing to give special incentives or upgrades.

TIP

Consider adding an attorney-review contingency to your contract. If bringing your own real estate agent appears unnecessary or impossible, at least insist that an attorney review your agreement. You can make this a condition of the sale (a "contingency"), as discussed in Chapter 10.

Getting the Best Agent Out There

It's worth putting some effort into finding an experienced real estate agent with whom you'll enjoy working. You could just walk into any real estate agency, but you'd probably end up with whoever had time to spare. Instead, start by getting recommendations from family members, friends, colleagues, or neighbors who've bought homes—particularly in the neighborhoods you're interested in.

If you come up dry, check out the NAR website at www.realtor.com, and click "Find REALTORS®." Yelp, Zillow, Trulia, and Realtor.com are also becoming rich sources of agent reviews. Your state association may also provide similar information. But keep in mind that this is a membership listing based on location and doesn't distinguish between good and bad agents.

CHECK IT OUT

Check their license. To make sure a prospective agent is currently licensed in your state, visit www.arello.com, the Association of Real Estate License Law Officials. The site can also link you to relevant laws and regulations.

Once you've got a few names, choose a few agents to meet in person. The agents' websites may contain their photos and descriptions of their skills, services, or philosophies. You're looking for an agent who is knowledgeable about the area and the type of house you want to live in, experienced, easily reachable and responsive to your needs, ethical and honest, compatible, and loyal. If you're interested in checking out unusual types of deals (a house in foreclosure or a short sale, for example, as discussed in Chapter 9), ask the agent about his or her experience with such transactions. At the interview, ask concrete questions about the agent's experience, certifications, and more, and how the agent's skills will be put to work for you. Also request the names of their three most recent clients, as references. Then, (assuming you're interested in the agent) follow up and call those clients, to make sure they had a positive working relationship.

Real Estate Agent Interview Questionnaire

Ask potential agents the following questions, as well as anything special to your transaction, like their experience helping buyers looking for fixer-uppers or newly constructed houses.

Name of real estate agent and contact information (phone, email, etc.):

Date of conversation:

1. Do you work full time as a real estate agent?
2. How long have you been in the real estate business? How many people work in your office?
3. Do you have additional certifications beyond your general real estate license? If so what are they?
4. Will you ever represent me as a dual agent?
5. How many residential real estate transactions have you been a part of in the past year?
6. In how many of those transactions have you represented the buyer?
7. What was the price range of homes you helped clients buy within the last year? What was the average price?
8. Do you specialize in a certain type of property?
9. Do you specialize in a certain geographic area?
10. Do you partner with other agents or use assistants?
11. How will I reach you? Are there days or times you're unavailable, or do you have any vacations planned? What if you're on vacation when my house is closing?
12. Can you provide at least three names of recent clients who purchased first homes with you, who will serve as references?

NOTES:

Real Estate Agent Interview Questionnaire Best Answers

1. Yes.
2. The longer the better, but at least three years. If the agent is still relatively new, definitely make sure he or she is part of a respected, vibrant office where agents share ideas and advice.
3. More certifications show a commitment by the agent. A Realtor® ABR or ABRM designation indicates that the agent has significant experience working with buyers.
4. Only acceptable answer is "No."
5. Should be a minimum of ten.
6. Should be at least half, but experience with representing sellers is relevant, too. Most agents start out representing buyers, then begin representing sellers after they've gained experience and their happy clients have come back ready to sell. Representing sellers also helps an agent develop a fuller sense of the whole transaction.
7. Should be about your price range.
8. Should be the type of property you're interested in, like a single-family house, condo, or co-op.
9. Should be the geographic area where you're looking to buy.
10. If so, find out who you'll be working with, what their real estate experience is, and what they'll be doing.
11. Make sure you can reach the agent when you need to. If you plan to buy soon, make sure the agent will be readily available (not on vacation).
12. Only acceptable answer is "Yes."

ONLINE TOOLKIT

For a comprehensive set of questions for both the agent and his or her references: Use the "Real Estate Agent Interview Questionnaire" and the "Real Estate Agent Reference Questionnaire" in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.) Samples of these forms are shown above.

Best thing we ever did

Got an agent who specialized in our neighborhood. Craig and Lorena had been looking for an affordable starter house in a much-desired neighborhood for months, with no luck. Lorena explains, "Although our agent specialized in our target neighborhood—she lived there—there just weren't many houses we liked at a price we could afford. We'd just about given up when she called us. A neighbor of hers was getting ready to sell and was willing to let us have first peek. We loved the place and immediately put in an offer, which was accepted. The place was never even advertised!"

Real Estate Agent Reference Questionnaire

Here's what to ask the agent's referrals. You can add any other questions that interest you, such as special issues if you're buying a foreclosure or a new house in a development.

Name of real estate agent:

Name of reference: Date:

1. How did you choose the agent? Did you know the agent before you worked together?
2. What kind of house did you buy?
3. Was the agent responsive? Did the agent return calls promptly, follow through on promises, and meet deadlines?
4. Did the agent take the time to find you the right property?
5. How long did you look?
6. How many houses did you look at before you bought? Did you make any previous offers that fell through, and if so, why?
7. Did the agent show you houses in your price range?
8. Are you happy with the house you bought, and the neighborhood it's in?
9. Did the agent help you coordinate other details of your purchase, like finding financing and working with the title company, inspectors, or insurance agents? If you bought a new home from a developer, were there some items that needed completion or adjustment after the closing? If so, did your agent help nudge the developer to get the work done?
10. Did the agent keep you up to date, and explain everything in terms you understood?
11. What was the best thing about working with this agent? The worst? Would you work with the agent again?

OTHER COMMENTS:

TIP

Don't spill your beans. Wait to tell the agent your own objectives (where you want to live, how much you want to spend, and what type of property you're looking for) until your questions have been answered. You don't want the agent to feed you the answers you want to hear.

If It Doesn't Work Out: Firing an Agent

One common misconception is that once you've chosen an agent, you can't fire that person. Whether you can extricate yourself from the relationship (and what it will cost you to do so) will probably be determined by the terms of your agreement. So make sure to get a signed agreement, and try to insert a clause at the outset allowing you to release the agent with sufficient notice (usually, about 48 hours) if things aren't working out. Watch out for a clause that requires you to pay a cancellation fee if you dump your agent. And to give you more flexibility, try to limit the relationship to 30 or 60 days rather than, say, six months.

Even if your agreement doesn't specifically give you the right to fire your agent, if an agent isn't showing you appropriate properties, or isn't responding to your calls or inquiries, or you just don't like working with that person, you may want to move on. Of course, if the problem can be resolved by a simple conversation, it's wiser to try that first. But if that's fruitless and the agent isn't willing to walk away, you may need to discuss the issue with the managing broker (the agent's boss).

If you decide to end a working relationship, do it *before* you find a house you want to buy. It would be totally unethical—and risk a lawsuit—to try to get out of the relationship just to avoid letting the agent claim the commission.

Who Does What	
It's your agent's job to ...	**But it's still your job to ...**
Talk to you about your needs.	Research and choose the right agent, and negotiate the terms of the agency.
Research houses and neighborhoods that meet your needs and give you data on comparable properties.	Clearly explain and describe to the agent what you're looking for.
Show you houses with features that you want, in your price range.	Choose the right neighborhood.
Help you write up offers (except in states where attorneys do this).	Choose the best house for you.
Deliver your offer to the seller.	Choose your professionals, like the mortgage broker, inspector, and closing agent.
Notify you of counteroffers and help you negotiate with the seller.	Secure your financing.
Recommend professionals like brokers, inspectors, and closing agents; help you coordinate working with these people.	Respond promptly to your agent's questions.
Attend important events like inspections, appraisals, the final walk-through, and (usually) the closing.	Avoid, or at least knowingly consent to a dual or designated agency relationship, if the situation arises.
Explain the process, timeline, and technical concepts.	Decide on the key terms of your offer.
Respond promptly to your phone calls and inquiries.	Speak up if there is a problem.
Help with any snafus you encounter during the process.	Read all documents carefully.
Disclose a dual or designated agency.	

Your Cash Cow: The Mortgage Broker or Banker

Even in inexpensive housing markets, you'll likely be taking out a mortgage to finance your purchase. In the next chapter, we'll talk about how to research options, select the best loan, and actually apply for it. Here, we're going to talk about the people you'll work with to do that.

More than half of all buyers get their loans through a mortgage broker or mortgage banker—a professional who's in the business of compiling and filtering through the options for you. Your other primary alternative is to go directly to a bank, credit union, or other commercial lender.

If you're buying a newly constructed home, the developer may line up financing for you—but it's worth checking out other options. While developers often form relationships with specific lenders, the terms offered sometimes favor the developer more than the buyer.

TIP

A "mortgage broker" and a "mortgage banker" aren't the same thing. A mortgage broker is the middleman who brings you and a lender together. A mortgage banker is a lender who actually lends you money.

Your Personal Shopper: The Mortgage Broker

A mortgage broker acts as your agent to "shop lenders" for the best possible loan terms, given your financial situation and goals. Nearly all states now require mortgage loan officers and brokerages to be licensed. This information is easily verified by using the National Mortgage Licensing System (NMLS) website at www.NMLSConsumer.org. Individual mortgage brokers are also sometimes certified by the National Association of Mortgage Brokers (NAMB). To be NAMB-certified, brokers must show a certain amount of work experience and other qualifications, pass a written exam, and attend continuing education training. There are two types of NAMB certification: Certified

Residential Mortgage Specialist (CRMS) and Certified Mortgage Consultant (CMC).

As for compensation, mortgage brokers make most of their money by marking up the costs on the loan the wholesale lender is offering. This may get passed on to you in the form of points (one point is 1% of the loan value), processing fees, or a higher interest rate. Although the broker's commission ultimately comes out of your pocket, a savvy borrower can negotiate down a fee that seems excessively high. Of course, a good mortgage broker should be able to save you the equivalent of his or her earnings and then some, by finding you a more affordable mortgage than you could locate on your own.

TIP

Choose a mortgage broker before you find a house. If you wait to get a broker until you've found a property you want to buy, you'll have very little time to find the best professional.

What Your Mortgage Broker Does for You

To help you find the best loan possible, a good broker will:

- Talk with you about your financial situation and goals.
- Find and explain financing options available to you.
- Work with you to get preapproved for a mortgage.
- Help you complete and assemble the documentation the lender needs. This might include your loan application, confirmation of employment and wages, financial information, and credit report.
- Once approved, review loan documents before you sign them. If the lender refuses to approve your loan, your mortgage broker should explain what went wrong and help find alternative mortgage options.
- Coordinate the property appraisal.
- Order title insurance.
- Continue to act as a liaison between you, your real estate agent, and the lender up through the closing day.

TIP

Run your own numbers. The mortgage broker's view of your finances will be much like the lender's—a measure of what you can qualify for based on your debt-to-income ratio. Don't look to the mortgage broker to tell you what you can comfortably afford: Conduct a personal evaluation of your finances, as explained in Chapter 3.

Getting the Best Mortgage Broker Out There

Good mortgage brokers possess many of the same traits as good real estate agents—integrity, professionalism, and experience. They should also be skilled (and patient) at explaining complicated financing concepts. In addition, good mortgage brokers stay informed about the policies, requirements, and products of various mortgage lenders, so as to provide you with up-to-date and accurate advice.

Get recommendations from friends, coworkers, and other homeowners. Your real estate agent is another good resource. A less reliable option is the "Find a Mortgage Professional" feature on the NAMB website, www.namb.org. NAMB membership is just a starting point: You'll want to learn more about each broker's education, experience, and philosophy. Ask whether the broker will tell you up front about every fee he or she will charge you (you may want to negotiate these fees, as we'll discuss in Chapter 6).

Next, interview two or three prospective mortgage brokers. Ask about their experience and certifications, plus any questions special to your situation (like whether they can provide help getting an FHA or other government-backed loan). Also ask for the names of three references, and follow up to check whether these folks enjoyed working with the broker and are still happy with the loan they got.

In the experience of adviser Fred Steingold, "Local sources are often the best option for obtaining a mortgage loan. Yes, you can get a lot of good information about mortgages online. But when it comes time to actually apply for your loan, working with someone face to face can reduce the chance for glitches in the process. Even if the local mortgage terms appear less beneficial than those offered online, paying a little more can be worth it for this personalized attention."

Mortgage Broker Interview Questionnaire

To get the best mortgage broker on your team, ask the following questions, as well as any special to your situation (for example, concerning a credit history issue, your interest in an FHA or other government-backed loan, or the broker's experience with self-employed buyers).

Name of mortgage broker and contact information (phone, email, NMLS number, etc.):

Date of conversation:

1. Do you work full time as a residential mortgage broker?
2. How long have you been in the residential mortgage business?
3. Are you licensed (if applicable) and certified by the National Association of Mortgage Brokers?
4. How many residential mortgages have you brokered in the past year?
5. How many of those transactions were with first-time homebuyers?
6. Can you describe a tricky deal you were able to successfully close?
7. Can you provide at least three names of recent clients who will serve as references, at least one of whom was a first-home buyer?

NOTES:

Best Answers:

1. Yes.
2. The longer the better, but at least two years.
3. Yes.
4. Should be a minimum of ten.
5. The more the better, but should be at least five.
6. Hopefully, you'll hear about a tough situation that the broker handled well. A broker who has done only easy deals may not have the experience you need.
7. Only acceptable answer is "Yes."

Mortgage Broker Reference Questionnaire

Here's what to ask the mortgage broker's references. You can add any other questions that interest you, for example, whether the person tried to negotiate the broker's fee down.

Name of mortgage broker:

Name of reference:

Date:

1. How did you choose the mortgage broker? Did you know the broker before you worked together?
2. What kind and size of loan did you get? Are you happy with it?
3. Was the broker responsive? Did the broker return calls and emails promptly, follow through on promises, and meet deadlines?
4. How long did you look?
5. Did the broker give you a variety of options?
6. Did the broker allow you to lock in your interest rate for either 30, 45, or 60 days prior to the closing?
7. Are you happy with the loan you got?
8. Did the broker help you coordinate other details of your purchase, like working with the title company or insurance agents?
9. Did the broker keep you up to date, and explain everything in terms you understood?
10. What was the best thing about working with this mortgage broker? The worst? Would you work with the broker again?

OTHER COMMENTS:

ONLINE TOOLKIT

For a handy set of questions to use in your interview and when checking references: Use the "Mortgage Broker Interview Questionnaire" and the "Mortgage Broker Reference Questionnaire" in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.) Samples of these forms are shown above.

Who Does What

It's your mortgage broker's job to …	But it's still your job to …
Offer you loan products that meet your needs.	Give the mortgage broker all relevant information about your financial picture.
Explain financing concepts and loan products.	Provide personal financial documents.
Coordinate loan approval with the lender.	Decide which loan you want.
Check your credit, help you fill out your application, arrange the appraisal, and verify your financial information.	Negotiate the terms of the loan if you think the broker's markup is too high.
Before the deal closes, make sure all of the lender's underwriting conditions are met, coordinating with you and the lender, appraiser, credit report company, title company, flood insurance certificate provider (if applicable), and mortgage insurance provider.	Return your broker's calls and respond to inquiries.
Make sure all loan conditions are met and the cash is transferred for closing.	Read all documents.
	Double-check that you've gotten a rate-lock commitment in writing.

Straight to the Source: Dealing With Lenders

Sometimes, a homebuyer goes directly to a lender, rather than dealing with a mortgage broker. The buyer may like the personal aspect of walking into a local bank branch or even have found a better deal than is available through a broker. You can often find a lender's advertised rates on the Web or in your local newspaper—we'll talk about searching for that in Chapter 6.

If you decide to work with a lender, you'll probably still be dealing primarily with a person within the institution called a "mortgage banker" or "loan officer." This person performs the same duties (more or less) as a mortgage broker, except that instead of scouring the entire loan market, the loan officer will help you identify which of the bank's own portfolio of loan products suits your needs. In other words, you'll be limited to the loan packages offered by that institution.

The loan officer should help you fill out your application and handle necessary paperwork like obtaining your credit report and getting an appraisal. However, once you've chosen a bank, you won't be able to choose your loan officer as you would a broker—or your available choices will be limited.

How much personal contact you have with a specific loan officer depends on the lender. Lenders come in all shapes and sizes, from the behemoth bank to the local credit union.

Some operate almost entirely online, even having you apply online. Examples include QuickenLoans, LoanDepot, and DiscoverHomeLoans.com. These lenders may be keeping their overhead low by cutting out the operating costs of the local office, passing the savings on to you. If you work with online lenders, you'll have to rely more heavily on technology (email, fax machines, and scanners) to transmit documents. You may also have to accept that you'll never meet the loan officer face to face or that you'll be dealing with several different people during the transaction.

Your Fine Print Reader: The Real Estate Attorney

In some states, such as New York, real estate attorneys are a regular part of the homebuying process. Even in states where this isn't the case, you may need an attorney's assistance in a complex transaction. After all, if you don't use an attorney and the transaction later goes awry, you'll still have to hire one, at much greater time and cost. If there's anything legally unusual about your planned purchase, save yourself headaches by working with a lawyer to structure the deal, not salvage it.

What's legally unusual? Adviser Fred Steingold suggests getting an attorney involved in situations such as these:

- You'd like to rent the home for an extended period, such as a year, before you're obligated to buy it.
- You'd like to move some belongings into the home's garage or basement before the closing date.
- You'd like an escalation clause that gives you the right—within limits—to meet or exceed any competing offer.
- You'd like to make sure that a current tenant in the home will be moving out before closing.
- You're willing to let the seller retain possession of the home for a time beyond the closing, but you want to make sure the seller will pay you a fair rent.

Easements are another classic example of when a lawyer's help might be warranted. Adviser Daniel Stea recalls a transaction in which the seller and neighbors had a verbal easement allowing the neighbors to access their parking spot through the seller's driveway. "The buyers naturally wanted to have this arrangement reduced to writing—and that writing is the sort of thing a lawyer should really draft, to make sure nothing is left out." However, Stea also notes that, "I'd estimate that out of every 50 home sales that I handle in California, only a couple need a lawyer's assistance."

TIP

There's no substitute for your own attorney. Don't expect the seller's attorney, the closing agent (who may be an attorney), the real estate agent, the mortgage broker, or anyone else in the transaction to look after your legal interests.

Who Real Estate Attorneys Are

A real estate attorney is, by definition, one who focuses on real estate transactions. This may sounds obvious, but you don't want to get stuck working with an attorney whose main expertise is estate planning or corporate mergers. Ideally, your attorney will have several years of real estate law experience, at least some of it working directly with other, more experienced attorneys. Additionally, in most cases, you'll want an attorney who specializes in helping buyers with their residential real estate transactions: drawing up contracts, researching title, and the like. An attorney who specializes in litigating disputes is a better fit if you think you'll need to sue or you might be sued—but when structuring your deal, you'll be trying to avoid that result.

CHECK IT OUT

Are attorneys always involved in real estate transactions in your state? Any experienced real estate agent should be able to tell you this right away, but you can also check with your state bar association. Find it through the American Bar Association's website at www.americanbar.org (search for "state and local bar associations").

What Your Real Estate Attorney Does for You

Depending on your needs and which state you're in, your attorney may become involved in one or more of the following: negotiating, creating, or reviewing the sales contract; overseeing the homebuying process to check for compliance with all terms and conditions of the contract; performing a title search or reviewing the title abstract or title insurance commitment (to determine whether there are any liens or encumbrances on the property); explaining the effect of any easements or use restrictions; negotiating or representing you in a contract dispute with the seller; reviewing the closing documents ahead of the closing and representing you at the closing.

TIP

Check your prepaid legal plan. Such plans—perhaps provided by your employer—may provide legal services for homebuyers, so if you have one, this may be the time to use it. However, make sure the plan truly offers the level of service you need. Make sure you'll be represented by the same attorney every step of the way, and won't be dealing primarily with a paralegal or secretary.

An attorney can also assist you in complex transactions, for example if:

- Legal claims have been made against your prospective house that must be satisfied by the time the property is sold—for example, a construction lien imposed by a contractor whom the seller hasn't paid yet for remodeling work. Your lawyer can make sure that the seller's lawyer addresses this issue.
- Problems show up with the title: for example, the driveway is shared by the house you want to buy and the neighboring house, but that isn't reflected in the home title. Your lawyer can prepare an agreement for you and the neighbor to sign that can become part of the title documents.
- You need help reviewing community interest development agreements and documents like CC&Rs, a co-op proprietary lease, or a new home contract drafted by the developer.
- You need to structure a private loan from a relative or friend to make the purchase.
- You are purchasing the house jointly with others and need to structure a cobuyer agreement and document how title will be held.
- A little later on, the seller tries to wiggle out of the deal, and you want your lawyer to inform the seller of the legal consequences for failing to perform.

"One of the most valuable things we do for our clients is simply to make sure that all discussions about seller repairs and the condition of property have been put into writing," says adviser Alicia Champagne. "The object is to avoid situations like one I had, where our client had been told by the seller's listing agent, as they talked in the house's basement, that the seller would extend a $1,500 escrow credit for replacing the hot water heater. Unfortunately, no one ever told any of the attorneys about this. We got to the closing, and the buyer said, 'Where's my $1,500?' The seller's attorney simply refused to authorize payment. And without any proof in writing, there was nothing we could do."

Getting the Best Attorney Out There

You may be tempted to get the cheapest attorney you can, but it's smarter to get one who's a real estate expert, even if it costs more. If you pay the attorney by the hour, the seasoned one will take less time than, for example, a criminal defense lawyer, who'll need to spend time just researching real estate laws.

Many, but not all, states require you to have a written fee agreement with your lawyer. It's worth doing, anyway. Your agreement establishes the terms of representation: what the lawyer is expected to do, how much you'll pay and on what basis (for example, hourly or a flat rate), and when the lawyer must be paid. Often you'll have to pay some advance money, called a retainer—but the rest of the lawyer's fee will be paid later.

TIP

Count the hours. If you have an hourly arrangement with your attorney, here's a way to keep costs in check: Ask that the attorney contact you before starting each discrete task (like reviewing condo CC&Rs) and give you an estimate of how long that task will take. If it sounds reasonable, say okay, but require the attorney to contact you if additional time is needed.

To find potential attorneys, start by getting recommendations from friends, coworkers, and trusted real estate professionals. If that doesn't pan out, you can get names from professional organizations or use lawyer referral services (such as the Nolo lawyer directory, at www.nolo.com).

Then interview three or four attorneys. Clarify in advance whether you must pay for this interview time. Some attorneys offer free consultations, others don't. It may be worth paying, though, to start your purchase off with a highly regarded attorney. At the interview, ask about not only the attorney's general legal skills, but also how much time he or she spends on transactions similar to yours—especially if you're buying a condo, co-op, or newly built house. Make sure the attorney is familiar with local real estate practices and relevant state and local rules that apply to your transaction.

If possible, get and check references for any attorney you plan to hire, especially if a substantial amount of legal work (and money) is involved. While some attorneys will be reluctant to provide names of clients (because of client confidentiality), it doesn't hurt to ask.

Who Does What	
It's your attorney's job to ...	**But it's still your job to ...**
Provide the services outlined in your agreement, such as drafting an offer or contract, reviewing the contract, or verifying title. Tell you how much services will cost. Keep everything confidential. Explain problems, complications, and the meaning of legal documents or terms. Advocate on your behalf to make sure contract terms are legal, fair, and satisfactory to you. Explain your options for describing your method for taking ownership on the title, and the legal effect of each option.	Give the attorney all relevant documents and information. Return your attorney's calls and respond to inquiries. Make all decisions affecting your transaction, such as whether to complete the sale if there is a cloud on title. Decide how you want to take title.

ONLINE TOOLKIT

For a handy set of questions to use in your interview and reference checks: Use the "Attorney Interview Questionnaire" and "Attorney Reference Questionnaire" in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.) Samples of these forms are shown below.

TIP

You can look up an attorney's bar record. Attorneys who violate ethics rules may be disciplined by the state bar (the organization in charge of licensing and regulation). Many states have online tools that allow you to check records; search online for "bar association" and the name of your state.

Attorney Interview Questionnaire

Ask the following questions, as well as any specific to your transaction—for example, regarding the attorney's experience with condo, co-op, or newly built house purchases.

Name of attorney and contact information (phone, email, etc.):

Date of conversation:

1. What percent of your time do you spend helping residential real estate buyers?
2. How many years have you been handling residential real estate legal matters? What are the typical services you provide?
3. Do you charge hourly rates (if so, at what rate) or flat fees for services?
4. Are you an active member of the state bar association?
5. Have you ever been subject to any bar association disciplinary proceedings?
6. Have you ever been sued for malpractice? What was the result?
7. How many individual homebuying clients have you represented in the past year?
8. Can you provide the names of three recent clients who will serve as references?

NOTES:

Best Answers:

1. More than 50%.
2. The longer the better, but at least two years.
3. No one right answer—you'll want to compare fees between attorneys. But try not to base your decision solely on how high or low the fees are.
4. Only acceptable answer is "Yes."
5. Only acceptable answer is "No."
6. Only acceptable answer is "No."
7. Should be a minimum of seven.
8. Not all attorneys will provide references, but if one does, it's worth your time to follow up.

Attorney Reference Questionnaire

Here's what to ask the attorney references. You can add any other questions that interest you—for example, if you're seeking a particular type of legal help, such as with buying a co-op.

Name of attorney:

Name of reference:

Date:

1. How did you choose the attorney?

2. Did you know the attorney before you worked together?

3. What kind of legal services did the attorney provide?

4. Was the attorney responsive? Did the attorney return calls and emails promptly, follow through on promises, and meet deadlines?

5. How long did you work together?

6. Are you happy with the attorney's services?

7. Did the attorney keep you up to date, and explain everything in terms you understood?

8. What was the best thing about working with this attorney? The worst? Would you work with the attorney again?

OTHER COMMENTS:

Your Sharp Eye: The Property Inspector

Before you buy a home, you'll have it inspected at least once (per a contingency you'll put in your contract, as discussed in Chapter 10). The purpose is to make sure that you're getting what you pay for—namely, a house in as good a condition as it appears to be. Suppose you make an offer assuming a place is in tip-top shape, then discover that the foundation needs to be redone? The value of that property suddenly plummets—you might not even want to buy it at all.

The traditional inspection contingency allows 14 days for inspections to be completed, and three days after that for you to approve them. That's not much time—in some U.S. regions, market conditions may shorten the inspection period dramatically, and the better inspectors have a waiting list. So it's good to choose your inspector before agreeing to buy a house.

Who Inspectors Are

A general home inspector visually examines the home, inside and out, for mechanical and structural flaws that could affect performance or safety. Then the inspector prepares a written report summarizing the findings. General inspectors usually have a background in general contracting, residential homebuilding, or engineering. Some states require home inspectors to pass a test and be licensed, while others do not. The more specialized inspectors have other areas of expertise and backgrounds and may need a state license (licensing is fairly common for pest inspectors, for example).

What Your Inspector Does for You

A general home inspection is usually limited to areas that can be seen during one visit without disturbing or damaging the property, such as viewing the condition of the roof, visually inspecting the electrical system, and examining the foundation. This inspection may also reveal that more specialized inspections are needed, for example, of the chimney or foundation.

A structural pest inspection, which most lenders require, is more limited in scope. The inspector looks for any pests, such as fungi, termites, or beetles, that can damage the structure.

Getting the Best Inspector Out There

When choosing a general home inspector, look for one who's been in the business for many years and is not only licensed (if that's available in your state), but affiliated with a professional or trade organization, most notably the American Society of Home Inspectors (ASHI). Ideally, you also want someone who has been a residential homebuilder or contractor.

Many buyers use a home inspector recommended by their real estate agent. Be careful: Inspectors who rely too much on agent referrals may be reluctant to find problems that could end up scuttling the deal, thus disappointing the agent. That's why it's worth getting independent recommendations from your friends, coworkers, and recent homebuyers.

TIP

The general inspector shouldn't do the repairs. A general home (not pest) inspector evaluates problems and recommends solutions. But no ethical inspector would say, "And guess what, I can fix that for you, at this price." That's a conflict of interest, violates the standards of the main industry trade groups such as ASHI, and is prohibited by law in many states.

Unlike general home inspectors, pest inspectors traditionally are the ones who do the extermination and fix-up work. Yes, it's a potential conflict, but that's the way the industry works, and the good news is that they actually have an interest in finding problems. For that reason, it's safe to go with your agent's recommendation; the remainder of this section will focus on general, not pest, inspectors.

To find a general inspector who will give the house a thorough going-over, interview two or three, asking questions about their experience, price, and scope of services. Also ask any questions specific to your situation, like whether the inspector has experience with historic remodeled properties. Then request the names of three recent references, and follow up to make sure they were impressed with the inspector's eye for defects and communication abilities—and haven't found subsequent problems!

Home Inspector Interview Questionnaire

Ask potential inspectors the following questions, as well as anything specific to your situation, like whether the inspector has experience with historic or remodeled properties:

Name of inspector and contact information (phone, email, etc.):

Date of conversation:

1. Do you work full time as a home inspector?
2. How long have you been in the home inspection business?
3. Are you affiliated with ASHI?
4. How many home inspections have you done in the past year in this area? What types of houses?
5. What kind of inspection report do you provide? Can I see an example?
6. Do you have current, active errors and omissions insurance?
7. What did you do before you were a home inspector?
8. Can I accompany you on the inspection? Can I take photos or videos?
9. Can you provide at least three names of recent clients who'll serve as references?

NOTES:

Best Answers:

1. Yes.
2. The longer the better, but at least two years.
3. Only acceptable answer is "Yes." ASHI is the national organization with the most stringent professional standards.
4. Should be a minimum of 15.
5. Many inspectors have sample reports on their websites; you want as comprehensive a report as possible, versus a short checklist. And you definitely want to see a sample report if there isn't one on the inspector's website.
6. Only acceptable answer is "Yes."
7. Only acceptable answer is a building-related position, such as a contractor or building inspector.
8. Only acceptable answer is "Yes" to the question of whether you can accompany the inspector. But whether you'll be permitted to take photos or videos is a matter of the inspector's own preference.
9. Only acceptable answer is "Yes."

Home Inspector Reference Questionnaire

Here's what to ask the inspector's references:

Name of inspector:

Name of reference:

Date:

1. How did you choose the inspector?
2. Did you know the inspector before you worked together?
3. What kind of inspection did you get and how much did it cost?
4. Was the inspector responsive? Did the inspector return calls and emails promptly, follow through on promises, and meet deadlines?
5. Did the inspector take the time to explain everything to you?
6. Did you go along on the inspection?
   If not, why not?
   If so, how long did it take?
7. What kind of report did you get?
8. Are you happy with the home inspection services and report you got?
9. Did the inspector keep you up to date, and explain everything in terms you understood?
10. What was the best thing about working with this inspector? The worst? Would you work with the inspector again?

OTHER COMMENTS:

ONLINE TOOLKIT

For a comprehensive set of questions for both the inspector and his or her references: Use the "Home Inspector Interview Questionnaire" and the "Home Inspector Reference Questionnaire" in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.) Samples of these forms are shown above.

Who Does What

It's your home inspector's job to …	But it's still your job to …
Inspect the house for defects.	Attend the inspection.
Write a summary report of the findings.	Read the inspector's report.
Recommend repairs or further inspections, if necessary.	Coordinate follow-up inspections.
	Negotiate with the seller over problems discovered during the inspection and arrange for or hire someone to make the necessary repairs.

Your Big Picture Planner: The Closing Agent

A lot has to happen between signing the agreement to buy a house and closing the deal—it's a process that usually takes at least a few weeks. You want to make sure that the house is in good shape, your financing is squared away, and that the seller doesn't pull any surprises. And on the closing day, a number of documents need to be signed, and money transferred back and forth.

To take care of the many details, it makes sense to have a third party—in many states, a completely neutral third party—to make sure both of you are doing what you promised. That's where the closing agent (sometimes called the "escrow agent," "escrow officer," "closing officer," or "title agent") comes in. Every state's requirements for who can serve in this role are different. In states where attorneys handle the closing (such as Massachusetts and

New York), you might not have one neutral intermediary, but instead two attorneys, yours and the seller's, sharing the tasks.

Who Closing Agents Are

Even though we call a closing agent a member of "your" team, the agent is really looking out for both you and the seller (unless you're each using your own attorney). The closing agent acts as a check on both of you, to make sure you complete the transaction according to the terms of the purchase agreement. The agent usually works for a title or escrow company.

What Your Closing Agent Does for You

Although you may not meet your closing agent until you're far into the purchase process—possibly until closing day—the agent will be working behind the scenes long prior to that. (You can meet your closing agent before then, if you want to—and if you have questions or envision some hairy complications, it's a good idea to get in touch.) Expect your closing agent to:

- **Arrange your title insurance.** The closing agent will order or perform (if he or she already works for a title company or is an attorney) a title search and arrange for a title insurance commitment to be issued. The title search and title insurance commitment will show whether the seller is actually in a legal position to sell the property to you and whether any liens, easements, or other encumbrances affect ownership of the property (we'll translate that gobbledygook in later chapters). After the seller clears up any title defects and your purchase is closed, the closing agent will help make sure you're issued a title insurance policy.
- **Coordinate with lenders.** The closing agent is going to coordinate with two different sets of lenders: the seller's lender(s), assuming the seller hadn't already paid off the mortgage, and your mortgage lender(s). The closing agent will make sure the seller's lenders are paid in full when the property is sold.
- **Establish an escrow or trust account.** The closing agent will keep any money you deposit in a separate bank account, called an escrow or a trust account, until the closing date, when the money will be

transferred to the seller. The seller may also agree to deposit money there, for repairs. In states where both parties are represented by attorneys, the seller's attorney opens this account.

- **Prorate expenses.** The closing agent will figure out who, between you and the seller, pays what proportion of any property tax, municipal assessments, and condo or association fees owing or paid during the time period around the sale.
- **Follow instructions.** The closing agent will follow written instructions prepared by you and the seller and make sure that all these tasks are accomplished by the date of closing—and sometimes even after the closing. For example, the closing agent may retain funds from the seller's check to assure that all utility bills get paid for service the seller received before the closing date.
- **Record the deed and pay the seller.** At the closing, the agent will transfer payment to the seller. Afterward, the closing agent will publicly record the new deed that transfers the property to you.

How You'll Pay the Closing Agent

The closing agent is paid a fee that's included in closing costs. In some locations, it's customary for the buyer to pay the fee; in other locations, the seller; and elsewhere the fees are split. Your real estate agent should know the local custom, though you and the seller can negotiate something different.

Getting the Best Closing Agent Out There

Who chooses the closing agent depends on local custom and how strongly you, as the buyer, feel about having a voice in the matter. The choice of a closing agent is usually made early on and spelled out in the purchase agreement. Often the closing agent is someone either the buyer's or seller's real estate agent knows, however. If you want to use a particular company or individual, mention it to your agent at the outset so it can be included in your offer.

Who Does What	
It's your closing agent's job to ...	**But it's still your job to ...**
Collect and coordinate paperwork, including financing and required disclosures. Obtain a title report and coordinate issuance of a title insurance policy. Prorate costs like taxes, insurance, and loan interest. Hold deposits of money in a separate account and transfer them as appropriate. Pay recording fees and taxes. Transfer and record the deed. Transfer your payments to the seller.	Understand and sign off on the instructions that guide the agent's activities. Obtain homeowners' insurance and supply the closing agent with the details, including premium amount. Read the preliminary title report and, with the help of your real estate agent or attorney, resolve any disputes. Arrange for a timely money transfer of whatever portion of the closing costs you agreed to pay (or arrange to have them paid through financing). Coordinate directly with other parties—inspector, real estate agent, or mortgage broker—to make sure everything is in order, including advising your agent when contingencies can be removed. Read all documents carefully before signing.

TIP

Choose a closing agent who's conveniently located. You'll have to drive there at least once, for the closing, and maybe more often, for example, to sign a power of attorney or deliver an old divorce decree.

To make sure you're choosing the best closing agent, get referrals from not only your agent, attorney, or mortgage broker, but from trusted family members, friends, neighbors, or colleagues. Adviser Sandy Gadow, author of *The Complete Guide to Your Real Estate Closing*, suggests making sure your referral source found the closing agent to be efficient, accurate, and able to handle the closing according to schedule.

Strength in Numbers: Other Team Members

Although we've covered the key players for most homebuyers' teams, there are a few other professionals whom you'll either want to consider bringing in or might interact with along the way. These include:

- **Tax professional.** You may want to consult an accountant or other tax pro to make sure you're taking advantage of all the tax benefits of buying a home. This is particularly important in the year you buy, when many of your expenses may be deductible.
- **Insurance agent or broker.** You're going to need to purchase homeowners' insurance for your house (the lender will require coverage of physical hazards, at a minimum, as described in Chapter 13). To do that, you'll probably work with an insurance broker. Your other option is to directly contact representatives of insurance agencies whose services come highly recommended.
- **Contractor.** If you're considering remodeling, or want to have someone lined up to handle any problems that an inspector's report identifies, it's worth getting recommendations for a good contractor early on. That way, you can have the contractor look at the house and tell you how much the remodel or repairs or repairs would cost, or whether it's worth buying in the first place.

What's Next?

With a team of professionals beside you, you're ready to really launch your home search. In the next chapter, we'll discuss one of the most important parts of homebuying: financing your mortgage.

CHAPTER 6

Bring Home the Bacon: Getting a Mortgage

Meet Your Adviser

Marjo Diehl, Mortgage Adviser at RPM Mortgage in Alamo, California (www.rpm-mtg.com), NMLS #280959, DRE License #00896740.

What she does Discusses alternatives with people buying or refinancing their homes, to help them determine the best available financing options depending on their specific financial and personal goals. She then works the mortgage transaction all the way to completion, including assisting the borrowers with preparing the loan application and gathering the documentation, dealing with the underwriters to get the loan approved, ordering loan documents, making sure the loan closes successfully, and communicating with all parties—buyers and real estate agents—the whole way through. Diehl's work has recently included handling an increasing number of FHA loans, as first-time homebuyers get into the market with minimal down payments.

First house "It was a condominium in San Leandro, California, that I bought at age 24, while I was working as a flight attendant. It was all I could afford, but it was a dream to be able to stop renting and have a place of my own! Buying as a single woman wasn't as popular then, and some people were surprised. But it worked great for me. It was close to my job at Oakland airport. I probably spent 40% of my time away from home, traveling. It was also nice to have the homeowners' association looking after the exterior maintenance. I stayed in my condo for two years, until I got married and bought a single-family home with my husband."

Fantasy house

"The house I live in now is my fantasy house! It's in a beautiful neighborhood, with views overlooking a canyon with lots of trees. We've upgraded it completely, with granite countertops, hardwood flooring, and big windows that take advantage of all the views. We also relandscaped the backyard, with lots of flowers and color. Our kitchen, which we're in all the time, overlooks our yard, and sometimes we just stand there and gaze out the window, enjoying the scenery and peacefulness that surrounds us."

Likes best about her work

"Working with the variety of people that I do, and helping them make financial choices that are truly best for them. I particularly like working with first-time buyers, helping them reach financial goals that a lot of times they didn't think were possible. For example, I did an FHA loan recently for a couple who were just finishing a bankruptcy. I was actually surprised that we were able to complete the transaction without a hitch, given that their bankruptcy had not yet been released. They were so thrilled when the house closed."

Top tip for first-time homebuyers

"I think it's so important to live where you want to live—don't just buy in order to buy, but pick a location where you know you're going to feel safe and be happy, within the range of your own affordability. Some people seem to just settle; they get anxious and want to get the home purchase done and over with, now, instead of being patient and waiting for the right home or the right situation to present itself."

If you're like most homebuyers, you simply won't have the cash on hand to buy a home outright. Thankfully, in spite of ever-tighter standards, there are still lenders willing to front you the money you'll probably need.

If you've already started researching mortgages, you may have been put off by all the numbers and fine print. People start out promising themselves, "I'm going to learn all about mortgages," and end up saying, "I'll take whatever's available; I just want to buy this house."

But you don't need to swing to either extreme. With a little buyer's savvy, you can avoid a mortgage that's just plain wrong for you or costs more than it should. We'll show you how by looking at:

- the basics of mortgage financing—interest rates, points, and more
- different loan options—fixed rates, adjustable rates, and everything in between
- how much to borrow versus how much to put down
- where to research mortgages, and
- the mechanics of applying for and getting a loan.

Let's Talk Terms: The Basics of Mortgage Financing

Before you start mortgage shopping, let's cover the basics: what a mortgage is and how it works. A mortgage is a loan to purchase property, with the property as collateral. That means that if you buy your dream home, and you don't make the payments, the mortgagee (the lender, in common parlance) can recover what it's owed by foreclosing on the property—that is, taking possession of and selling it.

> The average home buyer spends double the time researching a car purchase as he or she does researching a mortgage.
>
> —*Zillow*

Naturally, the lender gets into this risky business to make money. It does that primarily by charging interest and points (one-time fees when you take out the loan). The variety of mortgage options means you can borrow the same amount of money but with different terms and end up paying very different amounts back. While interest rates and points look like tiny numbers and percentages in the beginning, they add up to real dollars later.

> **EXAMPLE:** Rob and Amy have found their dream house but don't have a mortgage yet. The local bank offers them a $350,000, 30-year, fixed-rate mortgage at 4% interest, with no points. The monthly principal and interest payment would be about $1,671, and they'd pay about $251,543 in interest over the life of the loan.
>
> Meanwhile, Jimmy and Devon are interested in the same house. They go to a broker to discuss their options. She finds them a $350,000, 30-year, fixed rate mortgage at 3.5% interest, with one point. The point will cost them $3,500, but their monthly payment will be about $1,572, and they'll pay about $215,797 in interest over the life of the loan, $35,796 less than Rob and Amy.

All About Interest Rates

Most of us have been borrowing long enough—either to buy a car, go to college, or get this season's fashion must-haves—to understand what interest rates are and that we don't like them. An interest rate is an amount charged by a lender, calculated as a percentage of the loan amount. Interest rates are usually high on credit cards (sometimes above 20%), but thankfully lower on other forms of credit, like mortgages. And as we discussed in Chapter 1, interest paid on your mortgage is tax-deductible.

In the 2000s, home mortgage interest rates hit record lows, continuing well below 4% in 2014. When this book went to print, they looked unlikely to climb anywhere near early-1980s levels (15% and up) in the foreseeable future. Nevertheless, with the economy in flux, we should expect some volatility.

You're not stuck with your first mortgage for life. If you sell the house, you'll get a new mortgage when you buy your next one. And if you decide to stay put, you can refinance your mortgage (essentially, trade it in for a better one) if rates drop and the value of your house holds steady or climbs. Though you might pay fees to refinance, it could be well worth it. (If the value of your house drops, however, refinancing may not be an option—the precise reason that many homeowners, who were counting on refinancing, found themselves instead pushed into foreclosure in recent years.)

Monthly Payments for a $100,000 Fixed Rate Mortgage

This chart shows the variation among monthly payments for a 30-year, $100,000 fixed rate mortgage at different interest rates.

Interest Rate	Monthly Payment
3.0%	$422
3.5%	$449
4.0%	$477
4.5%	$507
5.0%	$537
5.5%	$568
6.0%	$600
6.5%	$632
7.0%	$665
7.5%	$699
8.0%	$734

What Those Percentages Really Mean

Unfortunately, mortgage interest rates aren't always as straightforward as they appear. For one thing, you may see them expressed two different ways: as a base rate and as an annual percentage rate ("APR"). Those two numbers aren't going to be the same. The base rate is the actual rate used to calculate your payment, while the APR is the total cost of taking out the loan, factored out over the life of the loan and taking into account any fees you pay, like appraisal fees and credit reports. Lenders provide the APR because they're legally required to.

The APR should be a good indicator of what a loan really costs, except that it factors the costs *over the life of the loan*—and the chances of living in the same place for the whole term of a mortgage, without refinancing, are pretty low. However, the APR can be informative—like when a loan is advertised at a very low interest rate, but a slew of additional fees increase the cost dramatically.

Why You Might Not Be Offered the Advertised Interest Rate

To complicate matters, the rates you see advertised aren't necessarily what you'll be offered personally. For starters, interest rates change daily, so if you're looking at them on a Sunday, by Monday they may be higher or lower. And the rates you're offered will depend on some factors unique to you, such as:

- **The type of mortgage you choose.** You'll typically be offered a lower initial interest rate on an adjustable rate mortgage (ARM) than on a fixed rate mortgage. Notice we said *initial*—stay tuned for more on that later in this chapter.
- **How risky you are as a borrower.** If you have a history of paying bills on time, a steady high salary or other significant income, low debt, plan to make a hefty down payment, and request a loan that isn't humongous relative to your overall financial situation, you'll probably be offered a comparatively low interest rate. If the opposite is true, your rate may be higher, to compensate the lender for the added risk.
- **The loan-to-value ratio.** A large down payment tells the lender that you're not likely to walk away from your investment. A small one, however, makes the lender nervous. If you default, the lender will spend time and money chasing you down and may have to initiate foreclosure proceedings. Also, the lender could lose money, if you owe more than the house is worth. It protects itself from such risks by charging you higher interest.
- **Whether the loan can be resold.** Lenders often resell loans on the secondary mortgage market, discussed below. That frees up the lender's capital to make more loans (meaning make more money). If your loan doesn't qualify for resale, it's less desirable for the lender. You'll pay a premium to make up for that.

The Secondary Mortgage Market and Jumbo Loans

A whole market exists in which original lenders sell loans to secondary lenders. Usually the original lender is paid a flat fee upon sale, and the new lender gets to collect the rest of your mortgage payments, including interest.

Why does this matter to you? Because the primary players in this secondary market, Fannie Mae (the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation), buy only those loans that meet certain financial criteria, including that the mortgage doesn't exceed a certain amount (which varies by location and is regularly adjusted: for 2014, it was $417,000 in most places, but as high as $625,500 in high-cost areas and up to $938,250 in Hawaii, Alaska, Guam, and the Virgin Islands). If your loan won't qualify for sale to Fannie or Freddie (a given if it's a "jumbo" loan—over the monetary limit), you'll probably be offered a higher interest rate.

- **Whether the loan has points.** Loans with points (an optional up-front fee) will normally come with a lower interest rate.

You can't be certain of the interest rate and the exact terms of your mortgage until you've selected and applied for it. But knowing what affects the rate will help you view all options with a critical eye.

All About Points

No, this isn't some obscure score in the homebuying game. A point is a loan fee equal to 1% of the principal on the loan (so one point on a $100,000 mortgage is $1,000). Points are added to the cost of some mortgages in exchange for a lower interest rate. You probably won't be offered more than two or three points on a loan, because the lender would have to significantly reduce your interest rate to make it financially beneficial to you.

Depending on how far the interest rate is lowered, it can, in theory, be beneficial to get a loan with points, particularly if you have the cash, are planning to stay in your place for a while, and don't plan to refinance soon.

But paying points on a loan is nowhere near as useful a strategy as it once was, for the simple reason that, as adviser Marjo Diehl explains, "Lenders are currently only offering around a ⅛% better rate per point. It's been this way for the last few years, with the result that 100% of my clients now opt for no-points loans."

There's a chance that this lender pricing approach could change by the time you're reading this, however, so be sure to talk the matter of points over with your mortgage broker. You can also run some comparative numbers on the latest loan offerings (with and without points). Use the below table (which shows how long you'd need to stay in a house to make up for your points payment through a lowered interest rate) and online calculators.

When to Pay Additional Points for a Lower Interest Rate

Use this chart to determine how many years you should stay in a house to recoup the cost of points.

Additional Points	Interest Rate Reduction							
	⅛%	¼%	⅜%	½%	⅝%	¾%	⅞%	1%
0.25	2.3 yrs.	1.1	0.7	0.5	0.4	0.3	0.3	0.3
0.5	5.3	2.3	1.5	1.1	0.8	0.7	0.6	0.5
0.75	10.0	3.7	2.2	1.6	1.3	1.1	0.9	0.8
1.0	23.5	5.3	3.1	2.3	1.8	1.4	1.2	1.1
1.25		7.2	4.2	2.9	2.3	1.8	1.6	1.3
1.5		10.0	5.3	3.6	2.8	2.3	1.9	1.6
1.75		13.5	6.5	4.4	3.3	2.7	2.3	2.0
2.0		21.0	8.0	5.3	3.9	3.2	2.6	2.3
2.25	**No matter how long you plan to have the loan, don't pay the extra points.**		9.8	6.2	4.6	3.6	3.0	2.6
2.5			12.0	7.2	5.3	4.1	3.4	2.9
2.75			15.0	8.5	6.0	4.7	3.8	3.3
3.0			21.0	9.8	6.8	5.2	4.3	3.6
3.25				11.4	7.7	5.9	4.7	4.0
3.5				13.5	8.7	6.5	5.2	4.4

CHECK IT OUT

Ready to run some numbers? Various websites have calculators that allow you to figure out whether a points or no-points loan works best for you, such as www.mtgprofessor.com and www.dinkytown.net. Also check out calculator apps from QuickenLoans, Zillow, and others.

One advantage to points it that they're tax-deductible in the year you pay them. In slow markets, sellers sometimes pay for points as an incentive to the buyer, and you can even deduct those. In the first year, when money is tight, this might be a significant advantage.

Who's Got the Cash? Where to Get a Mortgage

There are two major players in the mortgage game, both of whom can help you get the loan you need. You may work with a mortgage broker, who will help you find the best available mortgage from among a variety of lenders. Or you may go straight to a lender (sometimes called a mortgage banker), which will probably mean fewer options, but possibly a better deal. For more information on choosing a mortgage broker or lender, look back at Chapter 5.

Narrowing the Field: Which Type of Mortgage Is Best for You?

Mortgages come in two basic flavors: fixed rate mortgages and adjustable rate mortgages (also called ARMs). There are variations on these two types, and some are better for certain kinds of buyers than others. Though you'll discuss your unique situation with your broker or lender, you can first educate yourself about the options.

CHECK IT OUT

Mortgages have their own lingo. For a glossary that will help you decode it go to www.mtgprofessor.com (under "Other Tools," click "Glossary").

Fixed Rate Mortgages

If you like predictability and stability, you'll probably like fixed rate mortgages. The interest rate is set when you get the loan and never changes. If you borrow $250,000 at 4.65% interest, you'll continue to pay 4.65% interest until you've paid off the loan.

TIP

Despite the fixed rate, you're not actually paying the same amount of interest each month. That's because in the early years of your loan when the principal is at its largest, you technically owe more interest. But the lender calculates your payment so it's the same amount each month (the loan is "amortized"). The way amortization shakes out, the interest you owe makes up a greater portion of your early monthly payments. As you gradually start to reduce the principal, less interest accrues, and so more of your payment goes to reducing principal. So, for example, on a 30-year $200,000 loan, at 4% interest, your monthly payments of $955 would include $667 of interest in the first payment and $3 in the last.

Beyond buyers who crave predictability, fixed rate mortgages are good for those who want to stay put long term, particularly if interest rates are low. Even if interest rates go sky-high, you'll have a fixed rate you can live with. You pay a premium for this stability, because fixed rate mortgages usually have higher starting interest rates than ARMs. That protects lenders who are stuck giving you a nice low rate for the full term of the loan, even when interest rates increase and other buyers are paying them more.

The Gold Standard: 30-Year Fixed

The ultimate in predictability and stability tends to be the 30-year fixed rate loan. It allows borrowers to finance their home purchase at a preset interest rate and pay it off over a full 30 years. These loans make sense for people who plan to live in their homes for several years. (Of course, you don't have to stay in your house that long.)

The Saver's Special: 15-Year Fixed

If you're extremely disciplined and can afford it, you might consider a shorter-term fixed loan, most typically a 15-year mortgage. Like any fixed rate mortgage, these have stable interest rates and predictable terms. By paying more each month, you ultimately pay less interest overall. As an added plus, you probably get a relatively low interest rate.

You can see why they're not as popular, however: Paying money back faster means committing yourself to relatively high monthly payments.

> EXAMPLE: Adina wants to take out a loan for $150,000 to buy a new condo. She can choose between a 30-year, fixed rate mortgage with a 5% interest rate, and a 15-year fixed rate mortgage with a 4% interest rate.
>
> With the first loan, Adina will have a monthly principal and interest payment of around $805. After 30 years, she'll have paid about $139,888 in interest. If Adina takes the second loan, she'll have a significantly higher principal and interest payment, approximately $1,110 each month. However, at the end of 15 years, she'll have paid off her mortgage and spent about $49,716 on interest ($90,172 less than with the 30-year mortgage).

Shorter-term fixed rate loans free your income for other purposes earlier than longer-term mortgages do. If you know you're going to want money for something else—for example, to pay college tuition, purchase a second home, or retire—such a loan can act as a serious forced savings plan.

That doesn't necessarily make it the most financially savvy option, however—especially not if you can make money by investing elsewhere or reducing your higher-interest debt (like on credit cards). For example, if you commit to a 15-year mortgage instead of contributing your money to a retirement plan, you could end up house-rich but cash-poor—with a place to retire in, but not enough money to do so. A better way to accomplish your savings goals might be to take out a longer-term loan and contribute the cash you've freed up to a 401(k) or IRA.

As a compromise, some people take out a 30-year fixed rate loan but then make higher-than-required monthly payments to the loan principal. The more principal you pay, the less interest accrues, so if you make early payments, you also end up paying less interest overall. While this strategy won't save you quite as much money as a shorter-term fixed rate loan would (since your interest rate will probably be a little higher), you face less future risk. If someday you can't afford to make more than the minimum payment, you're not locked in.

TIP

Put it to principal. If you decide to make a prepayment, write on the check that the payment is to be applied toward principal. Otherwise, the lender might apply it toward the next payment that's due, which will defeat your purpose.

Adjustable Rate Mortgages

As the name implies, the interest rate on an adjustable rate mortgage ("ARM") can fluctuate during the loan term—and no one can predict with certainty where interest rates will go. For buyers who aren't put off by this risk, or see buying their first home as a short-term stepping stone, the ARM may be an attractive option.

The relatively low initial interest rates are certainly eye-catching and have made ARMs a favorite among new buyers.

But what about those fluctuating interest rates? They're definitely the main risk factor in an ARM. After the starter rate runs out, the rate adjusts periodically at an agreed-upon term. This term (called the *adjustment period*) may vary from one month to several years. Buyers in the last several years were lured by lenders offering ridiculously low initial interest rates, only to find their payments completely unaffordable once the rate adjusted (sometimes, as quickly as a month later). This contributed to the very problems in the mortgage market that make lenders more careful about offering ARMs today.

When you're looking at the loan description for an ARM, check out a number called an *index*: The lender will adjust your rate to equal the index plus an extra amount, so that it makes a profit. That bit of profit, calculated as either a set amount or percentage, is called a *margin*.

Luckily, your lender doesn't get to invent the index. It will draw on a particular published, market-driven number. Common indexes include the London Interbank Offered Rate (LIBOR), the 11th Federal Home Loan

Bank District Cost of Funds (COFI), U.S. Treasury Bills, or Certificates of Deposit (CDs). The LIBOR is usually the most volatile, meaning it jumps up or down quickly and dramatically, while the COFI is less volatile. Also, an index that averages rates over the long term (a year or every six months) is preferable to one that moves up and down based on the weekly "spot" rate.

Another number to seek out when comparing ARMs is the *life-of-the-loan cap*. This is a maximum on the ARM's total interest rate, no matter how high the index rises. The lender usually allows a well-padded 5%–6% above the starting interest rate, which can affect your monthly payment by hundreds or even thousands of dollars. Still, it's far better than getting an ARM without a life-of-the-loan cap—that's downright dangerous.

In addition to a life-of-the-loan cap, most ARMs limit how much your interest rate can increase at any adjustment period. This number is called the *periodic cap*. It's also a floor, limiting the amount the rate can decrease at one time. Look for an ARM that doesn't change by more than 2%–3% at each adjustment period. Otherwise, your monthly payment could shoot up very rapidly.

> **EXAMPLE:** On a $200,000 loan, you're choosing between a 30-year, fixed rate mortgage with a 5.85% interest rate and an ARM with an initial 5.5% rate. The life-of-the-loan cap on the ARM is 11.5%. Your monthly principal and interest payment on the fixed rate loan would be approximately $1,180 and never increase above that. Your monthly payment on the ARM would start at approximately $1,136. However, if your interest rate adjusts to the maximum 11.5%, your payment could go as high as $1,980—about $700 more.

Traditional ARMs

The traditional ARM works like this: The loan starts out at a below-market interest rate, called a *teaser rate*. This rate adjusts frequently, as frequently as every month in some cases. As we've seen, that adjustment can make a big difference in your monthly payment.

In the past, many people who chose a traditional ARM couldn't really afford the home that they were hoping to buy. But if you can only afford the monthly payment in the first few months when the interest rate is artificially low, what are you going to do when it goes up? Failing to recognize the possibility of a raise in ARM payments down the line is exactly what put many homeowners into foreclosure a few years back. As a result, lenders will no longer let homebuyers qualify for a mortgage based on their ability to make the initial, low ARM payments. You'll have to also show that you can afford higher ongoing payments.

With the benefits of easy loan-qualification gone, and interest rates still low (at the time this book went to print), adviser Marjo Diehl says, "I basically don't recommend ARMs to my clients any more, with the exception of hybrid fixed and adjustable rate mortgages" (discussed below).

CHECK IT OUT

Interested in a traditional ARM? You'll need to know what maximum amounts you could owe each month. Your mortgage broker should be able to calculate this for you, or you can use an online ARM payment calculator, like the ones at www.nolo.com/legal-calculators, www.interest.com, or www.dinkytown.net.

Interest-Only ARMs

The interest-only variety of ARMs were once very common, but are now difficult to find. This is, at least at the beginning, just what it sounds like: You start out paying only the interest that accrues on the loan principal, making for very low monthly payments. The downside is that you don't reduce the amount you borrowed (there's no "P" or principal in your PITI). And of course, you have to start paying off the principal some day—usually between three and ten years later. At that time, you'll have to pay much higher monthly payments.

Interest-only loans are attractive when home prices are going up fast, with first-time buyers squeezing into the market. These buyers hope to make the low monthly payments long enough for their house to rise in value, then either sell without having to pay off the loan principal or refinance on better terms.

But as the crash in most real estate markets shows us, this can be a dangerous strategy. Such buyers pin all their hopes on the value of the property increasing, especially because interest-only payments don't increase their equity. If the value of the property drops, the buyer could face a serious loss, particularly if forced to sell (maybe due to a job transfer) or after a change in the terms of the loan (an adjustment to the interest rate). And the buyer would remain responsible for paying the difference between the amount the house can be sold for and the remaining loan balance.

Buyers who pay down principal are in a much better position to weather unexpected drops in home prices. Even if forced to sell, they'll owe less than their interest-only counterparts, because they'll have built up some equity by reducing principal.

Judging an ARM Beauty Contest

If you decide to get an ARM, here's a summary of the features to examine:

- **Initial interest rate.** This should be significantly less than is available on a fixed rate mortgage, to balance the added risk of rate increases.
- **Adjustment period.** Look for annual or biannual (not monthly) adjustment periods.
- **Index.** A slow-changing index (such as the COFI) is preferable to a rapidly changing, volatile one.
- **Life-of-the-loan cap.** Don't agree to pay a maximum interest rate greater than 6% above the initial rate.
- **Periodic cap.** The interest rate should change only a reasonable amount at each adjustment period; 2% is about right on a one-year ARM.
- **Low margin.** The margin should be as low as possible; around 2.2% on a six-month ARM or 2.5% on a one-year ARM.
- **No prepayment penalty.** You will almost never see these anymore, but watch out if you do; you don't want to be charged extra for making early payments or refinancing.
- **Assumability.** ARMs are sometimes assumable, which means that when you sell the house, the next buyer can take over your loan. If interest rates are high then, this can be an incentive to prospective buyers. However, the new buyer will have to separately satisfy the lender's loan qualification criteria.

Hybrid Loans

Hybrid loans, like hybrid cars, can save you money. While hybrid cars do it by eating less gas, hybrid loans do it through lower interest rates. They're a safer and more realistic option for many first-time buyers who want to break into the market but don't plan to be in their first homes forever.

Someday, you'll be able to paint your front door red!

That's what homeowners in Scotland reportedly do after they've paid off their mortgage.

Hybrids work like this: For a set period of time, you pay interest at a fixed rate—usually, below the market rate on a regular fixed mortgage—and after that, the rate becomes adjustable. The fixed-rate term is usually three, five, seven, or ten years. The frequency of the adjustment varies, but it's usually every six months or one year. (A "5/1," for example, means that the rate is fixed for five years, then adjusts every year.)

That means you want to know how long you'll be in your home before signing up for a hybrid ARM. If you're not sure or you want to maximize flexibility and reduce risk, select a hybrid with a longer fixed-rate term (such as ten years). You might have to pay a slightly higher interest rate, but you'll save the cost of a refinance, if you realize at the end of the shorter term that you're not ready to go. And you'll save yourself the stress of trying to predict where you—and interest rates—are going to be in ten years.

Getting Your Cash Together: Common Down Payment and Financing Strategies

Talk to someone who bought their first home a decade or so ago, and you may hear, "We put zero down!" or "We got two mortgages so we could avoid private mortgage insurance!" But with the market having done a huge turnaround, such methods have nearly dropped off the map. To make sure you understand the full range of possibilities, however, we'll explain all the strategies here, from the traditional to the more creative.

The Traditional: 80/20

Lenders feel safe with buyers who pay 20% down and finance the rest. If you're willing to pay that much up front, the lender is relatively confident that you're not going to default: You've already shown you're a serious saver, and you'll have a lot on the line. Even if you default, the lender has a good chance of collecting what it's owed if it sells the house through foreclosure, because you have more equity in the property. In turn, the advantage to you of putting 20% down is that you avoid paying for private mortgage insurance (PMI), and you'll pay less interest overall.

Of course, if you're in a very hot market, you may not want to wait until you've scraped together a 20% down payment. That's especially true if increasing prices mean you'll later have to pay even more for a house (uh oh, that 20% amount just became a moving target). You could end up being priced right out of the market. What's more, if values are rising while you're saving, you won't reap the benefits of the increased value—instead, you'll pay for it down the road, when you're finally able to afford a place.

Not a Recommended Strategy

Homer: *Homer Simpson does not lie twice on the same form. He never has and he never will.*

Marge: *You lied dozens of times on our mortgage application.*

Homer: *Yeah, but they were all part of a single ball of lies.*

—*The Simpsons*

The Golden Past: Little or Nothing Down

While 100% financing was all the rage some years ago, lenders today almost universally don't allow borrowers to use it. If the value of the property drops and you haven't paid off a significant portion of the mortgage, the lender stands to lose everything; and after the downturn in the housing market, lenders simply aren't willing to risk that.

TIP

Want to make a low down payment? Check out FHA mortgages, described in Chapter 7.

Where Do I Look? Researching Mortgages

Once you understand your loan options, you can start researching where to get the best deals. We advise exploring several research avenues, from a mortgage broker to online. Then you'll have plenty to choose from, or at least know what to ask a mortgage broker about.

As you research, organize your findings in one folder or file. You might create a worksheet or spreadsheet to compare different mortgage features like interest rates, fees, or other terms or requirements. There's also one available online, on the Federal Trade Commission website (search for "FTC Mortgage Shopping Worksheet"). No need to fill out your worksheet for every mortgage, just the few you're seriously considering.

Online Mortgage-Related Sites

In addition to sites operated by individual lenders, various sites aggregate lender information and allow you to compare different loan options. At bankrate.com, for example, you can compare rates based on your geographic location, the amount you want to borrow, and the terms you're seeking. Then you can contact the prospective lenders directly to get more information.

CHECK IT OUT

Check out these sites to compare different lenders:

- www.bankrate.com
- www.hsh.com
- www.compareinterestrates.com.

Be careful, however, about any websites that require you to enter personal information like your name, Social Security Number, or address. In the worst case, you can actually agree to purchase a mortgage online—not the smartest impulse buy. More likely, you'll be contacted by potential lenders, or they'll check your credit history (and multiple inquiries can affect your credit score, though all checks within a 14-day window are treated as one).

Newspaper Ads

The real estate sections of newspapers often advertise interest rates (in print or online). Usually, lenders will list the different loan products they offer, with their base interest rate, APR, any points, and sometimes fees charged. These are probably the lowest rates offered to the very best borrowers—not necessarily the rate you'll get. Also, because interest rates change daily, printed numbers may not be an accurate reflection of what actual rates are. Use them only to ballpark what's available.

Banks and Other Direct Lenders

You can also research rates through banks and other direct lenders (such as savings and loans, credit unions, and investment firms). You can do this online, pick up printed information that's available in bank lobbies or sent in the mail, or talk to a loan officer. Your options range from large national lenders to small local ones: Don't assume a bigger bank means a better loan.

Mortgage Brokers

A mortgage broker is an obvious resource and should be able to give you detailed information and help you get preapproved when you find a good loan. For more information on choosing a broker, refer back to Chapter 5.

I'll Take That One! Applying for Your Loan

Assuming you get preapproved for a loan (described in Chapter 3), you'll have already dealt with most of the necessary loan paperwork and given a lender a laundry list of your relevant financial information. (Even if you decide to work with another lender, you'll still have all the documents in one place.) If you don't get preapproved, you'll probably get a loan after you've made an offer on a house and may be pressed for time. Usually, your contract will give you a few days to find financing on terms laid out in the contract. The lender is still going to want the documents listed in Chapter 3, as well as those below.

Assembling Your Documents

After preapproval, and after you've chosen a house, but before the loan is finalized, your lender will need:

- **A copy of the house purchase contract.** Your real estate agent should be able to provide this directly to the broker or lender.
- **A preliminary title report.** (Called a "title insurance commitment" in some parts of the United States.) The title company should give this directly to the lender or broker. The report tells the lender whether the seller owns the property free and clear and whether there are any financial or other encumbrances on the property.
- **A property appraisal.** The appraisal report (which the lender will arrange for) tells the lender whether you're asking to borrow more than the house is worth. If the actual value of the home is lower than the purchase price, then the lender is not well protected if it has to foreclose, and the loan won't meet its loan-to-equity standards. Let's say the purchase price for your home is $500,000 and the lender is willing to lend you 80% of the home's value ($400,000). Your 20% down payment would be $100,000. But if the appraiser says the home is worth only $450,000, the lender would be willing to lend you only $360,000 (0.80 x $450,000 = $360,000). You'd likely have to come up with a $140,000 down payment to close the deal (unless the seller agrees to lower the price).

It's also typical for the lender to ask permission to get more financial information about you, either from you directly, or by contacting different entities that have that data. This can include getting not only your credit history, but also your employment records (from current and past employers), bank records, and possibly even IRS tax records.

ONLINE TOOLKIT

The "Financial Information for Lenders" checklist in the Homebuyer's Toolkit on the Nolo website includes a complete list of the documents you need to apply for a loan. (See the appendix for the link.)

Lessons learned the hard way

The mortgage paperwork will be ridiculous. "I thought we were in good shape," said Catherine, who recently bought a condo in San Francisco. "Both my husband and I had gotten job promotions, and we'd saved up for a 20% down payment. Still, we had to supply reams and reams of paper. I sent the lender something like 12 months' worth of my checking account statements, which it went through line by line, asking about various transactions. They wanted to know, for instance, why I was paying someone $365 a month. It was to our dog walker!"

Filling Out the Application

Many lenders use a standard mortgage application form called the Uniform Residential Loan Application (sometimes called "Form 1003"), mainly because it's used by Fannie Mae and Freddie Mac. You might want to take a peek at the form before it's given to you, at www.efanniemae.com. Although the form is quite long, a lot of the information is stuff you already know. The rest, the loan officer or mortgage broker should be able to help you with.

If you're lucky, your mortgage broker or loan officer will actually offer to fill out the form for you (sometimes after asking you to fill out a mini-version). At a minimum, they should be willing to explain how certain items should be filled out. Ultimately, however, you're responsible for making sure the information is accurate, truthful, and complete, so review the form carefully before signing.

TIP

Play it straight. Think a little fib on your application is no big deal? Watch out: It's known as mortgage fraud, and as mortgage broker Russell Straub explains, "It's rarely prosecuted on the front end, but if a mortgage goes bad and ends up in foreclosure, a scapegoat is usually looked for. The original application is scrutinized, and in the worst cases—which I've seen—borrowers go to jail."

How About Locking in a Rate?

Interest rates change frequently. If you apply for a loan and rates go up before the sale is complete, the lender will require you to pay the higher rate.

To avoid that, you can ask for a "lock in" or "rate lock." It ensures you get the interest rate quoted to you. If interest rates are on the rise, this is a great thing, especially if you can't afford a higher rate.

There are some downsides: Lock-ins are usually tied to a specific property, and they're usually short term. Typically, you can get a lock for 30 to 60 days without much trouble, but you may have to pay for it, perhaps in the form of extra points or a slightly elevated interest rate.

What if you're planning to buy a short-sale property (as discussed in Chapter 9)? Realize that the seller's lender may take several months to issue a final approval—probably more time than you can get a rate lock for. You will, according to adviser Russell Straub, "really need to get an actual purchase contract with a fairly firm closing date in order to lock in an interest rate."

If you get a lock-in, make sure it's in writing and specifies the interest rate, closing costs, and any points you'll pay on the mortgage. For more information, see www.federalreserve.gov/pubs/lockins.

Getting an Appraisal

The final step in your loan application process is for the property you are buying to be appraised. Lenders today have to order appraisals through an appraisal management company. The idea is that the appraiser is an independent third party who will provide a written, objective evaluation of the home, thus assuring the lender that the buyer will have enough equity to meet its lending guidelines.

The appraiser will take a careful look at the property, inside and out, and take numerous pictures to show your lender the quality of the home. The appraiser will also consider how the local real estate market is doing and comparable sales data from nearby homes.

If the appraiser says your house is worth as much as or more than the amount you're paying for it, and everything else in your application looks good, your loan should be approved. If—as is all-too common—the appraisal report indicates you may be paying more than market value for the home, however, you may be in for complications. The lender will use the lower of the appraised value or the contract value in determining how much money it is willing to lend on the property. If the value of the property comes in lower than the contract price, you may have an option to "appeal" the appraisal. You would most likely do this by providing comparable sales information that might previously have been overlooked.

But think twice: What if you really did agree to pay an excessive price? Unless the property is uniquely valuable to you, you may not want to buy it at that price after all—or should at least commission an independent appraisal. (And you should be able to back out, based on your contract's "financing contingency," to be discussed in Chapter 10.)

Monitoring Your Loan Once You're Approved

After you're approved for the loan, you can focus your energy on other things. Trust us, plenty of other tasks will be competing for your attention. But realize that the loan isn't actually made until the day you close on the house. It's worth staying in touch with your broker or lender, particularly if you have continuing concerns about the terms of your loan or approval. Also be mindful of any date restrictions (for example, lock-in deadlines) as you finish the purchase process.

But before you forget about the details of your loan entirely, make sure you get a Good Faith Estimate (GFE) from the lender. You're entitled to receive this document within three days of applying for your loan.

Lenders are required to give you a standard GFE that looks like the sample below. Read it carefully. It spells out some very important details about the loan you're getting—for example, the initial interest rate, the initial payment amount, whether the amount can rise, and whether the loan has a prepayment penalty or balloon payment.

The GFE is important in another respect too: it prohibits lenders from raising certain costs at closing, and it locks the amount other costs can go up. For example, lenders cannot increase the origination fee (the up-front fee paid to the broker, usually a percentage of the loan amount), and can

Sample From Good Faith Estimate (page 1)

OMB Approval No. 2502-0265

Good Faith Estimate (GFE)

Name of Originator	Borrower
Originator Address	Property Address
Originator Phone Number	
Originator Email	Date of GFE

Purpose

This GFE gives you an estimate of your settlement charges and loan terms if you are approved for this loan. For more information, see HUD's *Special Information Booklet* on settlement charges, your *Truth-in-Lending Disclosures*, and other consumer information at www.hud.gov/respa. If you decide you would like to proceed with this loan, contact us.

Shopping for your loan

Only you can shop for the best loan for you. Compare this GFE with other loan offers, so you can find the best loan. Use the shopping chart on page 3 to compare all the offers you receive.

Important dates

1. The interest rate for this GFE is available through ______. After this time, the interest rate, some of your loan Origination Charges, and the monthly payment shown below can change until you lock your interest rate.
2. This estimate for all other settlement charges is available through ______.
3. After you lock your interest rate, you must go to settlement within ___ days (your rate lock period) to receive the locked interest rate.
4. You must lock the interest rate at least ___ days before settlement.

Summary of your loan

Your initial loan amount is	$
Your loan term is	years
Your initial interest rate is	%
Your initial monthly amount owed for principal, interest, and any mortgage insurance is	$ per month
Can your interest rate rise?	☐ No ☐ Yes, it can rise to a maximum of %. The first change will be in .
Even if you make payments on time, can your loan balance rise?	☐ No ☐ Yes, it can rise to a maximum of $
Even if you make payments on time, can your monthly amount owed for principal, interest, and any mortgage insurance rise?	☐ No ☐ Yes, the first increase can be in and the monthly amount owed can rise to $. The maximum it can ever rise to is $.
Does your loan have a prepayment penalty?	☐ No ☐ Yes, your maximum prepayment penalty is $.
Does your loan have a balloon payment?	☐ No ☐ Yes, you have a balloon payment of $ due in years.

Escrow account information

Some lenders require an escrow account to hold funds for paying property taxes or other property-related charges in addition to your monthly amount owed of $____.
Do we require you to have an escrow account for your loan?
☐ No, you do not have an escrow account. You must pay these charges directly when due.
☐ Yes, you have an escrow account. It may or may not cover all of these charges. Ask us.

Summary of your settlement charges

A	Your Adjusted Origination Charges *(See page 2.)*	$
B	Your Charges for All Other Settlement Services *(See page 2.)*	$
A + B	Total Estimated Settlement Charges	$

Good Faith Estimate (HUD-GFE) 1

only increase title insurance costs by up to 10% over the estimate on the GFE. This prevents lenders from tacking on "junk fees" at closing.

ONLINE TOOLKIT

The Homebuyer's Toolkit on the Nolo website contains a blank "Good Faith Estimate." (See the appendix for the link.) A partial sample is shown above.

New-Home Financing

If you're buying a newly constructed home, the developer is likely to offer you some unique financing alternatives. The usual possibilities include closing costs paid by the developer, mortgage subsidies (buydowns), or allowances for upgrades like higher-quality fixtures. All are more common when developers have large numbers of unsold properties and there's a large supply of new homes on the market. (And in particularly slow markets, developers may offer packages featuring everything from cruises to free fireplaces!)

Mortgage Rate Buydowns

To make its houses more affordable, a developer may offer to "buy down" your mortgage. That means subsidizing the interest rate you pay for the first two or three years by prepaying part of the mortgage interest. In a 2-1 buydown, for example, you pay a below-market interest rate (and make reduced mortgage payments) the first year of the loan, and a slightly higher (but still below-market) rate the second year, with the developer filling in the gaps. The two-year period is meant to cover the time when money is usually tightest for first-time homebuyers. The rate adjusts to market levels in its third year.

EXAMPLE:

Year	Interest rate you pay	Monthly payment on a $300,000 fixed-rate, 30-year mortgage
1	2.5%	$1,185
2	3%	$1,265
3–30	3.5%	$1,347

Depending on the particular developer, you may be able to apply a buydown to a mortgage you find yourself or you may be limited to mortgages offered through a developer's preferred lender. You usually need good credit to qualify for this type of program.

And as with any loan package, make sure the buydown works for you—will you really be able to pay the increased mortgage payments after the initial reduced-rate period? If there are any strings attached, such as high initial points or above-market interest rates after the buydown period ends, also consider how much you'll end up paying over the life of that loan. If you can afford higher monthly payments from the start, you may find a more competitive mortgage elsewhere. Use one of the mortgage calculators recommended in Chapter 6 to compare mortgage options.

Other Developer Financing Incentives

Many developers offer special financing deals to new homebuyers who use the developer's in-house or preferred lender. In some cases, the lender has done a blanket appraisal of all houses in the particular development, so you don't have to pay for a new appraisal. The lender will probably also offer special mortgage programs, often with faster or easier approval for creditworthy purchasers and simpler closing procedures. To seal the deal, developers may offer to pay closing costs or points; provide upgrades, such as better-quality carpet or countertops; even offer gift certificates for home design stores.

Although the developer may present its in-house financing as the world's greatest deal or even the only possible deal, don't cave to the pressure without doing your research. It might seem easier (time- and paper-wise) to go with the developer's recommendation, but that convenience may come at a price—namely, above-market interest rates. Particularly if the developer is anxious to sell, you might instead get a loan from another lender but negotiate with the developer for another benefit like a lower purchase price (a better deal than most financial incentives); a mortgage buydown; extra features, such as more closets or built-in bookshelves; or upgrades such as higher-quality lighting.

Unique Financial Considerations for Co-op Buyers

Much of the standard financial advice regarding homeownership doesn't apply to co-ops. Here's a summary of what's different:

- **Two-tiered financing.** Two loans are often involved with co-ops. First, the cooperative will take out a mortgage for its purchase of the property (which you'll probably help pay for, as part of your regular maintenance fees). Later, you'll probably need a loan to purchase your shares.
- **Higher down payment.** Co-op boards frequently require buyers to make large down payments—often upwards of 25% of the purchase price. Your co-owners have good reason for this: They want to make sure you're in sound financial shape and can afford your monthly maintenance payments.
- **Higher interest rates.** Some lenders are reluctant to finance co-op purchases, because if a buyer fails to pay on time, there's no house to foreclose on, only intangible shares in a corporation. Fewer willing lenders and greater risk translates into higher interest rates.
- **Tax deductions.** Tax deductions for co-op mortgage and maintenance payments are more complicated than with condos or single-family homes. While the co-op management will help you calculate how much of the maintenance payment can be deducted, you may need to consult a tax professional.
- **Flip taxes.** A "flip tax" is a misnomer—it's really a transfer fee levied by the co-op when a member sells. It can be calculated different ways: for example, based on the number of shares the seller holds, a flat amount, or the sale price. Usually the seller is responsible for this fee, but the seller may pass it off to the buyer.

What's Next?

You've probably got a good idea of which traditional method for financing your home works, if any. Still, you might want to consider alternatives. In Chapter 7, we'll discuss such methods as borrowing from family or friends or getting government-assisted or seller-backed financing.

CHAPTER 7

Mom and Dad? The Seller? Uncle Sam? Loan Alternatives

Meet Your Adviser

Timothy Burke, founder and CEO of National Family Mortgage (www.nationalfamilymortgage.com), based in Waltham, Massachusetts. National Family Mortgage has facilitated over $200 million in mortgage loans between relatives.

What he does "Despite what the 'CEO' title might suggest, I'm part of a small business (launched in late 2010) where everyone works as part of a team, each person doing a bit of everything. A good part of my time is spent interacting directly with clients; we've already helped thousands of families across the U.S. properly document and manage mortgage loans between relatives. I also deal with company finances, marketing, connecting with press, and more."

First house "I don't own a house yet! Investing in my company has taken first priority up to now. However, I'm recently married, and would like to buy a home one day. We're sort of waiting to see where we want to put down roots and start a family."

Fantasy house "It would be a classic New England farmhouse, with several wooden rocking chairs on a wraparound porch, and overlooking natural beauty—perhaps some conservation land."

Likes best about his work

"It's very rewarding when clients return to us to structure additional loans. That tells us that we're doing something right. And I do feel like National Family Mortgage is part of some exciting changes in the way people engage with financial services and handle their finances. Why pay a bank if you don't have to? The financial crisis and Occupy Wall Street movement have motivated people to take a harder look at such issues. It might sound cheesy, but I feel like we're helping make dreams come true, in a win-win transaction that hopefully benefits everyone."

Top tip for first-time homebuyers

"Don't focus solely on the purchase price and mortgage payments. You'll need to get ready for a host of new expenses that come with homeownership: like maintenance, property taxes, landscaping, furniture, and if you live in an area like mine, snow removal! I'd suggest doing a complete review of your spending habits, lifestyle goals, and ideally retirement plan (the earlier you start saving, the more effectively your nest egg will grow), in order to properly budget for a home you'll be able to afford over the long term."

With competing payment pressures from student loans and other bills, and the high cost of housing, it's hard—if not impossible—to come up with all the cash needed to buy a house. You may be struggling to get a down payment together or to qualify for a mortgage. And most traditional loans don't provide much flexibility, especially if down the road you want to make an adjustment to your payment schedule.

If this sounds familiar, we suggest you look into alternative, more flexible or affordable forms of financing. (Yes, this could mean your mother—but keep reading; it may be worth it.) We'll cover:

- gifts or loans from family members and friends
- financing directly from your house's seller
- low-down-payment loan programs available through federal, state, and local agencies, and
- special financing options available for new homes, such as direct financing from developers (buydowns).

No Wrapping Required: Gift Money From Relatives or Friends

Don't be shy: Many first-time homebuyers (over one-quarter) get some gift money from a relative (usually their parents) or a friend, according to the National Association of Realtors®. If used for the down payment, such gifts help buyers reduce their monthly mortgage payments or increase the amount of house they can afford. Large gifts may even be used to finance the entire purchase. Some buyers also use gifts for moving costs, home furnishings, and remodeling.

By making your home purchase possible, the giver gets not only emotional satisfaction, but financial and tax benefits. If someone is planning on leaving you money by inheritance anyway, a gift is a way to reduce the size of their taxable estate (large enough gifts can be taxed, though the laws on this are continually in flux). And better yet, your parents or other gift givers can watch you enjoy the money during their lifetime, rather than watch you pay extra interest to a bank.

CAUTION

If you're expected to pay it back, it's not a "gift." Adviser Timothy Burke says, "That may sound obvious, but I notice that a lot of folks, especially young people; tend to think of a 'loan' as money coming exclusively from a bank, but view all financial help from family, even if there's an expectation of repayment, as a gift. If you represent to your primary mortgage lender that the money coming from your family is a gift when you actually have every intention of paying it back, you may—even if unwittingly—be committing mortgage fraud. The lender is keenly interested in the difference, as it will factor loans into your debt-to-income ratio for loan qualification purposes, while leaving gift money out of the equation."

For advice on approaching your parents or others for a cash gift, see the discussion below on borrowing money from family or friends.

How Gift Givers Can Avoid Owing Gift Tax

Believe it or not, the IRS attempts to keep track of cash gifts—and if someone makes total gifts over a certain amount during his or her lifetime, that person's estate can end up owing "gift tax," even though the recipients of the money don't! Fortunately, not every gift counts toward this total, and the gift giver has to give away quite a bit of money for it to apply. Anyone can give a tax-free gift up to $14,000 per year to another person (2014 figure; it's indexed to go up with inflation) without any tax implications. That means, for example, that every year, your mother and father can give you $28,000 (plus $28,000 to your spouse or partner, if you have one), without it counting against the lifetime tax-free limit.

> **EXAMPLE:** Leslie and Howard would like to buy a house for $280,000 and hope to raise a 20% down payment, or $56,000. If each set of parents gives Leslie and Howard $28,000, the couple have reached the needed amount, with no tax liability for anyone.

If a relative or friend wishes to give you more than $14,000 during a single year, that person will need to file a gift tax return (Form 709) with the IRS. This doesn't mean the gift giver will have to pay gift taxes, because computing the gift tax debt is (as of recent years) put off until the giver's death. At that time, the first $5.34 million of all the gifts made over the person's lifetime will be exempt from the tax. For more information, see IRS Publication 559, *Survivors, Executors, and Administrators*, available at www.irs.gov; and the Estate Tax section of Nolo.com. If a sizable amount of money is involved, your relative or other gift giver should consult an estate planning or tax attorney.

Why You Need—And How to Get—A Gift Letter

If you use gift money to buy your house (not just furniture), your bank or mortgage lender will require written documentation from the gift giver stating that the money is in fact a gift, not a loan. Remember, the lender is carefully evaluating how heavy a debt load you'll have. It wants to make sure it's not competing with another creditor for your monthly payments.

The "gift letter" should specify the amount of the gift, your relationship to the gift giver, and the type of property (the exact address, if you know it) for which the money will be used. Most important, it should state that the money need not be repaid. Ask the gift giver for a letter or prepare your own for the giver's signature. Your lender may also have a gift letter form.

ONLINE TOOLKIT

The Homebuyer's Toolkit on the Nolo website includes a "Gift Letter" you can tailor to your situation. A sample is shown below. (See the appendix for the link.)

If the gift money hasn't been transferred to your account yet, the lender may want verification that the money is available, including the name of the financial institution where the money is kept, the account number, and a signed statement giving the mortgage lender authority to verify the information.

Gift Letter

A relative or friend should prepare this gift letter for your bank or other lender. Before finalizing the letter, check with your lender to make sure that it includes all required information, such as evidence of the donor's ability to provide these gift funds.

Date: ______________________________

To: *[name and address of bank or lender]*:

I/We *[name of gift-giver(s)]* intend to make a GIFT of $ *[dollar amount of gift]* to *[name(s) of recipient(s)]*, my/our *[relationship, such as daughter]*, to be applied toward the purchase of property located at: *[address of the house you're buying, if known]*.

There is no repayment expected or implied in this gift, either in the form of cash or by future services, and no lien will be filed by me/us against the property.

The SOURCE of this GIFT is: *[the account the gift is coming from]*.

Signature of Donor(s):

____

____

Print or Type Name of Donor(s):

____

____

Address of Donor(s): Street, City, State, Zip:

____

Telephone Number of Donor(s):

____

Preventing Emotional Fallout From Gift Money or Family Loans

To avoid family blow-ups, it's usually best if parents or relatives discuss the gift or loan with other close relatives (like your siblings). They might do well to make similar loans on the same terms to all children and document the transactions. Preferential treatment, or lack of documentation of intentions, are known to cause jealousy and conflict, especially if loans remain outstanding at the time of death and the children have differing recollections of the parents' intentions.

All in the Family: Loans From Relatives or Friends

Private loans are another popular way to finance a home: About 7% of homebuyers borrow money from family or friends, according to the 2013 NAR "Profile of Home Buyers and Sellers." (And that's just for their down payment. It doesn't include those few lucky buyers whose parents lend them the entire purchase amount.)

Before you say, "Oh no, not my family," consider that the numbers probably wouldn't be this high unless there was something in it for the family member or friend, too. Take a look at the total amount of interest you're likely to pay before your mortgage is paid off—wouldn't it be better to keep that amount within the family?

This section will explore private (also called intrafamily) loans, including:

- different ways to structure a loan from family or friends
- the benefits for borrower and lender
- how to raise the issue with your family member or friend, and
- dealing with the legal and tax issues concerning private financing.

Structuring the Loan

You can use a loan from family or friends for your:

- **Down payment.** An intrafamily loan can be helpful if you're short on cash and want to avoid paying for private mortgage insurance

(PMI), but can save up to pay back your private lender over time or when the house is sold.

- **First mortgage.** You could sidestep the traditional lending industry and finance your entire purchase price with a mortgage loan from your relatives, friends, or others.
- **Second mortgage.** A private loan may also be used to supplement a bank mortgage. How is that different from a down payment loan? Your private lender records the mortgage publicly, putting themselves in line behind the bank for repayment if the house is foreclosed on—a good way to protect the private lender. It's unwise to forgo this step unless the loan is relatively small (less than $10,000), for the reasons discussed below.

If you're borrowing part of the house's purchase price from an institutional lender, check whether it requires you to structure your private loan in a certain way or limits the amount you can privately borrow. For example, if you're borrowing down payment money, many institutional lenders require that at least 5% of the purchase price comes from your own funds.

Especially if a sizable amount of money is involved, you should get some advice on how to structure the loan from a real estate attorney.

Benefits of Intrafamily Loans to the Borrower

Some of the reasons that first-time homebuyers turn to family and friends for help financing their houses include:

- **Interest savings and tax deductions.** Family and friends often charge 1½% to 2% interest points less than conventional lenders, resulting in thousands of dollars in interest savings over the life of the loan. And if you document the loan properly (as we describe below), you can usually deduct the mortgage interest charged on your taxes, just as with a traditional mortgage.
- **Flexible repayment structures.** While a bank is probably going to require an unchanging monthly payment schedule, a private mortgage holder might be more flexible. For example, you may mutually agree that you'll make quarterly (not monthly) payments or delay all payments for the first few years. And if down the road

you want to temporarily pause payments (perhaps to take unpaid leave from work after the birth of your first child), your parents or other private lender may agree to that. Good luck finding such a flexible institutional lender.

- **No points or loan fees.** Institutional lenders often charge thousands of dollars in loan application and other fees. Family and friends don't.
- **Easier qualifying.** Your relatives or friends probably won't require that you have a great credit score. You qualify as long as your lender trusts that you'll pay back the loan. Of course, a "yes" isn't automatic, but as adviser Timothy Burke points out, "Family members tend to have a better sense than anyone of whether their child or other relation can be counted on to honor their debt."
- **Saving on private mortgage insurance.** If you borrow more than 80% of the house purchase price from an institutional lender, you'll have to pay PMI. By borrowing privately, you can avoid this cost.
- **Minimal red tape.** To borrow from an institutional lender, you must fill out an application form and provide documentation verifying every item on the form, then wait for approval. Friends and family don't usually adopt this level of scrutiny.
- **Better deal on the house.** If you've arranged private financing in advance and can close quickly, sellers who are time pressured may accept a slightly lower offer.
- **No lender-required approval of house's physical condition.** Private lenders don't usually require that a house's major defects be repaired before closing, as institutional lenders do. That would let you buy a fixer-upper and take care of its defects later. (Of course, you should still have the house professionally inspected.)

Benefits of Intrafamily Loans to the Lender

Here are a few ways that making a private loan can also benefit your family members or friends:

- **Competitive investment return.** You can offer to pay an interest rate that's higher than your lender could get on a comparable low-risk investment like a money-market account or certificate of deposit (CD). (And you're still likely to pay less than you would to a bank.)

- **Ongoing source of income.** Some investments just sit there and gain in value or pay occasional dividends. With your private loan, your lender will receive regular payments from you, which can be reinvested.
- **A financially liquid asset.** Some investments, such as long-term CDs, are hard to cash out in an emergency. Don't worry; we're not saying your family lender can change his or her mind. But he or she can potentially sell your mortgage to someone else. (There is a secondary market for the purchase and sale of existing mortgages, or you may be able to refinance if your lender wants out.)
- **Low risk.** Your parents or other private lender can count on two things: first, your commitment to repay the loan, somehow, someday, even if the original repayment schedule needs to be rejiggered; and second, that your house offers collateral. If worse comes to worst, you can sell it and repay the loan. (Or your lender can foreclose on you, though few would ever do that.)
- **Estate planning protection.** If your family members were planning to leave you money anyway, this lets them get a head start. By leaving a clear paper trail, they reduce the possibility for complications and transfer of money outside the family in the event of a later divorce, death, or remarriage.
- **Emotional satisfaction.** Don't underestimate the sense of achievement that your loved ones get by watching you gain a foothold in the world, with their help.

If all this sounds unrealistically rosy, consider Timothy Burke's experience: "Not only do we see return customers, as I mentioned, but the default rate among our clients is very low—under 1%. When a borrower can't make the payments, it's usually due to a legitimate crisis, such as a medical emergency. In that case, the family lender is typically quite willing to restructure the loan in some way. As long as you go into this arrangement with clear expectations, and document it properly, it can create a sense of mutual support, not conflict."

Best thing I ever did

Borrow from Mom and Dad. When Amy decided to buy a 1904 farmhouse in Northampton, Massachusetts, she assumed she'd get her mortgage from a bank. Then, her mother made her an offer she couldn't refuse: Borrow $180,000 from Mom and Dad, at a competitive 5.75%

interest rate. Her mother figured, "Why is my daughter paying the bank when she could be paying me?'" In addition to helping their daughter, Amy's parents earn a decent yield on a low-risk investment, not easy in these days of low interest rates. "It's a little bit scary borrowing from your parents, but this is an official thing," says Amy. And her mother jokes, "The mortgage was actually $173,000, but she wanted a little extra for shoes."

Will Private Financing Work for You?

Still feeling hesitant? The following questions will help you decide whether private financing will work for part or all of your home financing:

- **How much money do you need?** If it's $5,000 or $10,000 to help with the down payment, that will probably be a lot easier to come by than $50,000 or $100,000.
- **How long do you need to borrow the money for?** Some private lenders may be fine with a ten- or 20-year repayment period (and for tax reasons, may actually prefer a longer term). But if your relative or friend wants the money completely repaid in a few years, make sure such an arrangement is financially feasible for you.
- **Do you have any other options?** Is your credit so bad that no bank will approve the loan (or you'll only qualify at really unfavorable terms)?
- **Does a close relative or friend have the money to lend for the amount and term you need?** If your parents are well-off but are going to need money soon for retirement or to pay your brother's college tuition, they may not be in a position to help.
- **What are the personal costs to you?** If you risk hurt or jealous feelings of siblings, cousins, or others; a sense of perpetual debt or guilt; or similar hazards, the loan may not be worth it.
- **What are the costs to set up a private loan?** Getting specialized help from an attorney and accountant to structure your private mortgage may run in the thousands. Companies like National Family Mortgage may be able to set up and manage the loan for much less. Or, just go back to your conventional lender, especially if the private loan would be fairly small (say, less than $10,000).
- **Does your family member or friend trust you?** Your lender wants assurance that you'll eventually pay the money back, so not only

love, but trust, will be key. If you have a history of credit problems and debts, you'll need to show concrete evidence—to your lender and yourself—that you've learned how to responsibly handle debt.

How to Approach Mom, Dad, or Another Private Lender

Even people who are convinced that private loans are a win-win proposition may blanch at the thought of asking for one. But if you approach it like a business proposition, it's not so hard. You're offering a loan at a fair rate of interest, secured by a promissory note and a mortgage.

Unfortunately, family loans are enough of a business proposition that they in some cases may fall under the federal Dodd-Frank Act, which is implemented by the Consumer Financial Protection Bureau and governs mortgage lender licensing. Because of this, you may want to consult an attorney before getting too deep into proposing a loan to your family member—particularly if they're not a member of your immediate family (parent, child, spouse, sibling, grandparent, or grandchild).

Here's a little more on why Dodd-Frank might affect you: Although most state laws regarding mortgage transactions contain exemptions for loans made within the family, and indeed Dodd-Frank contains a similar exemption, it applies that exemption only to "immediate family." Aunts and uncles, for example, would be expected to comply with Dodd-Frank, as if they were a mortgage lending company. And just figuring out the compliance requirements could be a huge hassle—which, again, is why we suggest checking in with an attorney for help.

To present it this way, of course, you'll need to find the appropriate time and place. Never surprise a potential lender by blurting out a request at a social event or informal occasion, such as on the way back from shopping. Make an appointment, even if you see your parents (or brother or old roommate) regularly and the formality seems odd. Give them a general idea of what you want to talk about, but save the details. For example, you might say, "As you know, I'm actively house hunting now and looking for various ways to finance this. Rather than go into all the details now, I'd like to sit down and talk with you about this." If you sense resistance, back off gracefully.

If you get a positive response, schedule a specific time to meet. Be prepared to discuss your proposition logically and honestly. Ideally, you will have done a lot of homework trying to arrange a loan from a traditional lender, so you'll have all the numbers at your fingertips. Bring along photocopies of all relevant documents, such as the financial materials you pulled together for your bank or other lender.

Prepare a separate one-page list of key terms and issues you want to discuss with a relative or friend, including:

- the amount you want to borrow, at what interest rate and repayment schedule (see below for advice)
- the amount of money you have available for the down payment (the higher it is, the lower the lender's risk of loss)
- your financial ability to make monthly payments (even without setting rigid qualification rules, your lender will want to know)
- the financial protections you'll offer the lender (a promissory note and mortgage, as described below), and
- the financial benefits to the lender (how your proposed interest rate compares to money-market and CD rates).

When you meet, give the potential lender ample time to ask questions, and don't expect a decision on the spot.

The Loan Amount and House Purchase Price

How much you'll ask for depends on how much you expect to pay for your house and how much you think your parents or other private lender can spare. Your intrafamily loan will most likely be a second mortgage, to supplement financing from a bank or other traditional lender. The terms "first" and "second" literally refer to who gets paid first if there's a foreclosure. Your bank or institutional lender will no doubt insist on being the first in line, regardless of the size of its loan.

Your house purchase price won't be exact unless you've already made an offer and had it accepted. If you're still looking, be prepared to show the potential lender a close estimate, based on the price range you're looking in. If your private lender wants to make sure the house you find will be worth what you plan to pay, offer to get it appraised prior to purchase (if you're not already doing that for an institutional lender).

The Interest Rate You Propose to Pay

For a private loan, the interest rate you and your lender pick can in theory be anything between 0% and the limit set by usury law in your state. But for practical as well as tax reasons, it's best to charge a rate that's higher than the Applicable Federal Rate (or AFR; more on that below) but lower than what you'd pay to an institutional lender. Propose paying a little less than half the difference between these two. For example, if fixed rate mortgages cost 3.5% and the AFR is at 2%, you might propose paying 2.75% interest.

Websites such as www.compareinterestrates.com, www.bankrate.com, and www.hsh.com will give you a sense of current institutional interest rates. A simple search for "IRS AFR" should bring you to the right page, or you can find it posted on www.nationalfamilymortgage.com. By the way, although the AFR and interest rates change month by month, your loan doesn't have to follow suit—it's fine to stick with the rate you settle on initially, in the month you sign the loan.

ONLINE TOOLKIT

Use the "Private Loan Terms Worksheet" in the Homebuyer's Toolkit on the Nolo website to organize your presentation to a parent or other private lender. (See the appendix for the link.)

TIP

Is your family reluctant to charge you that much? Tell them they can always decide later to "forgive" you some or all of your payments, of not only interest but principal. For tax reasons, they should write you a letter referencing the loan and stating the amount they're forgiving. They'll also have to factor this decision into their gift tax obligations—forgiven loan payments are considered gifts. And it's best not to structure the whole loan with the assumption you'll never repay—the IRS sees this as a fraudulent way of avoiding gift tax, by stretching a one-time gift out over several years.

Check the AFR: Too-Low Interest May Cause Your Lender Tax Problems

The IRS sets a minimum rate for private loans, called the "Applicable Federal Rate" (AFR), each month. The exact percentage varies but is usually less than bank mortgage rates and higher than money-market account or CD rates. In mid-2014, the AFR averaged a little more than 3% for long-term loans (those lasting longer than nine years). For the current rate, search the IRS website at www.irs.gov.

What's the big deal if your private lender charges you less than the AFR—or even no interest at all? No problem for you (who wouldn't want a low interest rate?), but there may be tax ramifications for the lender. This is mainly an issue if you're borrowing a substantial amount of money from a relative or friend, or receiving a loan on top of a gift that exceeded the $14,000 annual exclusion. If the interest rate doesn't meet the AFR, the IRS will "impute" the interest to your lender—meaning it will act as though your lender really received the AFR-level interest on the loan. The question then becomes, where did the interest money go? Aha, reasons the IRS, your lender gave it right back to you, as a gift. Then the IRS can demand that the private lender file a gift tax return for any amount over the annual gift tax exclusion.

Also, even if your private lender charges you less than the "imputed" interest rate, the IRS requires him or her to report interest income at the imputed rate. If the lender doesn't and is audited, and the IRS discovers the omission (unlikely), the IRS will readjust his or her income using the imputed interest rate and charge the tax owed on the readjusted income plus a penalty. Theoretically, the IRS could zap the giver under both income and gift tax rules.

Other Proposed Loan Terms

You don't need to go into your discussion with a completely drafted loan agreement—after all, part of your objective will be to negotiate those details with the lender. Still, you can show that you've thought carefully about how to structure the loan profitably for both of you, by suggesting a:

- repayment schedule (such as monthly or quarterly)

- mortgage term (length)
- payment amount, and
- plan if things go wrong, such as late payments and fees, what constitutes loan default, and loan restructuring options.

Again, be sure to run these by your institutional lender, if any, before finalizing your loan agreement with a relative or friend, to make sure you won't be undermining your qualification for institutional financing.

Gracias, Arigato, Merci

Find a way to show your thanks for a gift or loan—a card, lunch at your new house, and maybe more. In case you're stuck for gift ideas, check at www.redenvelope.com. But be aware that, depending on your relationship with your relatives, they may also expect frequent stays in your new guest room, want you to follow their decorating advice, or feel that they can comment on your spending habits. Then again, some may act like this without having contributed to your house purchase!

Creating Your Loan Documents

If your relative or friend agrees to lend you money, you'll need to finalize the loan with the proper legal paperwork. A handshake isn't good enough for anyone. For one thing, it's easy to misunderstand something you've only talked about. Clarifying and writing your agreement down now avoids disputes, as well as memory lapses down the line. For another, failing to record your lender's mortgage on the property leaves that person out in the cold if some other lender or creditor forecloses on your house—they wouldn't be entitled to any of the proceeds, some of which might go to a creditor who came along later (like a contractor who worked on your house, whom you haven't yet repaid and who files a lien). And finally, written proof that you're paying mortgage interest allows you to deduct it at tax time.

To make your agreement legally binding, you'll need these two documents:

- **Promissory note.** You'll need to sign a note for the amount of the loan, including the rate of interest, repayment schedule, and other terms, such as penalties for late payments. You can find several promissory notes (including installment payments with and without interest and lump-sum payments with and without interest) for sale on Nolo's website (www.nolo.com). If you're borrowing only a few thousand dollars or less, a promissory note may be all you need. But for most intrafamily loans, it makes legal and financial sense to also prepare a mortgage.
- **Mortgage (or "deed of trust," in some states).** A mortgage gives your lender an interest in your property to secure repayment of your debt (per the promissory note). It needs to be recorded with a public authority, such as the registry of deeds.

Unless you're experienced in real estate transactions, we recommend you get an expert's help with preparing and recording a mortgage and related legal documents. Ask your lender or closing agent for advice, or check out a company like National Family Mortgage. We'll let adviser Timothy Burke explain the advantages of working with a company like National Family Mortgage, namely that, "It makes the process easy. Our intrafamily mortgage payment processing platform issues monthly statement to borrowers and lenders, collects and credits loan payments, and provides year-end tax forms. We even offer a way for borrowers to have their monthly insurance and property tax premiums put into a separate escrow account, just like you'd get with a bank mortgage."

A One-Person Bank: Seller Financing

Surprisingly, the seller can be one of the most flexible sources of financing for your new house. Seem counterintuitive? There are several ways that sellers can help—admittedly not that common, but keep your eyes open for situations where:

- The seller is having difficulty finding a qualified buyer or is anxious to move a house that's been on the market a long time.
- The seller would prefer to be paid over time at a favorable interest rate rather than receive all the equity at the time of sale, perhaps to supply a regular income for upcoming retirement.

- The seller can justify a higher price by helping with the financing.
- The seller's house has substantially appreciated in value over the years, so that the seller will owe a high amount of capital gains tax when it's sold. By in effect selling the house to you over time, the seller can reduce the tax hit.

Here's a brief overview of the various forms of seller financing. As with loans from family and friends, be sure to consult with your primary lender to find out how seller financing will affect your eligibility, and get expert help for documenting and recording the mortgage.

Getting a Mortgage From the Seller

A form of seller financing often called a "seller carryback" allows the seller to essentially sell you the house on an installment plan. The seller transfers ownership of the house to you at the closing, but in return receives a promissory note entitling him or her to scheduled payments and a mortgage, providing a lien on the property until the loan is repaid. It's often structured so that the buyer has a balloon payment after a few years, at which point you'd either refinance or move out of the house. This kind of arrangement works best for a seller who already owns the house free and clear and won't have to turn around and pay off a bank loan upon sale.

You can also use seller financing to cover a second mortgage, when the amount you've saved for a down payment plus your bank loan doesn't quite add up to the sales price. Experts say you can save 1% or 2% by offering to accept a seller-finance arrangement rather than taking out a second bank loan.

If seller financing looks like an option, approach the seller in an organized way (see our suggestions, above, for approaching family and friends). Be prepared to provide detailed information about your income, credit, and employment history, plus references—more information than you'd need for a close relative. As with other private loans, seller financing can be flexible and creative. You might ask the seller for:

- a competitive interest rate (less than you'd pay for a fixed-rate mortgage)
- low initial payments (unless you can easily afford high ones)
- a mortgage rate buydown (as described below)

- no prepayment penalty
- no large balloon payment for at least five years, plus the right to extend the loan at a reasonable interest rate if market conditions make it impossible to refinance or pay the balloon payment in full, and
- the right to have a creditworthy buyer assume the second mortgage if you sell the house.

This is a hard bargain, so be prepared to give up on the less important terms.

Assuming the Seller's Mortgage

Another option might be to assume the seller's mortgage: Essentially, you would take the seller's place with the seller's bank or mortgage holder, subject to all the conditions the seller agreed to. This type of financing makes most sense when the interest rate on the seller's mortgage is lower than the current market rate. It's all aboveboard, done with the lender's consent (unlike something called a "wraparound," where you pay the seller and the seller pays the unwitting bank—not recommended).

One problem with assumable mortgages is that you'll probably have to pay much more for the property than the seller owes on his or her mortgage and will either need a very large down payment or a second mortgage to cover the difference. Since second mortgages are usually at a higher interest rate, you won't want to assume a seller's mortgage if the savings on the assumed mortgage will be cancelled out by the higher rate on the second mortgage.

Another potential problem is that usually, only adjustable rate mortgages (plus FHA and VA loans, with some conditions) are assumable, so the interest rate probably won't stay where it is. Examine how high it might go using the suggestions in Chapter 6.

Finally, the seller usually wants something out of the deal, too: often, a higher asking price. That's because the seller is still on the hook for the mortgage if you default.

Backed by Uncle Sam: Government-Assisted Loans

The government thinks homeownership is a good thing—in fact, the federal Department of Housing and Urban Development (HUD) declares that its mission includes the creation of quality affordable homes for all." That may translate into some financial help for you, depending on where you live and whether you meet the eligibility requirements for programs administered by the:

- Federal Housing Administration (FHA)
- U.S. Department of Veterans Affairs (VA), or
- state and local housing finance programs.

We provide a brief overview of government low-down-payment and insured mortgage programs below, with contact information so you can check the latest offerings and eligibility requirements. New programs spring up all the time.

The application process for many government loan programs is similar to applying for a conventional loan. Your mortgage broker or lender can tell you what's available, which lenders participate, and whether or not you qualify based on your income and other eligibility requirements (such as your veteran status) and the price of the house you want to buy.

TIP

All types of homes qualify. Government loans are often available for loans for new houses, condominiums, co-ops, and manufactured homes—although there will be a few more hoops to jump through in terms of inspections, warranties, and other requirements.

CHECK IT OUT

Looking for a list of all government housing loan programs? Check out the "Housing" and "Veteran" loans sections at www.govloans.gov. In addition, be sure to see the sites mentioned below for FHA, VA, and state and local housing finance programs.

FHA Financing

The Federal Housing Administration, or FHA (an agency of HUD), helps people get into a home using a low down payment. The FHA itself doesn't provide financing, but it does provide government insurance for a variety of fixed- and adjustable-rate mortgages issued through FHA-approved lenders. The insurance means that if you default and the lender forecloses, the FHA reimburses the lender for its losses. This reduces the lender's risk and increases the lender's willingness to offer low-down-payment plans.

The FHA's most popular program (Section 203(b)) requires a low down payment—usually a minimum 3.5% of the sales price. This, coupled with higher loan limits, makes FHA financing more popular with homebuyers now than in previous years. (Maximum loan limits vary by area, but in 2014 are generally between $271,050 and $621,500 for single-family homes in the continental U.S. and up to $938,250 in Alaska, Guam, Hawaii, and the Virgin Islands.) FHA loans are assumable by qualified buyers, which may make your house easier to sell when the time comes. Also, there is no prepayment penalty, should you decide to refinance or pay off your loan early.

FHA loans are a particularly good option for buyers with less than stellar credit histories (including bankruptcy), because they're generally easier to qualify for than conventional loans.

Another important benefit to FHA loans, according to adviser Marjo Diehl, is that, "Unlike with other loans, you're allowed to get the entire down payment, as well as the closing costs, gifted to you. And family members are allowed to cosign on the loan to assist you in qualifying."

Not only gifts, but loans from family members are permitted by the FHA, Timothy Burke notes, "on a secured or unsecured basis, up to 100% of the borrower's required funds to close. This may include the down payment, closing costs, prepaid expenses, and discount points."

Sound good? Unfortunately, FHA loans don't work for all buyers, because of:

- **Fees.** Like all loans, FHA loans might include a loan origination fee (though some have dropped them) that you must pay at closing, plus a higher-than-normal mortgage insurance premium (the up-front portion of which can be added to the amount of the mortgage loan—but not the ongoing premium payments).

- **Appraisals.** The lender must have an appraisal of the house you want to buy done by an FHA-approved appraiser. If the appraised value is less than what you pay for the house, you must make up the difference in cash (not with the FHA loan).
- **Ineligibility of major fixer-uppers.** Standard FHA loan programs won't help you buy properties needing significant repairs; any work recommended by the appraisers must be done before the sale closes. (If you're buying a serious fixer-upper or foreclosure home, check out the FHA's Rehabilitation Mortgage Program, known as Section 203(k).)

If you're planning to buy a condominium, stringent FHA requirements passed in early 2010 may affect you. Lenders will be able to obtain FHA backing only if all the following are true:

- In the case of new projects, the developer has applied for and received preapproval of the entire project before individual buyers apply for their loans.
- The development maintains a reserve fund of 10% of the amount of its annual budget.
- No single investor (whether a person or a company) owns more than 10% of the units.
- No more than 15% of the condo owners are behind on paying their dues.

VA Loans

The VA provides access to competitive loans, usually with no down payment and no PMI, and no prepayment penalty, for men and women currently in military service and to veterans with an honorable discharge. There are specific eligibility rules that primarily relate to the length of service. For example, service personnel now on active duty are eligible after serving 90 days of continuous duty, regardless of when the service began.

Eligible veterans must have a good credit history, proof of employment during the past two years, enough cash to cover any down payment plus the closing costs, and enough income to meet monthly mortgage payments.

The VA doesn't actually make these loans but, similar to the FHA, guarantees repayment to the lender of certain loans (available from participating private lenders, such as mortgage companies, banks, and savings and loans). The most common offerings are 30-year fixed rate mortgages or ARMs.

The VA itself doesn't set a maximum loan amount, but its rules effectively set limits:

- The amount of the loan the VA will repay is based on the size of the loan—in 2014, up to 25% of FHA-estimated median home values. VA maximum guaranty amounts are adjusted annually.
- The loan amount may not exceed the property's "reasonable value," based on the VA's appraisal of the property.

You must pay the VA an administrative ("funding") fee for the loan, typically ranging from 1.5% to 3.3% of the total borrowed (depending on the amount of the down payment). Also, the VA places certain limits on what closing costs you may be charged for.

To avoid making a cash down payment, your loan must be at or below the VA's appraised value for the house. Of course, despite the VA providing backup, you're still expected to repay the whole loan.

CHECK IT OUT

To apply for the VA's "Certificate of Eligibility" (which may take several weeks) and see lists of participating lenders, contact the VA. See its website, www.va.gov (under "Benefits," click "Home Loans"), or call 800-827-1000. Check out VA publications such as *VA-Guaranteed Home Loans for Veterans*. Regional VA offices (listed on the main VA site) may also provide loan information.

State and Local Programs

Your state or local housing financing agency may sponsor special home financing programs at competitive rates and with low-down-payment options for first-time homebuyers. Also look for other local benefits, such as down payment assistance or local tax credits.

CHECK IT OUT

Looking for more information on state and local homebuyer programs? See the HUD website, at www.hud.gov/buying/localbuying.cfm.

What's Next?

Now that you understand all your financing options, you're ready to get out there and buy a house. Chapter 8 shows how to make the most of your house search.

CHAPTER 8

I Love It! It's Perfect! Looking for the Right House

Meet Your Adviser

Nancy Atwood, District Manager with NRT, based in Framingham, Massachusetts. Nancy is responsible for the legal compliance and mentoring of real estate agents who directly serve buyers and sellers.

What she does Nancy started out with ZipRealty, as an agent, then moved up to a position as broker, responsible for 175 full-service buyer and seller agents statewide. She was named a ZipRealty outstanding employee of the year in 2006. ZipRealty was acquired by Realogy in 2014, and became part of its brokerage subsidiary, NRT.

First house "It was a three-bedroom ranch-style home in Harvard, Massachusetts (not the college—Harvard is a rural town, 32 miles west of Boston). Finding it took a little work—I wasn't in real estate then, and our agent kept showing us places that cost $30,000 more than our absolute limit or needed more work than we were then capable of handling. But eventually we found this place and were so excited to be moving out of the city and into an area with good schools and more open space. Still, the house itself was so small that our kids would sit on the washing machine to talk to me while I made dinner."

Likes best about her work "I really like training and helping agents, especially those new to the business—I'm so excited when one of my agents makes his or her first deal. I tell them that it's not a sales job, but a support job, in which customers need to trust you with the largest purchase in their lives. I'm also particularly interested in ethical issues around real estate. Because it's a commission-based job, agents sometimes forget that our fiduciary responsibility is to the clients, not the commission. I tell them you can't control other people's ethics, but you can control your own. My agents like to hear that, they get it, and I'm proud of the fact that we've never had one ethics complaint filed against us here in Massachusetts."

Fantasy house

"The house I live in now. Around 1984, my husband and I bought four acres of land, designed a house, and had it built in Harvard, one quarter mile from the center of town. It's contemporary in style, very open and sunny, with passive solar energy. I know some couples fight over home construction, but for my husband and me it turned out to be an incredible bonding experience. We spent every weekend at Lowe's or Home Depot, choosing fixtures, lighting, and hardware. He did such tasks as the wiring, while I focused on designing the kitchen. It's the biggest room in the house, with granite countertops so I can just roll out my homemade pizza dough, and windows that overlook our neighbors' horse farm."

Top tip for first-time homebuyers

"Choose an agent you can trust. Interview your agent, and ask lots of questions—not only about the agent's experience, but about their level of caring and consistency of customer referrals. For example, when interviewing, I ask agents what they're most proud of. If they say something like, 'I'm still invited to so-and-so's home every December during the holidays,' that's wonderful. There are really a lot of agents like that out there. Don't let the negative things you may have heard about some agents make you settle for one who isn't both caring and professional."

The brakes are off, and you're ready to visit houses that seem to match your Dream List, and choose one. "Whatever you do, don't settle," says Realtor® Maxine Mackle (after 20-plus years of experience in the Connecticut market). "You should be really enthusiastic about a house before you make an offer on it."

Survey Says:

The average homeowner looks at ten to 12 houses before buying one. Some must be looking at a lot more than that, so don't sweat it if you're one of them! One of this book's coauthors looked at over 200 houses before buying (she had a *very* patient agent).

But first, breathe deeply and cultivate some nonattachment. Sellers of beautiful houses usually know they've got a gem and price it accordingly. Meanwhile, the market contains its share of duds: houses with dark rooms, weird layouts, and repair nightmares. This doesn't mean your perfect house isn't out there, just that you're unlikely to find it on day one. So to make your search productive, we'll show you how to:

- get help from your real estate agent, friends, and neighbors
- compare each house with your Dream List, looking past the fancy furniture or staging, the need for fixing up, or the shininess of a recent remodel
- see whether you can live with the layout
- review disclosure and other information you receive from the seller
- do your own, informal inspection for repair issues, and
- understand how to approach buying a not-yet-constructed house, or one in a common interest development (CID).

How Your Agent Can Help

While you should take an active role in househunting, your agent's expertise will be invaluable in several ways.

TIP

Take a photo with your smartphone, get instant info about the house. The award-winning (not to mention addictive) "Homesnap" app brings up data about price (if the house is currently on the market) or estimated value (if it's not), school district, tax assessments, its size, and more. (Inputting an old-fashioned street address works, too, but who can resist trying the photo function?) And while you're at it, the "Walk Score" app can tell you how the house rates for walkability to nearby restaurants, shops, schools, and more.

Diving deep into the Multiple Listing Service (MLS). Using this database, your agent can probably access more information than the general public

Adviser Nancy Atwood explains, "Not only does the MLS provide basic information about the house's price, features, and current status ('active,' 'under contract,' 'sale pending,' or 'closed'), it allows us to check out a home's complete market history (how long it's been for sale, previous offers, offers that fell through, and so forth). For example, the current listing might say that the house has been on the market for only 64 days. But with a little digging, we can see that it has actually been on sale for two years, having previously been listed with another broker. That tells us that the place is overpriced; I'd want to question the current listing broker about what's going on. Or, if a previous offer fell through, we'd ask the listing agent why. Termites? A bad inspection? The MLS can also access public records. For example, we can look at whether a house has been heavily refinanced—which might be important if it's causing the seller to refuse to lower the list price to its current market value. Having all that information handy is really good."

TIP

No need for embarrassment, your agent has heard it all. Some agents' stories might as easily have come from a therapist: homebuyers they've counseled about whether to have children, couples whose divorces they predicted. Get used to your agent knowing your private concerns, but try to work out issues on your own. A house visit isn't the place to argue about whether you need an extra bedroom for your mother-in-law to live in.

Knowing the inside scoop. Apart from the MLS, the agent has been watching the market for longer than you and may hear about houses coming up for sale long before they're advertised—valuable even in a down market, where the most desirable houses become the focus of buyers' interest. You'll be driving along and hear your agent say, "If you can wait another week, that house will be on the market."

Identifying reasonable sellers. When the market is dropping, some sellers may be stuck in the past, or bent on getting a certain price. Your agent may be able to find out which houses' sellers are worth negotiating with or are ready to drop their price.

Arranging showings. Your agent should take you to tour homes you're interested in—more than once per house, if need be.

Helping evaluate houses. Another set of eyes can be a great help when visiting houses. Your agent may point out defects that you missed or possibilities you hadn't imagined. Just don't let your agent's judgment overtake your own. And don't be shy about visiting houses without your agent—you can always bring the agent back for a second look. (And you absolutely *should* bring your agent back into the process when it's time to prepare an offer.)

And more. Some agents find creative ways to help. For example, home-buyers visiting from out of town may find their agent is willing to pick them up at the airport and make hotel reservations. Realtor® Mark Nash keeps five umbrellas in his car for rainy days. And agents regularly work evenings and weekends, showing you houses, reporting back on houses they've previewed, and more.

Best thing we ever did

Visit open houses without our Realtor®. Although Pat and her husband loved their Realtor® (their second one, after they'd fired the first), she was extremely busy. And, says Pat, "We knew finding an affordable house in a good school district, with yard space for our children, wasn't going to be easy—so we spent Sundays looking at every open house we could. By a stroke of luck, an agent at an open house told us that a nearby house would be up for sale soon. Its owner lived out of state and needed to sell in a hurry. Our Realtor® made some calls, and we put in a bid. On Christmas Eve, we found out that our bid had been accepted, and we got the house!"

What's Better? Open House or Individual Appointment?

The answer may actually be "both." Open houses are great for scoping out the possibilities quickly and anonymously, particularly on an action-packed Sunday. Visiting open houses unaccompanied by your agent can be nice for gauging your own reactions with no outside influence. But a quick visit is never enough—if a house looks promising, it's worth revisiting, with your agent.

The Rumor Mill: Getting House Tips From Friends

People planning to sell their house don't usually make a big secret out of it—they tell friends and neighbors, long before they formally list the house. If you can tap into the same network (most likely if you already live nearby), you may find out about a house before it's up for sale.

Tell friends, neighbors, your hair stylist, the florist, your dentist, and more. Some home seekers even print up letters explaining exactly what they're looking for and promising a treat or reward to anyone who helps them find a house.

Luke: *Maybe one place wasn't so bad.*

Lorelai: *Oh good, describe it to me.*

Luke: *I don't know. It had walls with a kind of a floor with a light.*

Lorelai: *Okay, hold on there, mister. If you tell me it's got a roof, I'm stealing that baby out from under you.*

—From the TV series *Gilmore Girls*, 2000

Keeping Track of New Listings

One of the most difficult parts of buying a home can be simply finding an acceptable one that's up for sale! Although the real estate market has improved in recent years, it's still true that fewer homes come on the market than is considered "normal." That means that in many areas of the U.S., buyers pounce on new homes as soon as they come up for sale.

This requires a proactive approach to househunting. As discussed, your agent can be a good inside source of information here. Another good strategy is to sign up for new-listing alerts from real estate websites such as Realtor.com or Zillow.

Planning Ahead for House Visits

Don't get too ambitious—most buyers find that visiting between four and eight houses per day is all they can handle before their brains fry. To make the most of your visits, do some prep work. Make sure you've got not only the complete list of houses you want to visit and a map, but all the items on the House Visit Checklist shown below.

ONLINE TOOLKIT

You'll find a blank version of the "House Visit Checklist" on the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.)

While you're looking at a house, the seller's agent (and the seller if present) are evaluating you. Dress comfortably but professionally, without overdoing it. As Illinois Realtor® Mark Nash puts it, "A lot of bling or overdress means the seller or agent will think you can afford full price. You want to be well groomed, understated, and home-price-range appropriate. This is a business transaction—don't give them a negotiating edge by allowing them to overread you."

TIP

If the house has a rental unit, never tell existing tenants what you will or won't do as owner. For instance, saying "I'll keep the rent low" could create false expectations, leading to later arguments. But be friendly, and ask tenants for information concerning roof leaks, sewer backups, break-ins, and more. Tenants may reveal things you'd never learn any other way.

Unless your child is small enough to carry in a sling or backpack, leave the kids at home for the first visit. Most parents can focus better without chasing a toddler or hearing choruses of "This will be *my* bedroom"/"No, *mine!*" You can (and should) get your kids' okay later. And this should go without saying, but don't bring your pets.

House Visit Checklist

Tuck the following into your bag:

- ☐ your Dream List (from Chapter 2)
- ☐ your list of Questions for the Seller or Condo/Co-op Checklist (from later in this chapter)
- ☐ your First-Look Home Inspection Checklist (from later in this chapter)
- ☐ something for taking notes (a pen and paper or smartphone)
- ☐ binoculars (handy for examining the roof)
- ☐ a camera, camcorder, or smartphone, to remind yourself of what you saw
- ☐ a tape measure and notes on the type and size of your furniture.

Come on In: What to Expect as You Enter

Okay, your feet are crossing the welcome mat, and you're getting your first peek inside. The seller's agent is probably in one of the front rooms, happy to greet you and to answer questions. If you've made an appointment, either the seller's agent will let you and your agent in, or the agent will get a key from a lockbox. In rare cases (and with FSBOs), the seller will be there as well.

TIP

If it's *really* awful, you can leave! No need to be polite and do the full tour. While some aspects of a house can be changed, such as filthy blinds or old cabinets, trust your instincts and don't waste your time.

Picking Up the Paperwork

Your first task is to see what paperwork the sellers have made available to you. This might include a property fact sheet, with basic information like the house's size and amenities; a disclosure form that details what the seller personally knows about the condition of the house's features, appliances, and environment; and/or a pest report and possibly a general inspection report, including details discovered by a professional.

You probably won't get all three of these—you may get none, or only the basic fact sheet or a flyer. How much information a seller is *legally* required to give potential buyers varies from state to state (though they may give more).

TIP

"As-is" on a fact sheet equals red flag. It normally means the seller wants you to buy the house without requesting payment for any repairs, perhaps without even doing a home inspection. Ask what it means to *this* seller.

First Questions to Ask

If the house looks promising, you and your agent should ask some basic questions concerning repair needs, utility costs, neighbors, and more. You'll most likely ask these of the seller's agent, but if the seller is there, or is selling without an agent, ask the seller directly.

ONLINE TOOLKIT

Use the "Questions for Seller Worksheet" in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.) A sample is shown below. Tailor this worksheet to your interests, for example, adding a question on whether there's hardwood flooring under any carpets. (Also, if you're buying a condo or co-op, the Toolkit contains a separate checklist for you.)

Questions for Seller Worksheet

Here are some basic questions you and your agent will want to ask about a particular house, in terms of repair needs, utility costs, and neighbors. Add anything else to this list of interest—for example, if you have specific questions about the garden. You'll most likely ask the seller's agent these questions, but if the seller is there, or is selling without an agent, ask the seller directly.

1. How long has the house been on the market? ____________________

2. What repairs or improvements have been done in the last few years?

   ____
   ____
   ____

   What are the house's major or most immediate repair needs?

   ____

3. Does the seller use a particular repairperson, plumber, electrician, or pest control person? If so, please provide their names: ____________________

   ____

4. How much money does the owner pay for monthly utilities (gas, garbage, electricity, water, cable, or satellite)?
   $ ____

   Are there any other ongoing costs? $ ____________________________

5. Has the owner had any problems with water or dampness in the basement or any other part of the house?

6. Is there a furnace and a central A/C system, and if so, when was it installed?

7. How are the neighbors? Are there issues regarding fences, trees, or property lines? Is there any kind of organized neighborhood association? Are there many school-aged kids on the street?

Questions for Seller Worksheet, continued

NOTES:

How to evaluate the answers:

1. If it's more than a few weeks (depending on how fast houses are moving in your market), ask whether there's been a price drop and whether any offers have fallen through and why. Maybe it's overpriced and ripe for you to make a lower bid on.

2. Some of these repair problems may be stated in the pest or other inspection report, but it's helpful to have the agent summarize them for you. Don't hesitate to be direct and ask things like "Have there been any roof leaks?"

3. Any use of repairpeople can reveal repair issues the seller didn't mention when answering Question #2. The information will also be useful if and when you move in!

4. If you're stretching just to buy the house, make sure it doesn't come with unusually high ongoing costs.

5. The basement and attic are likely suspects here. Moisture problems are hard to repair and hard to insure.

6. Installing a new furnace or A/C can be another major expense—and one that's important to deal with soon, for the sake of your personal comfort.

7. Difficult neighbors can't be repaired, while a community that works together can enhance livability. Specifically ask about their level of noise; cooperation regarding fence, tree, or parking issues; and any behavioral problems or oddities (school-age kids can, unfortunetely, be a source of trouble).

Do We Have a Match? Using Your Dream List

Even the "right" house probably won't be just as you imagined. Carrying your Dream List (with the first two columns filled out) will help you stay organized and avoid getting distracted—for example, being so impressed with stainless steel appliances that you forget that one bathroom won't be enough. Fill out your Dream List before leaving each house. At the end of a day's househunting, when you can barely remember your own name, it will answer questions like, "Was it the brick house that had the patio?"

TIP

Get organized. Keep a file for each house that seems like a possible match. Include your filled-out Dream List, property fact sheet, and other paperwork.

All the World's Been Staged: Looking Past the Glitter

In the old days, you'd see houses for sale pretty much as the sellers lived in them—with their furniture, dishes, and clutter. But in many parts of the U.S., the real estate industry has learned that by emptying out and then gussying up a place, with rented furniture, flowers, curtains, artwork, and more, buyers will be wowed into paying more—often tens of thousands more—for a home.

The resulting makeover job goes by the trade name "staging." And it's your job to look past it, to see whether the house has good bones or is just wearing a lot of cosmetics and concealer. To avoid being hypnotized:

- **Figure out whether each room has all the furniture it needs.** Stagers usually remove most of the owner's furniture and then bring in a select few pieces—some smaller than normal. As you look at a bedroom, for example, picture it with your queen-sized bed, nightstands, and bureau, not the twin bed and delicate side table.
- **Notice where flowers and knickknacks have replaced functional objects.** In a normal laundry room, you'd expect to find detergent, laundry

baskets, and a drying rack. Not in a staged house—you're more likely to see a wicker basket filled with fluffy, lavender-scented towels.

- **Observe what your eyes are being led toward—and therefore away from.** If the entry hallway is small and dark, you can bet you'll see a glorious display of flowers on a nearby table.
- **See whether your stuff will fit into the closets and cabinets.** With the owners having moved out their clutter, you might not immediately notice that there's no hall closet, linen closet, medicine cabinet, basement, or attic.
- **Figure out what style the house is without the staging.** Stagers can make a ranch house look like a Victorian, or a 1950s drab home look like an Arts and Crafts bungalow.
- **Turn on all the lights, including table lamps.** Stagers often set lamps next to beds or couches, even though there's no electrical outlet. A lack of outlets is a common defect in older homes. Also, check that kitchen and laundry appliances actually have a source of power and other connections needed for operation.
- **And smell that apple pie.** If the house smells dreamy or the music sounds divine—well, someone made it that way. And they don't come with the house.

Staging isn't all trickery—if it's well done, you might pick up some ideas for how you'd do up the place yourself. Just don't pay more than the house is worth simply because it looked gorgeous after the staging job.

Recent Remodels: What to Watch Out For

If you can afford a house that someone else has fixed up, great—you can save a lot of effort and ongoing maintenance. But not all sellers have good motives, judgment, or taste. In particular, watch out for houses where the seller has:

- **Never lived there, but fixed it up to make a profit.** This is called "flipping." Unfortunately, since the seller had no personal stake in the house, you can't count on good materials or workmanship. If you get as far as making an offer, you'll of course hire an inspector. But before things get that serious, save yourself a heap of trouble by making sure the necessary permits were issued and getting an independent appraisal before relying on appraisal reports the seller shows you. Fraud cases involving flipping are surprisingly common, where the appraiser is in cahoots with a seller and overvalues the house based on superficial or low-quality improvements.

- **Made fix-ups to suit unique tastes.** Overcustomizing can be detrimental to a house's value, like if the seller was a sports fan who did the whole house in team colors. If you and the seller are kindred spirits, great—but good luck finding the next buyer.
- **Overimproved the house.** A property can actually be made so fabulous that it's no longer comparable to surrounding homes. Unfortunately, surrounding homes set the standard for home values in that area. You might enjoy the house while you live there, but be prepared for slow rises in value and difficulty reselling.

Donkey: *Whoa. Look at that. Who'd wanna live in a place like that?*

Shrek: *That would be my home.*

Donkey: *Oh and it is LOVELY. You know, you're really quite a decorator. It's amazing what you've done with such a modest budget. I like that boulder. That is a NICE boulder.*

From the movie *Shrek*, 2001.

Walk the Walk: Layout and Floor Plan

The physical layout of a house can make a huge difference in whether you're comfortable living there. When visiting a house, imagine going through your daily activities. For example, "I'm opening the refrigerator—it bumps the oven door, and I'll have to chop vegetables on this tiny countertop across from the sink."

Best thing I ever did

Not buy the house with the weirdly placed bathroom. Kurt, an avid gardener, was close to bidding on a two-bedroom Victorian. He says, "It was on a corner, with a lot of garden space around it. I was already visualizing planting roses. The problem was, the one and only bathroom was stuck right between one bedroom and the kitchen. It just had a door on each side. Imagine being a guest and having to worry about locking both doors! I'm hugely relieved I held off."

Feng Shui Tips

The Chinese practice of feng shui is based on a simple truth: Your exterior and interior surroundings can influence your life. Even if you don't believe it, a house with good feng shui may appeal to later buyers. According to feng shui consultant and author Kartar Diamond (www.fengshuisolutions.net), "Every house has what I call an energetic blueprint. This can either enhance or undermine your health, well-being, and career." Though some feng shui issues can be fixed, Diamond recommends homebuyers avoid the following problems:

Exteriors

- lots of cracks in the outdoor pavement
- a triangular-shaped lot or one that narrows in the back
- a corner house on a busy street
- a house at the bottom of a cul-de-sac or below street level
- trees that appear to be leaning away from the property (like they're trying to escape!)
- a house within view of a cemetery, church, hospital, fire station, ugly eyesore, or place that makes a lot of noise, like an auto repair shop or bar.

Interiors

- chronically dark rooms or tight, congestive spaces
- uneven floors
- big exposed beams in the bedrooms
- front door aligned directly with back door or window
- toilet or kitchen in center of house
- stairs right behind entrance door.

What Do They Know? Reviewing Seller Disclosure Reports

One of the most important pieces of paper in this process is the disclosure report, which most—but not all—states legally require sellers to give prospective buyers. (Exceptions are sometimes made for certain properties, such as those in probate, where the original owner has died.) And it's become a standard practice even in states where the laws don't require it.

Most seller disclosures are made using a standard form, upon which the seller will check off features of the property and rate or describe their condition. If the house hasn't yet been built, the developer obviously won't have much to disclose—but may still need to tell you about things like the type of soil; previous uses of the property; possible future uses of surrounding land; and the developer's intentions regarding existing trees, streams, and natural areas.

What you read may affect your decision whether to make an offer. To find out more about a topic mentioned in the form, ask for it in writing. And if you receive the disclosure form *after* making an offer, you can cancel the sale if you don't like what you read. Even after the sale has closed, if a problem pops up that you believe the seller knew about and didn't disclose, you can sue the seller on that basis.

Exactly *when* you're given the seller's disclosures varies by state. In a few states, such as Alaska, Kentucky, and New Hampshire, sellers must give you disclosures before you've made an offer. But most states don't require the seller to do this until *after* you've made an offer, often just before the two of you sign the purchase agreement.

What's in a Typical Disclosure Report

The typical disclosure form is a few pages long and describes features like appliances; the roof, foundation, and other structural components; electrical, water, sewer, heating, and other mechanical systems; trees, natural hazards (earthquakes, flooding, hurricanes); environmental hazards (lead, asbestos, mold, radon, or contamination by use as a meth lab); and zoning.

Some disclosure forms also cover legal issues, such as ownership problems, legal disputes concerning the property, or community association fees. Strange but true, the forms might also require information about suicides, murders, and other deaths on the property; nearby criminal activity; or other factors, such as excessive neighborhood noise.

ONLINE TOOLKIT

See the sample disclosure forms in the Homebuyer's Toolkit on the Nolo website. (See the appendix for the link.) They're from Iowa and California, representing a range between short and long versions of the form. (California's disclosure laws are among the most demanding in the country and require sellers to also fill out a Natural Hazard Disclosure Statement, also included.) A page from the California transfer disclosure form is shown below.

California Real Estate Transfer Disclosure Statement

(CALIFORNIA CIVIL CODE § 1102.6)

THIS DISCLOSURE STATEMENT CONCERNS THE REAL PROPERTY SITUATED IN THE CITY OF ____________________, COUNTY OF ____________________, STATE OF CALIFORNIA, DESCRIBED AS ____.

THIS STATEMENT IS A DISCLOSURE OF THE CONDITION OF THE ABOVE-DESCRIBED PROPERTY IN COMPLIANCE WITH SECTION 1102 OF THE CIVIL CODE AS OF ____________________, __________. IT IS NOT A WARRANTY OF ANY KIND BY THE SELLER(S) OR ANY AGENT(S) REPRESENTING ANY PRINCIPAL(S) IN THIS TRANSACTION, AND IT IS NOT A SUBSTITUTE FOR ANY INSPECTIONS OR WARRANTIES THE PRINCIPAL(S) MAY WISH TO OBTAIN.

I
COORDINATION WITH OTHER DISCLOSURE FORMS

This Real Estate Transfer Disclosure Statement is made pursuant to Section 1102 of the Civil Code. Other statutes require disclosures, depending upon the details of the particular real estate transaction (for example: special study zone and purchase-money liens on residential property).

Substituted Disclosures: The following disclosures and other disclosures required by law, including the Natural Hazard Disclosure Report/Statement that may include airport annoyances, earthquake, fire, flood, or special assessment information, have been or will be made in connection with this real estate transfer, and are intended to satisfy the disclosure obligations on this form, where the subject matter is the same:

☐ Inspection reports completed pursuant to the contract of sale or receipt for deposit.

☐ Additional inspection reports or disclosures: ____

____

____

II
SELLER'S INFORMATION

The Seller discloses the following information with the knowledge that even though this is not a warranty, prospective Buyers may rely on this information in deciding whether and on what terms to purchase the subject property. Seller hereby authorizes any agent(s) representing any principal(s) in this transaction to provide a copy of this statement to any person or entity in connection with any actual or anticipated sale of the property.

THE FOLLOWING ARE REPRESENTATIONS MADE BY THE SELLER(S) AND ARE NOT THE REPRESENTATIONS OF THE AGENT(S), IF ANY. THIS INFORMATION IS A DISCLOSURE AND IT IS NOT INTENDED TO BE PART OF ANY CONTRACT BETWEEN THE BUYER AND SELLER.

Seller ☐ is ☐ is not occupying the property.

A. The subject property has the items checked below (read across):

☐ Range	☐ Oven	☐ Microwave
☐ Dishwasher	☐ Trash Compactor	☐ Garbage Disposal
☐ Washer/Dryer Hookups	☐ Rain Gutters	☐ Carbon Monoxide Device(s)
☐ Fire Alarm	☐ TV Antenna	☐ Satellite Dish
☐ Intercom	☐ Central Heating	☐ Central Air Conditioning
☐ Evaporator Cooler(s)	☐ Wall/Window Air Conditioning	☐ Sprinklers