Notes

Housing

Module Description

A ninety-to-one hundred and twenty minute interactive program suitable for all audiences, designed to develop knowledge and skills that will provide participants with the information needed in order to buy a home that will best suit their family's needs and finances. It is designed to introduce participants to the steps involved in purchasing a home. The offer to purchase, contingency clauses, various closing and pre-paid costs, and types of mortgage loans are discussed.

Materials

Financial Planning Worksheet

Checklist for Your House Hunt

Calculating Your Monthly Debt Ratio

Interviewing Agents

Setting Your Price Range

Checklist for Financing Your Purchase

Figuring Your Monthly Payments

Mortgage Affordability Chart

ARM vs. 30-Year Fixed-Rate Loan

Requesting a Quote for Homeowners Insurance

Homeowners Coverage

Additional materials, not required but beneficial:

Calculators and pencils

Pay Chart

VA Form 26-1880

Department of Veterans Affairs. Turning Dreams Into Reality: VA Home Loan Workshop

Local Property Taxes

Various other pamphlets that may be appropriate and available.

Note

This module is designed to be delivered in a lecture, question/answer format. Class discussion and participation should be encouraged depending on the size of the class.

Notes

Instructor References

Relevant Websites:
www.lifelines4qol.com

SECNAVINST 1754.1, Family Service Center Program

OPNAV Instruction 1740.5A (Draft), Personal Financial Management Education, Training and Counseling Program

Command Financial Specialist Training Manual, NAVPERS 1560.8C (or later)

Baldwin, Ben G. (1991). The Complete Book of Insurance. Chicago, Ill.: Probus Publishing company, 1991.

Bamford, Janet, et al (1995). The Consumer Reports Money Book. Yonkers, NY: Consumers Union.

Clark, Jordan. (1998). "Beat the System." Moneysworth. Boulder, CO.

Finding and Financing Home. USAA Foundation (1994).

Garton-Good, Julie (1994). All About Mortgages. Dearborn Financial Publishing.

Glink, Ilyce R. (1996). 10 Steps to Home Ownership: A Workbook for First-Time Homebuyers

O'Hara, Shelley (1994). The Complete Idiot's Guide to Buying & Selling a Home. Indianapolis, IN: Alpha Books.

Pond, Jonathan D. (1993). The New Century Family Money Book. NY: Dell Publishing.

Thomsett, Michael C. (1994) How to Buy a House, Condo, Co-op. Yonkers, NY: Consumers Union.

Objectives

At the conclusion of this program participants will be able to:

- Calculate what price home they can afford.
- Name four types of mortgage loans available.
- Identify various pre-paid and closing costs and about how much they total.
- Identify those items and contingency clauses important to include in an offer to purchase.

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Introduction

1. Introduce self:

Financial education background, affiliation with Navy.

A home is one of the most complicated and costly purchases you'll ever make. Getting the best deal at the time of purchase can reduce "life-of-the-loan" costs by thousands of dollars. This class will help buyers understand the many factors of this important purchase.

2. Introductory questions and discussion:

Ask some motivational questions and solicit answers from participants.

- How many of you are considering buying a home in the near future?
- Which is better—an ARM or fixed-rate mortgage?
- Who is looking out for the interests of the buyer during a real estate negotiation?
- Take five minutes and write down what you think the top five financial and top five emotional mistakes first-time home buyers make.

Purpose and Agenda

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1. State purpose and review agenda

Despite the importance of this major purchasing decision, many individuals do not have the information they need. The purpose of our class is to provide complete, objective, and unbiased information so prospective military home buyers will be confident in their decision whether or not to purchase a home, and better able to negotiate the potential financial pitfalls they may encounter during the home purchase process. Specifically, we will cover: 3

- Renting versus buying
- How much house can you comfortably afford
- What to look for in a neighborhood
- For whom does a real estate agent really work
- The importance of contingency clauses in your offer to purchase
- Types of mortgage loans
- The approximate closing and pre-paid costs
- Adjustable rate mortgages (ARMs) versus fixed-rate mortgages and their respective advantages and disadvantages
- Homeowner's insurance
- The top 5 financial and emotional mistakes new home buyers make

NOTE:
Pass out Financial Planning Worksheet with all handouts listed under Required Materials. Pass out pay charts, pencils, and calculators if available.

Rent or Buy

Some of you may not be facing this choice yet as you are living on base. However, at some point in your life you will be making the choice between renting and buying. To evaluate whether renting or buying is best for your family, consider some of the pros and cons of each choice:

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1. Renting may be better if:

- You move a lot. Unless you live in one place at least five to seven years, you will probably lose money when selling your home. If you cannot sell, you may become a landlord by having to rent your home.

- You are unfamiliar with the area. Before taking the plunge and buying a home, the potential buyer may want to identify a neighborhood and rent there first to determine its ultimate long-term desirability.

- You are low on cash to cover the down payment and initial costs involved in purchasing a home. Renting a while in order to save for a down payment and closing costs makes sense.

- You do not care to commit the time, effort, and expense of maintaining a home. The costs of maintaining a home greatly exceeds those of renting. If you cannot imagine not calling a landlord to fix the backed-up drain in the bathtub, you should rent.

- You are separating or retiring from the military. The VA has become much stricter about lending to separatees or retirees until two to three years after their dates of separation/retirement.

2. Buying may be better if: 5

- You are moving to an area enjoying high appreciation in the value of residential property. If an area's homes are appreciating at rates of 5 to 10 % a year, your home's increased value should offset the costs of selling it should you be transferred.

- You can afford to buy a home that will allow you to itemize on your tax return and include those charitable contributions. It must be expensive enough that the interest paid and real estate taxes nearly equal or exceed the standard deduction. We will elaborate on this point in a few minutes.

- You own pets that may be frowned upon by landlords.

- You are ready for stability and a sense of community. Buying a home automatically commits you to a region and a neighborhood. You become very interested in the zoning laws, the tax rates, the city's/county's plans for expansion and growth, and the appearance of your neighbor's property.

If you have the option, living in military housing may be the best choice for the mobile lifestyle military members live. While in housing you will not receive basic allowance for housing (BAH). However, many of your costs are covered and you have no monthly housing payments. The reality for most service members is that military housing is unavailable or the waiting list is so long that they must find other housing first. In this case, you will receive your housing allowance and pay all housing costs yourself. BAH is based on rental costs by pay grade, dependency

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status, and location. It is not designed to cover all your housing costs but is intended to allow you to maintain a standard quality of housing regardless of your duty station. For more information on BAH refer to the Military Pay Issues module.

Renters should always complete a through checklist upon move in, keep a copy signed by you and the landlord, and provide one to the landlord. This will protect you when you move out from being charged for repairs on preexisting conditions. Be sure to cover everything, down to a crack in the wall, window, or paint. Even though it seems extensive, no item is too small to note. Some landlords have charged servicemembers for a multitude of problems that existed before they even moved in! Any damage deposit you paid will be refunded after a checkout walkthrough. Be sure to bring your checklist with you for this, it is your protection from being charged for repairing damage you did not cause.

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What Are Your Goals?

Handout:
Checklist for Your House Hunt

1. The most important step in buying a home is defining what you want:

Your goals might seem obvious — your growing family needs a larger home — but don't let what seems obvious set your limits. Sit down with the family and talk about your dream house. Make a list.

Try to balance your needs and wants. Start by thinking about your present home and identify which features you really like. Next, envision your new home and try to build it in your mind. Does it have more bedrooms than your present home or a workbench in the garage, a fireplace, gas or electric stove?

Take the list you've created and divide it into **"needs"** and **"wants"**. The "needs" list will narrow your search by eliminating those houses that are hopelessly wrong for you. Your "wants" list will help you choose among the remaining possibilities.

2. What can you afford?

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NOTE:
Instructor should demonstrate the handout, Setting Your Price Range.

Have each participant determine their own price range.

Set your price range first. Know what you can afford. Looking at homes that are beyond a comfortable price limit will only result in frustration and wasted energy. The upper limit of your price range is the mortgage loan amount for which you qualify. However, keep one thing in mind. You may not want to purchase a home which price is at your upper limit. Make an honest assessment of your lifestyle. There may be other things you like to do rather than put most of your budget into house payments and maintenance. Some factors to consider include:

- Lenders base mortgage loan decisions on a number of factors:

    1. Income

    2. Debt

    3. Credit history

    4. Down payment

- Down Payment:
  A down payment is money you agree to pay, usually in a cashiers check, at the time of purchase. Your down payment will probably affect your price range because the loan amount is based on the purchase price, minus the down payment.

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The typical down payment for various loans are:

1. **Conventional** - 20% of the loan amount, with a minimum requirement of 5 to 10 percent. Conventional loans are not guaranteed or insured by the federal government.
2. **FHA (Federal Housing Administration)** - 3 to 5 percent. Available in all 50 states. Government insured.
3. **VA** - no down payment required. Loan amounts are generally higher than FHA. Both FHA and VA maximum loan amounts change periodically. (guaranteed by the Department of Veterans Affairs).

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Monthly Debt Ratio:

1. Mortgage payment should not exceed 28%of your gross monthly income.
2. All monthly debt obligations, including your mortgage payment, should not exceed 36 %of your combined gross monthly income.
3. VA will allow a total monthly debt ratio of 41%

Handout:
Calculating Your Debt to Income Ratio

Have each participant determine their own ratio.

These ratios are not as ironclad as they once were. Today, new buyers with good credit, adequate assets and an above-average down payment can qualify for a mortgage loan with higher ratios. The housing expense includes what you pay monthly (rent or mortgage/insurance/taxes) plus all utilities. Available income refers to what is left after taxes and normal deductions. If you are paying more then 36% in monthly debt obligations, you are likely to be living beyond your means, high housing costs may be limiting the rest of your budget.

Targeting Neighborhoods

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Handout:
Checklist for Your House Hunt

1. Golden Rule of Real Estate

"The three most important considerations about real estate are location, location, and location."

2. Take a tour

Find a good city map and the classified ads section of your local newspaper.

Survey prospective neighborhoods. Get to know various areas by selecting a dozen homes from the ads, then make a day of visiting them. The idea here isn't to find "the" house, but to narrow your search to the most desirable neighborhood. Remember it's much easier to fix up a house than a neighborhood. Contact a licensed real estate agent to help you with your survey, especially if you are unfamiliar with the area.

3. Family's needs

Considerations in this area include: driving time to work, shopping, recreation, medical care, church, and public transportation.

4. Crime

Talk to potential neighbors in various parts of town and in specific neighborhoods in which you might be interested. Ask the local police department if it furnishes comparative statistics.

5. School Districts

This will be easier if you have crystallized your definition of a "good" district and understand your children's individual needs.

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Even if you don't have school-aged children, don't overlook school district boundaries. This factor may figure prominently in the resale value of your home.

TIP: Look for a high concentration of military families. These neighborhoods have established themselves as attractive to military families. With a steady turnover of incoming and outgoing military families, it may make it easier to sell your home when the time comes.

Selecting a Real Estate Agent

10 **1. What can they do:**

A real estate agent can help:

Handout: *Interviewing Agents*

- Target suitable neighborhoods,
- Tell you which homes are available,
- Identify their cost, and
- Compare the cost per square foot of nearby homes that have recently sold,
- Assess your financial situation,
- And manage the myriad details of your purchase.

2. The players:

11 Let's review the various professionals associated with real estate.

- **Principal broker:** A self-employed individual who is licensed to operate a real estate office. May work independently or hire other agents. All real estate professionals must work under a principal broker's license.

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- **Realtor:** A member of the National Association of Realtors, a state Realtor's association and a local Board of Realtors. They are also bound by the Realtor's Code of Ethics. Realtors may access the Multiple Listing Service (MLS), a local computerized database of for-sale homes, unavailable to most non-Realtors. Through the MLS, a Realtor can give you a detailed printout on each listed home you plan to consider.

- **Agent:** The generic name for any licensed real estate professional (e.g. broker, Realtor). The three kinds of agents are:

  1) Listing agent: Signs up the home seller with a broker and "lists" the home with the MLS. As a buyer, you may never meet the listing agent. When the house sells, both the listing agent and the selling agent split part of their commission with their respective brokers.

  2) Selling agent: Usually learns about the for-sale house through the MLS, then finds the buyer. Though this is the agent which works with the buyer, he/she legally represents the seller and must get the best possible deal for the seller.

  3) Buyer's agent: Buyer's agents help the buyer find the house, terms and conditions most favorable to the buyer. The relationship is defined in a contract. Buyer's agents usually split part of their commissions with their brokers or may charge a fee for services. (This service may not be available in all areas, and may differ in practice by city or state. In Virginia, the seller usually pays buyer's agent's commission).

TIP: The law and the Realtor's Code of Ethics require that you be treated fairly and given full disclosure of all facts about the property. However, you are not required nor should you reveal the amount you may be willing to pay for a property. If you offer to buy a house for $80,000, for example, but tell the selling agent you are willing to pay $85,000, the selling agent is required to pass that information along to the seller. You will probably end up paying $85,000.

3. Questions to ask:

No matter what kind of agent you use, take time to find one you feel good about.

- Look for the agents and companies that have the most signs in the neighborhoods you like.
- Ask the managing broker to pair you with an agent that likes working with buyers. Ask friends and co-workers for a personal recommendation. It's still the best way to find a good agent.
- Look for solid credentials. Someone who listens well and can translate your wishes into homes and neighborhoods you like.
- Don't be pressured to choose a neighborhood that does not suit you or a house after visiting only four or so prospective properties. Drop that agent and find another.

TIP: Something else to keep in mind — the agent with the most For Sale signs in the neighborhood may not be the best to work with buyers. They tend to concentrate on listing property

Finding the Right Home

12 ***Handout:*** *Checklist for Your House Hunt*

1. If you use a real estate agent to assist you

- Arrange a meeting with your family to discuss house hunting goals. The more the agent knows about your family, the more effective he or she can be.
- Discuss your "needs" and "wants" lists and ask for suggestions. Review positive features of your previous homes.
- Discuss areas you have visited and ask for recommended neighborhoods you haven't seen yet.
- Have the agent recheck your loan qualifications. Armed with this information, the agent will arrange appointments for you to see homes in your price range.

2. When you look at homes

- Remember the ancient Latin principle of commerce: Caveat Emptor (let the buyer beware).
- Research the reputation of a home's builder (BBB).
- Look for signs indicating built-in quality: Is water pipe tubing made of PVC or a more expensive and durable material, like copper.

3. Consider a home's potential for improvement

- Are there title restrictions, zoning, homeowners association ordinances or other regulations prohibit you from making intended improvements?

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- What about structural and physical limitations? Could the structure accommodate a second story? Is there room to add a detached garage? If the home is on the water, are there any environmental restrictions?

4. Examine previous owner's utility bill

Rural homes usually have a septic system and a well. Ask to see copies of the percolation (perc) test made before the septic system was built. It will show whether the drainage on the property is adequate to handle waste disposal. Also ask to see reports certifying the quality of the home's well water.

TIP: Once you've decided on the home that's right for you, however, submit an offer and pursue it diligently. Many winning offers have been submitted and accepted while the first would-be buyers were still trying to make up their minds.

5. Purchasing resources

There are several sources from which one can purchase a home:

- The multiple listing service, which I have previously mentioned, features homes listed with real estate companies.
- The acronym FSBO stands for sale by owner. FSBOs can be excellent buys, but are more difficult to find since they are not listed in the MLS and are not shown by agents. They are usually advertised in the newspaper. If you have found a house you wish to buy directly from its owner, you should seek the help of an attorney who specializes in real estate transactions.
- Foreclosures can be downright bargains. Look in the newspaper for houses for sale by the Department of Veterans Affairs (VA), Federal Housing Administration

(FHA), Resolution Trust Corporation (RTC), Federal Deposit Insurance Corporation (FDIC) and other government agencies. Some local lenders may have foreclosed properties for sale. These are called Real Estate Owned (REO). Some come with excellent terms, others are sold at public auctions and require cash payment or a letter of credit. Many foreclosures need repairs ranging from cosmetic to structural. Ask your local agent for lists and acquisition information.

Negotiating the Deal

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You might think it is time to relax once you find your home because the hardest part is over. That can be an expensive mistake. Negotiating the deal and financing the purchase are just as important.

1. Offer to purchase

When you find the home you want, the next step is presenting an offer to purchase contract. After you make an offer, the seller may accept it, reject it or make a counter offer. If a counter offer is made — and they are quite common — you, in turn, may accept it, reject it or make another counter offer. This process continues until both parties agree or until one of you refuses to negotiate further. Be certain to put everything in writing.

- Set your price.
- Identify type of mortgage, if needed, acceptable to you.
- List personal property you may wish included; such as the refrigerator, washer and dryer, curtains, dining room chandelier to name a few.
- List needed repairs; i.e. peeling paint, cracked window panes,
- Cleaning or replacing carpet,

- Home inspection, make sure there is a contingency clause in the contract to allow the inspection and to give you an escape in case the inspection reveals problems which the buyer refuses to fix. More on that later.

2. Other factors to consider

- An earnest money deposit, though not required, shows your "good faith" while negotiating.
- The amount of the earnest money deposit may vary, usually $500 up to 10 percent of the sale price. If you cancel the contract, the earnest money deposit is usually forfeited to the seller; therefore limit your deposit to no more than $500 if at all possible.
- Your offer to purchase should be contingent on qualifying for financing within a specified time.
- Be sure to include the type of mortgage and the APR you are willing to pay.
- Your offer to purchase should be contingent on selling your present home. Can you afford to make monthly mortgage payments on both your new home and your present one? If not, this is a must. Usually a seller will insist his home remain on the market while giving you a 24-hour-to-notice contingency should another buyer come along.

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- The offer of purchase should include any contingency clauses that you deem necessary; i.e. a home inspection which we previously mentioned. A contingency clause may also be added to the offer to purchase by the seller; i.e. the 24 hour notice contingency.

3. Closing date

Closing is the final step in transferring home ownership from the seller to the buyer. It occurs when all the promises in the purchase contract are fulfilled, the loan documents are prepared and the loan is finalized. One thing you may not know is that rent payments are usually done on the first of a month for that month. Mortgage payments are paid in arrears - due on the first of a month for the previous month. Set your closing date as close to the end of the month as possible. It will minimize the amount of pro-rated interest charges you have to pay and you can skip a month before your first house payment is due.

Example: Close on the 30th of March. You will pay pro-rated interest for the days of 30 and 31 March and your first house payment will not be due until 1 May.

4. Closing costs

Usually, both the seller and buyer have closing costs. These are one-time charges unique to the transaction; such as an appraisal, cost of a credit report, and lawyer's fees. In a buyer's market, the buyer can ask the seller to pay part or all of the closing costs. VA loans require the seller to pay all closing costs.

5. Pre-paid costs

These are recurring charges; such as, ad valorem (real estate) taxes, pre-paid interest, homeowner's insurance, private mortgage insurance (PMI). We will talk about closing costs and pre-paids in greater detail later in the program.

Once you and the seller sign the offer, it becomes a contract. This contract spells out the requirements for both parties to fulfill in order to close the sale. A contract can be changed after it is signed, through an addendum that both parties must initial and date.

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Stable employment, sufficient income, and consistently paying bills on time will get you the mortgage loan. Most military members can generally demonstrate this type of reliability. However, separation or retirement from the military may make securing a mortgage difficult. If you've already separated or retired and are between jobs or have recently taken a new position, lenders may not approve your loan or may approve a lower amount than you expect.

TIP: The threat of walking away is one of your most powerful bargaining tools during negotiations, use it wisely. If you tell the selling agent you "must have this house," the seller has already won. If you remain willing to buy another house, you put the pressure on the seller to agree to your price as well as your terms.

Handout:
Figuring Your Monthly Payments
using an example such as, an interest rate of 7% for a $100,000 loan = 6.66 x 100 = $666 per month.

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Figuring Your Monthly Payments

1. The handout, Figuring Your Monthly Payments, is

A tool for quickly estimating your monthly mortgage payment. Once you find the estimated payment, list the amount onto page 3 of your Financial Planning Worksheet as a living expense.

- How does it impact your budget?
- Are reductions necessary in other living expenses or debt payments in order to cover the mortgage payment?

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Finding the Right Lender

1. Compare lenders

Finding a reputable lender with a variety of mortgages and attractive loan rates is important. Don't assume your Realtor's recommendation is the best or only option for you. Points of comparison involve the following:

Discount points - A discount point is 1% of the loan amount. The lower the interest rate the higher the number of points. Go for the lowest APR possible. A low APR is an attractive feature when it comes time for you to sell. (Be sure you will own the house for sufficient time to recover the cost of the points). Always — in your offer to purchase, ask the seller to pay most of the points. If the seller won't pay "the points" - and you must have that house - and the lender will allow you to fold the points into the loan, offer the seller a higher selling price which includes the amount of the points. This allows you to "finance" the points, which adds to the tax deductible amount of interest you pay.

Loan origination fee - A loan origination fee about 1% of the loan amount, is applied toward the lender's cost of making the loan. Usually paid by the buyer. You may negotiate the payment of points and loan origination fees with the lender. In a hot buyers' market, many sellers will pay all or some of these closing costs.

Lock-in - of current interest rate and points. Lenders usually honor guaranteed lock-in rates for a specific time, such as 45 or 60 days. If you close the transaction within that period, the lender guarantees to provide the interest rate you locked in, regardless of whether the rates rise or fall during the interim. Be sure to get a written lock-in agreement if you choose to lock in your rate. Or, you may prefer to let the interest rate and points "float," hoping they will decrease before closing.

Rate protection option - enabling you to lock-in at the current rate (or slightly higher), but, for a fee, lower your interest if rates fall during the processing period.

2. Referrals

Friends and co-workers can be an excellent source for finding a lender that you are comfortable with.

- Thoroughness. You want a loan officer that lists all necessary documents to bring to the first visit.
- Options. You want a lender that can offer several options, is knowledgeable of those options, and takes the time to explain them to you.

Handout:
Mortgage Affordability Chart

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Choosing a Mortgage Loan

Unless you have the cash to pay in full for your home, you will need to apply for a mortgage loan. There are many types from which to choose.

1. Assumption

Consider assuming the seller's existing loan – and interest rate — if the rate on the assumable loan is lower than the prevailing rate for a new loan. By assuming a loan, you take responsibility for paying the mortgage owed by the seller

2. Buy Down

If you cannot afford the prevailing interest rate, consider a buy down mortgage. The seller or even a family member can pay extra points to buy down the mortgage for the first few years. For example, a 3-2-1 buy down with a prevailing rate of 7% means that the first year you would pay 4%, the second year, 5%, the third year, 6%, and then the fourth and remaining years, the interest rate would be 7%. Buy-downs are common among new construction and first-time home buyers.

3. Fixed-Rate Loans

These are the most popular loans in the market because they offer stable, consistent payment throughout the life of the loan. The most common is the 30-year fixed rate. Other options are the 15-year (save half the interest over a 30-year), the 20-year (saves thousands of dollars of interest over the 30-year), and the relatively new 40 year (reduces the payment below a 30-year but adds three times the loan amount in interest).

4. Adjustable Rate Loans

A variable interest rate that fluctuates according to the financial index they are tied to and the type of ARM obtained. Some features that make them attractive even when the fixed interest rate is low are:

- First-year rate (the teaser rate) usually 1 or 2 points below the market rate.
- interest rate is capped. can rise only 5 (fha)or 6 points (depending on whether fha or conventional loan) over the life of the loan.
- rise of interest rate is limited to 1 or 2 points a year (depending on type of loan).
- research indicates that less interest paid with arm than with 30-year fixed rate mortgage.
- most useful to homebuyers who stay in home no more than 5 to 7 years.

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Handout:
ARM vs. 30 Year Loan

5. Step Loans

Combines the stability of a fixed-rate loan with the lower rates of an ARM.

There are two options: 5/25 and 7/23: Interest rate is fixed for the first five or seven years, then the loan adjusts once into a 1-year ARM or a fixed–rate loan.

- Lower interest than the prevailing rate for 30-year fixed-rate mortgages
- Amortized over 30 years

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6. Balloon Loans

Interest paid during the term of the loan does not fully pay off the mortgage. At the end of the loan term, must pay off the remaining principal in one lump sum.

- Terms are short in length, usually 5 to 7 years, but amortized over 30 years.
- Usually lower interest rates than fixed-rate loans.
- Most useful to homebuyers who stay in home no more than the term of the loan.

7. FHA Loans

Government-backed Federal Housing Administration loans designed for first-time or lower-income homebuyers.

- Interest rate usually less than conventional loans.
- Available in both fixed-rate or adjustable-rate mortgages.
- Down payment of 3% to 4% of loan amount.
- Maximum loan amount - $133,000

8. VA Loans

Loans available to veterans of the United States armed forces backed by the Department of Veterans Affairs. Have your lender check the VA funding fee.

- Zero down payment
- Interest rate usually less than conventional loans.
- Points must be paid by the seller. If seller is reluctant to pay points, buyer can increase offering price to include the cost of points.
- Available only in fixed-rate mortgages.
- Maximum loan amount - $203,000.

You may want to explore other mortgage loan options rather than use your VA. If you have to sell and a buyer comes along who wants to assume your mortgage, then your VA will be unavailable to you until that mortgage is cleared by a home sale with a substitution of a completely new mortgage. That may take years.

9. Seller Financing

The seller takes on the role of lender and gives the buyer a loan to purchase his/her property. Generally, the seller owns the property outright and can finance the entire purchase or has significant equity and can "carry back" a second mortgage which then can be used to finance the buyer's down payment.

- Best bets for seller financing - elderly homeowners who do not need the cash from the sale of their home to finance their next home.
- Advantages for buyers – get the prevailing or better interest rate without paying points or other junk fees.

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- Advantages for sellers - get a higher return on their money from the sale and receive a monthly stream of income.

Handout: *Checklist for Financing Your Purchase*

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The Mortgage Application Process

1. Pre-qualification

Pre-qualification visit to a mortgage lender — Determine which mortgage loan option is best for you and decide the maximum amount you can borrow. Usually takes one to two hours depending on the complexity of your finances.

2. Formal application

When offer to purchase is accepted by seller, buyer is expected to formally apply for financing within three to five days. If you have already pre-qualified, application time is minimal.

3. Processing

Processing time for conventional loans takes four to six weeks; for VA and FHA loans, six week to two months.

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Closing

Usually takes place at a lender's office, escrow company, title company or attorney's office.

1. When

Set the date for as close to the end of the month as possible. Will save you money on pre-paid costs.

2. Closing

Usually the date you take possession of the property.

- Ask for all keys – consider changing the locks.
- Collect from seller:

  All appliance and systems operating instructions and warranties,

  Names of contractors who have worked on the home,

  Paint colors (unless you want to change them),

  Location of utility turn-offs, and

  Security system combinations, if applicable.

3. Closing cost 21

Fees that are paid in order to "close" or complete the mortgage loan.

- Usually total approximately 2 to 4% of the loan amount.
- Traditionally paid by the buyer,
- Negotiable, some may be eliminated, reduced, or paid by the seller.

Examples of closing costs include: 22

1) **Appraisal** – Estimate of current value of a home ($300),

2) **Attorney's or Title company's fee** – Whoever chooses, usually pays the fees ($350 for an attorney, $250 for a title company),

3) **Credit report** – Furnishes lenders about buyer's current indebtedness and payment history ($60),

4) **Escrow company** – Acts as third party to both buyer and seller, handles the paperwork and collects and distributes the various money transactions, such as pre-paids, real estate commissions, down payments. ($300),

5) **Home inspection**– An independent, professional inspection of the property and all its electrical, plumbing, heating, cooling, and kitchen systems, ($200),

6) **Home warranty program** – Offers first-year protection from a breakdown of many household systems, including plumbing, water heater, disposal, heating and cooling, and appliances ($500-$800),

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7) **Loan origination fee** – A fee charged by the lender for making the loan (1%),

8) **Pest Inspection** - Separate from the home inspection which is optional, mortgage companies, particularly for VA loans, require a pest and water damage inspection ($100),

9) **Recording fee** – The cost to record your deed and your mortgage with the city/county in which the home is located ($75),

10) **Survey** – The measurement of the property by licensed engineers or surveyors in order to determine its area and attest to its boundaries ($175),

11) **Title search & insurance** – Researches the records and insures that the property's title is free from any encumbrances, that the property will transfer with a clear title. The insurance protects the mortgage company (required) and the buyer (optional) against any claims on the property not found during the title search (based on loan amount).

In a buyer's market, the buyer can ask the seller in the offer to purchase to pay for all or a portion of the closing costs.

4. Pre-Paid Cost

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At closing, the buyer will pay a number of recurring costs up-front with the money placed in escrow with the mortgage company and drawn when needed. Various pre-paid costs are as follows:

Private Mortgage Insurance (PMI) – Protects the lender against default on the loan.

- For conventional loans,
- Required when down payment is at least 5% but less than 20%,
- Can be a lump sum payment, monthly payment added to mortgage payment, or a higher interest rate. Ex. $200,000 purchase price, 10% down ($20,000), $180,000 loan amount, monthly PMI = .0052 x loan amount divided by 12 months = $78/month added to mortgage payment.

Mortgage Insurance Premium (MIP) – Protects the lender against default on the loan.

- For FHA loans,
- Down payments of 3 to 4 %.
- Lump sum payment of 2.25% of loan amount plus a monthly payment of .005 x loan amount divided by 12 months.

Homeowners insurance– (Total of 14 months premium payments)

- 12 months collected and used to pay first year's policy premium
- Extra 2 months collected and placed in escrow account from which future premium payments are made.

Ad valorem (property) taxes

- Prorate buyer's first month's share of taxes,
- An additional 3 months payments placed in escrow from which future tax payments are made.

Interest – Buyer pays a prorated share of first month's interest due on loan amount depending on the closing date.

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Reducing the payback time

1. Reduce payback loan time

There are two ways a buyer can reduce the payback time on a loan:

Apply for a shorter term loan. You can do this with a surprisingly modest monthly payment increase compared with a 30 year loan. For example: a 30-year mortgage of $100,000 at 7.5 percent interest carries a principal and interest payment of $699 a month; a 15-year mortgage with 7 per cent interest has a P&I payment of $899. In most cases, lenders offer lower interest rates for loans with shorter maturities. A 15-year loan will generally have a lower rate than a 30-year loan. This slide illustrates the amount of interest saved with a 15-year vs. a 30-year mortgage.

Prepaying the principal. This will reduce a 30-year fixed-rate loan's payback time to 20, 15, or even 10 years and will sharply reduce the amount of interest you pay over the life of the loan. If you are a disciplined money manager, and if your loan has no prepayment penalty, you may consider paying-off a 30-year mortgage in 15 years and one month by doubling the principal payment each month. Or you can take a 30-year loan and pay it back in 20 years in one of the three following ways: 26

1) Make an extra lump sum payment each year;

2) Increase monthly payment by $1/12^{th}$.

3) Pay bi-weekly; that means making one-half mortgage payment every other week. A total of 26 payments a year,

Military members who are retiring and plan to buy a home should strongly consider a 15-year mortgage. The house will then be paid off by the time the military retiree reaches "real" retirement at age 65.

Insurance

Handout:
Requesting a Quote for Homeowners Insurance and Homeowners Coverage

Since your home usually represents your largest purchase, it only makes sense to protect your investment from possible hazards. Many homeowners are underinsured, be sure to assess your needs and purchase adequate coverage. Of these policies HO-3 policies are the most popular because of its broad-based coverage.

Remember, if your are renting now or chose to rent later, always protect your possessions and liability to other with renters insurance.

27 **1. Minimal homeowner's coverage**

- The house itself, insure enough to rebuild not the amount you paid for the dwelling,
- Other structures, like a porch, garage, or outbuilding,
- Personal property and the main contents of the main dwelling, usually up to 50% of the coverage of the main dwelling,
- Living costs incurred because the homeowner unable to stay in the home while repairs are underway, usually up to 20% of the coverage on the main dwelling,
- Losses of personal property while away from home, including the possession of children residing at school, usually with a limit and under certain conditions,
- 28 Personal liability up to a maximum for each occurrence, usually up to $100,000,
- Medical payment for injuries that occur on the premises, up to a maximum per occurrence, usually set at $1000 per person,
- Damages to trees, shrubs, and plants up to 5% of the coverage on the main structure,
- Damage to property of others, usually up to $250, good neighbor clause.

29 **2. Replacement cost coverage**

Allows for rebuilding the home with exactly the same materials with which it is currently constructed. Replacement cost coverage also allows you to replace your contents at current market prices rather than depreciated amounts.

3. Umbrella policy (usually for $1,000,000)

Should be considered if the homeowner has a lot of assets, high earning potential, or an attractive hazard (swimming pool) in order to protect property and future earnings from lawsuits.

4. Riders

Additional coverage can be added for valuable personal property such as gun collections, antiques, and valuable jewelry. The insurance company may require appraisals.

5. Reducing premium costs 30

This can be accomplished in several ways:

- Shop around for the best rates. Be sure company is financially sound and reliable
- Raise deductible to $500 or $1000
- Non-smoker's discount
- Install fire and burglary detection systems
- Use the same insurance company for homeowners, auto, and life insurance

6. Exclusions and limitation 31

All policies have standard exclusions and limitations. These could vary from state to state. Be sure to inquire after them in any policy you consider.

Notes

- Flood insurance will be mandated at extra cost if the survey indicates your new home is located in a flood zone. However, if you are not in a flood zone, therefore carry no flood insurance, and your home is flooded by a freak storm, you will not be covered.

- Earthquake insurance works similarly to flood insurance. If the new home is in an earthquake-prone area, the homeowner may be required to carry the extra insurance at an extra cost. Most folks in Virginia do not carry earthquake insurance so should a damaging quake occur, homeowners will not be protected from loss.

- War and nuclear damage are never covered.

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Owning a Home as a Tax Break

1. Itemized deductions

In order to itemize on your tax return, your total deductions should exceed the standard deduction. The standard deduction amount changes every year so you may need to check to see if you are better off to use it or to itemize. For most military who itemize, mortgage interest is the single largest deduction. The most common itemized deductions are as follows:

- State income tax
- Real estate tax
- Personal property tax
- Mortgage interest
- Points
- Charitable contributions

In order to itemize the year of purchase, buy your home as early in the year as possible. If you wait until summer, there may be a chance you will not pay enough interest and property taxes that year to itemize on your taxes. "Points" must be deducted in the year of purchase; otherwise you will lose that deduction forever. You cannot carryover "points" to another year. 33

2. Example 34

$80,000, 30 year mortgage at 7% interest, couple filing MFJ. First payment due February 1.

- One year of interest
  = $5,574
- Real estate taxes ($1.20 per $100 purchase price)
  = $ 912
- Total
  = $6,486
- Standard deduction
  = $7,100
- Shortfall
  = $ 614

Need $614 of other deductions; i.e. state income tax, charitable contributions, for itemizing to make sense.

Notes

3. Capital Gains

Capital gains occur when you sell you and make a profit on the sale. A profit occurs if you have a net gain after subtracting the amount you paid for it, improvements and the costs of selling it from the sales price. If you do not make a gain, but instead have a capital loss, you must report this in the year that the loss occurred. You can exclude the tax on the capital gain however, the home must have been your primary residence and you must have lived in for 2 of last 5 years. You can exclude up to $250,000 single or $500,000 married of the capital gain. If you are going overseas, be certain to ask your lender, attorney, or accountant, if there is any extension granted for overseas duty obligations.

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Summary

Buying a home is a costly and complicated purchase. You are making an important early step by educating yourself. Armed with the information you have received today, you can save yourself money and wear and tear on your nerves. Though we have covered a lot of material, the following are the most important facts you need to leave with today.

- Know what you can afford. Analyze your lifestyle and budget.

- Target a good location for resale if you are active-duty military.

- Be sure to include a home inspection contingency clause in your offer to purchase. If you want the chandelier in the dining room, be sure to include that in your offer as well. In other words, **put everything in writing.**

- Get replacement cost homeowners insurance.

- Weigh the tax advantage of owning your home against acquisition and maintenance costs. Renting might be the better option. 36

Conclusion

I hope you are not feeling overwhelmed. Remember that at the beginning of the program you wrote down what you considered the top five financial mistakes often made by first-time homebuyers and the top five emotional mistakes often made by first-time homebuyers. Take a moment to review your answers and make any changes you might want.

NOTE:
Instructor should go around the room and take suggestions, writing the correct ones on the board. Once you have identified the correct five, show ***SLIDE #37***

1. The top five FINANCIAL mistakes 37

- **Blowing your budget – spending more than you earn.** If you are living beyond your means with the assistance of credit cards, you may find it difficult to qualify for a home loan. The second part to blowing your budget involves spending too much money on new home furnishings and improvements once you have your new home. Be careful.

- **Not saving enough for your down payment and closing costs**. Even though you may be planning to use your VA, there are still some costs that you will incur, such as the appraisal, home inspection, pest inspection, and your pre-paid taxes and insurance. Probably count on having at least 2 to 3% of the sale price available to meet any closing costs that you may have to pay.

- **Underestimating the costs of owning and maintaining a home**. Renting is easy. You write one check a month to the landlord, who takes care of maintaining the property. Owning is more complicated, since you're now responsible for replacing the leaking water heater. If you're on a tight budget and you don't factor in the costs of replacing and repairing major mechanical or structural item, you could find yourself caught with an empty wallet in January when your heating system goes kaput.

- **Mistaken mortgage assumptions**. It can be a costly mistake not knowing about the various mortgage products on the market before applying for a loan. Start by looking through the real estate section of your Saturday newspaper and seeing what interest rates and types of loans are available. If you will be in the house less than five years, strongly consider an ARM.

- **Not knowing when to seek professional help**. The path to home ownership is complex, filled with jargon that is confusing at best. If you are a first-time homebuyer, rely on the real estate and mortgage professionals that demonstrate they have your best interests foremost. If you are experiencing some financial difficulty, there are financial counselors who can assist you in managing your cash flow, balancing your budget, and improving your credit history.

Notes

2. The top five **EMOTIONAL** mistakes

- **Falling in love with a home**. Buying a home is an incredibly emotional experience for many people. This particular investment you will call home. It should be safe and secure, and in some way touch our emotional core. We identify with our homes. Our homes say something about us. Falling in love is OK but remember love fades and all the flaws you didn't notice at first will become all too apparent. Remember to be objective.

- **Losing control of your purchase**. First time homebuyers can lose control of the home buying process. Sometimes an assertive real estate agent will put you where he/she thinks you should be rather than where you want to be. They may encourage you to buy a home that you can qualify for but may be more expensive than you should buy considering your other lifestyle activities. Maybe your parents step in with a check and their two cents worth. Remain focused.

- **Being indecisive**. Do you want to buy a house? Or, do you want to start your own business? Buying a home means making plenty of tough decisions about budgets, neighborhoods, and even what you want in a house. Then you have to reconcile those choices with your spouse. If you're indecisive about what you want and where you want it, you may not be ready to buy.

- **Underestimating the responsibilities of homeownership**. As we already identified under top five financial mistakes, renting is easy. You write one check a month and the landlord is supposed to take care of the rest. Owning a home is more complicated and the responsibilities can weigh heavily. You must pay the mortgage,

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NOTE:
*Instructor should go around the room and take suggestions, writing the correct ones on the board. Once you have identified the correct five, show **SLIDE #38***

assessments, and taxes; but you also should be a good neighbor and work to improve the neighborhood. Landscaping and maintaining the appearance of your home will be important to increasing its value and to maintaining good relations with your neighbors. You may spend more of your weekends puttering around the house instead of putting on the golf course.

- **Buying a home before you're really ready**. Owning a home isn't for everyone. Savvy homebuyers recognize that they aren't really ready for the commitment. Do your homework to give yourself a base of knowledge and comfort. Do your budget so you know that you can comfortably afford a new home without compromising your other interests. Buying a home before you're really ready almost certainly will result in a heavy-duty case of buyer's remorse.

We have covered a lot of material today. Should you have a question after leaving here, don't hesitate to give follow up with a Financial Education Specialist or your Command Financial Specialist.