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Making the Buying Decision

Begin your decision-making process by analyzing the financial aspects of home ownership. Understand that there are many good reasons to buy which can't be measured with a calculator--your long-term security and leaving something to your children, for example. May it suffice that we briefly direct your attention to such matters and move on.

Assuming you plan to own your home for several years and can afford the payments, you'll likely be better off owning versus renting. Here are some points to consider:

	Rent	Buy
Tax Savings	You might receive a state income tax renter's credit, but nothing more.	Payments towards interest, taxes and points are tax deductible.
Equity Build-up	None, unless your rent payment is lower than the cost of owning a home, and you invest the difference in a CD, stock or mutual funds.	Even if your home value remains constant, your loan balance should decrease. This results in increasing equity your property.
Mobility	Most leases are less than 1 year in duration. It's easy to move at the end of a lease. Also, your landlord usually won't have to renew your lease, and you could be forced to move out at the end of your lease.	Selling a house can take time and may cost 6% to 8% of the sales price. If you have to sell quickly, it could cost even more. If you don't have to sell, yet must move, consider renting your house. You'll probably receive additional benefits by depreciating your home for income tax purposes. Remember, buying a

		home makes sense if you plan to hold it for several years.
Payments	Your rent payments generally increase every year. Rent increases are often tied to inflation.	Mortgage payments on a fixed-rate loan will not change. Adjustable-rate loan payments vary according to the terms of the note and economic conditions.
Timeframe	Renting makes sense if your time frame is less than 2 to 3 years.	The longer you plan to own your home, the more sense it makes to buy. Some buyers with plans to move relatively soon may buy if they expect the market to appreciate significantly.

Additional points to consider in your decision include:

- **What are my reasons of owning a home?**
Do you need a bigger home? Do you need a better neighborhood? Are you speculating that prices will increase? Whatever your reasons, it helps to write them down. Seeing your reasons on paper helps create objectivity, and will help you follow through in the event you get the "jitters" later on.
- **Do I have enough cash for the down payment?**
While this is certainly an important consideration, many lenders today offer zero-down and low down payment loans. However, you may still have to come up with cash for closing costs and moving expenses.
- **Can I afford to make house payments in addition to making payments on my other debts?**
This is probably the single, most important question to answer accurately. Spend adequate time creating a realistic budget. If you fall too far behind in your mortgage payments or property taxes, you'll probably lose your home and any equity you might have had in it. Generally, you should spend less than a third of your gross income on your total housing expense, including principal, interest, taxes and insurance.

How Much Money Should I Put Down?

A important step in purchasing a home is determining how much of a down payment you'll make, and from what sources the down payment and other costs will come. For accurate answers to these questions, a current inventory of your assets is crucial.

Begin by gathering all financial statements for all your assets. You may not plan to liquidate all assets, but a complete accounting is important. The assets you keep can serve

as collateral for a loan and as reserves which may be required by your lender. If you're going to receive a gift from a relative, try to obtain a letter stating the amount of the gift.

You may be able to borrow from your 401(k) without any tax penalties. If you liquidate your 401(k) or IRA, there may be tax implications. Consult with your tax advisor before liquidating any assets.

If you own stock you want to keep, consider borrowing against it with a margin loan. Consult with your stock broker regarding this option.

This worksheet may help you inventory your assets.

Checking Accounts: _____
Savings Accounts: _____
CDs: _____
Stocks: _____
Bonds: _____
Mutual Funds: _____
Other Securities: _____
Retirement Funds (401K, IRA,
etc): _____
Gifts from relatives: _____
Total Cash Available: _____

Determine the total cash needed to close:

Down payment: _____
Closing costs including points: _____
Prepaid expenses
(taxes, prepaid interest,
insurance, pmi): _____
Cost of repairs, if any: _____
Total Cash Needed: _____

Calculating the total cash needed can be challenging, especially if you're doing this for the first time. Consider getting help from a real estate or mortgage professional. They're usually quite generous with assistance and advice in anticipation of helping you with your transaction. Ask your mortgage company to provide a Good Faith Estimate of closing costs--including prepaid expenses.

If you're short on cash, consider asking the seller to pay your closing costs. Discuss this with your Realtor prior to making your offer.

Ideally, you'll want make a 20 percent cash down payment to avoid Private Mortgage Insurance (PMI) and get the best rate. If you are unable to put 20 percent down, there are many programs available. Here are some of them:

- **Zero Down Programs** There are many zero down payment programs available. If you qualify for a VA loan, you can get a zero down program. Even if you're not a vet, several lenders offer zero down loan programs. Your mortgage broker can help you find the best one for you.
- **Low Down Payment Programs** There are numerous FHA and conventional programs that allow you to put as little as 2 to 5 percent down.
- **Piggy Back Loans** By getting a piggy back loan, you can generally avoid paying PMI, even though you are putting less than 20 percent down. The most common piggy back loans are:

80-10-10

In the case of an 80-10-10, you put down 10 percent and get two loans--a first loan for 80 percent of the purchase price, and a second loan for 10 percent of the purchase price. Even though the second loan rate may be higher than the first loan rate, you generally come out ahead since you don't have to pay PMI.

80-15-5

Eighty percent first loan, 15 percent second loan, 5 percent down.

80-20

Eighty percent first loan, 20 percent second loan, no cash down.

How Much Home Can I Buy?

Like most industries, the mortgage industry uses its own jargon. Understanding the terminology of the industry will serve you well in understanding the process of buying and financing your home. Here is some terminology you will need to understand:

- **Application:** The loan application is a comprehensive document representing the borrowers income, expenses, assets, liabilities and net worth. It can be considered both an Income Statement and Balance Sheet of the borrower. The application helps the lender determine the borrower's credit-worthiness.
- **PITI:** An acronym for **P**rincipal, **I**nterest, **T**axes and **I**nsurance. Principal and interest refer to your monthly mortgage payment. Taxes and insurance refer to 1/12 of the annual property taxes and insurance premium. PITI is designed to represent the monthly cost of home ownership (**total housing expense**) for qualification purposes. (Total housing expense can include PMI and association dues if applicable.)
- **Gross Monthly Income:** Gross monthly income is your monthly income before income taxes. You are usually given full credit for your base salary. Overtime, commissions and bonuses are usually averaged over the previous 24 months. If you are self-employed, the income reported on your tax return will usually be averaged over the previous 2 years.
- **Front-Debt Ratio (top ratio):** Your front debt ratio is your **PITI** divided by your **Gross Monthly Income**. This **qualifying ratio** is used by the lender in making a decision to grant or deny your loan request.

- **Back-Debt Ratio (back-end, bottom, total expense, total debt ratio,):** Your back-debt ratio is **PITI + Other Monthly Debt Expenses** divided by your **Gross Monthly Income**. Other monthly debts include auto loans, credit cards, person loans, student loans, etc. Your phone and electric bills are NOT considered part of your debt expenses. This **qualifying ratio** is used by the lender in making a decision to grant or deny your loan request.
- **Loan to Value (LTV):** $LTV = \text{loan amount} / \text{the property value}$.

Here is an example of how the above information is used:

- Monthly base income: \$5,000
- PITI: \$1,000
- Other monthly debt (credit cards and student loans): \$600
- Home purchase price: \$100,000
- Down payment: \$20,000

With this information, qualifying ratios and the LTV can be calculated:

- Front-debt ratio: $\$1,000 / \$5,000 = .20$ or 20%
- Back-debt ratio: $\$1,600 / \$5,000 = .32$ or 32%
- LTV: $\$80,000 / \$100,000 = .80$ or 80%.

Mortgage companies and lenders like to see qualifying ratios at or below acceptable levels set by the industry. Acceptable qualifying ratios denote a borrower's ability to repay the debt. A low LTV is also desirable. The lower the LTV, the greater the equity the borrower has in the home, and the more secure the lender's investment. As the LTV increases, acceptable qualifying ratios decrease.

Here is a table of LTV and maximum qualifying ratios used in the industry. These ratios are general guidelines only. In practice, lenders make their own decisions based on a number of additional factors such as your credit history, length of employment, etc. Please check with your mortgage company regarding your particular situation.

LTV	Front-Debt Ratio	Back-Debt Ratio
90.1%+	28%	36%
At or Below 90%	33%	38%

Tips and Tricks: You may be able to increase your purchasing power by:

1. **Paying off debt:** This would reduce your back-debt ratio. Many lenders do not count the monthly payment on your installment loans if you have fewer than 10 payments left. If you have a car payment with 12 payments left, you may want to

consider making additional payments to reduce your total payments left to under 10.

2. **Making a larger down payment:** This reduces your LTV, total housing expense and provides for higher qualifying ratios. If you make a down payment of 20% or more, you won't have to pay PMI.
3. **Borrowing against your 401(k):** You can sometimes increase your purchasing power by using the proceeds of your 401(k) loan to pay down your other debt, or to use it towards the down payment. This can be a little tricky, so please consult with a mortgage professional.
4. **Obtaining a margin loan:** If you own stocks and do not want to sell them, your stockbroker may be able to arrange a margin loan, using your stock as collateral. Since a margin loan has no monthly payments, this generally does not affect your debt ratios. You may use the proceeds towards the down payment or to pay off debt.

Should you be pre-approved or pre-qualified?

As a potential buyer competing for a property, you'll have a better chance of getting your offer accepted by being as prepared as possible. Consider this hierarchy of preparedness:

1. Neither pre-qualified nor pre-approved
2. Pre-qualified
3. Pre-approved

The benefits available at each level can be easily understood when viewed from the seller's perspective. Imagine you're a seller in receipt of multiple offers to purchase your property. A complete stranger (buyer) is asking you to take your property off the market for at least the next two to three weeks while they apply for a loan. As the seller, let's consider the type of buyer you'd prefer to deal with.

1. Neither pre-qualified nor pre-approved

This buyer provides no evidence that they can afford to purchase your property.

You may wonder how serious they are since they're not at least pre-qualified.

2. Pre-qualified

This buyer met with a mortgage broker (or lender) and discussed their situation.

The buyer informed the broker regarding their income, expenses, assets and liabilities. The broker may also have seen their credit report. The buyer provided you with a letter from the broker stating an opinion of what the buyer can afford.

3. Pre-approved

This buyer provided a broker or lender written evidence of income, expenses, assets, liabilities and credit. All information was verified by a lender. As a result, much of the paperwork for this buyer's loan has been completed. This buyer will probably be able to close quickly. They provided you with a letter (pre-approval certificate) from the lender. You're as certain as possible that this buyer can close.

As a potential buyer, you can see that being pre-approved will give you the best chance of getting your offer accepted. This is critical in a competitive situation.

Start looking for a Home

You're prepared and ready to purchase a home. Now it's time to go out into the market place and find it. Will you use a real estate agent to help you look, or will you look on your own?

For practically everyone, it's worthwhile to use a real estate agent. The benefits of using an agent are numerous.

Advantages of using a real estate agent

A good agent builds a career by creating repeat customers and earning referrals. To that end, she does everything possible to make your home-buying experience as pleasant as possible. An agent is expert in her market. She knows (or can find) everything you want and need to know about the community.

An agent will:

- Arrange access to homes for you to preview
- Accompany you on your tour of homes
- Research the neighborhood, including market values
- Draft the offer to purchase
- Negotiate with the seller
- Arrange inspections
- Abide by all local, state and federal laws
- Help you obtain financing
- Review all closing documents for correctness
- Follow up after closing to make sure you're move-in is accomplished smoothly

Finding and keeping a good agent

Finding a real estate agent is easy. Finding one you'll enjoy working with may require some effort. When you find one, stick with her. Give her the same respect and consideration you'd expect. When she knows she has your loyalty, she'll be more likely to do the best job for you.

Two on-line resources which may help you find a real estate agent are [Realtor.com](#) and [Relocate America](#).

Disadvantages of using a real estate agent

One potential disadvantage of using an agent is that the seller may be less flexible with the price since they'll be paying a real estate commission. In the customary transaction, the seller pays the agent for their services.

Understanding Market Conditions

The price you pay for your home will be affected by prevailing economic (market) conditions. Changes in market conditions can have an immediate and significant effect on property values. For this reason, it's important to be aware of current conditions.

The price of real estate is affected by the supply and demand for credit and real property. The supply of capital is finite. Capital available for lending is shared among government, business, consumer, mortgage and other borrowers. If capital is in relatively short supply, the cost of capital rises. When capital is in relatively great supply, the cost of capital declines.

The supply of money and credit in the economy is regulated by the Federal Reserve Bank. If The Fed makes too little credit available, demand for money can cause interest rates to increase. Borrowing, investing and sales decrease as interest rates rise, which can lead to an economic decline. Alternatively, if there is too much available credit, interest rates can fall. When interest rates are low, price levels for goods and services can increase as people are willing to pay more and more for them, which can potentially lead to inflation. It's The Fed's job to use monetary policy to achieve a growing yet stable economy.

The price you pay for your home can be affected by interest rate levels. Interest rates can change relatively quickly. Conversely, the supply of housing changes slowly. In the short run, the housing supply can be considered fixed.

Consider what can happen in the housing market when interest rates are relatively low. Low interest rates allow a larger number of home buyers (borrowers) to enter the housing market. More buyers competing for a fixed supply of housing can cause the price of housing to increase. This type of market is sometimes referred to as a seller's market. In a seller's market, properties sell quickly, multiple offers are common and property values may be increasing. When interest rates rise, many would-be buyers no longer qualify for mortgages and leave the housing market. This type of market is referred to as a buyer's market. In a buyer's market, property values may be level or decreasing as sellers compete to attract buyers.

As a home buyer, your buying behavior can be influenced by market conditions. If you're in a seller's market, you may feel pressure to act quickly and offer top-dollar for a property. In a buyer's market, you may feel less hurried, more in control of the situation and inclined to offer relatively less for a home.

Make An Offer

You've finally found the property you want to buy and it's time to make an offer. Be careful not to act hastily. Draft your offer carefully and exercise good judgment. Here are some important steps to follow:

1. **Act now.** Assume there is no time to waste in making your offer. You've invested time and energy in your search for a home--now follow through. If possible, let the sellers know they'll be receiving your offer shortly.
2. **Determine your offering price.** You'll want to be aware of dynamic market conditions, as well as property-specific factors contained in a comparative market analysis (CMA).

The CMA is a tool for comparing the subject property with other similar properties in the neighborhood. A well-prepared CMA is critical in helping to determine the fair market value of the home (which may be what you offer). Your real estate agent should have a form specifically designed for this purpose. The CMA will also include Listing Date, Listing Price, Listing Expiration Date, Sale Price, and Sale Date, number of Days on the Market. The CMA should include homes currently for sale, home sold and homes which were listed but didn't sell.

3. **Protect yourself.** Your offer should contain financing and inspection contingencies for your protection. If you're working with a licensed real estate agent, it's likely she'll be using a comprehensive form which includes standard text for virtually all normal contingencies.
4. **Think ahead.** Now is the time to plan when you want to close the transaction. If you're nearing the end of your tax year, discuss with your tax advisor the best time to close. There may be benefits associated with closing in the next tax year. Consider closing near the end of the month. Pre-paid interest on your new loan will usually be less. Coordinate closing with the closing of your current home, or the termination of your lease.
5. **Present your offer.** If you're working with an agent, she'll likely present your offer for you. Letting her represent you will help protect against emotional flairs-ups which can occur in face-to-face negotiations between principals.
6. **Negotiate.** Unless you're offering the seller exactly what they're asking, prepare to negotiate. A good real estate agent will be schooled in the art of negotiation and will employ important negotiation techniques while representing you. Additionally, you can benefit by reading up on the subject. Local and on-line booksellers will have many books on the subject from which to choose.

Rules to Negotiate By

Many books exist on the art of negotiation. If you haven't read a book about real estate negotiation, you can still come out a winner by remembering two important rules. These rules will help save you more money than virtually all other negotiating techniques combined:

1. Deal with a motivated seller.

The more someone wants something, the more they'll sacrifice to get it. In the case of buying real estate, find a seller who wants your money more than you want their house. A motivated seller is much more likely to make concessions in your favor. You may have to make offers on several properties before you find a motivated seller. When you find one--you'll know it.

2. Know when to walk away. If you reach that point--walk.

How do you determine ahead of time when to walk away? Before making your offer, you completed (or had your agent complete) a Competitive Market Analysis (CMA). The CMA helps you determine the value of the home. Can you offer more than the CMA suggests? Sure. And in a hot market, you may have to. But decide ahead of time how high you'll go, and what concessions you're prepared to make. Price isn't the only reason you might walk away. Don't compromise on home inspections, removing contingencies too soon, allowing enough time to act, etc.

General principles

By all means, negotiate.

Negotiation is part of the process of buying a home. Price is just one point of negotiation. Personal property, home inspections and repairs, closing dates, etc., may also come into play. If you're like most people, your home is the largest purchase you'll ever make. It's likely the home-buying experience will be an emotional one. If you find yourself reaching the limits of your patience and endurance, don't despair -- that too is sometimes part of the process. By remembering the two rules, you'll do fine.

Maintain your objectivity.

This isn't always easy. At least two compelling influences will test your ability to remain objective: a hot market and finding the "perfect" home. A hot market can sway you to offer more than the home is perhaps worth. Finding the perfect home can also have such an effect. It is true that no two homes are exactly alike. For practical purposes, most homes are very much alike, however. When you think you've found the perfect home, chances are there's another one available just like it and for possibly a better price.

You can always increase your offering price.

But you can seldom decrease it. Unless you have the misfortune of buying in a hot market, start by offering lower than asking price. Just how low you make your first offer depends on several factors. How well is the home priced? If it's priced well and you don't want to risk insulting the seller, offer close to what the CMA suggests. If it's a hot market, you may have to offer full price or more. If it's a slow market and you think you have a motivated seller, you may be successful offering a relatively low price.

Get it in writing.

Your state may require that contracts for the sale of real property be in writing. Do not expect oral agreements to be enforceable.

Give up something to get something.

Ask for something you can easily give up. If the seller sees you're making concessions, they'll be more likely to give you what you really want. In your offer, include some things you can do without. Here's a hypothetical example:

A home is for sale for \$110,000. What you want most is to buy it for \$105,000. You offer \$100,000, 45-day escrow, you get the refrigerator and a \$1000 credit to clean the home.

During negotiations, you give up the \$1,000 credit, the refrigerator and agree to a 30-day escrow. The sellers feel like they won something, and you get the home for \$5,000 less than you were willing to pay!

The Impasse

There may be an item which bogs down negotiations. When this happens, quickly move off the item and onto something you can agree upon--no matter how small. This approach is also used to delay negotiations over an item you're sure will be a challenge to overcome. By reaching agreement on several smaller points, an environment of successful cooperation is created which helps to resolve larger issues.

Inspections and Disclosures

Generally, the seller should inform you of any adverse property conditions of which he or she is aware. This is of no help if there are adverse conditions of which the seller is not aware. The federal Real Estate Disclosure and Notification Rule requires that you be informed of certain adverse environmental conditions affecting the property.

Unfortunately, there are circumstances in which you aren't required to receive the disclosure. As a consumer, it is up to you to protect yourself, your family and your investment. While visiting properties, make notes of items possibly requiring investigation in the event you make an offer. Here are some areas of potential investigation to be considered when visiting and buying a home.

Age and condition of structural components

Be aware of the condition of plumbing, electrical, heating, or other mechanical systems.

Required permits

Have structural additions, alterations, replacements, or repairs been made? If so, were proper permits obtained?

Topography

Are there flood, drainage, settling or soil problems on or near the property?

Common areas

Are there homeowners' association obligations, deed restrictions or common area problems?

Neighborhood

Are there noise or nuisance problems?

Environmental conditions

Is there lead-based paint, asbestos, radon gas, fuel, chemical storage tanks, contaminated soil or water affecting the home? You may want to contact the [United States Environmental Protection Agency](#) for more information.

Final Loan Approval

Perhaps you were pre-approved prior to or during your home-hunting activities. Pre-approval can take place in the absence of having identified a home to purchase.

When you enter into a contract to purchase your home, you begin the process of obtaining final loan approval. To convert your pre-approval to final loan approval, the main items the lender needs include the appraisal, purchase contract and title information. Your real estate agent, loan agent and attorney (where applicable) will be instrumental in providing these documents to the lender.

If you were pre-approved, you probably gave many of these documents (below) to your lender. Review the list to make sure the lender has current documents. If you're just beginning the approval process and the lender will be verifying your income, assets and liabilities, you'll need to gather these documents:

A. All Borrowers:

- Copy of purchase contract
- Copy of sales contract on real estate you are selling
- Divorce or separation documents
- Bankruptcy files
- Relocation agreement
- Copy of most recent Social Security check
- Award letter and copy of most recent checks for disability, retirement, or legal settlement
- Recent statements for all credit card accounts
- Bank and financial brokerage account statements for the previous three months
- IRA, Keogh and 401(k) statements for the previous three months
- Title documents for automobiles under five years old

B. Employed Borrowers:

- (Documents in section A.)
- Pay stubs for the previous 30 days
- W-2s for the previous two years
- 1099s for the previous two years

C. Self-Employed Borrowers:

- (Documents in section A.)
- Federal tax returns for the previous two years
- Year-To-Date Profit-and-Loss statement for your business

Lock Your Rate

Locking your loan must be done prior to closing. If rates are rising, you may benefit by locking your loan early in the loan application process. If rates are stable or falling, you may benefit by waiting until the last possible moment to lock your loan. The shorter the

time period between the lock and closing dates, the lower the loan fees and interest rate.

A lock-in, or rate commitment, is a lender's promise to close your loan at a certain interest rate and number of points. Depending upon the lender, you may be able to lock upon submitting your application, during application processing, upon loan approval, or later. A lock protects you against rate increases while your application is being processed. However, a locked-in rate could cost you money if rates drop and you want a lower rate.

You will need to lock the rate prior to closing. There are five components to a rate lock:

- Loan program
- Loan amount
- Interest rate
- Points
- Length of the lock

The document describing the lock will contain the date the lock was made and usually the lock expiration date. The lender must disburse funds prior to expiration, otherwise, the rate lock is invalid.

A loan with a below-market interest rate is less attractive to a potential purchaser of the loan. The longer the lock period, the greater the risk that interest rates will increase before the loan closes. To offset this increased risk, the lender charges increasingly higher points and interest for longer lock periods.

If you're close to the contractual closing date for your new home, you may not have the option to choose when to lock your loan. You may have to lock it as soon as the lender will allow.

Congrats You Are A Homeowner !!

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