



Legal Insurance



A Step-by Step Guide to *Buying a Home*

Buying a home is one of the most rewarding – and expensive – decisions any of us will make. Before you put out the welcome mat declaring “Home Sweet Home,” you’ll want to ensure that your home and your home loan are sound both legally and financially.

This guidebook covers the basic process for understanding how much you can afford, shopping for a mortgage, making an offer and closing on a home purchase. You can save time and minimize hassle if you understand the basics of the process, including the terminology, background and legal consequences.

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Step 1: Know What You Can Afford

Are you ready to own a home?

One of the first things you'll need to do is decide how much home you can afford. Take an honest look at your current income and expenses so you understand how much you can afford to spend on a house. You'll also need a rough idea of how much down payment you'll have and what current interest rates are for different types of loans.

Check your credit report

Lenders will look at your credit report to determine what interest rate they'll offer you. A higher score generally means you're a lower credit risk and will qualify for a lower interest rate. Check your credit report for any inaccurate details before you start to shop for loans. If your credit score is low, you may want to take steps to improve it before taking on a mortgage.

How much will I need for a down payment?

Most mortgage companies require 20 percent of the purchase price as a down payment for financing. If you don't have the 20 percent down, you may pay a higher interest rate. You'll also need to set up an escrow account. An escrow account is an account held in the borrower's name to pay obligations such as property taxes and insurance premiums.



Determine how much house you can afford with an online calculator such as:

- [themortgagereports.com/mortgage-calculator/](https://www.themortgagereports.com/mortgage-calculator/)
- [lendingtree.com/home/mortgage/how-much-house-can-i-afford-calculator/](https://www.lendingtree.com/home/mortgage/how-much-house-can-i-afford-calculator/)
- [mortgagecalculator.org/](https://www.mortgagecalculator.org/)

Review Your Credit Report

The Federal Trade Commission (FTC) encourages consumers to review their credit reports every year. Clear up misinformation as soon as possible to keep from jeopardizing your credit rating or stalling your application for any credit purchase.

You get one free credit report a year from each of the three major credit bureaus by visiting [AnnualCreditReport.com](https://www.annualcreditreport.com). This is a free site that will not ask for your credit card number or try to sell you additional services.

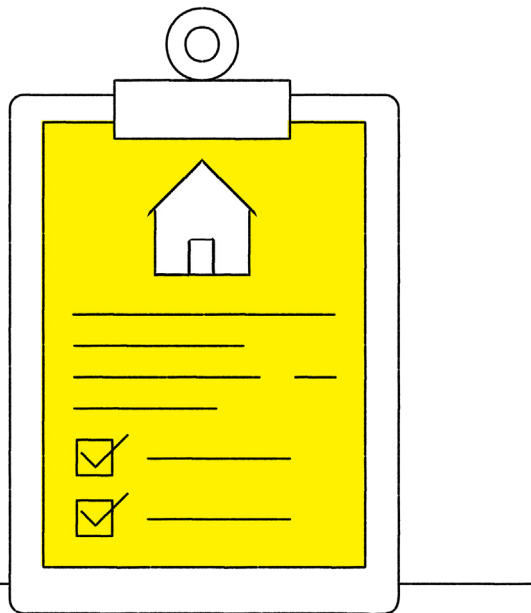
Step 2: Shop for a Mortgage

Shopping for a mortgage loan is important because different lenders will have different offers on loan terms, interest rates and fees. Talk with several lenders before you start to look for a house so you can get the best deal available.

Choose a lender who is willing to explain the pre-approval, approval and closing processes clearly. Be sure that your lender explains all fees, up-front costs, taxes, insurance and other costs of owning a home.



Visit [hud.gov/helping-americans/buying-a-home](https://www.hud.gov/helping-americans/buying-a-home) for calculators, podcasts and the option for free housing counseling.



How do I know what type of mortgage is right for me?

The type of loan you qualify for will determine your monthly payment amounts, the length of the loan and other terms of the mortgage.

- A **conventional loan** is a type of mortgage loan that is customarily made by a bank, savings and loan association or other financial institution that is without governmental underwriting (such as the Federal Housing Administration (FHA) insurance or a Department of Veterans Affairs (VA) guarantee.) Here the lender looks at your debt to income ratio, credit history and credit score to determine the terms of the loan. Conventional loans can be adjustable rate mortgage (ARM) or fixed rate loans.
- If you have filed for bankruptcy, you must be two years out of bankruptcy and have re-established good credit. If you have gone through foreclosure, you must be three years out of foreclosure and have re-established good credit.
- A **VA loan** is a mortgage guaranteed by the Department of Veterans Affairs. Generally, veterans, National Guard, reserve and some surviving spouses can apply for VA loans. The major requirements are a steady income and possession of a Certificate of Eligibility (COE) which verifies to the lender that you are eligible for a VA-backed loan. VA loans tend to be fixed rate loans.
- A **purchase money loan** is commonly known as a seller-financed loan where the buyer makes payments directly to the seller until the loan balance is satisfied. This type of loan is risky for a seller because the seller may not recover the balance from the buyer and runs the risk of foreclosure. The loan is equally risky for the buyer because the seller holds the title to the property and can potentially sell the property to another person without the knowledge of the buyer.

- **Construction loans** are usually short-term, variable-rate loans priced at a spread to the prime rate or some other short-term interest rate. The contractor/builder and the lender establish a draw schedule based on stages of construction and interest is charged on the amount of money disbursed to date. Many homeowners use construction-to-permanent financing programs where the construction loan is converted to a mortgage loan after the certificate of occupancy is issued. The advantage is that you only need one application and one closing.

Interest on your loan

The total amount of interest a buyer will pay the lender on their loan depends on the interest rate and how it will be applied for the duration of the loan.

- Fixed rate loans are mortgages with an interest rate that will not change over the life of the loan. The interest rate is fixed in advance to a set rate, usually in increments of 0.25% or 0.125%.
- Interest-only loans are loans where the borrower pays only the interest on the principal balance, typically for a five- or ten-year interest-only period.
- Adjustable rate mortgage (ARM) is a mortgage interest rate that changes periodically based on a selected index that reflects changes in inflation and cost of credit. The interest rate and your payments are adjusted up or down as there are changes in the index.

Pre-qualify for a mortgage

Generally you must establish a few things in order to qualify for a mortgage loan; for example, adequate income to support the continuing loan obligations and credit worthiness to demonstrate persistence in meeting credit obligations.

- The lender will consider your income to determine the amount of loan. Lenders look at your debt to income ratio to determine the amount of loan you will qualify for. In other words, the balances on your credit and other loans will reduce the amount of the mortgage loan you will qualify for. Your credit score determines the amount of interest and type of loan you can qualify for.
- The down payment is equally important. This is the amount of money you have to reduce the amount you need to borrow or increase the value of the house you can purchase. Some of your down payment can be applied to your loan to decrease your loan interest; this is called buying down points.

Pre-approval letters

Before you put an offer on a home, a seller will generally want to see a pre-approval letter. This letter tells the seller and their agent how much of a loan you qualify for, excluding the amount you have available for a down payment or have to bring to the closing table. Most realtors like to see a preapproval letter before they will agree to represent a buyer and begin showing them homes.

Based on your income, expenses and credit, a lender will provide you with a pre-approval letter for the loan amount and type of loan that they are willing to lend to you based on those factors.

Where can I get pre-approved for a mortgage loan?

- Your current bank or credit union. They typically have in-house loan officers and underwriters who review all of the information and decide if you qualify.
- A mortgage lending company that specializes in residential home sales. They can look for a wide variety of loan products and lenders that best suit your needs.

Federal income tax deductions and credits for home buyers

The mortgage loan origination fee (a fee charged by the lender to process the loan) is deductible if it was used to obtain the mortgage and not to pay other closing costs. The Internal Revenue Service (IRS) specifically states that if the fee is for items that would normally be itemized on a settlement statement, such as notary fees, preparation costs, appraisal fees and inspection fees, it is not deductible.



Energy related credits

To get information about residential energy incentives for your area, visit irs.gov/credits-deductions/home-energy-tax-credits



Mortgage interest

All interest paid and reported to you at the end of the tax year is deductible, unless your loan is more than \$1 million (\$500,000 filing separately).



Mortgage points

You can deduct points in the year you paid them if the loan is to purchase or build your main home. Points on a refinanced loan must be deducted over the life of the loan.



Property taxes

You can deduct the real estate taxes imposed on your property. You must have paid them either at settlement, closing or to a taxing authority (either directly or through an escrow account) during the year in order to deduct them.



Step 3: Find a Home

Determine if you want to manage the purchase by yourself or hire someone to help you. If you hire someone to help, know that not all realtors are real estate agents.

- A **realtor** refers to anyone who's an active member of the National Association of Realtors (NAR), including home appraisers, property managers, real estate counselors and real estate brokers.
- A **real estate agent** is specifically licensed to help consumers buy and sell commercial or residential property.

A knowledgeable local real estate agent can be helpful because buying a home requires understanding the many rules and requirements that have to be met locally by a buyer and seller. An agent can help you:

- Understand what price you have to pay.
- Find affordable mortgage lenders.
- Get the home inspected.
- Get title insurance and surveys.
- Handle the requests of all the parties involved in the transaction.
- Respond to problems along the way.

Hiring an agent also will provide more exposure because most traditional real estate agents share their property listings in a database called the Multiple Listing Service. Agents also represent potential buyers they can share your listing with before it even goes on the market. Some agents advertise their services and listings which lead to more exposure to potential buyers.



Considerations if you hire an agent

- Your agent should be there to look out for your best interests.
- Choose someone you feel comfortable with and who explains the home buying process in a way you fully understand.
- Ask friends or family for agent recommendations.
- Interview several agents before selecting someone to represent you.
- Select someone who is licensed in the state you are buying in and familiar with the areas you want to live.

How an agent is paid

A buyer's agent usually is paid through the commission fees the seller pays his or her agent. These fees are split by the seller's agent and buyer's agent at closing. Typically, a buyer's agent will have the buyer sign a contract, which is an agreement between the buyer and the buyer's agent. The agreement states whether it is exclusive or non-exclusive.

- If it is non-exclusive, the buyer can hire another agent to assist them in purchasing a home.
- If it is exclusive, the buyer may not hire another agent to assist them in their purchase. An exclusive buyer/ agent agreement binds that buyer's agent to you and you to that buyer's agent. You cannot buy a property without owing a commission to that agent.

Dual agency

In some states, agents and brokers are allowed to represent both buyer and seller. This is called dual agency. The agent is required to disclose this information to you if he or she is representing both you and the seller.

A dual agency could exist even if two different agents who both worked for the same brokerage company represented you and the seller. This may be the case even if the two agents didn't work in the same office.

Disclosures

Full disclosure of dual agency to the buyer and seller is required in all 50 states. Dual agents cannot operate in a fiduciary relationship with either party and must treat both sellers and buyers equally. They cannot share confidential information and they cannot give confidential advice.

Single agency agents must use care and due diligence to perform duties, disclose all material facts and be honest. They cannot share confidential information with the other party or the other party's agent.

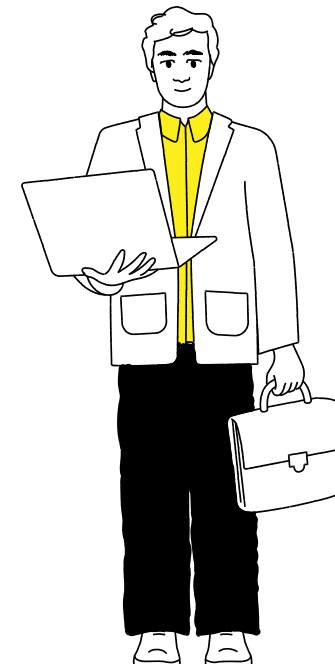
Advantages

In some limited situations the dual agency may not be a problem. The buyer's agent may really consider their needs and wants first and show them a wide variety of listings, even those outside their agency.

Disadvantages

Agents appreciate dual agency because they can get double commission. Too often, there may be a conflict of interest between buyers and sellers. A single agent may not be able to truly represent the best interest of both clients and often one party's needs is given priority, typically that will be the seller because they are paying the commission. Dual agents tend to show buyers dual listings.

For example, if you purchase a home from a builder, his or her agent is paid to represent the builder. Due to the high volume nature of brand new home sales, lots of builder's agents are paid less than a traditional commission; some earn a salary plus incentives. Therefore, their income is directly related to the number of homes they sell for the builder.



Step 4: Make an Offer

Once you find a home you want to buy, you'll submit an offer to the seller's agent. Typically, the offer is made in a standard form locally used by real estate agents and attorneys and is submitted by the buyer or the buyer's agent to the seller or the seller agents for review and acceptance. If the seller accepts the offer, the contract becomes binding, subject to contingencies.

Expiration date of the offer

This is the amount of time the offer will be valid for and how much time the seller has before the offer will terminate, which could be hours, days or weeks after the offer is submitted.

Purchase price

The total price the buyer is offering to purchase the property from the seller.

Initial deposit

Also known as earnest money, this is a good faith deposit held in escrow, while the buyer obtains financing.

Buyer down payment

Readily available cash that will be paid as part of the sale that is not financed. The buyer will need to disclose proof of this down payment to the seller (bank statement, check, etc.).

Financing terms

The rate and terms the buyer must receive if financing the sale.

Required home inspection

This language would entitle the buyer to have the home professionally inspected for construction defects, home systems functionality, code compliance and general habitability; the language may also include

provisions for responding to identified problems. In addition, it allows for the buyer to rescind their purchase offer if issues are discovered during said home inspection.

Contingencies

Events that would void an offer to purchase such as the buyer being unable to get financing at a certain rate or the inspection revealing serious structural problems.

Warranties

As to title (see "Warranties by Deed" on Page 13), condition of the property. Fees associated with closing the sale. If the seller will have to pay closing costs and if so, how much.

The seller can either accept or reject the offer or make a counter-offer stating the terms of the offer that need to change or be added to be acceptable. The buyer can then accept or refuse the counter-offer, or make a counter-offer to the new terms. The offer does not become a binding contract until both parties agree to the terms and sign the contract.

Inspection

Before you close, whether required by the contract or not, you should have the house inspected. A home inspector examines the physical structure and systems of a house from the roof to the foundation. Generally, a standard home inspector's report will cover the condition of the following:

- Heating system
- Central air conditioning system
- Interior plumbing and electrical systems
- Roof, attic and visible insulation
- Walls, ceilings, floors, windows and doors
- Foundation, basement and structural components

The fee for the home inspection could be small in comparison to major repair issues if they are discovered down the line. If you are acquiring an FHA or VA loan, an inspection of the property will be required.

A buyer should generally request an inspection, even if it is not required by the lender. The inspection puts the buyer on notice of most major defects in the property and repairs that buyer otherwise would have to undertake after taking possession. A thorough inspection may cause some buyers to back out of a sale, negotiate a lower sales price or ask the seller for repairs before closing: choices that a buyer without an inspection report would not have.

10 Questions to Ask Your Home Inspector

- 1. What does your inspection cover?** Make sure the inspection and inspection report meets all applicable requirements in your state and complies with a well-recognized standard of practice and code of ethics.
- 2. How long have you been a home inspector and how many inspections have you completed?**

- 3. Are you specifically experienced in residential inspection?**

- 4. Do you maintain membership in a professional home inspector association?** There are many state and national associations for home inspectors. Request to see their membership ID.

- 5. Do you participate in continuing education programs to keep your expertise up to date?** The inspector's commitment to continuing education is a good measure of his or her professionalism and service to the consumer. This is especially important in cases where the home is much older or includes unique elements requiring additional or updated training.

- 6. Do you offer to do repairs or improvements based on the inspection?** Some inspector associations and state regulations allow the inspector to perform repair work on problems uncovered in the inspection. Other associations and regulations strictly forbid this as a conflict of interest.

- 7. How long will the inspection take?** The average on-site inspection time for a single inspector is two to three hours for a typical single-family house; anything significantly less may not be enough time to perform a thorough inspection. Additional inspectors may be brought in for very large properties and buildings.

- 8. How much will it cost?** Costs vary depending on the region, size and age of the house, scope of services and other factors. A typical range might be \$300-\$500, but consider the value of the home inspection in terms of the investment being made. Cost does not necessarily reflect quality.

- 9. What type of inspection report do you provide and how long will it take to receive the report?** Ask to see samples. Most inspectors provide their full report within 24 hours of the inspection.

- 10. Will I be able to attend the inspection?** This is a valuable educational opportunity, and an inspector's refusal to allow this should raise a red flag. Never pass up this opportunity to see your prospective home through the eyes of an expert.

What if the report reveals defects?

Several things can occur if inspector lists some defects in his inspection report.

- If inspection was part of the purchase contract, then the contractual responses will be triggered.
- If you have an FHA loan, the house must pass FHA standards before your final loan will be approved and you can purchase the property.
- If the seller had made warranties in the contract, the seller may be willing to negotiate a rebate off the sales price for the repairs or make the repairs prior to closing. As a buyer, you should contact some contractors and find out how much the repairs will cost. If the seller is unwilling to make repairs prior to closing, then you may want to cancel the sales contract.



Prior to closing

Other tasks that need to happen before closing include:

- **Title search.** This verifies that the seller really owns the property and there are no other claims to the property.
- **Title insurance.** The lender requires title insurance to protect the investment in case the title comes into question after closing. Title insurance for the homeowner can be purchased at the same time. This protects the homeowner's interest in the property.
- **Homeowner's insurance.** You'll be required to have a receipt of payment and declaration of insurance when you close.
- **Survey.** This is a technical drawing of the property and its structures. A survey can take weeks and needs to be ordered in advance to be ready in time for closing.
- **Flood search.** This determines if the property is located in a designated flood zone. If it is, you may be required to get federal flood insurance.
- **Septic certification.** Some states require this inspection if the property you're buying has a septic tank.
- **Well testing.** Some states require this inspection if the property has a well.
- **Termite inspection.** This requirement varies by state. It must be completed before closing.
- **Final walk-through.** Generally, the sales contract includes a clause that allows you a walk-through inspection within 24 hours before closing. This gives you the chance to see that the seller has moved out, made agreed-on repairs and kept other terms of the agreement.

Different Types of Insurance

Homeowner's Insurance

Also commonly called hazard insurance and often abbreviated in the real estate industry as HOI, it is the type of property insurance that covers private homes. It is an insurance policy that combines various personal insurance protections, which can include losses occurring to one's home, its contents, loss of its use (additional living expenses) or loss of other personal possessions of the homeowner, as well as liability insurance for accidents that may happen at the home or at the hands of the homeowner within the policy territory. If you have a mortgage loan, then the mortgage holder is also made an insured on the policy in order to ensure its investment is protected in the event of serious or total damage.

Private mortgage insurance

Generally referred to as PMI, this is an insurance policy that a lender will require a buyer to have if the loan is more than 80 percent of their new home's value. In other words, if your down payment is less than twenty percent, your lender will generally require you to obtain this insurance.

As the borrower, you can request cancellation of PMI when you pay down your mortgage to less than 80 percent of the original purchase price or appraised value of your home at the time the loan was obtained. You also need a good payment history, meaning that you have not been 30 days late with your mortgage payment within a year of your request, or 60 days late within two years.



Warranties by Deed

A new home warranty is generally provided to a buyer by a builder and offers warranties on limited coverage on workmanship and materials relating to various components of the home, such as windows, heating, ventilation and air conditioning (HVAC), plumbing and electrical systems for specific periods (typically a year).

A seller's warranty provides added assurance that any repairs to major appliances, plumbing and other home systems will be covered by the seller within a specified time period after the home is purchased.

A seller may also provide a warranty as to validity of the title they convey to the buyer. It is important that your real estate agent or real estate attorney do due diligence and perform a thorough title search to insure that you are being conveyed good title when you purchase your home. However, since the seller may be hard to locate or lack the resources when a problem arises, a seller's warranty should be secured by holding back some of the seller's sales proceeds for the warranty period.

A general warranty deed is where the seller warrants the title of the property against any other third parties.

A special warranty deed is where the seller warrants the title of the property to the buyer against any one claiming an interest under the seller (heirs, assigns).

A quitclaim deed is a deed where the seller provides no warranties and makes no statement as to title to the extent that they state they are transferring whatever interest they have to the buyer. This is usually used to transfer property from one spouse to another after divorce.

Forms of Ownership

Ownership type

If the property is owned by more than one person there are various ways the property can be titled. The way a property is titled determines the property interests and rights of the co-owners, how the property can be sold/transferred and creditor's rights against the property.

- Tenancy in common is the most common form of multiple ownership. In many states a property titled in the names of unmarried individuals is presumed to be this type of ownership. Each co-owner is a cotenant, and each co-tenant's ownership interest is equal to the amount that co-tenant contributed to the property's acquisition, or, if the property was a gift, by the co-tenants' allotment of shares as expressed in the deed. In this type of ownership the interest of any co-tenant is freely alienable without the other co-tenants' permission.
- Joint Tenancy with the right of survivorship is a classification of multiple ownership where each interest is considered to be an undivided whole interest. In other words, the interest is not divisible without the permission of all the tenants (owners). When a joint tenant dies, their interest passes to the other tenant or tenants without having to go through the court system.
- Tenancy by the Entirety is a classification of ownership where the property is titled/deeded in the name of a husband and wife. Creditors of only one of the spouses cannot stake a claim or place liens on this type of property interest. This form of ownership is not available in all states.

Ask your real estate title agent or attorney about joint ownership laws in your state.

Step 5: Closing

Closing is the final step in the process. During closing, the deed of title is delivered to the buyer, the title is transferred, financing documents and title insurance policies are exchanged and the agreed-on costs are paid. Some of the final documents, including the deed and mortgage or deed of trust, are signed by the appropriate parties and then delivered to the county recorder to be recorded.

Closing costs

Local practice establishes which side – seller or buyer – is responsible for some or all of the closing costs in a transaction. But generally, the buyer is required to pay those costs associated with their obligations in the transaction, such as:

- Agent commissions
- Loan fees
- Title insurance charges
- Recording and filing fees
- Some upfront costs: down payment, first month of the mortgage
- Buyer's portion of transaction taxes and other fees



Did you know?

As part of the sale, the buyer can negotiate with the seller to pay a portion of their closing costs up to a certain percentage depending on the law and type of mortgage involved.

Consult an Attorney

A real estate attorney plays a different role than an agent and in some states you are required to hire a real estate attorney to assist with the closing. The role of the attorney is to:

- Help the buyer understand the sales contract and mortgage loan, including how the buyer will take title on the property.
- Run or review a thorough title search to make sure there are no covenants, easements, liens, etc. registered against the property that will impede your use of it.
- Prepare and record all the legal documents.
- Evaluate any adjustments, including taxes owed and utilities costs paid, prior to the transaction closing.
- Attend the closing and review all the papers you will be required to sign.
- Arrange or review title insurance protection to protect you from losses due to title defects.
- Ensure you receive a validly recorded ownership subject only to the liabilities you have accepted.

Bonus: 10 Tips to Be a Smart Homebuyer

- 1** Before you buy a home, attend a homeownership education course offered by nonprofit counseling agencies approved by the U.S. Department of Housing and Urban Development (HUD).
- 2** Interview several real estate professionals. Ask for and check references before you select one to help you buy or sell a home.
- 3** Get information about the prices of other homes in the neighborhood. Don't be fooled into paying too much.
- 4** Hire a properly qualified and licensed home inspector to carefully inspect the property before you are obligated to buy. Determine whether you or the seller is going to be responsible for paying for the repairs. If you have to pay for the repairs, determine whether or not you can afford to make them.
- 5** Shop for a lender and compare costs. Be suspicious if anyone tries to steer you to just one lender.
- 6** Don't let anyone persuade you to make a false statement on your loan application, such as overstating your income, the source of your down payment, failing to disclose the nature and amount of your debts or even how long you have been employed.



- 7 Don't let anyone convince you to borrow more money than you know you can afford to repay.
- 8 Never sign a blank document or a document containing blanks. If information is inserted by someone else after you have signed, you may still be bound to the terms of the contract. Insert "N/A" (i.e., not applicable) or cross through any blanks.
- 9 Read everything carefully and ask questions. Do not sign anything that you don't understand. Before signing, have your contract and loan agreement reviewed by an attorney skilled in real estate law, consult with a trusted real estate professional or ask for help from a housing counselor with a HUD-approved agency.
- 10 Be honest about your intention to occupy the house. Stating that you plan to live there when, in fact, you are not (because you intend to rent the house to someone else or fix it up and resell it, for example) violates federal law and is a crime.

Be Prepared When *Legal Happens*

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