Steps to Homeownership

CreditSmart® Asian

Freddie Mac

We make home possible®

About Freddie Mac

Freddie Mac is a stockholder-owned corporation chartered by Congress in 1970 to create a continuous flow of funds to mortgage lenders in support of homeownership and rental housing. Freddie Mac purchases mortgages from lenders and packages them into securities that are sold to investors. Since its creation, Freddie Mac has helped finance one in six American homes.

About CreditSmart® Asian

CreditSmart Asian is a multilingual series to guide Asian American consumers on how to build and maintain better credit, understand the steps to buying a home and how to protect their investment.

Special Thanks

Special thanks to the following organizations for their collaboration in the development of the CreditSmart Asian: Asian Americans for Equality, Boat People SOS, Chhaya CDC, Filipinos for Affirmative Action, Korean Churches for Community Development, Nakatomi & Associates, National Coalition for Asian Pacific American Community Development (National CAPACD), National Congress of Vietnamese Americans, National Korean American Service & Education Consortium, Inc., and Quon Design.

Freddie Mac:
Steps to Homeownership

- Maintain your good credit rating
- Establish your home buying budget
- Save money for a down payment and moving expenses
- Pre-qualify for a home loan
- Find the home you want to buy
- Make an offer
- Apply for a mortgage
- Complete all escrow requirements
- Move in

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Get Credit Smart®: Steps to Homeownership

Welcome,

For millions of families, homeownership is a route to creating wealth. It builds financial security for the future.

As you begin the journey to homeownership, Freddie Mac is providing this information to help you successfully make your way through the process. We know the process may seem daunting, especially if you have limited English skills or if you don't yet have credit established and don't know how the system works. We created this series of guidebooks to help get you started. The guidebooks cover the importance of establishing your credit, the process of buying a home, including how to make the best financial choices for you and your family, and the responsibilities of being a homeowner.

There are many other resources available to you, including community organizations, your local government housing agencies, real estate agents and lenders who understand and are willing to work with prospective homebuyers like you. We strongly encourage you to seek out their professional services to gather the facts so you can make the best decisions. You will face many choices throughout the process.

In this guidebook, *Steps to Homeownership,* you will learn the steps to buying a home. You will gain important knowledge that will help you through the purchase of your first residence. We also explain important terms used in the homebuying process—which sometimes seems like a foreign language.

Having a good credit history is an important first step. If you have not yet established a credit history or need information on how to establish or improve your credit history, you should review our companion guidebooks, *The Importance of Good Credit* and *Homeowner Benefits and Responsibilities* to understand how to protect and grow your investment now that you are a homeowner. Together, these books are a valuable road map addressing the issues and questions most important to you.

From all of us at Freddie Mac, we wish you great success. With proper planning, time and hard work, you can realize your dream of homeownership.

As you begin the journey to homeownership, Freddie Mac is here to help guide you through the process.

A Home of Your Own

Are you ready for the responsibilities of homeownership in America?

You and your family members work hard. You save your money. You have established and maintained a good **credit history**.

Now, after years of dedication, you are ready to give your family a valuable gift: a home. Or perhaps you are new to the United States, and you want to prepare to buy a home some day. Do you know where to start? Are you ready for the responsibilities of homeownership in America?

After reading these guidelines, you will know the steps involved in buying your first home, and you will know what questions to ask along the way to make sure the process goes as smoothly as possible. Because of the complexity of buying your own home in America, it is advisable that you seek assistance from a non-profit organization that provides homeownership education and counseling services.

Don't rush into it. A home will be one of the largest purchases you will make in your lifetime. With preparation and research, you will achieve your dream of homeownership.

Your first home is not only a place to live and grow together, but it also is a valuable **asset** for the future—one that will create wealth for you and your family over time. While home values can go up and down in general, the value of your home **appreciates** (or increases) over time; it becomes an asset that can be passed down to your children. It can be an effective way to establish financial security for your family. Homeownership is more than having a shelter; it can help you finance your business or your children's education.

DID YOU KNOW...?

Research shows that children of homeowners do better in school, and neighborhoods with high levels of homeownership tend to be safer (Haurin, Donald R., T. Parcel, and R. Jean Haurin. Does Homeownership Affect Child Outcomes? *Real Estate Economics,* vol. 30, issue 4, 2002).

Getting Started

Whether you currently live with friends and family members or rent your own apartment, you need to analyze the pros and cons of owning your own home versus renting.

Renting a Place to Live

Cons:

- ✖ Your rent payments do not build **equity** for you—your money goes to your landlord.
- ✖ You cannot freely make improvements, such as upgrading your kitchen or bathroom, to your home or dwelling.
- ✖ There may be restrictions regarding children or pets.
- ✖ There may be restrictions regarding how you can decorate your home.
- ✖ You may not feel comfortable cooking your favorite ethnic dishes.
- ✖ You do not have control over whether rent will increase.
- ✖ Your landlord could ask you to move because he or she has made other decisions regarding the property (wants to sell or change use).

Pros:

- ✔ Someone else handles the repairs and maintenance.
- ✔ The landlord pays the property insurance, taxes and certain utilities.
- ✔ You can move when you want without having to sell the home.

Owning a Home

Cons:

- ✖ You are responsible for paying more than just your **mortgage** payment, including property tax, **homeowner's insurance**, homeowner association fees, utilities and other expenses.
- ✖ You must pay for repairs and maintenance, as well as renovations, of your home and property.
- ✖ If you cannot pay your mortgage, your home may be subject to **foreclosure**.

Pros:

- ✔ You have an asset that you own.
- ✔ Your property builds equity over time, giving you a valuable wealth-building tool that you can use to buy a larger home, finance your business or perhaps fund your child's education or even your own retirement.
- ✔ It provides security. You have a home of your own where you and your family can live and grow together.
- ✔ There are tax advantages (consult a tax advisor for potential benefits).
- ✔ You monthly mortgage payments will not change if you choose a **fixed-rate mortgage**.
- ✔ You have a recognized voice in civic affairs, allowing you to help build a strong sense of community.
- ✔ You have the freedom to choose the décor of your home.
- ✔ You have the freedom to follow religious and cultural customs that are important to you and your family.
- ✔ You may have more room and freedom to prepare the types of food that you and your family enjoy.

The value of your home appreciates over time; it becomes an asset that can be passed down to your children.

Are You Ready?

Your homebuying team… will help make your transaction proceed smoothly.

As you begin your search for a home, you need a variety of professionals to help you along the way, including non-profit homeownership education counselors, a **real estate professional** (agent), a real estate attorney, a home inspector, an **appraiser** and more. Each is a member of your homebuying team that will help make your transaction proceed smoothly.

Real estate agent—This person will help you find prospective properties, make your **offer** and assist you through the homebuying and **escrow (closing)** process. (See the section "Your Rights as a Borrower" for more information on the escrow process.) To choose an agent, you may want to ask trusted friends or relatives for their referrals. Or you may wish to contact a professional organization, such as the National Association of Realtors (www.realtor.org) or the Asian Real Estate Association of America (www.areaa.org), for a reference in your area. The home seller usually pays the agent's fees from the proceeds of the sale of the house.

Mortgage lender or mortgage broker—When it is time to obtain your mortgage, you need to choose a lender or broker to help you select the best mortgage option. A mortgage broker provides a range of products and services, allowing a borrower to compare different mortgage products from several lenders. Contact several lenders or brokers to compare **mortgage rates** and terms, and ask about programs for first-time homebuyers. Be aware that the borrower pays the broker's service fee.

Your family and friends—This is perhaps your most valuable resource when considering a home for purchase. Trusted friends and relatives can help you weigh the pros and cons of each property and discuss their own experiences with the homebuying process. However, you must remember that ultimately you are responsible for your purchase, so always trust your own instincts first. You are responsible for getting the right information and for considering all your options.

Community-based organizations, housing counselors, local housing agencies and web sites—These are important resources to consider when you begin your research for the best loan product or programs for you and your family.

Other professionals—You may need a home inspector (to evaluate the condition of your home prior to purchase), contractors to handle any necessary repairs you cannot do yourself, and movers (if you use a professional moving company rather than family or friends).

QUESTIONS FOR YOUR REAL ESTATE AGENT

Here is a list of questions you should ask a prospective real estate agent when you begin the homebuying process.

- Are you familiar with the neighborhood where I want to buy? (Often, real estate professionals specialize in certain geographic areas.)
- **Are you fluent in my language?** (If you prefer to do business in a language other than English, you may want to use a bilingual agent.)
- How many buyers and sellers are you representing now? (If your agent is very busy, you may not get personalized attention.)
- Will you provide me with recent references? (You may want to speak with a recent homebuyer who worked with the agent.)
- How many home sales have you closed in the past year? (This will give you an idea about how successful the agent is.)
- How long have you worked in the real estate business? (This is important if you prefer working with someone with a lot of experience.)

To choose an agent, you may want to ask trusted friends or relatives for their referrals.

Your Own Home

Before you start shopping for a home, it is often best to begin by determining how much you can afford.

While it is tempting to look for your dream home right away, there are some steps to follow before you start shopping for a home. It often is best to begin by determining how much you can afford. Your first step should be to talk to a homeownership education counselor (see www.HUD.gov for counseling organizations) to learn the homebuying basics and to evaluate your financial readiness (ask if the counseling provider has services in your native language). Next, begin talking to a lender or a mortgage broker to review your income and expenses, which determine the type and amount of mortgage for which you qualify. Some of the criteria you should review with your prospective lender are presented here. As you gather your information from experts, you need to determine what type and how much of a mortgage are most appropriate for you and your family.

How Much Can You Afford to Spend?

For a general idea of your homebuying power, multiply your annual gross income by 3.5. For example: $47,000 (annual income) x 3.5 = $164,500 (cost of home). (Your annual gross income is the income you earn in a year before taxes and other deductions. It also can include income you earn from a commercial or business rental property, self-employment, alimony, child support, public assistance and retirement accounts.) Remember, this calculation is just an estimate, and it does not mean you can afford the monthly payments associated with this mortgage amount. Even if you are pre-qualified for a certain mortgage amount by a lender, you need to decide for yourself the loan amount and monthly payments that meet your budget and are most comfortable for you.

Is Your Income Steady?

Perhaps you are new to your job, your income varies throughout the year or you have a cash business. Lenders prefer to offer mortgages to individuals who can show a steady source of income. Be prepared to give proof of your income sources with tax forms or other documentation.

Do You Have Good Credit?

By now you should have established **credit** in your own name and maintained a history of timely payments. You should obtain a copy of your **credit report** to make sure all the information it contains is correct. If there are errors, report them to the **credit bureaus** immediately. If there are negative items on your report that are correct and require your attention, now is the time to call your creditors and settle your **debts**. Ask them to report the repayment to the credit bureaus right away. Refer to Freddie Mac's guidebook "The Importance of Good Credit" for more information.

Do You Have Enough Money for a Down Payment and Closing Costs?

Today there are many mortgage products that allow prospective homeowners to buy with little money—or no money—for a **down payment**. Years ago, a conventional mortgage required that the buyer prepay 20% of the purchase price as a down payment. In high-cost areas, home prices appreciate very quickly. Now, mortgage products with a 0% to 3% down payment are widely available, and more families and individuals are able to become homeowners. If you do not prepay 20% of the purchase price, you will have to pay a premium for **mortgage insurance** (MI). This insurance typically is paid to the lender for home loans with less than a 20% down payment. It is required for all government sponsored and conventional loans with less than a 20% down payment.

However, the insurance requirement does not apply to the entire duration of the mortgage loan. Under federal law, your lender is obligated to cancel MI when your mortgage is paid to 22% of the purchase price. The lender must inform the borrower at the closing when the mortgage will reach the 78% mark. You also can request cancellation of MI coverage when your equity has reached 20%. Talk to your lender for more information.

The MI premium does not reduce the **principal** loan amount. Because this MI premium is in addition to your normal mortgage payment, you need to factor its cost into your decision to buy a home.

You need to do your research and determine if it is more beneficial to you to buy sooner and pay MI or to wait additional years and save 20% for a down payment.

Ask your lender about your options, and set aside enough money to pay your down payment and **closing costs**. (Closing costs generally range from 2% to 7% of the mortgage amount. Your lender will provide you with a written estimate of closing costs—called a **good faith estimate**—during your mortgage approval process.)

INDIVIDUAL DEVELOPMENT ACCOUNTS

In high-cost areas such as New York, San Diego, or Los Angeles, a home purchase is not within reach for many low- or moderate-income families unless they have a 20% down payment or more. Many families are pooling resources to buy a home together. Others take advantage of special home-buying programs, such as individual development accounts (IDAs), which match family and individual savings for a period of time to purchase an asset, such as starting a business, homeownership or a college education. For more information about IDAs and a list of organizations offering IDA programs, visit www.CFED.org.

MORTGAGES TODAY

No longer must you have a 20% down payment for a house to receive a mortgage. Today there are many mortgage options available to consumers. Some lenders have mortgage products designed specifically for individuals with non-traditional income sources, such as those who are self-employed or those who run cash businesses. Ask your lender for information about the options available to you. Some mortgage products feature beneficial options, such as:

- Small down payments (0% to 3%).
- The ability to use additional sources of money for your down payment, such as grants or funding from a non-profit organization, your employer, a private foundation, a family member or a federal, state or local government agency. If you belong to a cultural savings club (for example, referred to by Chinese Americans as “su-su” and by Korean Americans as “kye”), some lenders will accept a letter from the treasurer or the fund administrator as documentation of supplemental funds and good payment history.
- Expanded debt-to-income ratios up to 42% (allowing you to qualify for a mortgage payment that is a larger percentage of your monthly income than the standard 36%).
- Special consideration for people with limited incomes in high-cost areas.
- Homeownership education programs.
- Low-cost mortgage insurance.
- Contributions to your closing costs from the seller.
- Special rates or terms for buying a home within a designated area.

Consider all your options and your costs before deciding on paying 20% for a down payment, or choose a financing option that allows you to pay less. There are benefits and drawbacks; consider all factors before deciding which option is best for you.

If you do not have enough money saved to pay for these items, ask your lender about programs from local government agencies or non-profit organizations to help first-time homebuyers. If a friend or family member gives you the money for your down payment or closing costs, he or she may have to provide your lender with a letter stating that the money is a gift, and you do not have to pay it back.

Do You Have Enough Cash to Move?

Your expenses do not end when your mortgage is funded. You need to have money for moving expenses, as well as for any repairs required at your old or new home, for any upgrades to your new home, plus for any new furnishings you will need, including appliances and furniture. To keep costs low, find ways to do as much of the work yourself, and look for items on sale. Perhaps you can delay the purchase of some furniture for a few months after you move to your new home.

How Much House Can You Afford?

One of the best ways to calculate how much house you can afford is to create a budget of your monthly income and your expenses. Use the following form to help you determine your budget:

Sample Budget Worksheet

The following budget is broken down into the following types of expenditures: Fixed Expenses, Periodic Fixed Expenses, Variable Expenses and Indebtedness.

Depending on your situation, some expenses (for example, long distance calls or a cell phone) may be considered variable rather than fixed expenses. **Be sure to adjust the budget categories to best reflect your needs and lifestyle.** *(Report all expenses as monthly amounts.)*

Fixed Expenses

Housing

Rent, Mortgage or Lot Rent	$
2nd Mortgage/Equity Loan/Association Fees, etc.	$
Heating	$
Electricity	$
Telephones (basic service)	$
Other	$

Transportation

Gas/Public Transportation/Taxi/Parking	$
Car/Truck Payment	$
Other	$

Insurance

Health (medical and dental, if not payroll deducted)	$
Life/Disability	$
Other	$

Child Care

Child Care/Babysitters	$
Child Support/Alimony	$
Other	$

Family

Money you send to relatives living in another country (if you send the same amount each month,if applicable)	$

Personal Savings

Remember to pay yourself first	$
FIXED EXPENSES SUBTOTAL	$

Periodic Fixed Expenses *(list 1/12th of the annual payment amount)*

Housing

Property/Real Estate Taxes (if not included in mortgage)	$
Home Insurance (if not included in mortgage payment)	$
Renter's Insurance	$
Water/Sewage	$
Trash Service	$
Other	$

Transportation

Car Insurance	$
Car Licenses	$
Car Repairs and Maintenance	$
License Plates/Registration Fees	$
Other	$
PERIODIC FIXED EXPENSES SUBTOTAL	$

Variable Expenses

Food

Food/Groceries	$
Work Related (lunches and snacks)	$
School Lunches	$
Other	$

Child Care

Diaper Expense	$
Other	$

Medical

Doctor	$
Dentist	$
Prescriptions	$
Glasses	$
Other	$

Clothing

Clothing	$
Laundry/Dry Cleaning	$
Other	$

Education

Tuition	$
Books/Papers/Magazines/Supplies	$
Lessons (sports, dance, music)	$
Other	$

Donations

Religious/Charity	$
Other (if not payroll deducted)	$

Gifts

Birthdays	$
Major Holidays	$
Other	$

Personal

Barber/Beauty Shop	$
Toiletries	$
Children's Allowance	$
Tobacco Products	$
Beer, Wine, Liquor	$
Other	$

Entertainment

Movies, Sporting Events, Concerts, Videos, Theater, etc.	$
Internet Service	$
Cable/Satellite T.V.	$
Restaurants	$
Gambling/Lottery Tickets	$
Fitness or Social Clubs	$
Vacations/Trips	$
Other	$

Miscellaneous

Home Maintenance	$
Checking Account or Money Order Fees, etc.	$
Pet Care/Supplies	$
Hobbies and Crafts	$
Postage	$
Money you send to relatives living in another country (if you send the same amount each month, if applicable)	$
VARIABLE EXPENSES SUBTOTAL	$

Indebtedness

Debts

Student Loan	$
Credit Card (monthly minimum*)	$
Credit Card (monthly minimum*)	$
Credit Card (monthly minimum*)	$
Medical Bills	$
Personal Loans	$
Other	$
INDEBTEDNESS SUBTOTAL	$

FIXED EXPENSES SUBTOTAL:	$
FIXED PERIODIC EXPENSES SUBTOTAL:	+ $
VARIABLE EXPENSES SUBTOTAL:	+ $
INDEBTEDNESS SUBTOTAL:	+ $
TOTAL MONTHLY EXPENSES	= $

TOTAL MONTHLY NET INCOME:	$
MINUS TOTAL MONTHLY EXPENSES:	- $
EQUALS AMOUNT LEFT OVER FOR SAVINGS AND INVESTMENTS	= $

** Although it is strongly recommended that you pay more than the monthly minimum payment due, lenders will use this amount when calculating monthly debt obligations.*

Qualifying for a Mortgage

Once you have a detailed picture of your monthly income and expenses, and you have created your budget, you can begin to think like a lender. Lenders conduct a four-part review of **capacity**, credit, capital and **collateral** (the four C's) to determine if a borrower has the ability to repay a loan and, therefore, can qualify for a home mortgage.

Capacity

Capacity is your ability to repay a mortgage loan based on your income and work history. Your lender considers the following:

- Do you have a stable income that is likely to continue?
- Do you have enough income to meet the mortgage payment expenses?
- What is your debt-to-income ratio? Ideally, lenders want to see that your mortgage principal, **interest**, homeowner's insurance and property taxes will not exceed 28% of your **gross monthly income**. They also want to see that your mortgage principal, interest, homeowner's insurance and property taxes, as well as your recurring monthly debts, such as auto loans, student loans and installment and revolving credit card payments, will not exceed 36% of your gross monthly income. (Your gross monthly income includes any additional income from overtime, part-time employment, bonuses, dividends, interest, royalties, pensions, Veterans Affairs compensation, net rental income, alimony, child support, Social Security benefits, trusts, business activities or investments, workers compensation and disability). Talk to your lender or mortgage broker for more details.
- Do you have the ability to go from your present rent payment to the proposed house payment?
- Does your present financial lifestyle allow for a savings pattern for unforeseen housing expenses?

Credit

Credit is borrowing money to pay for something you get today, such as a home, furniture or car, with an agreement to pay the money back. Credit is granted through several means, including credit cards, personal loans, car loans and home mortgages. Your credit report will be reviewed to determine if you will be granted credit (see Freddie Mac's guidebook "The Importance of Good Credit" for information on credit reports). To prepare for this review, request a free copy of your credit report each year from the credit bureaus—Equifax, TransUnion and Experian. Review the reports and check them for any errors. If there are errors, now is the time to resolve them. If you have credit problems, start working to resolve them now. By working with your creditors, in time your credit report will indicate a healthy credit history, and you will be ready for a mortgage.

If you do not have any credit accounts, ask your lender if a non-traditional credit history will be accepted. You create an "alternative credit report" in your name, which reflects the manner

Lenders conduct a four-part review of capacity, credit, capital and collateral (the four C's).

Collateral is any property you own that is acceptable as security for a loan or obligation.

in which you have paid your financial obligations such as rent, utilities and car insurance (see "The Importance of Good Credit" for more information). It is imperative that you keep receipts of these payments if you choose a non-traditional credit evaluation.

Capital

Capital is your wealth in terms of your property or money, including any money you have saved for your down payment and closing costs. Your lender will look at your checking accounts, savings accounts, insurance policies, gifts, **individual retirement accounts, Keogh funds** and other assets.

Collateral

Collateral is any property you own that is acceptable as security for a loan or obligation, which in this case is the home you are buying. Before signing a contract to purchase a home, consider the following:

- Can I afford this house?
- Does this house meet the needs of my family?
- What kind of maintenance does this house require?

It is strongly advisable to hire a professional inspector to examine the house for you. You have the right to hire a licensed inspector to do a **home inspection** at your own expense. The inspector will answer important home condition and maintenance questions, such as: Does the roof appear to have at least five years of life left? Does the plumbing work? Does the electrical system appear to operate efficiently? Is the basement or crawl space dry? Is the foundation of the house in good condition?

If you paid for an **appraisal** of the home you want to buy, you are entitled to a copy of it. Get your copy as soon as your mortgage lender receives it and review it carefully. If you have any questions about the property, ask your real estate agent (or real estate attorney) or inspector, before your loan closes. Every question is important.

Remember, this may be the largest purchase you ever make. Be sure you know what you are buying, and that you are comfortable with your decision.

Get Pre-Approved

Once you have narrowed down your price range for a home, and you are ready to buy, you should get pre-approved for a loan. Pre-approval is a service provided by banks or other lenders based on a preliminary review of your credit report and income documents. A **pre-approval letter** shows a prospective seller that a lender has determined that you have the capacity (refer back to the four C's) to be approved for a mortgage based on the information you provided. Some sellers may see your pre-approval as an attractive part of your home offer, since it indicates that you are a serious buyer.

To obtain pre-approval, contact your bank, mortgage broker, credit union or other lender.

Finding Your Way Home

Once you know what you can afford, and you are pre-qualified for a mortgage, you can begin shopping for your home. There are many factors to consider. One of your primary concerns should be location. Many people select their home based on proximity to work, school, church and community. If a particular school is important to your family, you should call school district officials to confirm if a prospective home is located within the desired school district. You may need to balance your desire to be within a particular school district with how far you are willing to commute to your job.

When choosing a potential neighborhood, you also may want to consider what amenities are nearby, including public transportation, parks, community centers, doctors' offices, hospitals and shopping centers. Do you want a home on a quiet street, or would you prefer a busy location near shopping and restaurants? Do you want neighbors who have young children for playmates for your children? Do you want to live in a gated community?

You also need to evaluate what type of dwelling you want: a detached single-family home or perhaps a co-op, condominium or townhouse. You might prefer a co-op or **condominium** because all the owners in the building share maintenance costs. Or you may prefer a multi-family house because the rental income can help with monthly mortgage payments.

When considering a co-op or condominium, inquire about by-laws, declarations and rules and restrictions on the use of units, common areas and pets.

Making an Offer

Once you have found the property you like, you are ready to make a formal offer. Your real estate agent will assist you through the process. The offer will state the down payment you propose to pay, the price for which you want to buy the house and how long your escrow will last. (Escrow is a process during which a third party holds all funds related to the sale of the home before closing. During escrow, you will be responsible for getting the home inspection and testing for radon and termites.) Additionally, your offer can include any **contingencies** or special requests, such as repairs you want made before the sale closes or items you want to remain in the home, such as a refrigerator or a washer/dryer. Although not required, you should always include a home inspection contingency in your offer.

At the time of your offer, you will be required to pay an **earnest money deposit** (a "good faith" deposit)—usually between 1% and 5% of the purchase price—to show that you are a serious buyer, and that you intend to move forward with the purchase of the house. It is common for your first offer to be met with a counter-offer

Many people select their home based on proximity to work, school, church and community.

from the seller, unless your offer is for the asking price or higher. Depending on the local real estate market and your desire for the specific home, you and your family will have to consider each counter-offer carefully. If the terms begin to be unattractive, you may wish to refuse the counter-offer and move on to another property.

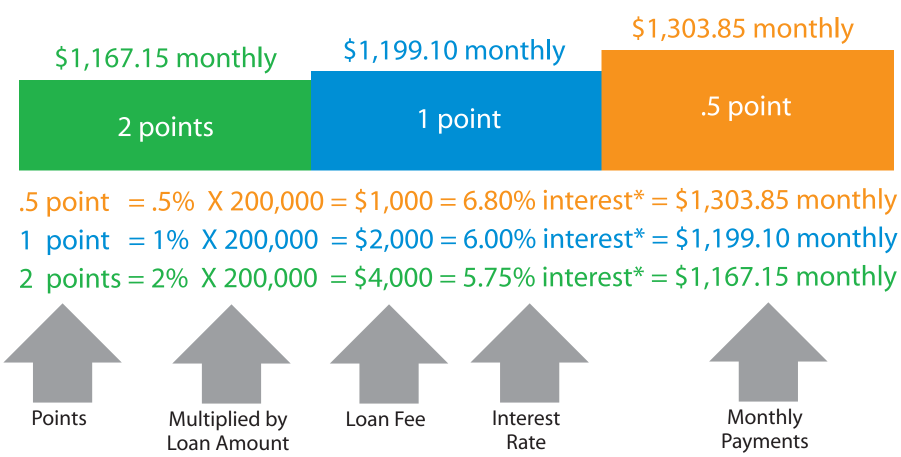
After the Offer

Once you have found your home, and your final offer has been accepted, you must begin the mortgage application process in earnest within an agreed upon time frame. You should contact your preferred lender and start all the necessary paperwork to move forward.

Here are some questions to ask your lender:

- Do you offer any special loan programs to first-time homebuyers or for the purchase of a home in the neighborhood where I want to buy?
- Is first-time homeownership education required to be eligible for special loan programs?
- What is the lowest interest rate you offer for a conventional, fixed-rate mortgage? If I were to pay one, two or three **points** (one point equals 1% of the loan), how does that affect my rate? (see graph)
- How does the term of the loan affect my interest rate (30 years vs. 20 years vs. 15 years)?
- Do you offer any special loan programs if I don't make a 20% down payment, and I don't want to pay mortgage insurance?
- What fees are included in my loan? Are these negotiable?
- When can I **lock in** my interest rate? What is my rate lock period? What if rates drop further?
- What is the current adjustable interest rate for a mortgage of my amount? How is my rate calculated? Is there a **rate cap** (annually or for the life of the loan)?
- Is there a prepayment penalty? (You want to avoid loans that have a prepayment penalty.)
- How long will it take for the lender to process my loan?
- What is the **annual percentage rate** (APR)?

Based on 30 year fixed-rate mortgage of $200,000



*These interest rates and scores are for illustration only; actual mortgage rates depend on many variables, including credit scoring.

MORTGAGE APPROVAL

The mortgage approval process can be intimidating, but not if you think like a lender. Remember the four C's—capacity, credit, capital and collateral. In general, lenders want to see that you are a good risk and, thus, a likely candidate to repay your loan obligation on time and in full.

How do they determine this? First, they look at your job history. Steady employment is a good indicator of stability. They also may look at your income (including your past income tax returns) and contact your employer for confirmation of employment and stated earnings. Additionally, they will request your credit report to determine your total debt. Finally, they will consider the property you wish to buy by appraising its **market value** and considering any potential problems associated with reselling the property should you **default** on the loan. If all these factors show that you are a good credit risk, and your home appraisal (your collateral) is equal to or higher than the value of the loan, you should have an easy approval process.

What if your lender questions one of these factors? Perhaps you have switched jobs recently, or you have a few negative items on your credit history. It is best to begin by offering your prospective lender an explanation of your situation. Your new job may be because you recently graduated from college, and your credit history issue might be because of an error unrelated to you. It is important to keep the discussion open with your prospective lender so you are not penalized with mortgage delays or high interest rates.

Lenders want to see that you are a good risk and, thus, a likely candidate to repay your loan obligation on time and in full.

Mortgage Types

Fixed-rate mortgages lock in your interest rate for the length of your loan.

When you shop for a mortgage, you have several choices. This section discusses some of the different mortgage options available.

Fixed-Rate Mortgages

Fixed-rate mortgages lock in your interest rate for the length of your loan. This may be advantageous if you are wary of interest rates rising or just want a stable payment plan. Fixed-rate loans can range from 15 years to 50 years, some examples include:

- **30-year, fixed-rate loan.** This is the most common fixed-rate term. With its longer term, this loan gives you the best chance of keeping your payments predictable.
- **20-year, fixed-rate loan.** Because this loan is just for 20 years, you have the opportunity to own your home debt-free sooner, with just a slightly higher monthly payment than for a 30-year, fixed-rate loan.
- **15-year, fixed-rate loan.** With a lower interest rate than a 30-year or 20-year, fixed-rate mortgage; a 15-year, fixed-rate mortgage saves you a significant amount of interest. You build equity quickly and own your home sooner. However, your monthly mortgage payment will be considerably higher than for a 30-year, fixed-rate mortgage.
- **Other terms.** Mortgages that extend for 40 or 50 years allow you to have a lower monthly payment than for the 30-year or less mortgage term. These longer-term mortgages may make homes more affordable in high-cost areas such as New York, San Francisco, or Los Angeles. Consider all the pros and cons of these new longer-term products, which limit your ability to build equity, potentially extend your debt into your retirement years and increase the amount of interest you will pay.

Adjustable-Rate Mortgages (ARMs)

Like the name suggests, the interest rate on ARMs adjusts higher and lower as financial market conditions change. An ARM may be advantageous if you do not plan to live in your home for more than a few years. Many ARMs offer lower initial interest rates and payments, and they may allow you to qualify for a larger loan amount than a fixed-rate mortgage.

It is important to examine all the terms associated with an ARM carefully, especially in a changing real estate market. Your ARM may involve structured payments that increase annually or initial interest-only payments. Newer hybrid ARMs offer a combination of fixed and variable terms.

THINGS TO ASK YOUR LENDER ABOUT AN ARM:

- Is there a cap during each adjustment period?
- How often is my rate adjusted?
- Is there a lifetime cap?
- Is my ARM tied to a particular financial index? If so, which one?
- What has been the performance of the index in recent years?

Ask your lender about its **cap** during each **adjustment period** (usually once or twice a year) and its lifetime cap. Ask if your ARM is tied to a particular financial **index**, such as treasury-indexed ARMs, CD-indexed ARMs or Cost of Funds–indexed ARMs. If you determine which index your loan will be tied to, you can track its performance during a recent year. While this will not guarantee your future interest rates, it may give you an idea about your particular loan.

Other Mortgages

Balloon mortgages—Balloon loans offer low interest rates for a short term. At the end of the term, the borrower must **refinance** the balance or pay the balance with a lump sum payment. If you consider this loan, you must ask about all the conditions of the loan, since some lenders may not guarantee your loan past the balloon date. While this loan may be appropriate for you if you plan to sell your home within a few years, you should consider all the terms beforehand, since the conditions may be strict.

Special mortgage products—Some non-profit organizations, government agencies and lenders offer special mortgage products to help first-time homebuyers. If you have difficulty qualifying for a standard loan product, you may want to find a lender who can offer special loans with flexible features.

Interest-only mortgages—Instead of paying part of the principal (the loan amount) each month plus interest charges, interest-only loans require that the borrower pay only the interest for the first 5 or 10 years. After that, the borrower must either pay the balance of the loan or start paying both principal and interest monthly for the remaining period, perhaps 20 to 25 years. The potential risks are significant for interest-only loans, especially if the interest rate on the loan increases, and the required payments of both principal and interest are well beyond your ability to pay each month. After the interest-only period ends, the monthly payment will be substantially higher than if you had used a traditional 30-year mortgage loan.

Option ARMs—Also called "flex" ARMs, these loans let the borrower decide how much to pay from one month to the next based on a few choices. The options range from making a full monthly payment (what you normally would pay in principal and interest for a traditional mortgage) to a "minimum" payment that does not fully pay for the interest due, but the shortfall is added to your loan balance. If you do not have enough money for your regular monthly payment, you can send in a low payment and not be defaulting on your loan.

Some non-profit organizations, government agencies and lenders offer special mortgage products to help first-time homebuyers.

The U.S. Department of Veterans Affairs guarantees VA loans to make housing affordable to eligible U.S. veterans.

Option ARMs may be beneficial for people who earn a good annual salary, but their monthly income fluctuates. Perhaps they rely heavily on commission checks or sizeable year-end bonuses. But if they defer too much interest their total costs can go up, because they will be paying interest on a higher loan amount, and they likely will be doing that for many years. If you end up deferring a substantial amount, you may owe more on the loan than the value of your home. Then if you sell during a time of declining values, the sales price of the home may not pay for the loan balance.

Government Programs

The Federal Housing Administration (FHA), Department of Veterans Affairs (VA) and the Rural Housing Service (RHS) offer special mortgage plans for borrowers or properties that meet certain restrictions. If you are a low-income borrower, a veteran or you wish to buy a home in a rural area, you should investigate these options.

FHA Loans—The FHA, part of the U.S. Department of Housing and Urban Development (HUD), insures a home loan, so your lender can offer you a better loan package, including down payments as low as 3% of the purchase price, low closing costs and easy credit qualifying. To speak to a counselor call (800) 569-4287, or visit www.hud.gov for more information.

VA Loans—The U.S. Department of Veterans Affairs guarantees VA loans to make housing affordable to eligible U.S. veterans. You can apply for a VA loan with any mortgage lender that participates in the VA home loan program. You will need a certificate of eligibility from VA to prove to the lender that you are eligible for a VA loan. For specific loan-related questions, you must contact a VA Regional Loan Center (VA RLC). Visit www.home-loans.va.gov for more information.

RHS Loans—Rural Housing Guaranteed Loans, called Section 502 loans, primarily are used to help low-income individuals or households purchase homes in rural areas. Funds can be used to build, repair, renovate or relocate a home, or to purchase and prepare sites. Families must meet income requirements and be without adequate housing, but they must be able to afford the mortgage payments, including taxes and insurance. In addition, applicants must have reasonable credit histories. There is no required down payment. The lender must determine repayment feasibility using ratios of repayment (gross) income to mortgage and to total family debt. For more information visit http://www.rurdev.usda.gov/rhs/ or call (800) 414-1226.

MORTGAGES FOR NEW AMERICANS

If you are new to the United States, or if your beliefs and traditions have prevented you from establishing a banking relationship or a traditional credit history, many lenders today will help you become a homeowner through special underwriting guidelines and mortgage programs. U.S. citizenship is not a requirement for getting a mortgage.

You may still qualify for a mortgage if you:

- Do not have a bank account.
- Have no (or a limited) credit history.
- Have applied for your permanent residency but have not yet obtained the status.
- Have been employed in the United States for less than two years.
- Have been paying taxes in the United States.
- Only want to share limited financial information about yourself, or none at all.
- Pool your funds with your extended family.

When you look for a mortgage, ask local non-profit counseling agencies and lenders about the options available to you. Check www.hud.gov for community programs in your area.

U.S. citizenship is not a requirement for getting a mortgage.

The interest rate for your mortgage will depend on the current market, your credit rating and the terms of your loan.

Interest Rates: How Low Can You Go?

Once you begin shopping for a mortgage, you will hear a lot about interest rates. The interest rate for your mortgage will depend on the current market, your credit rating and the terms of your loan. In general, the better your credit rating, the better the terms you will be offered. You also may see a difference in interest rates for fixed-rate mortgages (which lock in your interest rate for the length of your loan) versus adjustable-rate mortgages.

If you want to reduce your interest rate further, you may be offered the chance to buy points on your loan. For each percentage point you buy (for example, one point on a $100,000 loan would cost you an up-front fee of $1,000), you can reduce your rate. The benefits of this depend on how long you plan to live in this home, your cash flow and your loan terms. Weigh all your options before deciding.

You also may see a difference in mortgage interest rates depending on the length of the loan. For example, a 15-year loan may have a lower interest rate than a traditional 30-year loan.

Locking In

As you shop for a loan, you may notice that interest rates change from time to time. Once your loan is being processed, ask your lender if you can lock in your rate. This can be beneficial if rates are rising, since you can avoid thousands of dollars of interest over the length of your loan by locking in at a lower rate early in the loan approval process. However, if rates are falling, you may want to wait to lock in to obtain the lowest possible interest rates.

Your Rights as a Borrower

As a homebuyer, you have rights at every step of the process. Your real estate agent should disclose any conflict of interest, such as representing the home seller in addition to representing you. You also have the right to a full property disclosure about the house you want to buy. This disclosure states the physical condition of the property and any known potential hazards or defects. States, counties and cities may require additional disclosures. Ask your real estate agent or escrow officer for guidelines.

During the mortgage process, you also have the right to advance notice of any estimated closing costs and a full disclosure of all loan terms (a good faith estimate). By law, a lender must provide this to the borrower within three days after a formal loan application has been submitted.

Entering Escrow

The escrow process is an exciting time. It means you are close to achieving your dream of homeownership. During this period, you will have many responsibilities, which may include scheduling a home inspection, conducting repairs, obtaining homeowner's insurance and preparing for your move. It is important to be organized and remember the deadlines you must meet.

Your real estate agent, real estate attorney and escrow officers should communicate with you frequently to keep your escrow moving toward its closing date. You may be required to sign certain documents or attend various meetings related to your home purchase. Be sure to keep your appointments so that your closing date is not jeopardized.

If any problems arise during your escrow, you will need to inform your agent, lender and escrow officer immediately. Often, delays can be avoided by keeping communications open. Remember, everyone on your team has an interest in your transaction proceeding smoothly.

ASK QUESTIONS

You are entitled to understand every step of the homebuying process. As you search for a home, make your offer, enter escrow and finalize your mortgage, it is common to have questions, regardless of any past experience with homebuying. At any point in the process, you should feel free to ask your real estate agent, lender, escrow officer or other party to explain any portion of the transaction you need clarified. Pay careful attention to fees and extra costs.

If you are asked to sign any paperwork you do not understand, stop and ask for an explanation. If you are not satisfied with the answer, do not proceed. Remember, this is a major financial transaction, one that may involve the next 30 years of your life, so you must remain in control of the process.

As a homebuyer, you have rights at every step of the process.

An inspection will tell you about the condition of the home and can help you avoid buying a home that needs major repairs.

Home Inspection

Make your offer on a home contingent on a home inspection by a trained, licensed expert. An inspection will tell you about the condition of the home and can help you avoid buying a home that needs major repairs. The inspector will:

- Evaluate the physical condition of the home's structure, construction and mechanical systems.
- Identify items that should be repaired or replaced.
- Estimate the remaining useful life of the major systems, such as electrical, plumbing, heating, air conditioning, roofing, equipment, structure and finishes.

As a homebuyer, it is your responsibility to select the inspector and pay for the inspection. Ask your real estate agent, a non-profit housing program agency, family and friends for recommendations of qualified inspectors.

QUESTIONS FOR YOUR HOME INSPECTOR

1. What does your inspection cover?
2. How long have you been practicing in the home inspection profession, and how many inspections have you completed?
3. Are you specifically experienced in residential inspection?
4. Do you offer to do repairs or improvements based on the inspection?
5. How long will the inspection take?
6. How much will the inspection cost?
7. What type of inspection report do you provide, and how long will it take to receive the report?
8. Will I be able to attend the inspection?
9. Do you maintain membership in a professional home inspector association?
10. Are you bonded?
11. Do you participate in continuing education programs to keep your expertise up to date?

The Closing Process

The time between your offer being accepted and the actual closing meeting can take longer than you think. There are several things you need to do before the closing meeting, including setting the closing date, reviewing the closing documents and understanding all the closing costs.

- The closing date is set when your mortgage is approved and you sign a **commitment letter** with your lender. Make sure the closing date occurs before your lock-in rate expires.
- You should ask if it is possible to receive your closing documents before the actual closing meeting and read them carefully. It may be a good idea to have a lawyer review the documents with you. Before the meeting, be sure you understand the documents you will be asked to sign. If documents are not available in advance, it is strongly advisable to bring a reliable translator with you to explain what you are signing.
- Closing costs can include many different things and can add up to a sizeable amount of money. Be prepared. Know exactly what is included in your closing costs and the total amount you will be expected to pay at the closing meeting. You may not be allowed to use a personal check for the payments due at the closing meeting. You may need a certified or cashier's check.

Closing meetings are standard in the homebuying process, although there are a few states where there are no closing meetings. At the meeting you will sign documents such as the closing statement, the mortgage note and a truth-in-lending statement. Proof of insurance and inspections, as well as any payments due, will be required before you get the keys to your new home. You will receive a settlement sheet (also known as **HUD-1 settlement statement**), which itemizes all closing costs. This sheet also itemizes the seller's closing costs. The settlement agent or escrow agent should obtain this documentation on behalf of the lender. See the following sample settlement statement.

Once your loan is being processed, ask your lender if you can lock-in your rate. This can be beneficial if rates are rising.

The settlement agent or escrow agent should obtain this documentation on behalf of the lender.

A. **Settlement Statement**

U.S. Department of Housing and Urban Development

OMB Approval No. 2502-0265 (expires 9/30/2006)

B. Type of Loan

1. ☐ FHA 2. ☐ FmHA 3. ☐ Conv. Unins. 4. ☐ VA 5. ☐ Conv. Ins.	6. File Number:	7. Loan Number:	8. Mortgage Insurance Case Number:

C. Note: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.

D. Name & Address of Borrower:	E. Name & Address of Seller:	F. Name & Address of Lender:

G. Property Location:	H. Settlement Agent:	
	Place of Settlement:	I. Settlement Date:

J. Summary of Borrower's Transaction		K. Summary of Seller's Transaction	
100. Gross Amount Due From Borrower		**400. Gross Amount Due To Seller**	
101. Contract sales price		401. Contract sales price	
102. Personal property		402. Personal property	
103. Settlement charges to borrower (line 1400)		403.	
104.		404.	
105.		405.	
Adjustments for items paid by seller in advance		**Adjustments for items paid by seller in advance**	
106. City/town taxes to		406. City/town taxes to	
107. County taxes to		407. County taxes to	
108. Assessments to		408. Assessments to	
109.		409.	
110.		410.	
111.		411.	
112.		412.	
120. Gross Amount Due From Borrower		**420. Gross Amount Due To Seller**	
200. Amounts Paid By Or In Behalf Of Borrower		**500. Reductions In Amount Due To Seller**	
201. Deposit or earnest money		501. Excess deposit (see instructions)	
202. Principal amount of new loan(s)		502. Settlement charges to seller (line 1400)	
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204.		504. Payoff of first mortgage loan	
205.		505. Payoff of second mortgage loan	
206.		506.	
207.		507.	
208.		508.	
209.		509.	
Adjustments for items unpaid by seller		**Adjustments for items unpaid by seller**	
210. City/town taxes to		510. City/town taxes to	
211. County taxes to		511. County taxes to	
212. Assessments to		512. Assessments to	
213.		513.	
214.		514.	
215.		515.	
216.		516.	
217.		517.	
218.		518.	
219.		519.	
220. Total Paid By/For Borrower		**520. Total Reduction Amount Due Seller**	
300. Cash At Settlement From/To Borrower		**600. Cash At Settlement To/From Seller**	
301. Gross Amount due from borrower (line 120)		601. Gross amount due to seller (line 420)	
302. Less amounts paid by/for borrower (line 220)	( )	602. Less reductions in amt. due seller (line 520)	( )
303. Cash ☐ From ☐ To Borrower		**603. Cash ☐ To ☐ From Seller**	

Section 5 of the Real Estate Settlement Procedures Act (RESPA) requires the following: • HUD must develop a Special Information Booklet to help persons borrowing money to finance the purchase of residential real estate to better understand the nature and costs of real estate settlement services; • Each lender must provide the booklet to all applicants from whom it receives or for whom it prepares a written application to borrow money to finance the purchase of residential real estate; • Lenders must prepare and distribute with the Booklet a Good Faith Estimate of the settlement costs that the borrower is likely to incur in connection with the settlement. These disclosures are manadatory.

Section 4(a) of RESPA mandates that HUD develop and prescribe this standard form to be used at the time of loan settlement to provide full disclosure of all charges imposed upon the borrower and seller. These are third party disclosures that are designed to provide the borrower with pertinent information during the settlement process in order to be a better shopper.

The Public Reporting Burden for this collection of information is estimated to average one hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number.

The information requested does not lend itself to confidentiality.

Previous editions are obsolete

Page 1 of 2

form **HUD-1** (3/86)
ref Handbook 4305.2

Conclusion

You are well on your way to reaching your dream of homeownership. By following the steps in this guidebook, you will be well prepared for the home-buying process.

As you research your preferred neighborhood, find the home of your dreams, assemble your real estate team and shop for a mortgage, remember to consider each step of the process carefully. Ask questions and remember your rights as a homebuyer.

The day your escrow closes will be one of the most exciting days of your life. Not only will you have a new home for you and your family to enjoy, but with proper maintenance you also will have a valuable asset that will grow and create wealth for you and your family for years to come. For more information on the responsibilities of homeownership, see “Homeowner Benefits and Responsibilities”

**Congratulations—
you are on your way home!**

The day your escrow closes will be one of the most exciting days of your life.

Glossary

Actual Cash Value: An amount equal to the replacement value of damaged property minus depreciation.

Adjustable-Rate Mortgage (ARM): Also known as a variable-rate loan, an ARM usually offers a lower initial rate than a fixed-rate loan. The interest rate can change at a specified time, known as an adjustment period, based on a published index that tracks changes in the current finance market. Indexes used for ARMs include the LIBOR index and the Treasury index. ARMs also have caps, a maximum and minimum that the interest rate can change at each adjustment period.

Adjustment Period: The time between interest rate adjustments for an ARM. There is usually an initial adjustment period, beginning from the start date of the loan and varying from 1 to 10 years. After the first adjustment period, adjustment periods are usually 12 months, which means that the interest rate can change every year.

Amortization: Paying off a loan over the period of time and at the interest rate specified in a loan document. The amortization of a loan includes in each mortgage payment the payment of interest and a part of the amount borrowed.

Amortization Schedule: Provided by mortgage lenders, the schedule shows how, over the term of your mortgage, the principal portion of the mortgage payment increases and the interest portion of the mortgage payment decreases.

Annual Percentage Rate (APR): How much a loan costs annually. The APR includes the interest rate, points, broker fees and certain other credit charges a borrower is required to pay.

Application Fee: The fee to cover processing costs that a mortgage lender charges the borrower to apply for a mortgage.

Appraisal: A professional analysis used to estimate the value of the property. This includes examples of sales of similar properties.

Appraiser: A professional who conducts an analysis of the property, including examples of sales of similar properties, to develop an estimated value of the property. The analysis is called an appraisal.

Appreciation: An increase in the market value of a home due to changing market conditions and/or home improvements.

Arbitration: A process where disputes are settled by referring them to a fair and neutral third party (arbitrator). The disputing parties agree in advance to agree with the decision of the arbitrator. There is a hearing where both parties have an opportunity to be heard, after which the arbitrator makes a decision.

Asbestos: A toxic material that was once used in housing insulation and fireproofing. Because some forms of asbestos have been linked to certain lung diseases, it is no longer used in new homes. However, some older homes may still have asbestos in these materials.

Asset: Something of value an individual owns.

Assumption: A homebuyer's agreement to take the primary responsibility for paying an existing mortgage from a home seller.

Balloon Mortgage: A mortgage with monthly payments based on a 30-year amortization schedule, with the unpaid balance due in a lump sum payment at the end of a specific period of time (usually five or seven years). The mortgage contains an option to "reset" the interest rate to the current market rate and extend the due date if certain conditions are met.

Bankruptcy: A legal declaration that you are unable to pay your debts. Bankruptcy can severely affect your credit record and your ability to borrow money.

Cap: A limit to how much an adjustable rate mortgage's monthly payment or interest rate can increase. A cap protects the borrower from large increases and may be a payment cap, an interest cap, a life-of-loan cap or an annual cap. A payment cap is a limit on the monthly payment. An interest cap is a limit on the amount of the interest rate. A life-of-loan cap restricts the amount the interest rate can increase over the entire term of the loan. An annual cap limits the amount the interest rate can increase during a 12-month period.

Capacity: Your ability to make your mortgage payments on time. This depends on your income and income stability (job history and security), your assets, your savings and the amount of your income that remains each month after you have paid your housing costs, debts and other obligations.

Closing (Closing Date): The completion of the real estate transaction between buyer and seller. The buyer signs the mortgage documents, and the closing costs are paid. It is also known as the settlement date.

Closing Agent: A person who coordinates closing-related activities, such as recording the closing documents and disbursing funds.

Closing Costs: The costs to complete the real estate transaction. These costs are in addition to the price of the home and are paid at closing. They include points, taxes, title insurance, financing costs, items that must be prepaid or escrowed and other costs. Ask your lender for a complete list of closing cost items.

Collateral: Property that is used as security for a debt. In the case of a mortgage, the collateral is the house and property.

Commitment Letter: A letter from your lender stating the amount of the mortgage, the number of years to repay the mortgage (the term), the interest rate, the loan origination fee, the annual percentage rate and the monthly charges.

Concession: Something given up or agreed to when negotiating the sale of the house. For example, the sellers may agree to help pay for closing costs.

Condominium: A unit in a multi-unit building. The owner of a condominium unit owns the unit itself and has the right, along with other owners, to use the common areas. The owner does not own the common elements, such as the exterior walls, floors, ceilings or structural systems outside of the unit; the condominium association owns these. There are usually condominium association fees for building maintenance, property upkeep, taxes and insurance on the common areas, and there are reserves for improvements.

Contingency: A plan for something that may occur but is not likely. For example, your offer may be contingent on the home passing a home inspection. If the home does not pass inspection, you are protected.

Counter-offer: An offer made in response to a previous offer. For example, after the buyer presents his or her first offer, the seller may make a counter-offer with a slightly higher sale price.

Credit: Credit is the ability to borrow tomorrow's money to pay for something you get today. Credit is extended based on a lender's good opinion of a person's financial situation and reliability.

Credit Bureau: A company that gathers information on consumers who use credit. The company sells that information to credit lenders in the form of a credit report.

Credit History: A record of credit consisting of a list of individual consumer debts and a record of whether these debts were paid on time or as agreed. Credit institutions have created a detailed document of your credit history called a credit report.

Credit Report: A document used by the credit industry to examine your use of credit. It provides information on money that you have borrowed from credit institutions and your payment history.

Credit Score: A computer-generated number that summarizes your credit profile and predicts the likelihood that you will repay future debts.

Creditworthy: Your ability to qualify for credit and repay debts.

Debt: Money owed from one person or institution to another person or institution.

Debt-to-Income Ratio: The percentage of gross monthly income that goes toward paying your monthly housing expense, alimony, child support, car payments and other installment debts, and payments on revolving or open-ended accounts such as credit cards.

Deed: A legal document transferring ownership or title to a property.

Deed of Trust: A legal document in which the borrower transfers the title to a third party (trustee) to hold as security for the lender. When the loan is paid in full, the trustee transfers title back to the borrower. If the borrower defaults on the loan, the trustee will sell the property and pay the lender the mortgage debt.

Default: Failure to fulfill a legal obligation. A default includes failure to pay a financial obligation, but it also may be a failure to perform some action or service that is non-monetary. For example, when leasing a car, the lessee usually is required to properly maintain the car.

Depreciation: A decline in the value of a home due to changing market conditions or lack of upkeep on the home.

Down Payment: A portion, usually between 3% to 20%, of the price of a home. This portion is not borrowed and is paid up front.

Earnest Money Deposit: The deposit to show that you are committed to buying the home. The deposit is not refunded to you after the seller accepts your offer unless one of the sales contract contingencies is not fulfilled.

Equity: The value of your home above the total amount of liens against your home. If you owe $100,000 on your home, but it is worth $130,000, you have $30,000 of equity.

Escrow: The holding of money or documents by a neutral third party before closing. It also can be an account held by the lender (or servicer) into which a homeowner pays money for taxes and insurance.

Fixed-Rate Mortgage: A mortgage with an interest rate that does not change during the entire term of the loan.

Foreclosure: A legal action that ends all ownership rights in a home when the homeowner fails to make the mortgage payments or is otherwise in default under the terms of the mortgage.

Glossary

Gift Letter: A letter that a family member writes verifying that he or she has given you a certain amount of money as a gift, and that you do not have to repay it. For some mortgages, you can use this money toward a portion of your down payment.

Good-Faith Estimate: A written statement from the lender itemizing the approximate costs and fees for the mortgage.

Gross Monthly Income: The income you earn in a month before taxes and other deductions. It also may include rental income, self-employment income, income from alimony, child support, public assistance payments, and retirement benefits.

Home Inspection: A professional inspection of a home to determine the condition of the property. The inspection should include an evaluation of the plumbing, heating and cooling systems, roof, wiring, foundation, and pest infestation.

Homeowner's Insurance: A policy that protects you and the lender from fire or flood, which damages the structure of the house; a liability, such as an injury to a visitor to your home; or damage to your personal property, such as your furniture, clothes or appliances

Housing Expense Ratio: The percentage of your gross monthly income that goes toward paying for your housing expenses.

HUD-1 Settlement Statement: A final list of the costs of the mortgage transaction. It states the sales price and down payment, as well as the total settlement costs required from the buyer and seller.

Index: The published index of interest rates used to calculate the interest rate for an ARM. The index is usually an average of the interest rates on a particular type of security, such as the LIBOR.

Individual Retirement Account (IRA): A tax-deferred plan that can help you build money for retirement.

Inflation: An increase in prices.

Inquiry: A request for a copy of your credit report. An inquiry occurs every time you fill out a credit application or request more credit. Too many inquiries on a credit report can hurt your credit score.

Interest: The cost you pay to borrow money. It is the payment you make to a lender for the money it has loaned to you. Interest is usually expressed as a percentage of the amount borrowed.

Keogh Fund: A tax-deferred retirement savings plan for small business owners or self-employed individuals who have earned income from their trade or business. Contributions to the Keogh plan are tax deductible.

Liability: A debt or other financial obligation.

Lien: A claim or charge on property for payment of a debt. With a mortgage, the lender has the right to take the title to your property if you do not make the mortgage payments.

Loan Origination Fee: A fee paid to your mortgage lender for processing the mortgage application. This fee is usually in the form of points. One point equals 1% of the mortgage amount.

Lock-In Rate: A written agreement guaranteeing a specific mortgage interest rate for a certain amount of time.

Low–Down Payment Feature: A feature of some mortgages, usually fixed-rate mortgages, that helps you buy a home with as little as a 3% down payment.

Margin: A percentage added to the index for an ARM to establish the interest rate on each adjustment date.

Market Value: The current value of your home based on what a purchaser would pay. Sometimes an appraisal is used to determine market value.

Mortgage: A loan using your home as collateral. In some states the term mortgage also describes the document you sign (to grant the lender a lien on your home). The term also may indicate the amount of money you borrow, with interest, to purchase your home. The amount of your mortgage is usually the purchase price of the home minus your down payment.

Mortgage Broker: An independent finance professional who specializes in bringing together borrowers and lenders to complete real estate mortgages.

Mortgage Insurance or Private Mortgage Insurance (MI or PMI): Insurance needed for mortgages with low down payments (usually less than 20% of the price of the home).

Mortgage Lender: The lender who provides funds for a mortgage. Lenders also manage the credit and financial information review, the property and the loan application process through closing.

Mortgage Rate: The cost or the interest rate you pay to borrow the money to buy your house.

Mutual Fund: A fund that pools the money of its investors to buy a variety of securities.

Net Monthly Income: Your take-home pay after taxes. It is the amount of money that you actually receive in your paycheck.

Offer: A formal bid from the homebuyer to the home seller to purchase a home.

Open House: When the seller's real estate agent opens the seller's house to the public. You do not need a real estate agent to attend an open house.

Point: 1% of the amount of the mortgage. For example, if a loan is made for $50,000, one point equals $500.

Pre-Approval Letter: A letter from a mortgage lender indicating that you qualify for a mortgage of a specific amount. It also shows a home seller that you are a serious buyer.

Predatory Lending: Abusive lending practices that include making mortgage loans to people who do not have the income to repay them, or repeatedly refinancing loans, charging high points and fees each time and "packing" credit insurance onto a loan.

Pre-Qualification Letter: A letter from a mortgage lender that states that you are pre-qualified to buy a home, but it does not commit the lender to a particular mortgage amount.

Principal: The amount of money borrowed to buy your house, or the amount of the loan that has not yet been repaid to the lender. This does not include the interest you will pay to borrow that money. The principal balance (sometimes called the outstanding or unpaid principal balance) is the amount owed on the loan minus the amount you have repaid.

Private Mortgage Insurance (PMI): See Mortgage Insurance.

Property Appreciation: See Appreciation.

Radon: A toxic gas found in the soil beneath a house that can contribute to cancer and other illnesses.

Rate Cap: The limit on the amount an interest rate for an ARM can increase or decrease during an adjustment period.

Ratified Sales Contract: A contract that shows both you and the seller of the house have agreed to your offer. This offer may include sales contingencies, such as obtaining a mortgage of a certain type and rate, getting an acceptable inspection, making repairs and closing by a certain date.

Real Estate Professional: An individual who provides services for buying and selling homes. The seller pays the real estate professional a percentage of the home sale price. Unless you specifically have contracted with a buyer's agent, the real estate professional represents the interest of the seller. Real estate professionals may be able to refer you to local lenders or mortgage brokers, but they generally are not involved in the lending process.

Refinance: The process of getting a new mortgage and using all or some portion of the proceeds to pay off the original mortgage.

Replacement Cost: The cost to replace damaged personal property without a deduction for depreciation.

Securities: A financial form that shows that the holder owns shares of a company (stock) or has loaned money to a company or government organization (bond).

Title: The right to, and the ownership of, property. A title or deed sometimes is used as proof of ownership of land.

Title Insurance: Insurance that protects lenders and homeowners against legal problems with the title.

Truth-in-Lending Act (TILA): A federal law that requires disclosure of a truth-in-lending statement for consumer loans. The statement includes a summary of the total cost of credit, such as the APR and other specifics of the loan.

Underwriting: The process a lender uses to determine loan approval. It involves evaluating the property and the borrower's credit and ability to pay the mortgage.

Uniform Residential Loan Application: A standard mortgage application your lender will ask you to complete. The form requests your income, assets, liabilities and a description of the property you plan to buy, among other things.

Warranty: A written guarantee of the quality of a product and the promise to repair or replace defective parts free of charge.

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