BUY NOW OR LATER

Making The Best Financial Decision In A Changing Market.

TABLE OF CONTENTS

Home ownership has always been at the very heart of the American Dream. Even earlier, from medieval times and before, it was the landowners who were the most respected—and who held the greatest power. Those who did not own their homes were subject to the whims of the landowners, who could raise rents any time they pleased.

While we live in better times today, there is still a certain lack of power for those who don't own their own homes. Landlords can say, **"No pets allowed!"** They can raise rents whenever they want, so long as the market can support the increases.

A landlord may also decide that he's tired of dealing with tenants and sell the property. The renter's life is turned upside-down—and he may discover that the price of renting a replacement residence in the same area has become prohibitive.

A homeowner has none of these problems. Buying a home with a fixed-rate mortgage means that the mortgage payment will never increase (although property taxes and maintenance costs may go up from time to time). When you are a homeowner, no one can tell you, "I'm going to sell this house next month. Here's your 30-day notice to vacate."

As a homeowner, you are the one to decide whether you want to keep pets. You get to decide to plant azaleas in the back yard. You can build a treehouse in that big elm tree in the back yard. You can invest in the play structure your children have been begging you for.

While owning your own home is appealing, reaching the goal of ownership can be a problem. If you believe the stories told in the media, getting a mortgage is “insanely difficult.” They’ll try to make you believe that you should save up the “normal 20% down payment” to buy. If you can’t get that much cash together, you’ll get the punishment of mortgage insurance.

They’ll say that you should have nearly flawless credit; after all, that is what **“The Banks”** will require to be willing to lend you so much money.

You try to save that large sum of money for your down payment—but you watch home prices continuing to increase with each month, and saving a large sum can be challenging in the face of normal living expenses. You may feel discouraged, as though you were running after your train which has just left the station.

As dismal as this story may sound, there is hope—lots of hope. Reading this book, you have already started on a successful journey to homeownership.

THE DEPARTING TRAIN

You should first realize that real estate values are increasing in most areas of the country. You can do your own research to determine what that rate of increase has been in the recent past, or you can ask a local Realtor® for that information. It's their job to stay fully informed on market trends. Let's start with the assumption that homes are appreciating in your area at the rate of 4% per year. While it may be more or less than this example figure, it will give us a starting point.

If the kind of home that will meet your needs is selling today for $400,000, it will sell for around $416,000 a year from today. That $16,000 increase per year (if that's what's happening in your area) is one part of the cost of waiting to buy.

Today's Interest Rates

Mortgage rates have been exceptionally low for several years. These low rates are due partially to actions taken by the Federal Reserve to stimulate the economy.

If mortgage rates increase by ¼%, your monthly payment to get a new mortgage will be higher—about $15.00 for every $100,000 you borrow.

While this may seem like a comparatively trivial amount now, higher rates can reduce the amount of home you can qualify for in the future.

THE TRUTH ABOUT MORTGAGES

We've already mentioned the story the media tries to sell you: that banks prefer 20% down, that you must have perfect credit, that getting a mortgage is very hard, that mortgage insurance is a sort of expensive punishment inflicted on those who don't have at least 20% to put down. Now let's look at the real story.

Your Down Payment

For most first-time buyers, the cash needed to buy is the biggest single hurdle to overcome. Let's explore how much you really need to become a homeowner.

Lenders look at every dollar they lend out in terms of risk. They must ask themselves, "If this borrower doesn't make the payments, how can we limit or eliminate the amount of money we could lose?"

If a borrower doesn't make the monthly payments as agreed, they are said to be "in default." The lender can go through a legal process to get their money when the borrower doesn't hold up their end of the deal.

This is called "foreclosure." They have the legal right to force the sale of the property to get their money. With a 20% down payment, there is only a small chance that they'll lose any money. The 20% down payment made by the buyer originally is called "protective equity." It protects the lender from loss if they had to sell the property to get their money.

Mortgage Insurance

If the buyer puts a smaller amount of cash down, the lender carries more risk.

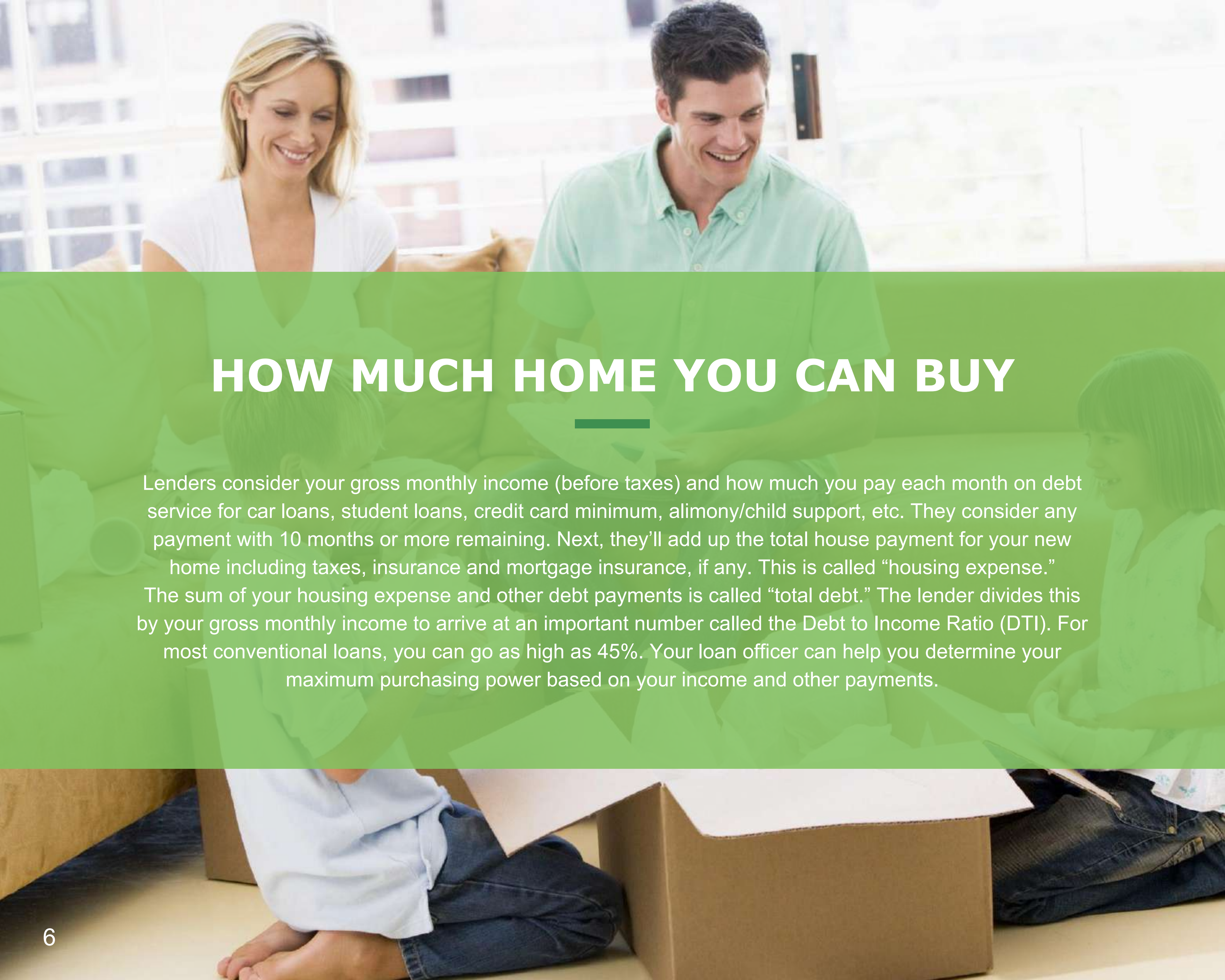
If the loan is 90% of the property's value, they could lose money in a foreclosure situation. To limit their risk, the lender requires mortgage insurance. This protects them if they have to foreclose and the property has gone down in value. The cost of that mortgage insurance depends on the loan-to-value ratio (LTV) and the borrower's credit score. A buyer who makes a 10% down payment will pay as little as .31% if they have excellent credit (760 or higher) to as much as 1.10% for not-so-good credit (620). For a $400,000 home, mortgage insurance would cost between $93 and $330 per month.

For a higher LTV **(smaller down payments),** the lender's risk is higher, so they'll want more protection. A 97% loan, for example (3% down payment) will need mortgage insurance costing between .69% (excellent credit) and 2.37% (barely acceptable credit).

Getting Rid of Mortgage Insurance

You should always keep in mind that mortgage insurance is a tool that will allow you to become a homeowner earlier, by lowering the cash requirement to buy. You should also be aware that it is temporary.

Once you can prove to the lender that your loan balance is 80% of your home's value or less, they'll let you drop the insurance. Most lenders require a full appraisal to document the market value. This will cost money (typically $350-$500), but it will save thousands of dollars over the long term. If you buy a home with a 10% down payment (90% loan) and homes in your area are appreciating at 4% each year, you should be able to eliminate mortgage insurance in less than two years. If you made a smaller down payment **(let's say 3%) it will take longer—about 2½ years.**



HOW MUCH HOME YOU CAN BUY

Lenders consider your gross monthly income (before taxes) and how much you pay each month on debt service for car loans, student loans, credit card minimum, alimony/child support, etc. They consider any payment with 10 months or more remaining. Next, they'll add up the total house payment for your new home including taxes, insurance and mortgage insurance, if any. This is called "housing expense." The sum of your housing expense and other debt payments is called "total debt." The lender divides this by your gross monthly income to arrive at an important number called the Debt to Income Ratio (DTI). For most conventional loans, you can go as high as 45%. Your loan officer can help you determine your maximum purchasing power based on your income and other payments.

THE TRUTH ABOUT CREDIT SCORES

You are probably familiar with the term “FICO score.” This is a three-digit number that lenders use to determine how creditworthy a prospective borrower is. The FICO score looks at all the information on the borrower’s credit report, analyzes it, and comes up with a three-digit number between 300 and 850.

Lenders require a minimum FICO score of 620 for a conventional loan, but as low as 580 for a government-insured FHA loan.

The computer program that analyzes your credit report and generates the FICO score looks at the following aspects of your report:

- Are there any late payments? How many were there, and how long ago?
- Are there any collection accounts? Are they still open? How old are they?
- Are there any past-due balances?
- Are there any public record items, such as tax liens or court judgments?
- Are there any credit cards whose balances are over the credit limit?

These are all derogatory entries. They will reduce your FICO score by hundreds of points in some cases.

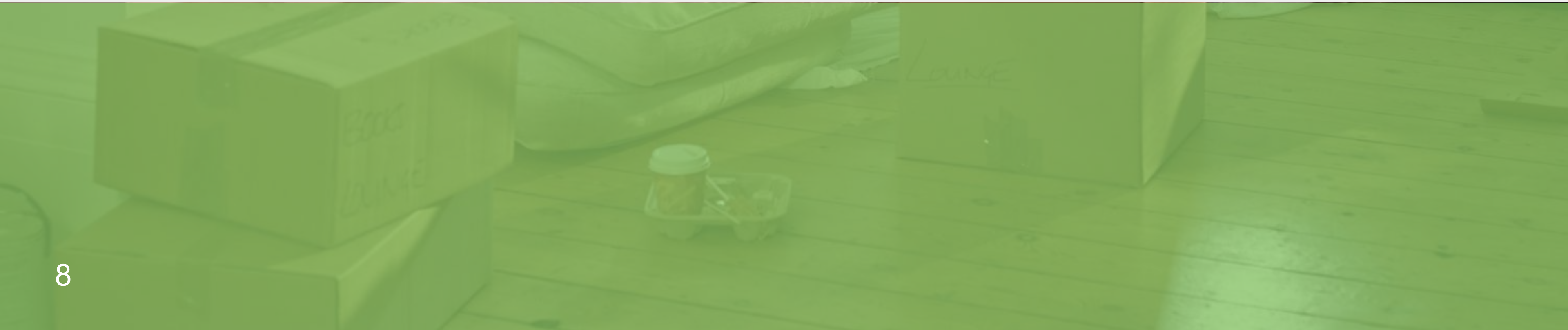
There are some other items that are not derogatory, but which will reduce your scores as well:

- Credit card balances exceeding 30% of the credit limit
- Accounts that have been opened very recently—within 90 days. These are called “unseasoned accounts.”
- Loans to consumer finance companies such as “payday” lenders. These are often the last resort of consumers who are in financial trouble, and the lender's notice this. They also carry interest rates well into three digits. Avoid them at all costs.

Finally, there are entries on your credit report that will enhance your score:

- Long-established accounts, such as credit cards that you opened ten or twenty years ago. You should be aware that owing money is **not** a requirement for a good FICO score.

If you pay the full balance on your credit cards each month, you’ll never pay a penny of interest, but you’ll enjoy a high credit score.

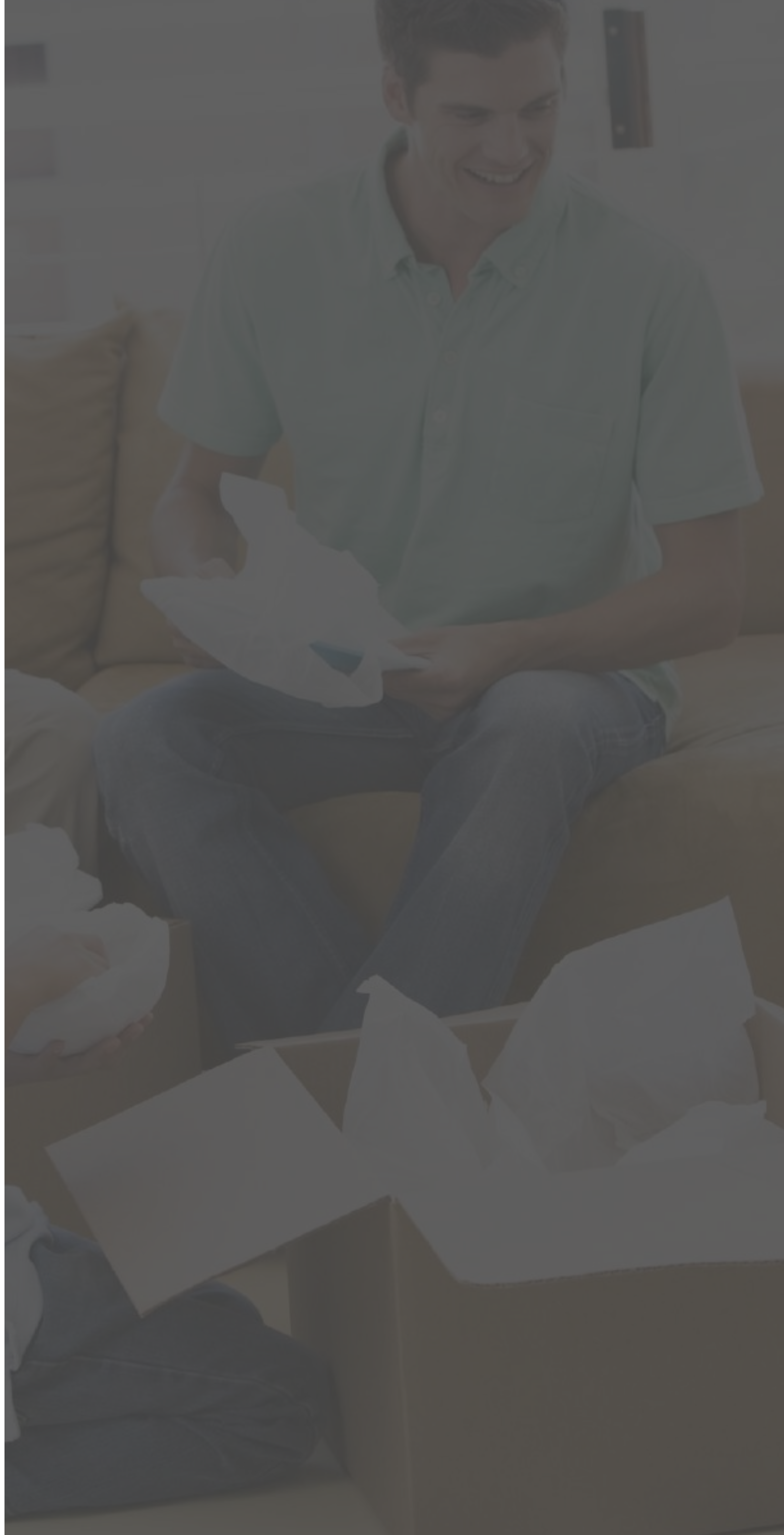


Why Does Your Score Matter?

When a lender makes its decision to approve your loan application, they are looking at your credit score for just two reasons:

- Is the score high enough to qualify for the loan program? If you're applying for a conventional loan, a score of 620 or is probably sufficient. That's the threshold for a conventional loan.

- What will the rate be for this borrower? Fannie Mae and Freddie Mac, the two mortgage giants who own or guarantee most conventional loans in the U.S., apply pricing adjustments based on credit score and loan-to-value ratio. Those two aspects of the loan application will tell them how much to adjust the rate the lender can offer. A borrower with a 620 score will have a much larger rate adjustment—about .75% higher than a borrower with a 740 score.



Improving Your Score

As you are preparing to become a homeowner, you should get a copy of your credit report. Your loan officer can help you with this, or you can get a free credit report from a site like CreditKarma.com.

You should look first at any derogatory entries. Are there any past-due payments you weren't aware of? Bring them current. Are there collection accounts? Contact the creditor or collection agency and settle with them. Many people are not aware that collection agencies will settle for pennies on the dollar. If you are in this kind of situation, be sure to get the settlement agreement from the creditor in writing before sending them any money.

Look at credit card balances. Are any of them above 30% of the credit limit? Reducing those balances can add dozens of points to your score. Improving your score can save you thousands of dollars. Increasing your **FICO** score from 675 to 680, for example, can improve your rate .25%.

THE MATTER OF CLOSING COSTS

When you buy a home, you'll have to deal with certain fees and costs over and above the down payment. These are the "closing costs," and can come as an unpleasant surprise when you're not ready for them. Let's talk about what they are, and how to handle them.

Non-Recurring Costs

Some of the costs you'll incur will happen only once when you buy your home. These include title and escrow fees, document preparation, lender underwriting fees, appraisal and recording fees. There will be some others, but these are the largest ones. They are called “non-recurring closing costs” for the obvious reason.

Pro-rations and Prepaids

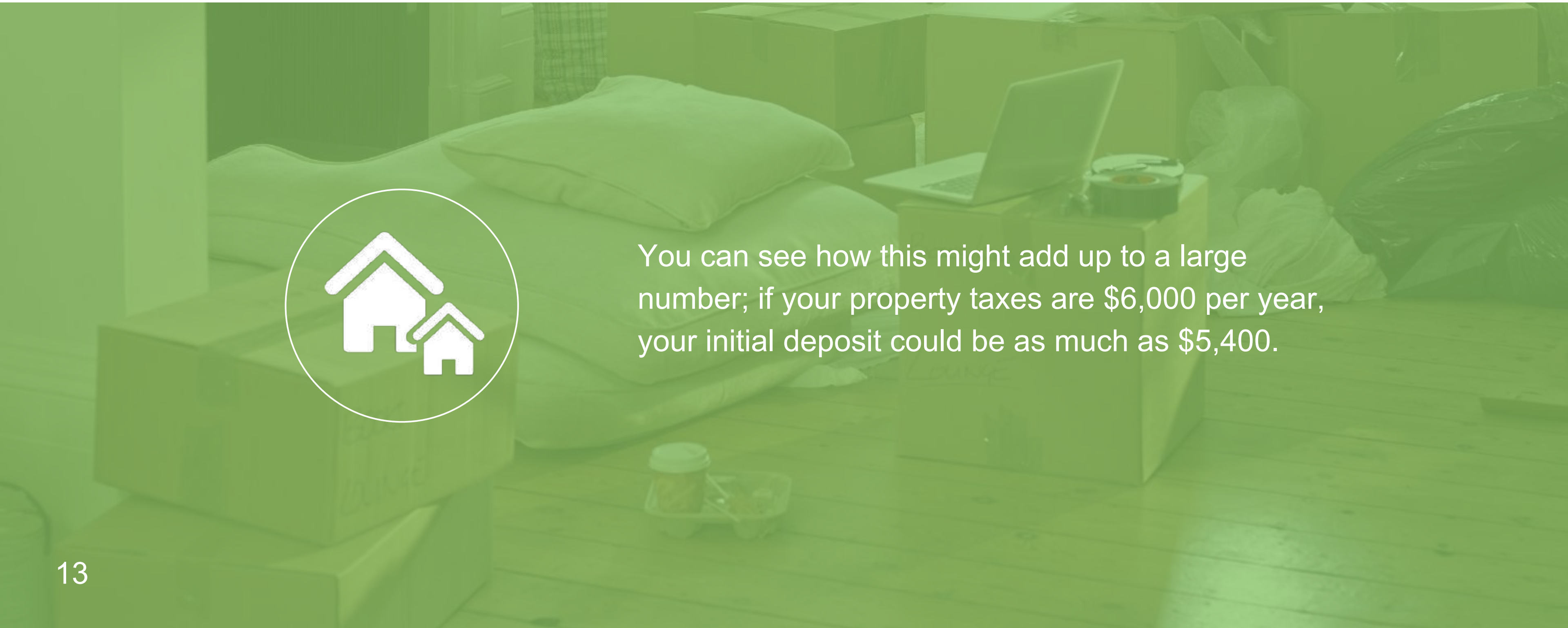
Some of the costs of home ownership occur regularity. You'll pay property taxes, renew your homeowner's insurance and pay interest on your loan.

When you buy your home, you'll pay for a full year of homeowner's insurance in advance. This may be between $500 and $1,200, but it will depend on the price of your home, the type of policy you buy and your insurance carrier's rates.

You'll pay “prepaid interest” at close of escrow. This is the only time you'll pay advance interest on your loan. When you make a mortgage payment, you will pay interest for the previous month. This is called “interest in arrears.” In most cases, your first mortgage payment will be due more than 30 days after your close of escrow. If you close escrow on the 15th of June, for example, your first mortgage payment will be due on August 1. That payment will cover interest for the month of July (interest in arrears). The lender wants to be paid interest for every day you are using their money, so they charge you per diem interest from the close of escrow through the end of June—15 days in this example.

You'll also create an "impound account" or "escrow account" **(they mean the same thing)** for taxes and insurance. The lender will collect 1/12 of your property tax bill and 1/12 of your homeowner's insurance renewal with each payment. The lender puts that portion of your payment into the impound account. They'll pay your taxes and insurance when they fall due.

The lender wants to be sure that there will always be enough money in your impound account to pay those obligations when they fall due, plus a two-month "cushion" when the account hits the lowest point during the years. The initial deposit will depend on the local tax collection schedule and when your first payment occurs. You may have to put as much as nine months' property taxes into the account, or as few as three.



You can see how this might add up to a large number; if your property taxes are $6,000 per year, your initial deposit could be as much as $5,400.

DEALING WITH CLOSING COSTS

There are three ways to handle closing costs:

- Pay them out of pocket
- Ask the seller to pay them
- Arrange for the lender to pay them

We'll disregard the first choice, since it's so obvious. The second one, asking the seller to pay them, is completely acceptable to any lender, but it may be hard to get a seller to agree in today's competitive real estate market. It's not impossible, however.

You can increase your offer price by the amount of the credit you are asking the seller to give you. The seller will get the same amount of cash at closing, but you should be aware that an appraiser may not agree with the higher value.

Finally, you can arrange for a credit ("rebate") from the lender. You can ask the seller to give you a credit at close of escrow in exchange for a higher interest rate. You can generally expect that raising the rate .25% will get you a rebate of about 1%. While this is a valid "rule of thumb," it doesn't hold true in every case. Discuss rebates and your personal situation with your loan officer.

You can also combine any or all of the three closing cost strategies.

GETTING YOUR OFFER ACCEPTED

Today's real estate market is quite competitive in most areas. Multiple offers—several people competing to buy the same house—are common. If you are competing with other prospective buyers, you can improve your chances of being the successful bidder in a few ways.

Pre-Approval

This is the most important part of your success strategy. You should be able to include a strong pre-approval letter from your lender along with your offer. This letter should be as specific as possible. It should tell the seller that the lender has reviewed all your financial information and credit report and has rendered an initial decision based on that review.

Initial Deposit

When you make an offer to the seller, you'll include an "earnest money deposit." This is a check made out to the title company. Its purpose is to show the seller that you are serious (in "earnest"). You don't risk a penny of this money—in fact, if the seller doesn't accept your offer, you'll get the check back without its being deposited.

A large deposit tends to get people's attention. Make your check as large as you can manage. Remember, there is no risk to you at all. Once you have an active transaction, your agent will deposit the check with the title company, where it will be part of the cash needed to close your purchase. If the total cash required to close escrow is less than the deposit you've made, the title company will refund the balance to you at closing.

A “Love Letter” to the Seller

Selling a home can be a highly emotional experience. Many buyers have been able to win when they were competing with other buyers by writing the seller a personal letter telling them how much they love the home, and how much they look forward to raising their family there.

This may seem excessive to you, but there is no disadvantage to doing this—and a good possibility that your letter might be the one factor that tips the scales in your favor. Consider doing it.

Over the Asking Price

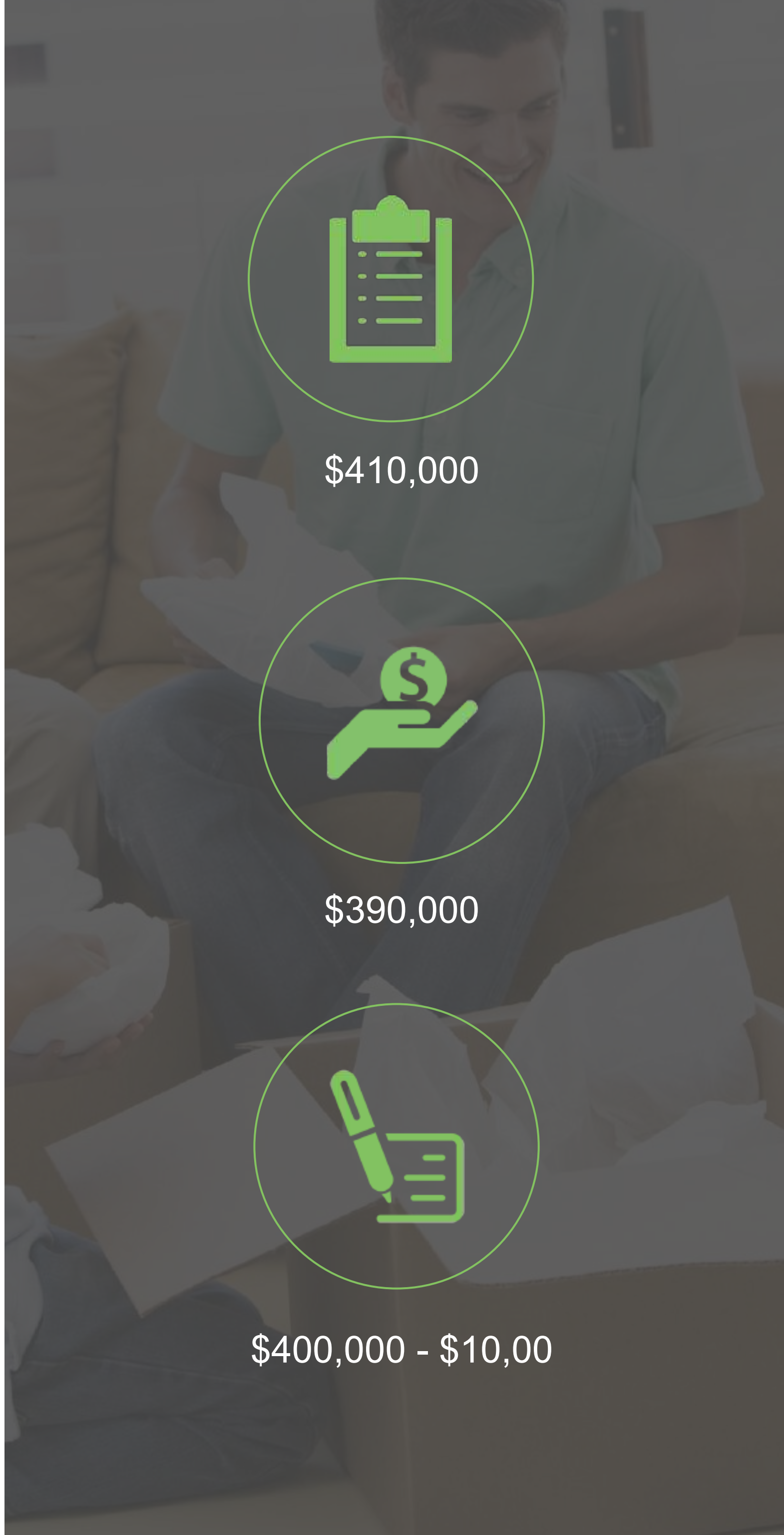
If you know you will be competing with other prospective buyers, consider making an offer above the seller’s asking price. This may be what it takes to win the seller’s acceptance. There is the matter of the appraisal, but that can protect you from paying too much for the home.

An appraisal is an objective analysis of a home’s value compared to other similar ones in the area. The lender will base its loan amount on the lower of the agreed purchase price or the appraised value. If you agreed to pay $400,000 for the property and the appraiser’s opinion of value was $410,000, the lender will use the lower figure for its loan.

If the property doesn’t appraise for the purchase price, you have some choices. Your written offer to purchase contains an “appraisal contingency” unless you specifically agree to waive it. In plain language, the appraisal contingency says, “My offer is subject to this property appraising for the full price I’ve offered. If it appraises for less, I get to walk and get my deposit back.”

Here’s what this means to you. You offered $410,000 for the property, which was listed for $390,000. You did this because you were competing with three other buyers, and you wanted to be sure your offer would be the one the seller accepted. You won.

The appraisal gave the property a value of **$400,000--$10,000** below your offer price. Now you renegotiate with the seller, but you are no longer competing with other buyers. The seller may agree to drop their price to the appraised value or you may meet in the middle. Your loan will be based on the appraised value, since it is the lower of the two values.



LOOKING AT THE TAX ASPECTS

You already know that home ownership carries certain tax benefits. Specifically, you may be able to itemize your deductions and write off mortgage interest and property taxes. You should consult your tax advisor for the specifics, but owning your home may save you considerable money if your itemized deductions are larger than the Standard Deduction when you file your tax return.

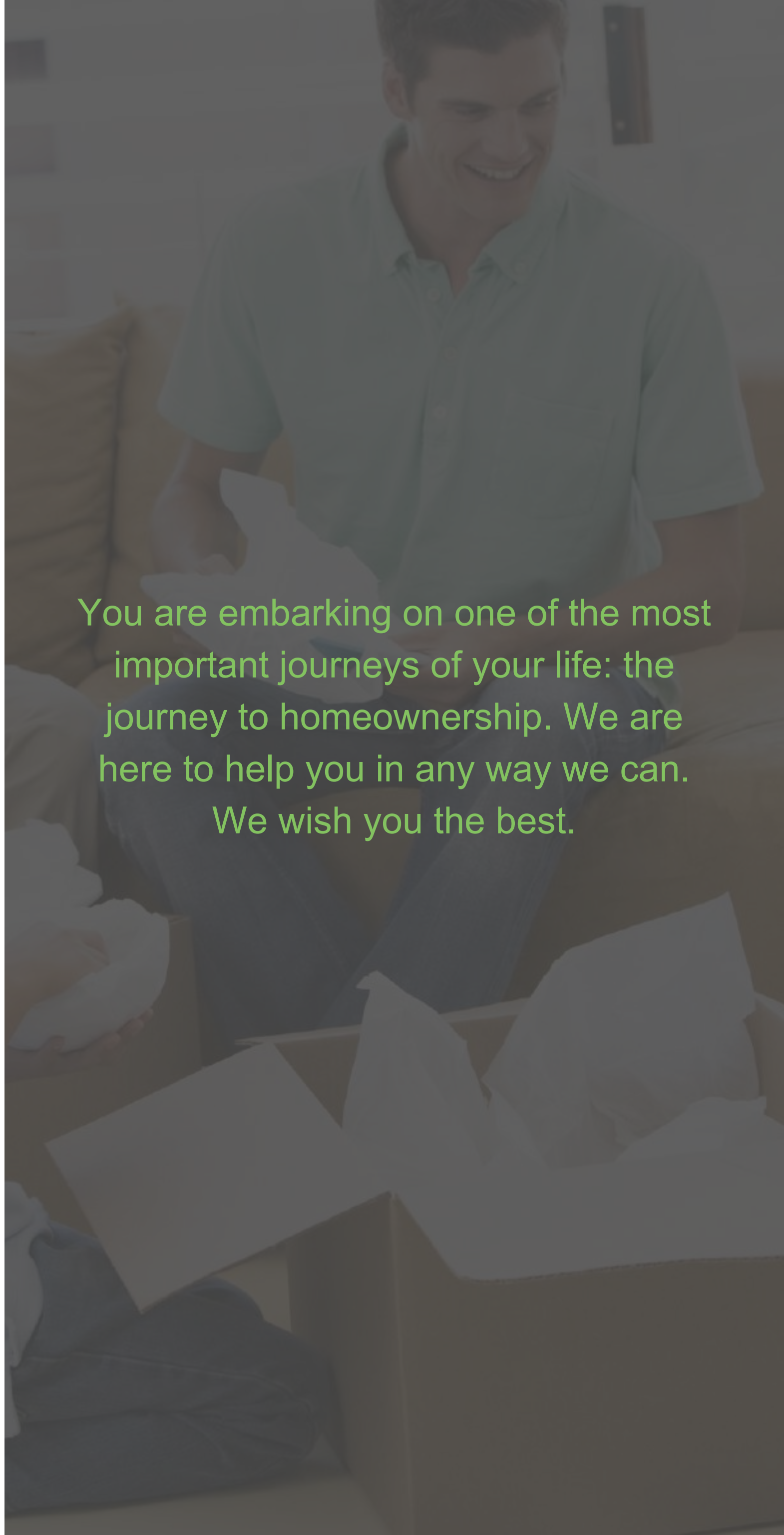
If your tax advisor assures you that you will save money by itemizing your deductions (including mortgage interest and property tax), you can get the benefit of this in the form of more take-home pay. You would do this by increasing the exemptions you claim on form W-4 to decrease the amount of money your payroll department takes out of your check each pay period for income taxes. Your tax advisor can show you exactly how to do this. If you don’t increase your take-home pay by changing your exemptions, you’ll get your tax savings at the end of the year, in the form of a tax refund. Most people prefer to get the money with each check—but it’s your decision to make.

PUTTING
IT ALL TOGETHER

You’ve started your journey to homeownership by reading this book. You have gone over your credit report and optimized your credit score to get the best rate. You have gotten enough cash together for your down payment and closing costs. Your lender has pre-approved your loan. Now you’re ready to go house shopping!

When you find the Realtor® you want to work with, give him or her a copy of your pre-approval letter. This will prove that you have done your homework.

Don’t be afraid to make an offer—but don’t get emotionally committed to a home before a seller has accepted your offer. In today’s competitive market, you may have to make offers on more than one property before you get an acceptance. It’s just a fact of life today.



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