Steven M. Vogt, CPA, EA

Buying Your First Home

It is just about everyone's dream to own their own home. Buying your first home can seem like an enormous task. There are a great number of issues to deal with. They include the emotional trauma of a lifestyle change, financial aspects, tax implications and legal considerations. The process may seem a bit overwhelming, but everyone has to go through it. There are many books written on the subject and you certainly should approach the process with your eyes wide open and as prepared as possible for the undertaking. The process from start to finish will consume a great deal of your time. The following are some tips to help you down the path to home ownership.

- Are You Ready to Buy a Home?
- Home Ownership vs. Renting
- Tax Benefits
- How Much of a Home Can You Afford?
- Location, Size and Amenities
- Selecting a Real Estate Agent
- Creditworthiness
- Shopping for a Loan
- Down Payment
- Holding Title to Your Home
- Maintaining Home Improvement Records

Are You Ready to Buy a Home?

This is the first question that needs to be answered before making a home purchase. There is no need to expend the energy and time it takes to find, finance, acquire, and move into a home if you are not ready. Ask yourself the following questions:

- Do I have a steady source of income (from a job or business)?
- Have I been employed on a regular basis for the last 2-3 years?
- Is my current income reliable?
- Do I have a good record of paying my bills?
- Do I have few outstanding long-term debts like car payments?
- Do I have money available for a down payment?
- Am I credit worthy enough to qualify for home financing?
- Do I have the ability to pay a mortgage every month, plus additional costs?

If you can answer "yes" to these questions, you are probably ready to buy your own home.

Home Ownership vs. Renting

There is a big difference between owning your own home and renting. Generally, renting is free of most home maintenance responsibilities other than cleaning and yard care and even the gardening is included with many rental agreements. But at the end of the rental agreement, you have nothing to show for all those rental dollars that you shelled out, and you are generally at the mercy of the landlord. You have also helped the landlord pay down his mortgage and build his equity instead of yours. That's not to say home ownership is for everyone; many prefer a lifestyle unencumbered by the responsibilities of home ownership.

On the other hand, a home purchase provides significant benefits, some immediate and some long-term. When you make a mortgage payment, you are building equity. And that's an investment. Owning a home also qualifies you for tax breaks that assist you in dealing with your new financial responsibilities - like insurance, real estate taxes, and upkeep - which can be substantial. But given the freedom, stability, and security of owning your own home, they are generally worth it.

Tax Benefits

The tax benefits available with home ownership can greatly reduce the cost of ownership. An individual who rents cannot deduct the cost of the rent on his or her tax return. However, if you are buying the home, the mortgage interest and property taxes (1) are a tax deduction (when itemizing) which provides considerable benefits and can substantially offset the cost of owning the home. This is best explained by example.

Illustration: Let's assume that you are a married couple filing jointly. Your mortgage payment is $1,500 per month ($18,000 per year) and the property taxes for the year are $5,000. In the first years after purchasing your home, the mortgage payment is primarily interest, which means most of the payment will be tax-deductible (so we will use $17,000 of the mortgage payment as deductible home mortgage interest). Assume your "other" deductible itemized deductions (medical, charity, other taxes and miscellaneous) for the year after AGI adjustments totaled $4,000 and your standard deduction for the year would have been $12,600. Assuming that you are in the 25% tax bracket, your tax savings can be determined as follows:

Deductible Interest	*$17,000*	
Property Taxes (1)		*5,000*
Other Itemized Deductions		*4,000*
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Standard Deduction (2015)	*<12,600>*	
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Net Tax Savings (25% Tax Bracket) ***$3,350***

This benefit generally can be more or less based on a number of factors. Had this illustration been for a single taxpayer with a standard deduction of only half that of the joint filing taxpayers, the savings would have been $4,925! Tax bracket also has a big impact. Had the illustration been for a single individual in the 35% tax bracket, the savings would have been $6,895.

You can project your savings by substituting your estimated deductible interest and taxes, using the standard deduction that you would use if not itemizing and your marginal tax rate (2).

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(2) Frequently, a taxpayer's taxable income before and after the increase in deductions will straddle two tax brackets and result in a blended marginal rate.

Keep in mind that the annual cost of the home will be more than mortgage payments and taxes. The lender will require the home to be insured for fire and possibly flood. Your utility bills may increase and an allowance for home maintenance and repairs should be set aside.

Determine How Much of a Home You Can Afford

First of all, you will need enough up-front cash to cover the down payment and closing costs. In addition, unless you are purchasing a furnished model, you will need some amount of cash to cover curtains, paint, and whatever other modifications you think are necessary to occupy the home. Don't forget that once you buy the house, you will have expenses moving there.

Before you start looking for a home, the following two things should be determined:

What Can You Afford: Before anything else, figure out how much you can comfortably afford for monthly home expenses. That will include the mortgage payment, taxes, insurance, possible increased utilities and an allowance for home maintenance. Formulate a budget that includes all of your other monthly expenses less those expenses attributable to your current rental. Be careful not to overlook transportation, entertainment, medical expenses, eating out, etc., unless you plan to change your lifestyle. Use that budget to determine how much you can afford monthly for housing.

What Loan Amount Will You Qualify For: Unless you have affluent family members, you will need to determine the maximum loan amount that you will qualify for. A potential lender considers your debt-to-income ratio, which is a comparison of your gross (pre-tax) income to housing and non-housing expenses. Non-housing expenses include long-term debts such as car or student loan payments, alimony, or child support. According to the FHA, monthly mortgage payments should be no more than 29% of gross income, while the mortgage payment, combined with non-housing expenses, should total no more than 41% of income. The lender also considers cash available for down payment and closing costs, credit history, etc. when determining your maximum loan amount.

You may wish to get pre-qualified for a mortgage before you make an offer to a seller. Having been previously approved by a mortgage lender removes a large amount of uncertainty in the seller's mind, and increases the likelihood of a quick closing. With pre-qualification, you'll be in a stronger position to negotiate a better price on the house that you would like to buy. Prequalification is quick and easy. Some lenders charge for the service while others don't. It will also let you know ahead of time how large of a loan you are qualified for.

Location, Size and Amenities

Before you start searching for that perfect home, there are several things you need to determine that will save yourself hours of wasted time. Figure out the type of house that you want early in the process and set your requirements. This cuts out a lot of the guesswork and makes it easier for your real estate agent to find something suitable. Things to consider are:

Size: How big of a home do you need? How many bedrooms? Will the family size be increasing?

Amenities: Narrow your search by specifying the amenities that you require, such as the number of bathrooms, a pool, 2 or 3-car garage, fireplace, yard size, etc. Categorize these items by the need, from your minimum requirements to a wish list.

Location: Select a community that you will be comfortable in. Many people choose communities based on the schools. Do you want access to close shopping and public transportation or a more rural area? How close do you want to be to your place of business or family?

Selecting a Real Estate Agent

Typically, the first person you consult about buying a home is a real estate agent or broker. Although real estate brokers provide helpful advice on many aspects of home buying, they may serve the interests of the seller and not your interests as the buyer. The most common practice is for the seller to hire the broker to find someone who will be willing to buy the home on terms and conditions that are acceptable to the seller. Therefore, the real estate broker you are dealing with may also represent the seller. However, you can hire your own real estate broker, known as a buyer’s broker, to represent your interests. Also, in some states, agents and brokers are allowed to represent both the buyer and seller.

Sometimes, the real estate broker will offer to help you obtain a mortgage loan. He or she may also recommend that you deal with a particular lender, title company and attorney or settlement/closing agent. You are not required to follow the real estate broker’s recommendation. You should compare the costs and services offered by other providers with those recommended by the real estate broker. Make sure that you do your research.

Find an agent by inquiring around with associates and friends for recommendations. If you have multiple recommendations, interview them before choosing one. Look for an agent who listens well and fully understands your needs. Pick one who is familiar with the area in which you wish to purchase your home. You want to choose an agent that can provide all the knowledge and services that you need.

Creditworthiness

When you're applying for credit - whether it's a credit card, a car loan, a personal loan or a home mortgage - lenders want to know your credit risk level. In other words, "If I give this person a loan or credit card, how likely is it that I will get paid back on time?"

There are three major credit reporting agencies (Equifax, Experian and TransUnion) in the United States that maintain records of your use of credit and other information about you. These records are called credit reports, and lenders will want to check your credit report when you apply for credit. In most cases, lenders will also want to know your credit score. A credit score is a number that summarizes your credit risk, based on a snapshot of your credit report at a particular point in time. A credit score helps lenders evaluate your credit report and estimate your credit risk. Your credit score influences the credit that is available to you and the terms (interest rate, etc.) that the lenders offer you. It's a vital part of your credit health. If your credit score is low, you will generally end up with a less favorable home mortgage. The interest rate most likely will be higher, which will make the monthly home payments higher.

If you are in the planning stages of acquiring a home, you may wish to check your credit score before applying for a loan. If you find errors in the report, you should take steps to have those errors corrected to improve your score.

The most commonly encountered credit score is your FICO® score, which can range from 300 to 850, and is which is easy to check online. Although in most cases, there will be a charge to obtain the FICO® score. An important time to check your FICO® score is six months or so before you plan to purchase a home. This will give you enough time to verify the information on your credit report, correct errors if there are any, and take actions to improve your FICO® score if necessary. In general, any time you are applying for credit, taking out a new loan or changing your credit mix is a good time to check your FICO® score. Improving your FICO score can help you:

- Get better credit offers;
- Lower your interest rates; and
- Speed up credit approvals.

The payoff from a better FICO® score can be big. For example, with a 30-year fixed mortgage of $150,000, you could save approximately $165,000 over the life of the loan - or $459 on each monthly payment - by first improving your FICO® score from 550 to 720.

Shopping for a Loan

Your choice of lender and type of loan will influence not only your settlement costs, but also the monthly cost of your mortgage loan. There are many different types of lenders and loans you can choose from. You may be familiar with banks, savings associations, mortgage companies and credit unions, many of which provide home mortgage loans. Also check online for a listing of some mortgage lenders or your local newspaper for a listing of rates.

- <u>Mortgage Brokers</u> - Some companies (known as "mortgage brokers") offer to find you a mortgage lender willing to make you a loan. A mortgage broker may operate as an independent business and may not be operating as your "agent" or representative. Your mortgage broker may be paid by the lender, you as the borrower, or both. You may wish to ask about the fees that the mortgage broker will receive for its services

- Government Programs - You may be eligible for a loan insured through the Federal Housing Administration ("FHA") or guaranteed by the Department of Veterans Affairs or similar programs operated by cities or states. These programs may require a smaller down payment. Ask lenders about these programs. You can get more information about these programs from the agencies that run them.

- Computer Loan Origination Systems (CLOs) - CLOs are computer terminals sometimes available in real estate offices or other locations to help you sort through the various types of loans offered by different lenders. The CLO operator may charge a fee for the services the CLO offers. This fee may be paid by you or by the lender that you select.

Types of Loans - Loans can have a fixed or variable interest rate. Fixed rate loans have the same principal and interest payments during the loan term. Variable rate loans can have any one of a number of "indexes" and "margins" which determine how and when the rate and payment amount change. If you apply for a variable rate loan, also known as an adjustable rate mortgage ("ARM"), a disclosure and booklet required by the Truth in Lending Act will further describe the ARM. Most loans can be repaid over a term of 30 years or less and have equal monthly payments. The amounts can change from time to time on an ARM depending on changes in the interest rate. Some loans have short terms and a large final payment called a "balloon." You should shop for the type of home mortgage loan terms that best suit your needs.

Interest Rate, "Points" & Other Fees - The price of a home mortgage loan is usually stated in terms of an interest rate, points and other fees. A "point" is a fee that equals 1 percent of the loan amount. Points are usually paid to the lender, mortgage broker, or both, at the settlement or upon the completion of the escrow. Often, you can pay fewer points in exchange for a higher interest rate or more points for a lower rate. Ask your lender or mortgage broker about points and other fees.

A document called the Truth in Lending Disclosure Statement will show you the "Annual Percentage Rate" ("APR") and other payment information for the loan you have applied for. The APR takes into account not only the interest rate, but also the points, mortgage broker fees and certain other fees that have to be paid. Ask for the APR before you apply to help you shop for the loan that is best for you. Also ask if your loan will have a charge or a fee for paying all or part of the loan before the payment is due, otherwise known as the prepayment penalty. You may be able to negotiate the terms of the prepayment penalty.

Lender-Required Settlement Costs - Your lender may require you to obtain certain settlement services, such as a new survey, mortgage insurance or title insurance. They may also order and charge you for other settlement-related services, such as the appraisal or credit report. A lender may also charge other fees, such as fees for loan processing, document preparation, underwriting, flood certification or an application fee. You may wish to ask for an estimate of fees and settlement costs before choosing a lender. Some lenders offer "no cost" or "no point" loans but normally cover these fees or costs by charging a higher interest rate.

Comparing Loan Costs - Comparing APRs may be an effective way to shop for a loan. However, you must compare similar loan products for the same loan amount. For example, compare two 30-year fixed rate loans for $100,000. Loan A with an APR of 3.35% is less costly than Loan B with an APR of 3.65% over the loan term. However, before you decide on a loan, consider the up-front cash you will be required to pay for each of the two loans as well.

Another effective shopping technique is to compare identical loans with different up-front points and other fees. For example, if you are offered two 30-year fixed rate loans for $100,000 and at 3.5%, the monthly payments are the same, but the up-front costs are different:

Loan A - 2 points ($2,000) and lender required costs of $1,800 = $3,800 in costs.

Loan B - 2 1/4 points ($2,250) and lender required costs of $1,200 = $3,450 in costs.

A comparison of the up-front costs shows Loan B requires $350 less in up-front cash than Loan A. However, your individual situation (how long you plan to stay in your house) and your tax situation (points can usually be deducted for the tax year that you purchase a house that will be your primary residence) may affect your choice of loans.

Lock-ins - "Locking in" your rate or points at the time of application or during the processing of your loan will keep the rate and/or points from changing until settlement or closing of the escrow process. Ask your lender if there is a fee to lock-in the rate and whether the fee reduces the amount you have to pay for points. Find out how long the lock-in is good, what happens if it expires, and whether the lock-in fee is refundable if your application is rejected.

Tax and Insurance Payments - Your monthly mortgage payment will be used to repay the money you borrowed plus interest. Part of your monthly payment may be deposited into an "escrow account" (also known as a "reserve" or "impound" account) so your lender or servicer can pay your real estate taxes, property insurance, mortgage insurance and/or flood insurance. Ask your lender or mortgage broker if you will be required to set up an escrow or impound account for taxes and insurance payments.

Transfer of Your Loan - While you may start the loan process with a lender or mortgage broker, you could find that after settlement another company may be collecting the payments on your loan. Collecting loan payments is often known as "servicing" the loan. Your lender or broker will disclose whether it expects to service your loan or to transfer the servicing to someone else.

Mortgage Insurance - Private mortgage insurance (PMI) and government mortgage insurance protects the lender against default and enables the lender to make a loan which is considered a higher risk. Lenders often require mortgage insurance for loans where the down payment is less than 20% of the sales price. You may be billed monthly, annually, by an initial lump sum, or some combination of these practices for your mortgage insurance premium. Ask your lender if mortgage insurance is required and how much it will cost. Mortgage insurance should not be confused with mortgage life, credit life or disability insurance, which is designed to pay off a mortgage in the event of the borrower's death or disability.

You may also be offered "lender paid" mortgage insurance ("LPMI"). Under LPMI plans, the lender purchases the mortgage insurance and pays the premiums to the insurer. The lender will increase your interest rate to pay for the premiums - but LPMI may reduce your settlement costs. You cannot cancel LPMI or government mortgage insurance during the life of your loan. However, it may be possible to cancel private mortgage insurance at some point, such as when your loan balance is reduced to a certain amount. Before you commit to paying for mortgage insurance, find out the specific requirements for cancellation.

Flood Hazard Areas - Most lenders will not lend you money to buy a home in a flood hazard area unless you pay for flood insurance. Some government loan programs will not allow you to purchase a home that is located in a flood hazard area. Your lender may charge you a fee to check for flood hazards. You should be notified if flood insurance is required. If a change in flood insurance maps brings your home within a flood hazard area after your loan is made, your lender or servicer may require you to buy flood insurance at that time.

Down Payment

If you have the funds for a down payment and a good credit rating, this is probably a good time to purchase a home, since there is a large inventory of property available and in many areas the prices still have not rebounded to the heights they were before the financial crisis of the mid- to late-2000s began.

The typical down payment required for the purchase of a home is twenty percent of the purchase price. In the past, banking on steadily increasing home values, some creative financing arrangements required a much smaller down (some no down payment at all). However, with the decline in home values during 2008, these creative home loan arrangements are generally no longer available.

If you lack the ready cash for the down payment or are short on the amount you need, the following may be possible sources:

IRA Account - If you have an IRA account and you qualify as a first-time home buyer, tax law permits you to make up to a $10,000 penalty-free withdrawal from an IRA to purchase a home. (Please note that even though the withdrawal might be penalty-free, it is still taxable). The tax definition of a first-time homebuyer is quite different from the literal definition of a first-time homebuyer. As it turns out, you can qualify even if you owned a home before. Generally, you are a first-time homebuyer if you had no present interest in a main home during the 2-year period ending on the date of acquisition of the home which the distribution is being used to buy, build, or rebuild. If you are married, your spouse must also meet this no-ownership requirement. To qualify for the first-time homebuyer penalty exception, the distribution must be used to pay qualified acquisition costs before the close of the 120th day after the distribution was received. When added to all of your prior qualified first-time homebuyer distributions, if any, the total distributions cannot be more than $10,000. If you are married, and both you and your spouse have an IRA, you each can withdraw up to $10,000.

Other Retirement Accounts – The penalty-free withdrawal from IRA accounts does not apply to other types of retirement accounts. However, funds can be rolled from a qualified plan to an IRA and then a penalty-free distribution can be taken from the IRA.

Gifts – Often parents or other relatives can assist a potential homebuyer by gifting them the funds to help with the down payment.

Holding Title to Your Home

You also need to consider how you intend to hold title to the home. Surprisingly, many home purchasers don't give much attention to the question even though the manner in which the title is held can have far-reaching ramifications.

The best way to come to a decision about the title is to consult with a real estate attorney. Before you do that, however, you may want a little background on the more prevalent title-holding methods:

• **Title held in the name of one individual.** Single individuals would probably be the most likely candidates for this method of holding title. However, married individuals may also, for one reason or another, choose to take title individually rather than with their spouse. When the owner of the property dies, probate is necessary (unless the property was held in a living trust). However, the property takes on a new value for the beneficiary - generally equal to its fair market value at the date of the original owner's death.

• **Joint tenancy with right of survivorship.** Under this form of ownership, all (two or more) owners hold title to the property. Each owns an equal share of the property. When one owner dies, the others become owners of the decedent's portion. An advantage of joint tenancy is that it cuts probate costs since the decedent's portion of the property normally reverts to the remaining joint tenants automatically (ownership recording, of course, need to be changed). The basis of the decedent's part is revalued at the date of death.

• **Community property.** Married couples in community property states of Arizona, California, Idaho, Nevada, New Mexico, Louisiana, Texas, Washington and Wisconsin (and by election, Alaska) can claim community title to property. Under community property rules, each spouse owns half of the property and each spouse can pass his/her portion either to the other spouse or to someone else. An advantage of community property is that when it is willed to a surviving spouse, the entire property gets revalued to its fair market value at the date of the decedent spouse's death.

Other methods of holding title, like tenancy in common or holding property in trust, are also available. All have their "special" pros and cons. Some community property states also have special methods of holding title such as California's "community property with right of survivorship," which combines the tax benefits of holding title as community property including a double basis adjustment with the ease of property transfer available to the survivor of joint tenancy property. Before making your final decision, take some time to check out the different methods of holding title in your state to determine what's best for you.

Maintaining Home Cost & Improvement Records

One of the benefits of home ownership is the ability to exclude up to $250,000 ($500,000 for a married couple) of gain from the sale of the home. To qualify for the exclusion, taxpayers must meet the ownership and use tests. This means that during the 5-year period ending on the date of the sale, taxpayers must have:

1) Owned the home for at least 2 years (if a joint return, only one spouse needs to meet the ownership test), and

2) Except for short temporary absences, lived in (used) the home as their main home for at least 2 years.

The required 2 years of ownership and use during the 5-year period ending on the date of the sale does not have to be continuous. Taxpayers meet the tests if they can show that they owned and lived in the property as their main home for either 24 full months or 730 days during the 5-year period ending on the date of sale. Where taxpayers do not meet the two-out-of-five use and ownership requirements, they may qualify for a reduced exclusion if the home was sold as a result of unforeseen circumstances.

Maintaining good records will help reduce any future gain and minimize any potential tax when the home is sold. Therefore, it is important to keep a copy of your purchase documents that itemize the costs of purchasing the property, along with substantiation for all subsequent improvements to the home. Don't make the mistake of thinking that the $250,000 or $500,000 gain exclusion will cover all subsequent appreciation in value of the home.

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Amenities: Narrow your search by specifying the amenities that you require, such as the number of bathrooms, a pool, 2 or 3-car garage, fireplace, yard size, etc. Categorize these items by the need, from your minimum requirements to a wish list.

Location: Select a community that you will be comfortable in. Many people choose communities based on the schools. Do you want access to close shopping and public transportation or a more rural area? How close do you want to be to your place of business or family?

Selecting a Real Estate Agent

Typically, the first person you consult about buying a home is a real estate agent or broker. Although real estate brokers provide helpful advice on many aspects of home buying, they may serve the interests of the seller and not your interests as the buyer. The most common practice is for the seller to hire the broker to find someone who will be willing to buy the home on terms and conditions that are acceptable to the seller. Therefore, the real estate broker you are dealing with may also represent the seller. However, you can hire your own real estate broker, known as a buyer’s broker, to represent your interests. Also, in some states, agents and brokers are allowed to represent both the buyer and seller.

Sometimes, the real estate broker will offer to help you obtain a mortgage loan. He or she may also recommend that you deal with a particular lender, title company and attorney or settlement/closing agent. You are not required to follow the real estate broker’s recommendation. You should compare the costs and services offered by other providers with those recommended by the real estate broker. Make sure that you do your research.

Find an agent by inquiring around with associates and friends for recommendations. If you have multiple recommendations, interview them before choosing one. Look for an agent who listens well and fully understands your needs. Pick one who is familiar with the area in which you wish to purchase your home. You want to choose an agent that can provide all the knowledge and services that you need.

Creditworthiness

When you’re applying for credit - whether it’s a credit card, a car loan, a personal loan or a home mortgage - lenders want to know your credit risk level. In other words, “If I give this person a loan or credit card, how likely is it that I will get paid back on time?”

There are three major credit reporting agencies (Equifax, Experian and TransUnion) in the United States that maintain records of your use of credit and other information about you. These records are called credit reports, and lenders will want to check your credit report when you apply for credit. In most cases, lenders will also want to know your credit score. A credit score is a number that summarizes your credit risk, based on a snapshot of your credit report at a particular point in time. A credit score helps lenders evaluate your credit report and estimate your credit risk. Your credit score influences the credit that is available to you and the terms (interest rate, etc.) that the lenders offer you. It’s a vital part of your credit health. If your credit score is low, you will generally end up with a less favorable home mortgage. The interest rate most likely will be higher, which will make the monthly home payments higher.

If you are in the planning stages of acquiring a home, you may wish to check your credit score before applying for a loan. If you find errors in the report, you should take steps to have those errors corrected to improve your score.

The most commonly encountered credit score is your FICO® score, which can range from 300 to 850, and is which is easy to check online. Although in most cases, there will be a charge to obtain the FICO® score. An important time to check your FICO® score is six months or so before you plan to purchase a home. This will give you enough time to verify the information on your credit report, correct errors if there are any, and take actions to improve your FICO® score if necessary. In general, any time you are applying for credit, taking out a new loan or changing your credit mix is a good time to check your FICO® score. Improving your FICO score can help you:

- Get better credit offers;
- Lower your interest rates; and
- Speed up credit approvals.

The payoff from a better FICO® score can be big. For example, with a 30-year fixed mortgage of $150,000, you could save approximately $165,000 over the life of the loan - or $459 on each monthly payment - by first improving your FICO® score from 550 to 720.

Shopping for a Loan

Your choice of lender and type of loan will influence not only your settlement costs, but also the monthly cost of your mortgage loan. There are many different types of lenders and loans you can choose from. You may be familiar with banks, savings associations, mortgage companies and credit unions, many of which provide home mortgage loans. Also check online for a listing of some mortgage lenders or your local newspaper for a listing of rates.

- Mortgage Brokers - Some companies (known as "mortgage brokers") offer to find you a mortgage lender willing to make you a loan. A mortgage broker may operate as an independent business and may not be operating as your "agent" or representative. Your mortgage broker may be paid by the lender, you as the borrower, or both. You may wish to ask about the fees that the mortgage broker will receive for its services

- Government Programs - You may be eligible for a loan insured through the Federal Housing Administration ("FHA") or guaranteed by the Department of Veterans Affairs or similar programs operated by cities or states. These programs may require a smaller down payment. Ask lenders about these programs. You can get more information about these programs from the agencies that run them.

- Computer Loan Origination Systems (CLOs) - CLOs are computer terminals sometimes available in real estate offices or other locations to help you sort through the various types of loans offered by different lenders. The CLO operator may charge a fee for the services the CLO offers. This fee may be paid by you or by the lender that you select.

Types of Loans - Loans can have a fixed or variable interest rate. Fixed rate loans have the same principal and interest payments during the loan term. Variable rate loans can have any one of a number of "indexes" and "margins" which determine how and when the rate and payment amount change. If you apply for a variable rate loan, also known as an adjustable rate mortgage ("ARM"), a disclosure and booklet required by the Truth in Lending Act will further describe the ARM. Most loans can be repaid over a term of 30 years or less and have equal monthly payments. The amounts can change from time to time on an ARM depending on changes in the interest rate. Some loans have short terms and a large final payment called a "balloon." You should shop for the type of home mortgage loan terms that best suit your needs.

Interest Rate, "Points" & Other Fees - The price of a home mortgage loan is usually stated in terms of an interest rate, points and other fees. A "point" is a fee that equals 1 percent of the loan amount. Points are usually paid to the lender, mortgage broker, or both, at the settlement or upon the completion of the escrow. Often, you can pay fewer points in exchange for a higher interest rate or more points for a lower rate. Ask your lender or mortgage broker about points and other fees.

A document called the Truth in Lending Disclosure Statement will show you the "Annual Percentage Rate" ("APR") and other payment information for the loan you have applied for. The APR takes into account not only the interest rate, but also the points, mortgage broker fees and certain other fees that have to be paid. Ask for the APR before you apply to help you shop for the loan that is best for you. Also ask if your loan will have a charge or a fee for paying all or part of the loan before the payment is due, otherwise known as the prepayment penalty. You may be able to negotiate the terms of the prepayment penalty.

Lender-Required Settlement Costs - Your lender may require you to obtain certain settlement services, such as a new survey, mortgage insurance or title insurance. They may also order and charge you for other settlement-related services, such as the appraisal or credit report. A lender may also charge other fees, such as fees for loan processing, document preparation, underwriting, flood certification or an application fee. You may wish to ask for an estimate of fees and settlement costs before choosing a lender. Some lenders offer "no cost" or "no point" loans but normally cover these fees or costs by charging a higher interest rate.

Comparing Loan Costs - Comparing APRs may be an effective way to shop for a loan. However, you must compare similar loan products for the same loan amount. For example, compare two 30-year fixed rate loans for $100,000. Loan A with an APR of 3.35% is less costly than Loan B with an APR of 3.65% over the loan term. However, before you decide on a loan, consider the up-front cash you will be required to pay for each of the two loans as well.

Another effective shopping technique is to compare identical loans with different up-front points and other fees. For example, if you are offered two 30-year fixed rate loans for $100,000 and at 3.5%, the monthly payments are the same, but the up-front costs are different:

Loan A - 2 points ($2,000) and lender required costs of $1,800 = $3,800 in costs.

Loan B - 2 1/4 points ($2,250) and lender required costs of $1,200 = $3,450 in costs.

A comparison of the up-front costs shows Loan B requires $350 less in up-front cash than Loan A. However, your individual situation (how long you plan to stay in your house) and your tax situation (points can usually be deducted for the tax year that you purchase a house that will be your primary residence) may affect your choice of loans.

Lock-ins - "Locking in" your rate or points at the time of application or during the processing of your loan will keep the rate and/or points from changing until settlement or closing of the escrow process. Ask your lender if there is a fee to lock-in the rate and whether the fee reduces the amount you have to pay for points. Find out how long the lock-in is good, what happens if it expires, and whether the lock-in fee is refundable if your application is rejected.

Tax and Insurance Payments - Your monthly mortgage payment will be used to repay the money you borrowed plus interest. Part of your monthly payment may be deposited into an "escrow account" (also known as a "reserve" or "impound" account) so your lender or servicer can pay your real estate taxes, property insurance, mortgage insurance and/or flood insurance. Ask your lender or mortgage broker if you will be required to set up an escrow or impound account for taxes and insurance payments.

Transfer of Your Loan - While you may start the loan process with a lender or mortgage broker, you could find that after settlement another company may be collecting the payments on your loan. Collecting loan payments is often known as "servicing" the loan. Your lender or broker will disclose whether it expects to service your loan or to transfer the servicing to someone else.

Mortgage Insurance - Private mortgage insurance (PMI) and government mortgage insurance protects the lender against default and enables the lender to make a loan which is considered a higher risk. Lenders often require mortgage insurance for loans where the down payment is less than 20% of the sales price. You may be billed monthly, annually, by an initial lump sum, or some combination of these practices for your mortgage insurance premium. Ask your lender if mortgage insurance is required and how much it will cost. Mortgage insurance should not be confused with mortgage life, credit life or disability insurance, which is designed to pay off a mortgage in the event of the borrower's death or disability.

You may also be offered "lender paid" mortgage insurance ("LPMI"). Under LPMI plans, the lender purchases the mortgage insurance and pays the premiums to the insurer. The lender will increase your interest rate to pay for the premiums - but LPMI may reduce your settlement costs. You cannot cancel LPMI or government mortgage insurance during the life of your loan. However, it may be possible to cancel private mortgage insurance at some point, such as when your loan balance is reduced to a certain amount. Before you commit to paying for mortgage insurance, find out the specific requirements for cancellation.

Flood Hazard Areas - Most lenders will not lend you money to buy a home in a flood hazard area unless you pay for flood insurance. Some government loan programs will not allow you to purchase a home that is located in a flood hazard area. Your lender may charge you a fee to check for flood hazards. You should be notified if flood insurance is required. If a change in flood insurance maps brings your home within a flood hazard area after your loan is made, your lender or servicer may require you to buy flood insurance at that time.

Down Payment

If you have the funds for a down payment and a good credit rating, this is probably a good time to purchase a home, since there is a large inventory of property available and in many areas the prices still have not rebounded to the heights they were before the financial crisis of the mid- to late-2000s began.

The typical down payment required for the purchase of a home is twenty percent of the purchase price. In the past, banking on steadily increasing home values, some creative financing arrangements required a much smaller down (some no down payment at all). However, with the decline in home values during 2008, these creative home loan arrangements are generally no longer available.

If you lack the ready cash for the down payment or are short on the amount you need, the following may be possible sources:

IRA Account - If you have an IRA account and you qualify as a first-time home buyer, tax law permits you to make up to a $10,000 penalty-free withdrawal from an IRA to purchase a home. (Please note that even though the withdrawal might be penalty-free, it is still taxable). The tax definition of a first-time homebuyer is quite different from the literal definition of a first-time homebuyer. As it turns out, you can qualify even if you owned a home before. Generally, you are a first-time homebuyer if you had no present interest in a main home during the 2-year period ending on the date of acquisition of the home which the distribution is being used to buy, build, or rebuild. If you are married, your spouse must also meet this no-ownership requirement. To qualify for the first-time homebuyer penalty exception, the distribution must be used to pay qualified acquisition costs before the close of the 120th day after the distribution was received. When added to all of your prior qualified first-time homebuyer distributions, if any, the total distributions cannot be more than $10,000. If you are married, and both you and your spouse have an IRA, you each can withdraw up to $10,000.

Other Retirement Accounts – The penalty-free withdrawal from IRA accounts does not apply to other types of retirement accounts. However, funds can be rolled from a qualified plan to an IRA and then a penalty-free distribution can be taken from the IRA.

Gifts – Often parents or other relatives can assist a potential homebuyer by gifting them the funds to help with the down payment.

Holding Title to Your Home

You also need to consider how you intend to hold title to the home. Surprisingly, many home purchasers don't give much attention to the question even though the manner in which the title is held can have far-reaching ramifications.

The best way to come to a decision about the title is to consult with a real estate attorney. Before you do that, however, you may want a little background on the more prevalent title-holding methods:

• **Title held in the name of one individual.** Single individuals would probably be the most likely candidates for this method of holding title. However, married individuals may also, for one reason or another, choose to take title individually rather than with their spouse. When the owner of the property dies, probate is necessary (unless the property was held in a living trust). However, the property takes on a new value for the beneficiary - generally equal to its fair market value at the date of the original owner's death.

• **Joint tenancy with right of survivorship.** Under this form of ownership, all (two or more) owners hold title to the property. Each owns an equal share of the property. When one owner dies, the others become owners of the decedent's portion. An advantage of joint tenancy is that it cuts probate costs since the decedent's portion of the property normally reverts to the remaining joint tenants automatically (ownership recording, of course, need to be changed). The basis of the decedent's part is revalued at the date of death.

• **Community property.** Married couples in community property states of Arizona, California, Idaho, Nevada, New Mexico, Louisiana, Texas, Washington and Wisconsin (and by election, Alaska) can claim community title to property. Under community property rules, each spouse owns half of the property and each spouse can pass his/her portion either to the other spouse or to someone else. An advantage of community property is that when it is willed to a surviving spouse, the entire property gets revalued to its fair market value at the date of the decedent spouse's death.

Other methods of holding title, like tenancy in common or holding property in trust, are also available. All have their "special" pros and cons. Some community property states also have special methods of holding title such as California's "community property with right of survivorship," which combines the tax benefits of holding title as community property including a double basis adjustment with the ease of property transfer available to the survivor of joint tenancy property. Before making your final decision, take some time to check out the different methods of holding title in your state to determine what's best for you.

Maintaining Home Cost & Improvement Records

One of the benefits of home ownership is the ability to exclude up to $250,000 ($500,000 for a married couple) of gain from the sale of the home. To qualify for the exclusion, taxpayers must meet the ownership and use tests. This means that during the 5-year period ending on the date of the sale, taxpayers must have:

1) Owned the home for at least 2 years (if a joint return, only one spouse needs to meet the ownership test), and

2) Except for short temporary absences, lived in (used) the home as their main home for at least 2 years.

The required 2 years of ownership and use during the 5-year period ending on the date of the sale does not have to be continuous. Taxpayers meet the tests if they can show that they owned and lived in the property as their main home for either 24 full months or 730 days during the 5-year period ending on the date of sale. Where taxpayers do not meet the two-out-of-five use and ownership requirements, they may qualify for a reduced exclusion if the home was sold as a result of unforeseen circumstances.

Maintaining good records will help reduce any future gain and minimize any potential tax when the home is sold. Therefore, it is important to keep a copy of your purchase documents that itemize the costs of purchasing the property, along with substantiation for all subsequent improvements to the home. Don't make the mistake of thinking that the $250,000 or $500,000 gain exclusion will cover all subsequent appreciation in value of the home.