

How The Heck Do I Go About

# Buying A Home?

Written by: **Charles J. Fisher, Esq.**  
*A Member of the Law Firm of*  
*Pollack Cooperman & Fisher, P.C.*  
*Located in Massapequa, New York*

[www.NassauSuffolkLaw.com](http://www.NassauSuffolkLaw.com)

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## **Purpose of the Book**

Let me begin by saying that this book is NOT a book about how to become a millionaire real estate investor, "with no money down". I would not want you to read this book, only to find out that it is a fortune-finding tease, and then toss it onto a shelf to gather dust. I designed this book to be the exact opposite. I designed this book to be your tool - your guide - to accomplishing one simple, very attainable goal - buying a house (or condominium or townhouse or cooperative unit).

Over the years, I've had more than a few people approach me and ask, "How do I buy a house?" I'm an attorney, so putting the question to *me* is not as unusual as it first may seem. Initially, though, I hadn't a clue as to what people were really asking. I would say, "Put a little bit away each month, and before you know it, you'll have enough money for a down payment." Frustrated but undeterred, they would come back, "No, I mean, what is the process? Suppose I go looking for a house and find one I like. What the heck comes next?"

It dawned on me after a time, that the details of how to go about buying a house are not readily available to the public. Certainly, there are courses and seminars for attorneys, real estate brokers and others in the industry, but there are not many sources that outline the process for the average home buyer. Thus, the idea for this book was conceived.

This book is, by no stretch, an all-encompassing guide to real estate. It is short, but it is informative. Most importantly, though, if you have little or no idea of what to expect when you endeavor to buy a house, this book is UNDERSTANDABLE.

## Cast of Characters

### *Starring . . .*

#### You, as the “Buyer” . . . . .

You go from the very beginning to the very end of the house-buying process.

### *And Introducing . . .*

#### The “Seller” . . . . .

This person owns or is building the house you want to buy. Generally, he or she is friendly and accommodating, but this person is going to protect his or her own interests, just like you.

#### The “Real Estate Broker” . . . . (formally introduced in Chapter 3)

The real estate broker is usually hired by, and the agent of, the Seller. He or she should be knowledgeable about the houses shown to you as well as the communities in which they stand. The real estate broker may take you to see one house or fifty houses before you find “The One”.

#### The “Home Inspector” . . . . . (a/k/a the “Engineer”) (formally introduced in Chapter 5)

The home inspector, hired by you, walks through the house and yard and makes a written report on all observations, especially defects, irregularities and potential hazards.

#### The “Attorney” . . . . . (formally introduced in Chapter 5)

Your attorney should be consulted by you as you begin serious pursuit of a house. He or she will guide you through the process and protect your interests.

#### The “Termite Inspector” . . . . . a/k/a “Exterminator” (formally introduced in Chapter 7)

The termite inspector, hired by you, searches the house for wood-destroying insects or evidence of their damage. The termite inspector and home inspector may be one and the same person.

#### The “Mortgage Broker” . . . . . (formally introduced in Chapter 8)

This is the person who tries to find you the best deal on a mortgage loan and assists you with the application process. This is not the person who actually lends you the money.

#### The “Lender” or “Bank” . . . . . (formally introduced in Chapter 8)

This is the institution that actually lends you the money to buy the house. You could end up dealing directly with the lender, or you could find yourself dealing with the lender through a mortgage broker.

#### The “Title Company” . . . . . (formally introduced in Chapter 9)

This company and its agents search the public records for information on the house, the seller and you. They make sure you are buying exactly the property you bargained for, free of liens and the rights of others to it. They obtain insurance for you to protect your ownership interest in the property, should it be challenged.

#### The “Closing Agent” . . . . . (a/k/a the “Escrow Agent”) (a/k/a “Bank/Lender Attorney”) (only a mention in Chapter 8)

This person oversees the closing or settlement of the transaction. He or she also handles the loan funds for the lender and disburses them accordingly. Sometimes, this is the same person as the title closer or even the real estate broker.

#### The “Movers” . . . . . (formally introduced in Chapter 10)

These are the people you hire, the people kind enough to help you for free pizza and beer or the people who owe you one.

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## **Introduction**

For most people, buying a home is a terrifying step in life. This is for reasons that are fairly obvious. You are about to put your life savings into one, single item. As well, you probably are about to incur an unprecedented amount of personal debt. Be certain, however, that in the overwhelming majority of cases, this will turn out to be one of the best investments of your life.

When I was sixteen, I bought my first car for about \$2,000.00. It was a 1978 Pontiac Grand Prix. I put new tires on it right away (\$250.00). Two weeks after getting my license, I crashed it. I spent about \$2,000.00 to straighten the frame and repair the body. I replaced the 2-barrel carburetor with a 4-barrel, giving the car more speed (\$200.00). I replaced the cracked windshield, put in a retractable antenna and bought a new stereo and sound system for the car (\$500.00). I could easily go on with the money I sunk into this vehicle, but suffice it to say that my father ridiculed me by calling it "the \$20,000.00 car", and back then, that was a lot of money for a set of wheels.

A few years passed, and I ended up selling the Pontiac to a friend for \$500.00. He used it for one year and then turned it over to a demolition derby driver. What is the moral of this story? Houses hold their value better than most assets, making it okay - sometimes wise - to invest money into them. Aside from collectibles, automobiles and most other assets lose their value very quickly. So unless your car is a collectible, there are better places to sink your money.

I am an attorney in New York State, and for the past fourteen years, I have assisted hundreds of clients in purchasing homes, buying houses as investments and refinancing existing mortgage debt. I also have gone through the experience of buying my own homes on Long Island as well as purchasing an investment property. I know how the process works, and be sure that I am acquainted with the anxiety that goes with it. This book is not designed to scare you. It is quite the opposite, actually. It is designed to de-mystify the real estate transaction and inform you of the risks, the benefits, the ups and the downs along the way. Most importantly, I want you to know that everyone has similar questions and experiences similar fears when it comes to making such a large purchase.

It is perfectly natural to hesitate before making a drastic financial change. You are about to give up something you know for something about which you're not quite so certain. Actually, that is the very reason you've sought out this book. You've probably spoken with family and friends about budgets, prices, locations, etc., and now you'd like to further arm yourself with knowledge of the details of the process. So, here we go:

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### **Everyone has his or her own reason for purchasing a house:**

1. We're married and want a house in which to raise a family.
2. I'm tired of throwing money away on rent.
3. I want a house that is closer to my job.
4. We want to buy a house, live in it and rent part of it to a tenant.
5. I want to buy a house as an investment property and rent it to tenants.
6. I want to buy a "handyman special", fix it up and sell it for a profit.

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### **Did I hit on your reason or reasons?**

## Chapter 1 - Location, as the Saying Goes

Finding the right house is mostly about location, location, location. Size and condition of the house and yard are two other considerations. It all depends upon your taste and your circumstances. Please take some time to chew on the following points:

**School District:** This factor may seem inane at first glance, especially for a buyer without children, but it definitely is among the more critical points in determining the value of a particular house - the better the school district, the higher the value. A good school system may not be important for you, but odds are that when you go to sell the house, it will be important to your potential buyers. Which school district the house falls into is among the first questions that Long Islanders ask when looking over a particular house. Some say that we are obsessed with it, and I might have to agree. However, it is what it is. On that note, watch for the houses on the town or city borders. A house may be located in the desired town or city and yet may be zoned for the neighboring school district. Conversely, the house may be located in the desired school district, but the post office address may not be in the desired municipality.

**Proximity to Job(s):** It is up to you to research the area surrounding your prospective home with respect to commutation. How close is the house to a major highway or a train station? How long will it take you to get to your job? If you choose a house that is located an hour away from your job, this is two hours that you must be willing to carve out of each day. Weigh heavily how your commute will impact on the quality of your life.

**Proximity to Conveniences:** My father recently retired and moved from Long Island to rural Pennsylvania. He has found quite a paradox. On Long Island, it took him five minutes to get to quality restaurants where he would wait twenty-five minutes to be seated at a table. In Pennsylvania, it takes him twenty-five minutes to get to the restaurant, but he is seated immediately by the owner who knows him by name. The pros and cons sometimes balance evenly. Like I said, though, he has retired. This means that he has reached the age when he will be more dependent on doctors. The nearest hospital is approximately forty-minutes from his house, and he has had a heck of a time finding a nearby doctor who is registered with his particular insurance plan.

**Proximity to Family:** For some of you, there is no issue when it comes to proximity to family. It simply does not matter. For others, proximity or the lack thereof is crucial. If you're a young couple looking forward to having children, perhaps you would like the convenience of having family members (aka babysitters) within a short driving distance from your home. For others, the further you can get from your family, the better. There are always telephones, right? I am caught somewhere in the middle. I am a few towns away from my nearest family member, but most of my family lives within a half-hour drive. For me, it's a beautiful balance.

**Condition of House:** One theory is to look for the worst house in the best neighborhood. This way, you are more likely to get a good purchase price, and you can fix up the house after you buy it. A few years ago, you would have seen fix-me-up's sell for as much as fixed-up's, but not today. Today, in a buyer's market, the buyer makes the rules or walks to the next home. It is my strong belief that, in 2009, prices will continue to fall with the passage of time, and sellers (if they really need to sell) should be willing to reduce their prices and make deals work.

**Size of House and Property:** How about the size of the house? Do you want to buy a small house and move out when your family outgrows it? Would you like a small house that you could expand later? Have you considered buying a bigger house into which your family could grow. And how do you feel about the property size, also known as lot size? Children and yards go well together. However, if you are a career person, a traveler or older in age, perhaps a big yard will just be a big burden. A small yard can be maintained more easily, and in the case of a condominium or cooperative apartment, your payment of the monthly maintenance fees covers your responsibility for the “common areas”.

## Chapter 2 - How Expensive a House Can I Afford?

I will make this an extremely short chapter by listing the expenses which you should not forget to consider when budgeting for your house. After the list, I will set forth a general proposition that you most likely will not believe until you experience its truth.

When compiling a budget to see if you can afford the house you want, you should divide all your expenses on a monthly basis. The following expenses should probably be part of your analysis:

□ *Mortgage Payment* - Your mortgage payment usually will include the interest on your mortgage loan for one month, the principal portion, and often a little bit more than 1/12 of the annual real estate taxes, homeowner's insurance and other insurance, if required (e.g., private mortgage insurance, flood insurance). Mortgage payment calculators can be found on many lender websites.

a. *Real Estate Taxes* (sometimes paid directly by you, and not included in the mortgage payment) - Find out what the taxes are for the year and divide by 12 to obtain the monthly apportionment. Real estate taxes can be levied by the county, the school district, the town, etc. Real estate taxes pay for items such as your police department, sanitation service, parks maintenance, etc.

b. *Homeowner's Insurance* (sometimes paid directly by you, and not included in the mortgage payment) - Find out the amount of the annual premium from an insurance company of your choice, and divide by 12. An insurance broker or company should be able to give you an estimate, if you give them (1) an approximation of the price of the house, (2) an approximation of the square feet of living space in the house and (3) other details such as the location and whether there is an alarm system.

c. *Private Mortgage Insurance* (If required, this payment is always included in the mortgage payment.) - When your mortgage amount is greater than 80% of the sales price of the house, an institutional lender will force you to pay for mortgage insurance. This is insurance that covers the lender for the amount it loaned to you in the event you default on the mortgage.

□ *Energy Bills* - Most houses are heated by oil, gas or electric. Most houses are powered by gas or electric.

□ *Telephone* - These days, many of you also have wireless telephones and beepers. Don't forget those bills in addition to the regular telephone bill.

□ *Television* - Cable? Satellite? Both? Neither?

□ *Car Payment* - If you do not have car loan or car lease payments, then perhaps you should allot some money for service and repairs.

□ *Gasoline* - As difficult as this has been to estimate lately, aim higher than today's rate.

□ *Food* - This should include both groceries and eating out.

□ *Student Loans* - I actually list these separately because they are so prevalent among first-time home buyers.

□ *Personal Expenses* - Bundle together clothing, movies, books, magazines, a trip to the dentist, a CD, flowers for Mother's Day, a tie for Father's Day, candy for Valentine's Day, your sister's wedding. . . , and divide by 12.

□ *Rainy Day Repairs* - Is anything left? What if the refrigerator breaks or the lawnmower dies because you left last year's gas in it over the winter?



□ DO NOT INCLUDE worries such as, “What if I lose my job?” and “What if I get sick?” If you waited until you were so wealthy that you could financially survive any calamity that could be visited upon your life by fate, then you’ll never buy a house or have a baby or visit Europe or do anything that costs you money.

Yes, putting together a budget is a real “downer”. To be honest, after compiling the above list for this book, I don’t know how I stayed afloat after buying my first house. However, this leads me to the famous proposition told to me by my parents and in-laws before I bought my house.

**My Parents’ Proposition:** Budget everything down to the penny, and it will appear as though you cannot afford the house. Then buy it. Somehow, it ends up working.

**My Proposition:** Budget well. The idea is for you to own the house, not for the house to own you!

My theory of why the above propositions work is that people do not factor wage increases into their budgets, as well they should not. However, the expenses that appear so insurmountable this year, will seem to shrink as the years march forward.

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**NOTE:** Of course, if you are looking for a house solely to rent to tenants, you must budget like a business, comparing the house expenses against the rental income. Ask a local real estate broker what tenants generally pay as rent in your area. He or she will accommodate your request as well as offer to find you a tenant when the time comes.

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Now that you have some idea of what you are looking for, how do you go about finding the house you want?

## Chapter 3 - Finding a House

### **Do I Need a Real Estate Agent?**

The answer to the question, “Do I need a real estate agent”, is that you do not need a real estate agent. However, there is a better question. “Should I use a real estate agent?” The answer to this question is “yes”, especially if you are unfamiliar with the location of your search to any degree.

One of the only real limitations to using a real estate agent in your pursuit of the right house is that real estate agents will not show you a house if the seller of the house is not offering a commission to your real estate agent. To put it another way, a real estate agent will be showing you houses on a multiple listing service, but he or she will bypass the house with the “For Sale By Owner” sign on the front lawn. In my opinion, however, buyers cannot lose. Ride around with a real estate agent and look at houses. Then, on your own, look in the newspaper or call the number on “For Sale By Owner” sign for comparisons. There is no reason that you cannot look for a house using an agent’s resources as well as your own. However, let me say this. If you have been working diligently with a real estate agent in your search, and using his or her time to the nth degree, I feel that you have a moral obligation (but not a legal one) to stay loyal to your agent. You are how that agent earns a living, and if you’ve just spent a few weeks or months of her time and then walk into an open house without her and cut a deal, well, you do the math. There’s a lot of precious time involved in vetting houses and making appointments for you.

Keep in mind that a real estate agent or broker is in the business of helping people who need to sell their homes find people who need to buy homes. This is the agent’s job. It is not your job. Consequently, a real estate agent can usually dedicate more time to finding the right match for you than even you can. This is why an agent will give you a business card with an office number, a fax number, mobile phone number and an e-mail address. A good agent or broker is familiar with the communities he or she covers. Chances are that your research efforts will not produce the same insights that a real estate agent possesses with respect to a community.

As discussed above, the alternative to using a real estate agent is to find a house on your own. You must be prepared to devote quite a bit of time to this endeavor. You may want to flip through the real estate section of newspapers and local periodicals. You may want to pick up a specialty magazine such as “For Sale By Owner”, or you could search the internet. There even are local cable television channels that carry classified real estate ads shows. Lastly, you could drive around the neighborhoods in which you have an interest and look for “For Sale” signs. Remember that even if you find a house on your own, you still may end up dealing with a real estate agent or broker if the seller has an agreement with one, and so, the broker’s fees will still be built into the selling price of the house.

## Using a Real Estate Agent:

Real estate agents and brokers are SALESPEOPLE. Remember this. Many will strike you as aggressive, and some, even annoying. I'm being brash, but I'm trying to tell the truth. Again, this is how they put food on their plates. If possible, find a real estate agent who is a friend, or a friend of a friend, or a recommendation from someone you know. If you do not know of a particular agent or broker, simply visit the office in the area in which you are looking for a house.

When you've found a real estate agent, he or she probably will have you complete a questionnaire or otherwise answer a few questions with respect to your finances. It is intrusive but necessary. Many agents then will submit your answers to a lender or mortgage broker, who will analyze your financial information in no time and issue to you what is called a pre-qualification letter. A pre-qualification letter carries no official meaning, and it does not mean that you are approved for a mortgage. It simply serves as a guide to sellers and their agents that you are a good candidate for getting approved for a mortgage up to the amount designated in the pre-qualification letter. Although you may never have heard of this document before in your life, your possession of a pre-qualification letter will suddenly put smiles on people's lips and dollar signs in their eyes. Pre-qualification letters are not difficult to obtain, so do not spend too much time worrying about this simple process.

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**NOTE:** If you are selling a house and need the proceeds of that sale in order to purchase a new house, you will not be considered a qualified buyer until you can show a real estate contract for the sale of your house. Selling and buying at the same time involves a degree of planning and coordination. If possible, you should hire the same attorney to assist you with both transfers. There is more on this subject in Chapter 12.

For the next few weeks or months, expect to be called constantly by the real estate agent. If you do not have a special relationship with the agent, expect that the agent will show you good prospects as well as houses that may not be suitable for you. An honest real estate agent will tip you off with body language and tones when a house is not a good fit. However, it is extremely rare that an agent will tell you outright that a house is not for you. Why, then, would the agent have taken you to see it in the first place? The answer is that there is always the chance that you will surprise the agent and like the house that he or she shows you. Thus, the rule of thumb is that a real estate agent will push hardest for the good prospects but not so hard for houses he or she feels do not fit your circumstances.

You might notice that owners normally play a minimal role when you first view a house. This is no coincidence. Among the reasons that owners/sellers are usually absent or stationary during your preliminary look at a house is that the owners know about every little fault in their house, and if they are particularly talkative people, what they tell you may break your interest in the house. At the very least, if the owners tell you something about the house that concerns you, they could give you excellent fodder for negotiating the price of the house downward. Thus, it is best that a real estate agent not have to introduce you to the owners. If the owners are home, you may find them watching television or reading a book in an isolated room. They will shake your hand and greet you, but they will not join you in your walk through the house. They probably have been so instructed.

You, on the other hand, must not be passive when dealing with a real estate agent. If an agent wants to take you to an area in which you are not interested, then do not go there if you think it will waste your time. Ask about the school district. Ask what the sale prices were of houses recently sold in that same area. Ask the age of the oil burner and the roof. Ask whatever questions come to mind. In fact, keep a pad with you from now until the day you enter into contract, and write down questions you would like to ask about your potential house. This decision will have a great impact on your life. Be thoughtful, and do not be timid!

## **Chapter 4 - You Think You've Found Your House? It's Time for an Offer.**

It may not be your dream home, but you think you've zeroed in on a house that fits you and your needs comfortably. Now, for the biggest move in the whole book - making an offer.

At the turn of the millenium, in the Long Island real estate market, if a house had an accurate list price, e.g., \$250,000.00, the house lasted a day or two on the market, if that. Buyers swarmed in and actually bid up the prices. It was not unusual for that \$250,000.00 house to sell for \$275,000.00 within forty-eight hours. This was called a seller's market, and it was extreme. In 2009, the pendulum has swung back the other way. House prices have been falling year-to-year, except for springtime in which period prices temporarily stabilize. If you are interested in a house that has a list price of \$550,000.00, perhaps you should consider offering the seller \$510,000.00 for it. That is the way to play the game. Of course, if you are convinced that you must have the house and you fear that the seller may sell it to another person, then offer the seller close to the list price right off the bat. From time to time, there are houses that are properly priced or even underpriced and they will sell fairly quickly even in today's sluggish market.

If the seller accepts your offer, you usually are asked to sign a preliminary sales agreement or "binder". In addition to signing the binder, some real estate agents ask that you give the seller some nominal amount of money such as \$100.00, to show your good faith interest. This may be in exchange for the seller to stop showing the house or entertaining further offers. In reality, neither a binder nor the \$100.00 good faith deposit will protect you very much because neither is very binding. In fact, in the State of New York, the binder has no legal enforceability. It simply memorializes the basic terms of the transaction. For example, the binder usually lists the name and address of the seller and buyer, the purchase price, the amount of the down payment, the prospective closing date, and the name of the real estate broker and the attorneys for the seller and buyer, if known. In the State of New York, you can walk away from the whole deal (including the binder) for any reason, up until the time you sign off on a "Contract of Sale" (also known as a "Purchase Agreement").

## **Chapter 5 - The Seller Has Accepted Your Offer. Now What?**

Once the seller accepts your offer on the house, you must move into what I call your protective mode. Your protective mode starts with contacting two parties: a licensed home inspector (sometimes called an engineer) and your attorney.

### **The Home Inspector's (Engineer's) Role:**

It's nice to have an uncle from the carpenter's union walk through the house with you and examine it for its soundness. However, even this examination should be followed up by an examination by a licensed home inspector, also referred to as an engineer. After all, if you find out the next Spring that the attached garage is slowly collapsing on the left side, are you going to sue your relative for missing this?

Once you are serious about a house, you should pay a licensed home inspector to examine the house for any and all flaws. If you do not know of any home inspectors, ask your attorney to recommend one. Call the home inspector and have his office coordinate an appointment with the real estate agent or with the seller directly, so he can obtain proper access to the house. A licensed home inspector will walk around the home and list defects, leaks, even potential problems, because he does not want to be sued for missing something he otherwise should have seen. The home inspector will flush toilets, test outlets, check the electrical system, climb into the attic, crawl into crawl spaces, inspect decks, test appliances and many other tasks. The home inspector should be knowledgeable about local codes and regulations such as the height of steps or the necessity of hand railings. Also, it is better if you are able to accompany the home inspector while he does his inspection and analysis because you really should see any important defects in person as well as in a written report.

After the examination has been completed, the home inspector will give you a written report of his findings. The home inspector's fee should be no more than a few hundred dollars for an average house. It is helpful to provide your attorney with a copy of the home inspector's report.

If there are no substantial defects in the house, you can proceed with the transaction by entering into a "Contract of Sale" or "Purchase Agreement". If there is a substantial defect in the house, such as joist rot, foundation cracks, roof leaks, visible faulty wiring or problems with the heating or plumbing system, you should consider withdrawing your offer. If you still desire the house despite the substantial defect, you may want to obtain a second opinion of the problem. If the substantial defect is a valid one and you still want the house, make a new but lower offer, citing the reasons, or push for the seller to fix the defect.

If there are less substantial problems with the house, such as a cracked window, minor water damage or a dysfunctional appliance, these problems can be dealt with in the Contract of Sale (Purchase Agreement). Consult your attorney or the real estate agent.

*Radon* - Radon is a naturally-occurring, radioactive gas that rises from the earth and mixes with the atmosphere. It occurs nearly everywhere but typically is concentrated in soil where granite and shale are present. Ask your real estate agent whether yours is an area prone to radon gas problems. The danger is that the radon could be seeping out of the earth and concentrating in the house you now want to buy. What do you do if the risk of radon is high in your prospective community? Simply ask the seller if the house has been tested for radon recently or whether the house is equipped with a radon ventilation system. If the answer is "no" to both these questions and the area is prone to radon problems, you should have the house tested for radon before you buy it.

*Lead Paint* - If a structure was built before 1978, federal law requires that a buyer must be given a pamphlet identifying the risks of lead-based paint. The seller must disclose any knowledge he or she has of lead-based paint in the dwelling because of possible negative health effects, especially on young children. This problem is most prevalent in old structures, especially in large cities such as New York. For example, you may want to have the house tested for lead paint if it is an old structure in Brooklyn, New York, and you have small children that are liable to put paint chips in their mouths.

### **Using an Attorney:**

No, you do not "need" to have an attorney represent you when you purchase your home. And if you are arrested by the police because you are in the wrong place at the wrong time, you have the choice of being your own criminal defense attorney as well. What do I mean by this sarcasm? I mean that there are certain times when it is worth it for you to be counseled through a process, if not for any other reason than peace of mind in knowing that the chances of someone taking advantage of you have dramatically decreased. I know. I know. I'm an attorney, so how believable is this advice coming from me?

Remember this. An attorney knows exactly what to look for in the real estate transaction process. Language in a Contract of Sale or Purchase Agreement that may seem innocuous to you, may seem like a bad risk to an attorney. Fees may seem high to you, but how can you be sure? Attorneys serve both as your adviser and your security blanket. It is worth it to pay an attorney. By the way, in my experience, the average range of an attorney's fees for a real estate transaction up to \$999,000.00, start at \$750.00 and go to about \$1,500.00. Any lower of a fee makes me concerned about how much personal attention the attorney will pay to your file, and anything more makes me concerned about overcharging. However, there are legitimate reasons for higher fees. Just make sure you and your attorney have a clear understanding of the fees he or she is charging you.

It is always reassuring to have contacted your attorney while you are in serious pursuit of your house and before you make your actual offer. You at least will have discussed fees, the preliminary steps and an outline of the buying process. Your attorney also can assist you with hiring a home inspector as well as a termite company and title company, as explained later.

Once your offer on the house is accepted by the seller, you should either give a copy of the binder to your attorney, or if there is no binder, tell your attorney the basic terms of the sale. In New York, the seller's attorney traditionally drafts the Contract of Sale (Purchase Agreement) and sends it to the buyer's attorney for review, changes and signature.

## **Chapter 6 - The Negotiation and Signing of a Contract of Sale** **(a/k/a Purchase Agreement)**

To restate the hypothetical facts, you have looked for a house and have found one. You made an offer which the seller has accepted. For purposes of illustration, let's say that you offered \$400,000.00 for the house. You signed a binder agreement which outlines the terms of the sale, and you made sure your attorney received a copy of it. The home inspector you hired has made a report. You're concerned about some missing shingles in the back of the house, a leaky faucet in the downstairs bathroom and some loose bricks in the front steps. Your attorney informs you that she has received the Contract of Sale (Purchase Agreement) from the seller's attorney and would like to go over it with you.

First, let me demystify you with a brief description of the Contract of Sale (Purchase Agreement) document. Most residential real estate contracts are standard forms which are a few pages long, followed by add-on terms called "riders". The standard form part of the Contract of Sale (Purchase Agreement) will be filled in with the basic terms of the transaction. The standard form provides spaces for names, addresses, purchase price, down payment, closing date, etc. As for the rider, every attorney seems to have a personalized list of specific terms deemed by him or her to be important enough to memorialize in writing at the end of the Contract of Sale (Purchase Agreement). As a good attorney experiences or hears of new and different real estate transaction problems over the years, he or she will adjust and add to his or her rider in order to protect future clients.

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**NOTE: A Contract of Sale (Purchase Agreement) is a flexible document and not just a form. You and your attorney can negotiate almost anything into a Contract of Sale and provide adequate protection for yourself against many occurrences.**

The actual negotiation of a Contract of Sale (Purchase Agreement) may surprise you. It is not a knock-down, drag-out brawl around a long, polished table. In fact, it is quite common for you to sit down with the seller only once during the whole sale process - at the closing or settlement of the transaction.

The seller's attorney or agent usually drafts the Contract of Sale (Purchase Agreement) and forwards it to you or your attorney's office, depending upon the State in which the property is located. Your attorney should then speak with you about the house and what you want out of the deal:

- *Discuss the basic terms of the transaction.*
  - Confirm the party names, the property, the purchase price, the down payment, when you prefer to close the transaction, etc.



- *If you will be financing the purchase of the house with a mortgage, discuss this.*
  - Make sure that the contract is contingent upon you obtaining a mortgage. In other words, if you apply for a mortgage and are turned down, you want to be able to receive your down payment back and walk away from the contract without being held liable for breaching or breaking the contract.
  - Discuss (i) the size of the mortgage you will need as well as (ii) how much time you will be given to apply for a mortgage and obtain an approval or commitment from the lender.
- *Discuss any personal items you assume will be part of the transaction.*
  - Perhaps you discussed the sale of some furniture along with the house.
  - Perhaps there is a pool table, lawnmower, air conditioner or painting that you wish to purchase as part of the transaction. Generally speaking, if the item can be attached to the house, such as an air conditioner, appliance, chandelier or window treatment, state this item in the Contract of Sale. If the item can simply be walked off the property, such as a pool table, patio furniture or wide-screen television, then you may either want to lock up the promise in the Contract of Sale or make a separate deal between you and the seller. Generally speaking, I do not include true personal property in a real estate contract.
- *Discuss possession issues.*
  - Is possession of the house an issue? Does the seller need to stay in the house until a date certain? Believe it or not, you can agree to close the transaction one day and permit the seller to live there even after the closing. By the same token, usually in the event of an empty house, you may be able to move possessions into the seller's house before the actual closing date. I suggest avoiding this activity if possible, so if you must move items in, I suggest putting them into the garage of the new house, or putting them in a storage container in the driveway. Such a move involves trust, yes, but it could also involve damage and insurance issues as well.
  - ***Is there a tenant in the house? If you want the tenant out of the house before closing, state it in the Contract of Sale (Purchase Agreement).***
- *Discuss broken or dangerous items on the property.*
  - As mentioned above, your house has missing shingles, a leaky faucet and loose bricks in the front steps. Do you want these items repaired by the seller? Would it be acceptable if the seller fixed the leaky faucet and the loose bricks but gave you \$200 off the purchase price for the missing shingles?

After the preliminary conversation between you and your attorney, your attorney will contact the seller's attorney or agent to hash out the final details and modify the Contract of Sale (Purchase Agreement). When the Contract of Sale (Purchase Agreement) is ready for you to sign, your attorney should call you and set up an appointment for you to come to the office. Your attorney also should direct you to bring a check in the amount of the ***down payment***.

The standard ***down payment*** amount used to be ten percent (\$40,000.00 for our \$400,000.00 house example), but with houses skyrocketing in value over the last decade, more and more sellers will accept less than ten percent. Your attorney will tell you to whom to make the check payable, however, it most likely will be payable to the seller's attorney or another escrow agent. The escrow agent is obligated, usually by the Contract of Sale (Purchase Agreement), to deposit your ***down payment*** check into his or her escrow account and hold the money there until the closing. *Except for some new construction situations, the down payment monies may not be used by the seller for any purpose before the closing of the transaction, unless otherwise agreed, and I advise you not to otherwise agree, if possible.*

When you arrive at your attorney's office to sign the Contract of Sale (Purchase Agreement) and turn over the ***down payment*** check, you still should examine the Contract of Sale. A good attorney will give you a copy of the Contract of Sale (Purchase Agreement) and read through it with you, emphasizing each term of important note. If something bothers you, this is your chance to say something. Ask your questions, no matter how stupid you are afraid they may sound!

## **Chapter 6.5 - Important Steps Right After Signing the Contract of Sale (Purchase Agreement)**

The Contract of Sale (Purchase Agreement) becomes valid when, and only when, it is fully executed by you and the seller. In the average case, you, the buyer, will sign the Contract of Sale (Purchase Agreement) first, but it becomes a valid “contract” only on the date that it is counter-signed by the seller or sellers. This date is important because it starts the clock running on several items, such as the time for you, as buyer, to obtain approval for a mortgage loan.

In fact, after both you and the seller sign the Contract of Sale (Purchase Agreement), there are three items that must be addressed immediately:

(1) *Termite Inspection* - There should be a provision in the Contract of Sale (Purchase Agreement) permitting you, as buyer, a certain period of time - usually two weeks or less - within which to have the house inspected for wood-destroying insects. As **Chapter 7** urges, have the termite inspection done because it is important. Do not play cheapskate at this point in the game. It's akin to checking under the hood before buying a used car.

(2) *Mortgage Application* - Although it is highly recommended that you start applying for a mortgage loan before you find a suitable house, if you have not already done so, this would be the time to begin the process. If you intend to finance the purchase of the house with a mortgage loan, you or your attorney should have had a mortgage contingency clause drawn into the Contract of Sale (Purchase Agreement). This means that the sale of the house to you depends upon you obtaining a loan for a specific amount and within a specific time. All these “specifics” should be put into the Contract of Sale (Purchase Agreement). **Chapter 8** outlines today's typical mortgage application process.

(3) *Ordering a Title Report* - If you have an attorney, your attorney will be very familiar with this step and will be able to order a title report for you from a company she knows and trusts. In most States, however, those that do not customarily use attorneys, the seller's agent will take care of ordering the title search for the property. If the termite inspection and mortgage application steps seem self-explanatory, this title report business may seem a bit sketchy to the inexperienced buyer. It's really less complicated than you may think. The goal of buying a house is to acquire a measured-off piece of property from the seller, free of violations of record as well as judgments, liens and other interests of third parties. The purpose of the title report is to make sure that the seller is really the owner of the property, that he or she has the right to transfer the property, that the property to be transferred is exactly the property that both parties intend to be transferred and that the property is being transferred free and clear of violations of record as well as judgments, liens and other interests that a third party may have against the property. More on the title report can be found in **Chapter 9**. The title report should be ordered immediately after the full execution of the contract of sale (purchase agreement) because if there are “clouds” or objections to title, the seller have time to address the issue or issues before closing.

## **Chapter 7 - Wood-Destroying Insect Inspection**

It is possible that you had the wood-destroying insect inspection performed before you signed the Contract of Sale (Purchase Agreement) - about the same time you hired the home inspector. In many an instance, though, you've signed a Contract of Sale (Purchase Agreement) but you still need to have a wood-destroying insect inspection done. The cost for the inspection is usually borne by you, the buyer. Do you really need a wood-destroying insect inspection? Let me say this:

Do not treat lightly your opportunity to have the house inspected for termites and other wood-destroying insects. First of all, if you need a mortgage to buy the house, you'll find that institutional lenders often require that such an inspection be done and governmental lenders almost always insist on it. Your lender is concerned - and rightly so - that it might be lending its money to buy a house that is infested with insects that have or will harm the house's structure. If that were the case, the mortgage loan that is being given to you could never be recouped by the lender since the house will be devalued greatly by the little pests. YOU should be just as concerned, because the house that you've contracted to purchase for \$400,000.00 may be worth a lot less with termites in it.

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**NOTE: "Termite" or "pest" inspection is the popular term. However, the inspection actually encompasses all "wood destroying insects". Termites happen to be the most prevalent of these pests.**

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Most houses do not have a wood-destroying insect problem, but a substantial minority do. Termites are usually a hidden but potent problem. They literally can destroy a structure without revealing visible signs. You'll be carrying your new television into the basement and fall right through the third step. Why? Because termites have burrowed through the wood and weakened the stair case. For these reasons, a good Contract of Sale (Purchase Agreement) is contingent upon the results of a wood-destroying insect report.

Most often, there is a provision placed into the Contract of Sale (Purchase Agreement) giving you, the buyer, a short time period within which to have the house inspected for wood destroying insects. I usually give buyers fourteen days from the full execution of the Contract of Sale (Purchase Agreement). In other words, immediately after receiving a fully-signed Contract of Sale (Purchase Agreement), you should make an appointment with a licensed inspector or extermination company to go to the house and inspect for wood-destroying insects. (Sometimes, a home inspector also has a license to inspect for wood-destroying insects.) Ask your attorney to refer a company he trusts, or look in the yellow pages, call a few companies and compare their fees. When you've chosen a wood-destroying insect inspection company, you then have to arrange for the company's access to the house, just like with the home inspector. If there is a real estate agent involved in your purchase, let the agent arrange a time with the seller for the inspection. *A real estate agent's job does not end with the signing of a Contract of Sale (Purchase Agreement). He or she will be available to facilitate your purchase whenever possible.*

One of three situations could result from a wood-destroying insect inspection. First, “no evidence” of wood destroying insects on a report means what it sounds like it means - that the inspection revealed no evidence or trace of wood destroying insects, dead or alive, and no evidence of their damage to the house. The inspector will provide you, the buyer, with a report to this effect, and you frequently are asked to provide a copy of the report to your lender.

Second, “evidence of damage” means that the inspector found damage to the house which likely was caused by wood destroying insects. However, in this scenario, the inspector has found no “active infestation” or rather no evidence that the damage is currently being perpetrated by live insects. In this second scenario, you should ask the inspection company to issue to you a one-year guaranty against active infestation, in addition to the report itself. Some lenders will be satisfied that there is no active infestation on the date the report is issued, but a number will require a guaranty from the wood-destroying insect inspection company that extends for one year.

In the third scenario, the inspector finds an active infestation. It sounds bad, and it is, but a good Contract of Sale (Purchase Agreement) will cover this situation as well. Remember, a Contract of Sale (Purchase Agreement) is a flexible document, not just a form. You and your attorney can negotiate almost anything into it. Contracts of Sale (Purchase Agreements) may permit you, the buyer, to back out or terminate the contract if there is evidence of an active infestation. A better Contract of Sale (Purchase Agreement) will give the seller an opportunity to remedy the wood-destroying insect problem by having it treated within a reasonable period of time, usually at the seller’s expense, and having any related damage repaired.

Not to sound redundant, but . . . most houses are made substantially of wood. Thus, termites are the arch enemies of houses, and you should be sure to protect yourself against the risk they pose.

## **Chapter 8 - Mortgage Financing**

In many states, the instrument that secures a loan against a house is called a “deed of trust”. In New York and other areas, the instrument is called a “mortgage”. I will be referring to this instrument as a “mortgage” because it is more manageable of a term than “deed of trust”.

Most people have to borrow money to purchase a home. If you are going to take out a loan to finance, say, eighty-percent of your \$400,000.00 house, that loan will amount to \$320,000.00. You will need to sign a promissory note and a mortgage (deed of trust) at the closing. The promissory note is your promise to pay back the \$320,000.00. The mortgage is the document that is recorded in the county or municipality in which the house is located. Its function is to secure your house as collateral for the bank in case you fail to make payments on the note. In other words, if you default on your loan payments, the bank reserves the right to take steps to sell your house at auction in order to get paid. The mortgage is put on the public record so as to put the world on notice that there is a \$320,000.00 lien against your house.

In a perfect world, the mortgage application process should begin even before you enter into a Contract of Sale (Purchase Agreement). But how can this be if you haven't even found the house you'd like to purchase yet? Easy. Simply start inquiring. There are various sources for mortgages. Visit your corner bank and pick up a pamphlet. Speak to a friend who has purchased a house recently and ask where he or she obtained a mortgage. Go online and search for lenders. Get a feel for current interest rates and the different loan programs that lenders have to offer. In essence, begin to scope out the different lenders, and based upon what you read and hear, start to narrow the field. This way, when you do enter into a Contract of Sale (Purchase Agreement), you can get that mortgage application process rolling in no time.

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**NOTE: Be careful not to apply for a mortgage with too many lenders. It is tempting to apply with many different lenders these days, especially online lenders, mainly because it is all done at your fingertips. However, each lender, as part of the process, runs a credit check on you. If you have six or seven credit checks against your name within a recent period, this actually raises a negative flag and pushes your credit “attractiveness” downward, making it more difficult for you to obtain the best terms on your loan.**

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## Mortgage Broker v. Direct Lender:

A *mortgage broker* acts as an agent between you and an actual lender of money. A mortgage broker is supposed to shop around for you and find the best loan program available for your particular situation. A mortgage broker is supposed to keep on top of your case and tell you what the lender requires from you as part of your application. If there is an obstacle during the loan application process, the mortgage broker is supposed to work with you to overcome the obstacle. Is there a downside to using a mortgage broker rather than working directly with a lender? Well, just keep an eye on that broker's fee. As you might expect, the mortgage broker has to make itself money for the intermediary role it plays. Sometimes, the lender pays the mortgage broker for you, making it a more attractive deal. Often, though, the lender builds the mortgage broker's fee into the loan or the mortgage broker charges you directly with an origination fee or discount points. Either of these last two methods costs you, the buyer/borrower, a bit extra. However, a mortgage broker may be able to cover its charges to you, because a mortgage broker does have access to wholesale interest rates, and that can save you money in the long run.

A *direct lender* is the institution that actually lends the money to you. You may have a checking account down on the corner at the First National Bank. These are the guys I'm talking about. You pick up a mortgage application from the branch, complete it and give it to one of the assistant managers or the bank's mortgage liaison. After your mortgage is processed by their mortgage department, you will receive a call, usually requesting additional or updated documentation about your financial status. The upside is that there is not a broker's fee, but there could be a downside (see below).

A *mortgage broker* works on commission. If the money is lent to you, money is made by the mortgage broker. By contrast, a bank or *direct lender's* representative, lacking the same monetary incentives as a mortgage broker, may show less of an interest in your loan application than a mortgage broker. In other words, direct lenders may not be as aggressive about getting your application processed and completed. However, a *direct lender* may be less likely to "beat you up" with charges, whereas a *mortgage broker* could profit by adding charges. And although the previous points laid out in this paragraph could be true to some extent, these points do not apply if you are dealing with an honest lender or an honest mortgage broker who does right by the borrower.

## **"How Much Must I Borrow to Buy the House?"**

How much must I borrow or how big a mortgage do I need are not a stupid questions. No matter how much you dislike crunching numbers, it is a necessary chore when purchasing a house. Do not bury your head in the sand on this one. The numbers are calculated as follows, starting with the contract price of the house:

(1)	\$400,000.00	Contract Price:
(2)	(20,000.00)	Less: down payment
(3)	\$380,000.00	Balance on Contract Price
(3)	\$380,000.00	Balance of Contract Price
(4)	( 60,000.00)	Money toward purchase price you are willing to pay at closing
(5)	\$320,000.00	Subtotal
(5)	\$320,000.00	Subtotal
(6)	15,000.00	Add: Estimated Closing Costs and Escrows
(7)	\$335,000.00	Amount you need to borrow

The above formula may be simplistic, but it is a good way to estimate the size of the mortgage you might need. The first three lines are self-explanatory. You agree to a contract price and give the seller a down payment on the house. This brings you to the third line, "Balance on Contract Price".

In addition to the down payment money that you pay to the seller upon signing the Contract of Sale (Purchase Agreement), you may intend to pay more money to the seller from your own pocket when it is time to close the transaction. Obviously, this is money which you do not need to borrow from a lender. In our case, we'll say that you have \$60,000.00 in your savings which you also will use for the house. Thus, we subtract another \$60,000.00 and come up with \$320,000.00. Remember, however, the calculations do not end here. We still must account for the costs of the transaction as well as the escrows, if any, that must be deposited with the lender at closing.

Line "6" represents the total amount of charges from your lender, your title company and your attorney as well as escrow deposits for taxes and insurance which probably will be taken from you by the lender at the settlement or closing. At this stage, we do not have exact figures for the costs and escrows and therefore must estimate them. Your lender or mortgage broker will supply you with such an estimate - called a "Good Faith Estimate". Since this chapter is about mortgage financing, we will save explanation of the title charges for next chapter and we will break down only the lender's charges and escrows at the end of this chapter.

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**NOTE: In my experience, bank charges, title charges, escrows and attorney fees generally add up to between 2.5% and 4.5% of the purchase price of the house.**

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After we add the estimated lender's charges, title charges, attorneys' fees and escrow deposits to our calculation, we come up with a good guess of what we need to borrow. As stated in the previous paragraph, your lender or mortgage broker will help you calculate how much you will need to borrow in order to buy your house. This is their business and their job.

### **Types Of Loans:**

There are many different types of loans available to you when buying a house, but most conventional loans are best broken down into two categories: fixed rate loans and variable rate loans.

**Fixed rate loans** traditionally are 30-year, 20-year or 15-year loans wherein the interest rate does not change during the life of the loan. On a 30-year loan, if your first payment is due on February 1, 2006, then your final payment will be due on January 1, 2036. All the while, your interest rate of 6.25% per year remains the same. In fact, your mortgage payment will not change over those 30 years, except to the extent that part of your mortgage payment is for taxes and insurance. In that case, your mortgage payment only increases when your taxes and insurance rates are raised, but the principal and interest portion of your mortgage payment stays the same.

**Variable rate loans** (also called *adjustable rate mortgages (ARMs)*) are loans in which the interest rate changes over the life of the loan. The life of a variable rate loan runs as long as a fixed-rate loan - typically 30, 20 or 15 years. A variable rate loan often starts off with an interest rate below the rate you ordinarily could obtain on a fixed-rate loan. For example, if you could obtain a fixed-rate loan at 6.25% per year, a variable rate loan might start you off at 5.50%. The rate of 5.50% usually stays fixed for the first year or few years of the loan and then begins to change at regular intervals based on a governmental or institutional index. A variable rate loan should have a maximum and minimum allowable interest rate over its life and should not be permitted to rise or fall too quickly at any given adjustment time. For example, your variable rate loan might contain terms which state that the interest rate will never go above 12% and never fall below 4%, and will never rise or fall more than two percentage points at one time.

**A short squib on hybrid loans.** As the term implies, a hybrid loan is a loan that has a fixed rate for the early life of the loan (3, 5, 7, 10 years) and automatically rolls into a variable rate loan after the fixed rate period ends. Be aware that they exist.

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**NOTE: If you intend to own your home only for a few years - perhaps your job keeps you on the move - then you might want to consider a variable rate loan which begins with a below-market interest rate. By the time your interest rate starts to change upward with the trend of the market, you will be ready to sell.**

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**Government Program Loans**, such as those insured through the Federal Housing Administration ("FHA") or guaranteed by the Department of Veterans Affairs ("VA"), usually require less of a down payment than conventional loans. In other words, you might be able to finance 95% of the house with an FHA loan, whereas a conventional lender would not be willing to lend so high a percentage of the market value of the house. Sometimes government-backed loans are offered at below-market interest rates. *Ask your lender or mortgage broker about these programs, or contact the agencies that run them.*

**Grants.** If you are a first-time home buyer, you should research government-related grants. Check out the opportunities that your state, city and county may have. There are generally three qualifications: (1) you must be a first-time home buyer, (2) your income must be under a certain threshold and (3) the contract price of the house you are buying must be under a certain amount. If you can qualify on all three prongs, the program or municipality will approve you and promise you a certain amount toward your purchase price and a certain amount toward your closing costs. You must enter in a Contract of Sale (Purchase Agreement) within a certain period of time after approval and then you must close the transaction within a certain, longer period of time from approval. The final catch is that you must coordinate your closing of the house purchase with the issuance of the check from the program or municipality. This requires a bit of scheduling ingenuity, as some programs and municipalities require several weeks of "lead time" from the time you request the check to the issuance and delivery of the check. Lastly, most of these grants work like this: a mortgage is recorded against the home for the amount of the grant, in essence making it a contingent loan. If you use the house as your principal residence for more than ten years, for example, then the loan is forgiven and it is considered a true grant. However, if you move or sell within the ten-year period, the loan stays a loan and must be repaid. The programs seek to accomplish two goals: (1) to assist first time home buyers and (2) to create more owner-occupied residences which are deemed more desirable for the community.

There are many other types of loans available. Some have been around for years. Others are recent innovations. As the old saying goes, where there's a will, there's a way. And while I recommend being optimistic about your future economic status, don't get in over your head. Buy a house you can afford, and perhaps you will be able to sell it and purchase a more expensive house in the future.

### **The Application Process:**

Some lenders still sit their customers down for face-to-face interviews, but in today's fast-paced society, this has become impractical for the overwhelming majority of institutions. Thus, the interview has disappeared, and the process has become a big paper shuffle. It starts with the traditional loan application and ends with you either signing a mortgage commitment letter or reading a rejection letter from the lender.

Believe it or not, most institutional lenders do not consider subjective factors when deciding whether to lend you money. The process is simply a mathematical calculation, a scoring if you will. The days of "It's A Wonderful Life" are gone. The banks aren't interested in Mr. Johnson's life history so much as they are interested in his asset-to-debt ratio. In fact, below is a list of factors that lenders weigh most heavily when deciding whether to lend you money for a house:

*Credit Report:* Credit reporting agencies such as Equicredit and Transunion compile financial data on all individuals who have social security numbers. It is the financial news, starring you. Lenders always run a credit report on a potential borrower. On a typical credit report, a lender will find a list of your credit accounts and loans, whether you have been delinquent in the payment thereon, the extent of the delinquency and any judgments or liens against you. Bankruptcy filings also appear on your credit report, despite the fact that the bankruptcy may have wiped clean most or all of your debt. It should be noted that lenders will consider logical explanations for temporary periods of delinquency. For instance, it will behoove you to explain to the lender that you were unable to pay your bills on time for eight months because of job loss, illness, etc.

□ *Income:* What is your present income?

□ *Expenses:* What are your current expenses?

□ *Income/Expenses Ratio:* Disposable income equals the amount earned by you in a given month which is left over after you pay your expenses for the month. Is it enough to carry the mortgage for which you are applying?

□ *Assets:* What assets can you fall back on in times of trouble? Do you own a car, a boat, another house? How much do you have in your bank accounts, your retirement accounts, your stock portfolio?

*(If you expect to buy the house with money given to you by a relative or friend, you're going to need to document it with a "gift" letter from the person. The sudden appearance of a lump sum of money must be explained to your lender.)*

□ *Debts:* What are the outstanding balances on your credit card accounts, student loans, car loan, etc.

□ *Asset/Debt Ratio:* This ratio is less important than the income/expense ratio. Your assets do not necessarily have to exceed your debts in value, but any lender will hesitate to give a loan to someone who owns only a car and a stereo yet owes \$150,000.00 in loans and credit card debt.

□ *Employment:* This is about as subjective as a mortgage application gets. The lender wants to know things like how you make your living, how long you've held your present job and what your salary was in the past two years. If your salary now deviates substantially from previous years, you must explain the jump or decline.

*(It is important to note that lenders want to see that you've been working at your present job for at least two years. However, even if you have been working at your present job for less than two years, it usually is satisfactory if you have been in the same line of work or at least the same industry for more than two years.)*

Here's the subjective part. Say you are on the bubble, and the lender is looking for some reason to approve or reject your application. All other things being equal, being a professional (e.g., doctor or accountant) is better than being a furniture salesperson because it is deemed to be more stable of a career, with more earning potential. Further, a salaried employee is looked upon with more favor than a self-employed applicant. Once again, the stability factor plays a big part.

□ *FICO Score:* These days, all your financial data are put into a formula, and you receive points for each positive aspect of your financial condition. After all the numbers are "crunched", a computer will spit out your FICO score, or credit rating. The lender then will determine if your score is high enough to risk lending you the money for which you've asked.

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**NOTE:** There may be errors on your credit report that will haunt you if left uncorrected. For example, you may read that you were delinquent in the payment of a credit card bill in the amount of \$300.00, but what you will not read is that you validly contested the charge. I don't like to scare people, but it has been my experience that credit reports frequently contain errors. I advise that you write for a free copy of your credit report at least once every two years, just to check for accuracy. By law, you are entitled to a free report once per year.

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### **Commitment v. Lock-In:**

After the lender has considered your application for the loan, it will issue to you either a rejection or "**commitment**" letter. If you receive a rejection letter, you need to present this letter to the seller in order to get your down payment back and be released from the Contract of Sale. The rejection letter proves that you have complied with the Contract of Sale (Purchase Agreement) by trying to obtain a loan and that you have been formally rejected. You should note, however, that if granted enough time under the Contract of Sale (Purchase Agreement), you may want to apply with another lender before the expiration date. In the alternative, you may want to ask the seller for an extension of time to obtain a mortgage commitment.

If the lender makes a decision to extend you the loan for the house, it usually will notify you with a **commitment** letter. If you intend to accept the loan and its terms, you should sign the commitment and return it to the designated office of the lender or to your mortgage broker. At this time, you also will want to provide your attorney with a copy of the commitment letter so that he can forward the letter to the seller's attorney (or agent) to show that you have satisfied your duty under the Contract of Sale (Purchase Agreement) to apply for a loan and obtain approval. Once you have obtained a firm commitment for a loan from the lender, you can finally take steps toward setting an actual closing date.

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**NOTE:** Sometimes, as part of a governmental loan, the lender will condition the loan upon certain work being done to the house (i.e., fixing a housing code violation). In such a case, permit sufficient time for the work to be done when scheduling a closing date.

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A **lock-in**, also referred to as a rate-lock or rate commitment, is a lender's promise to make the loan to you at a given interest rate with a certain number of points or no points at all (points are the cost of your interest rate, as explained below). If you lock into a 6.25% rate, and rates are 6.50% by the time you go to the closing, then you have made a great deal. However, if rates are 6.00% when you close, then you have lost out on the deal unless your mortgage broker can re-lock at the lower rate. You may decide that you do not want to lock into a rate at all, in which case, you will be given the rate available from that lender at the time of closing. Rates go up, and rates go down. It's a little bit like playing the stock market.

You may be able to lock in with a lender even before your loan application is processed. Ask your lender or mortgage broker if there is a fee to lock in. Additionally, a lock-in is good only for a specific period of time (e.g., 30 days). If the lock-in period expires before the closing date, it may cost you money to extend the lock-in period. Ask your lender or mortgage broker about extensions and fees, as well as if the lock-in fees are refunded if your application is rejected.

### **Lender or Bank Charges:**

Before I begin this section, please remember to request an estimated itemization of the closing costs from your mortgage broker or lender. You can do this during the application process. This itemization is usually called a ***Good Faith Estimate***, and it is exactly that - an estimate. However, it does give you an idea of what to expect regarding the lender's charges, the escrow deposits for taxes and insurance and the title charges. Now, let's move into more specific discussion.

Some of the lender's charges are paid up front, before the closing of the loan. For example, the mortgage application processing fee is often paid upon submission of the application. Another cost that is frequently paid before the closing is the appraisal fee. The lender wants to make sure that the house is worth a certain percentage more than the loan amount, so it sends an appraiser to the house for a full report. The lender pays the appraiser a fee, so it needs to recoup that fee from you whether or not you actually buy the house.

A word of caution - If a mortgage broker or lender asks you to pay an origination fee or point(s) (explained below) up front, avoid forking over this money as best you can. These fees may run in the thousands of dollars, and it would not be the wisest of choices to part with so much money before the house transaction actually takes place. Nothing is a done deal until the closing, so why put such a large amount of money at risk? This is my standard rule, even when told that the origination fee or point(s) are refundable.

I feel the need to explain one other thing about lenders' charges before delving into specific, notable examples. I toyed with not mentioning it, but I decided in the end that full disclosure of the details was best. A lender's charges and the escrow deposits are taken directly from the proceeds of the loan, so the lender never actually parts with the money. The lender usually wires the loan proceeds into its closing agent's bank account on the day of closing, but the monies it wires is generally the total amount of the loan minus the lender's charges and escrow deposits. In other words, of our \$320,000.00 mortgage loan, the lender may make only \$315,250.00 available to you. This is called the net proceeds of the loan. The lender withholds the remaining \$4,750.00. You never see it, but you certainly pay interest on it.

- i. *Origination Fee Points / Discount Points.* Unlike airline mileage points or credit card shopping points that can be saved up and turned in for something positive, mortgage points cost you. To be exact, a point is equal to one percent (1/100) of your loan amount. If our lender charges us one point on our \$320,000.00 mortgage loan, then the charge is \$3,200.00. What is the difference between the two types of points?

An *origination fee* point represents the lender's charge for processing the loan for

you. Origination fees are based upon risk. If you are a good risk, the lender may charge no fee. If you are a bad risk to the lender, the lender may charge you three or four points. You can often negotiate origination fees. A *discount point* refers to the amount charged to you for lowering your interest rate. If the interest rate offered to you by the bank is 6.50% with no points, then you might be able to get a 6.25% interest rate if you pay one point at closing. It's called buying down the rate. Therefore, in our example, the cost of lowering the interest rate from 6.50% to 6.25% on our \$320,000.00 mortgage loan would be \$3,200.00. Discount points generally are less negotiable than origination fee points because a discount point is a charge for something calculable, the lowering of the interest rate. The scale for origination fee points is more arbitrary.

- ii. *Underwriting Fee.* This fee is for the process of analyzing the risk of lending money to you.
- iii. *Closing Agent's Fee.* The lender needs a closing agent. The lender's closing agent usually provides office facilities for the closing, a bank account in which to wire the mortgage loan funds and disburse settlement checks and a person to handle the paperwork related to the closing. The closing agent, sometimes called the escrow agent or bank attorney, earns a fee for these services, which fee is passed on to you, the borrower.
- iv. *Interest.* At the closing, you will have to pay interest from the closing date to the end of that particular month. Here's why. Most times, your first mortgage payment will be due on the first day of the month after the month following the closing. This means that if you close your loan on June 15<sup>th</sup>, your first mortgage payment will be due on August 1<sup>st</sup>, not July 1<sup>st</sup> as you might expect. Your payment on August 1<sup>st</sup> will cover interest that accrued in July. So, how does the bank get paid interest from June 15<sup>th</sup> through June 30<sup>th</sup>? It takes the interest for those days at the closing. Thus, there is no free month, despite that it may appear that way.
- v. *Miscellaneous.* The remaining lender charges are for various miscellaneous functions: a tax service fee (for setting up accounts for the payment of your taxes and insurance), flood certification fee (for determining whether the house is in a designated flood zone), document preparation fee (for preparing the loan documents for you to sign), and the list goes on.
- vi. *Escrows.* There are other monies that are withheld from your mortgage proceeds but do not qualify as the lender's "charges" or "costs". These are the monies that are held in "escrow" for the payment of your *taxes and homeowner's insurance*. If the house is located in a designated flood zone, the lender will also require you to maintain flood insurance on the house. Many lenders do not want to depend upon you to pay the real property taxes and insurance on the house. If you do not pay the taxes, the lender runs the risk of the local municipality slapping a tax lien on the house which supercedes the mortgage and thus becomes the new first lien on the house. If you do not make the insurance payment and there is a fire, the insurance company will not repair the house and the lender may end up holding a \$320,000.00 mortgage on a burned out shell. For these reasons, many lenders will collect 1/12th of the year's taxes and insurance with each mortgage payment and hold that 1/12th

in special accounts used exclusively for the payment of these expenses.

Under Federal banking law, a lender is permitted to hold more money in these escrow accounts than it actually needs. Because it is allowed to hold a buffer, the lender usually takes a few months' worth of tax and insurance payments at the closing in order to start these accounts. Do not worry, though, escrow monies that are not used by the lender do not enrich the lender. The extra money, if there is any, is refunded to you, by law, at the end of the tax year, with interest. To the opposite end, if the lender underestimates (e.g., your taxes may be raised) and is forced to advance money on your behalf, then the lender will be asking you for that money at the end of the tax year. It happened to me, and the lender added \$50.00 per month to my mortgage payment for six months in order to recapture the money from me.

While homeowner's insurance covers fire, storms or accidents on the property, and flood insurance covers what you think it would cover, there is another escrow account a lender could maintain for you. It goes to pay *private mortgage insurance (PMI)*. When a lender lends you more than 80% of the contract price of the house, the lender will require you to purchase private mortgage insurance to protect the lender's interest in case you default.

Generally, the differences between the lender escrowing for homeowner's insurance and escrowing for private mortgage insurance are the following:

Lenders require that you pay the first full year of homeowner's insurance before the closing and show the lender a paid receipt and policy binder at the closing. Generally, this premium is not permitted to be paid at the closing or deducted from the mortgage proceeds. In addition to the first year's premium which is paid prior to the closing, a few months' worth of homeowner's insurance is deposited into escrow at the closing, and this part is deducted from the mortgage proceeds. If private mortgage insurance is required, the lender usually will withhold from the loan proceeds both the first year's premium and approximately two months' worth of escrow to start the account for next year's premium.

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**NOTE:** If you have to pay private mortgage insurance (PMI) because your mortgage loan is more than 80% of the contract price on the house, you may be wondering what happens to your obligation to pay the premium if your loan balance falls below 80% of the value of the house, ahead of schedule. The answer is that you can get rid of this extra cost. In such a case, you must contact the lender to find out exactly what you have to do. The lender usually will NOT contact you about it.

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vii. *Title Charges.* I mention the title charges here only because we are now talking about money that comes from your end at the closing. However, I only mention title

charges and do not discuss them here because the title charges are generated by the title company. They are not the charges of the lender and they have little or nothing to do with mortgage financing. Thus, title charges are discussed in their own chapter - chapter 9.

The mortgage application process, in the majority of cases, turns out to be the most time-consuming step in the house-buying process. As mentioned earlier, once a mortgage commitment is obtained from the lender, you can finally think about scheduling a specific closing or settlement date. More on scheduling your closing date can be found in Chapter 10, right after we discuss the title company's role in all of this.



## Chapter 9 - The Title Work

### **The Role of the Title Report:**

It is your responsibility, as a buyer, to search the public records for information on the property you are purchasing as well as to search against the name of each party to the transaction - each seller and each buyer. However, you do not want to waste your time pulling records at town hall and all the courthouses in the county, so you hire the experts. The companies that perform these searches are referred to as title companies or abstract companies. These companies generally do not cater directly to the public like RadioShack and WalMart. They advertise to people in the real estate business (like your attorney or your mortgage broker), and then your attorney or mortgage broker takes care of dealing with the title company for you. Although you may choose not to be bothered with all the details of what title companies do, you do pay for their services and you do deserve to have an explanation of their role. So, here it is:

Title companies (1) prepare a report of public record findings for you and (2) obtain insurance which provides protection for you against anyone else in the world making a claim against all or part of the property which you are buying.

The title report provides you with the results of public record searches for judgments and liens against the property in question, against you and against each seller. If a judgment is found against the seller, for example, the seller must satisfy (pay off) the judgment either at the closing or sometime before transferring the property to you, or you will be buying the property with the judgment against it. This is significant, especially because a lender will not give you a mortgage unless the property is free and clear of all judgments and liens. The title report also contains a search to see if the sellers or buyers are in bankruptcy, a search to see if any party is on the terrorist watch list, a search to confirm that the registered structures on the property are built in conformity with local building codes and whether there are any known violations in existence at the property, such as violations of local fire or electrical codes. The title report also confirms that the seller or sellers really do own the property and have the power to sell it. The title report also contains a tax search, which provides you with the tax assessment on the property and whether the taxes have been paid on recent due dates. Finally, the title report allows one to match up a survey map of the property and the legal description of the property with an actual inspection of the property. This is how you (or your attorney) make certain that you are purchasing exactly the parcel of land that is proposed to be sold, down to a measurement in feet.

After it is proven that the seller really does own the property, that the property is the exact property sought and that the property is free and clear of any violations of record as well as judgments or liens that will interfere with your ownership, then the title company will obtain title insurance for you. The title insurance will be paid by you at the closing, once and only once. It is not a recurring expense like your homeowner's insurance premium. Title insurance guarantees that if a third party should ever appear and claim ownership or right to all or part of your property, the title insurance company will provide legal defense on your behalf and will indemnify (reimburse) you for any loss covered in the insurance policy.

## Title Charges:

Remember the below calculation from the previous chapter?

(1)	\$400,000.00	Contract Price:
(2)	(20,000.00)	Less: downpayment
(3)	\$380,000.00	Balance on Contract Price
(3)	\$380,000.00	Balance of Contract Price
(4)	( 60,000.00)	Money toward purchase price you are willing to pay at closing
(5)	\$320,000.00	Subtotal
(5)	\$320,000.00	Subtotal
(6)	15,000.00	Add: Estimated Closing Costs and Escrows
(7)	\$335,000.00	Amount you need to borrow

Well, the title charges are part of line number (6). You will be charged for each search contained in the title report, from the judgment and lien search to the tax search. Additionally, you will be charged the title insurance premium. (In New York, you must pay a premium for owner's coverage as well as a smaller premium for lender's coverage.) Finally, you will be charged for the fees and service of taking your deed and mortgage to the county clerk's office and having them put on the public record. In New York and other states, there is a tax for the mere transfer of any real property. There are exceptions to the rule, but customarily, the seller is responsible for the payment of the transfer tax, and the title company will pick up the tax payment from the seller.

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**NOTE: If there are property taxes or other charges that are due around the time of your closing, the title company may take a check from you for payment of those taxes or charges, and will most likely take a small fee for handling the funds and making sure the municipality is paid.**

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There is one more thing I must mention before leaving the world of title searches. To be clear, a survey map is a simple drawing of the property and all structures on the property, with dimensions included. Sometimes, a survey map cannot be located by the title company, or the existing survey may not be guaranteed or may be so old that your lender will require that a new survey be drawn. In these cases, the buyer usually is responsible for paying for a new survey map. Your attorney should know a reputable surveyor in the area, who will do a good job without a long waiting period. Lately, though, surveys are in such demand in New York, that they have become expensive - between \$500.00 and \$800.00 for an average residential property. At times, I have been able to convince the seller to pay for part of the new survey map, but most of the time, I am unsuccessful on this issue. I just thought I'd put this information out there for you, as I want this process to contain as few surprises as possible.

## **Chapter 10 - Last Minute Business Before the Big Closing Date**

Basically, once you are approved for a mortgage and once the title report is complete, it won't be long before a closing date is scheduled. There are several items you must take care of before the closing date. Unlike your usual chores, however, you undoubtedly will put a bit of zest into these tasks since your ultimate goal is now just around the corner.

### **Homeowner's Insurance:**

Homeowner's insurance is also known as hazard insurance. It is insurance against storm damage, fire, accidents and theft on your property, etc. Residential policies last one year, so it is a yearly expense for homeowners. If you are financing the purchase of your house with a mortgage, the lender will require you to purchase a homeowner's insurance policy and have the first year's premium paid before the closing date. In fact, you probably will have to supply the lender with proof of your insurance as well as a paid receipt for the first year's premium, at or before the closing. Remember, even though you will have paid a whole year's worth of homeowner's insurance by the closing date, the lender will still collect a few months' worth of homeowner's insurance from you at closing if the lender is going to maintain an escrow account for payment of each year's premium.

You will want to start the insurance coverage no later than the date you purchase the home. If you do not have a closing date set yet, then get everything else done regarding the insurance and tell the insurance agent that you will give him or her the exact date that coverage should begin, as soon as you know the closing date.

The homeowner's insurance company is *your* call, not the lender's call. Shop around for a good rate. If you are unsure of where to go for a policy, ask someone you know who owns a home. Every homeowner should have a home insurer. If you are new to the area, then ask your attorney or your broker about homeowner's insurance. Usually, if you insure your car and your house with the same company, you will receive a discount. Don't let this be the deciding factor, though. You want a reputable company that will process your claim fairly and efficiently when and if the time comes.

The next few subjects are logical ones, and I include them as a reminder to you. We'll start with the movers.

### **The Movers:**

Whether "the movers" means an actual moving company, the rental of a truck or just the coordination of friends and family, you must schedule the move ahead of time. It is important to note that you rarely will be able to move into your new house before the closing. On the other side of the coin, you usually are able to move into your new house on the closing date or anytime after the closing. If you have an actual, scheduled closing date, then scheduling the movers is easy. Just call them up and schedule them for the closing date, or shortly thereafter. *For your information, the toughest times to schedule professional movers are at the beginning and end of each month.*

There is a chance, though, that you will only know the closing date a few days before the closing. Then, there are times when the closing date is postponed. Do your best to coordinate, and always be ready to deal with frustrating, last-minute changes. Do not forget to call the movers if your closing date is postponed.

### **Electric/Gas, Water and Telephone:**

Logic dictates that you want to have power, water and a telephone as soon as you move into your new house. This is easier than most people think. Just call up the local power company, the water district and the telephone company. They will ask you for some personal information, the address of your new home and the date you would like to open your account with them. Most of the time, these utilities are on the ball with changes in home ownership, and everything will work on the move-in date.

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**NOTE: Having immediate telephone service in your new home used to be of utmost importance, but with the proliferation of mobile phone use, you may be able to survive adequately if you do not procure telephone service for your home right away. However, hooking your new house up with the local power company still remains a necessity in most civilized regions.**

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You may be wondering, "Well, what about heating my home if I move into the house in the winter?" If the house is heated by natural gas or electric, then opening up a new account with the power company should cover the heating. If your new house is heated by oil, then there should still be oil in the oil tank - at least enough to heat your house for a week or two. If the closing occurs in the dead of winter in a cold region, then make sure the seller does not turn off the heat and leave you with a dry oil tank. The pipes could freeze, leaving you with a big problem. In any event, by the time you move into your new home, you'll be swarmed with calls and mailings from local home heating oil companies that want your business. When choosing your new oil company, try to get a contract for the best price (obviously) as well as a contract that states that the new oil company will maintain and service the existing oil burner (furnace).

### **Forwarding Address:**

Don't forget to go to the post-office and fill out a change-of-address form. You want all that junk mail to follow you to your new home, don't you? But seriously, you do not want to have to rely on the people who move into your old apartment or house to forward your mail - even temporarily. What if they throw away something important to you?

## **The Walk-Through:**

After the closing is scheduled, you must arrange with the real estate agent or the seller for access to the new house, so that you can walk through and give it one, last inspection. Every Contract of Sale (Purchase Agreement) should provide for your right to enter and inspect the property within one or two days of the closing. If it does not say so in the Contract of Sale (Purchase Agreement), then insist on an inspection anyway. It is customary and an industry standard. Ideally, you should do your walk-through the morning of the closing, but this is not always convenient.

You will not have the home inspector with you this time. This inspection is in your hands. So, what are you looking for in a walk-through?

*Items that the seller agreed to repair or alter:* If you remember from Chapter 6 - The Negotiation and Signing of a Contract of Sale (Purchase Agreement), we pretended that your new house had missing shingles, a leaky faucet and loose bricks in the porch. Let's say that the seller agreed to give you \$200.00 off the purchase price for the missing shingles but agreed to fix the leaky faucet and the loose bricks. This is your chance to make certain that those things were done. Turn the faucet on and off. Does it leak? Kick the bricks. Was the repair made?

*Making sure that the house is "as-was":* Everything about the house and property, except for the faucet and bricks discussed above, should look and function the same as when you signed the Contract of Sale (Purchase Agreement). Go through the house and turn on everything from the oven to the shower. Look up, look down, and look all around. If the seller has already moved out, then check for deep scratches or breakage in the walls and floors. Sometimes, damage can be caused during the move. But don't go crazy. Most marks are easy fixes. We are looking for damage that is more significant than a six-inch hair-line scratch, and we are looking for damage that obviously was not there when you first agreed to buy the house.

*Vacant and broom-swept:* According to your Contract of Sale (Purchase Agreement), the seller probably is required to transfer the property to you vacant and broom-swept clean. Once again, if the seller has already moved out, whether it is clean is easy to determine. There should be no junk in the yard or the house, including the garage and attic. The house does not have to be spotless. It just has to be empty and fairly clean. If there were tenants living in the house, unless you wanted them to stay, make certain that these people have moved out of the house before you go to the closing table.

## **Arranging for Access to Your Money:**

In Chapter 8 - Mortgage Financing, you intended to bring approximately \$60,000.00 of your own money to the closing. As the closing date nears, you should confirm that you have access to this money. If you needed to sell a stock or mutual fund, you should have done this several weeks prior to the closing. The money should now be sitting in a savings or checking account, and you should be able to run to the bank only hours before the closing to obtain this money in the form of a certified or banker's check.

## **Chapter 11 - The Closing or Settlement**

The grand finale has several names. It is called the closing, the closing of title, the transfer of title and the settlement. They all mean the same thing. The purchase money is transferred to the seller, and the deed (title) to the property is transferred to you, the buyer. The transaction usually closes in the office of someone involved with the transaction, e.g., the title company's office, the lender's office, the lender's attorney's office, etc. In some locations (i.e., some western areas), the parties do not even meet around a table. Settlement is done through a settlement agent and the documents are delivered by parcel or the mail, upon agreement.

### **What To Bring To The Closing:**

What should you bring to the closing? Below is a general list of things that you should be prepared to bring to your closing:

1. Bring *yourself and anyone else* who will become the owner of the new house. Everyone whose name will be going on the deed (title) to the new house must be present to sign documents.
2. Bring your *certified or banker's checks*. Check with your attorney or mortgage broker first. Any money that you are required to pay at the closing over a certain amount - usually \$500.00 or \$1,000.00 - must be brought in the form of a certified or banker's check.
3. Bring your *personal checkbook* to the closing. You may have to make up a small difference between your certified or banker's checks and the actual closing figures. Rarely are the estimates before the closing exact. You also may be paying for certain services (e.g.'s, your own attorney or the surveyor) separately.
4. Bring your original *homeowner's insurance* binder or policy if your lender does not already have it and bring proof that you have paid the first year's premium.
5. Bring your *one-year guaranty* from the *termite* inspection company, if applicable.
6. Bring a state-issued *identification card* (driver's license will suffice). You must show proof that you are who you purport to be.
7. There may be *something else* that your lender specifically requires you to bring to the closing. No transaction is identical. Check with your attorney or mortgage broker.

### **What To Expect At The Closing:**

In states like New York, the closing table will be full of people. You and your attorney will be there. The seller and the seller's attorney will be there. The lender's attorney, the real estate broker and the title company representative will also be there. In other, more relaxed states, it might only be you and a title company representative at the closing table.

One thing that varies little from state to state, however, is the paperwork. As a buyer who is financing the purchase of a house with a mortgage, you will have to sign a pile of documents. The note and the mortgage are the most important documents in the pile. Most of the remaining documents are disclosures to you by the lender. "We are maintaining an escrow account on your behalf for the payment of your real estate taxes. Please sign at the bottom." The documents are not so simply stated, but this is the gist of it.

Most closings take over an hour. Once in a while, a difficult closing will take a whole

morning or afternoon. Lots of things can go wrong. It may be something trivial like a disagreement with the seller over the cost of a repair. No one gets the best of you, right? You are sick of this guy and his tricks! Do you know what, though? It's not worth it. Settle the dispute. On the other hand, the problem may be monumental. You may have been promised a lower rate of interest by the lender than what you see on the documents. A mistake like this could cost you lots of money. In the absolute, worst-case scenario, you may have to threaten to get up and walk away from the closing. I say over and over that I don't want to scare you, but I do want you to know what could possibly happen.

### **Last Bout with the Calculations:**

Take one more look at the simple formula below, and especially take notice of line number (3). The Contract Price minus the down payment equals the balance that you owe at closing, plus or minus certain adjustments. What are adjustments?

(1)	\$400,000.00	Contract Price:
(2)	<u>(20,000.00)</u>	Less: down payment
(3)	\$380,000.00	Balance on Contract Price (plus or minus adjustments)
(3)	\$380,000.00	Balance of Contract Price (plus or minus adjustments)
(4)	<u>( 60,000.00)</u>	Money toward purchase price you are willing to pay at closing
(5)	\$320,000.00	Subtotal
(5)	\$320,000.00	Subtotal
(6)	<u>15,000.00</u>	Add: Estimated Closing Costs and Escrows
(7)	\$335,000.00	Amount you need to borrow

What are adjustments, you ask? Adjustments are small amounts that are either added to the amount you owe the seller or subtracted from the amount you owe the seller. For example, rather than repair the missing shingles on the house, the seller promised to give you \$200.00 off the price of the house. Thus, you can adjust the balance owed to the seller (line (3)) from \$380,000.00 to \$379,800.00. On the other hand, the seller may appear at the closing with an oil reading, stating the number of gallons of heating oil in the tank and the price per gallon that he paid. Let's suppose that the seller is leaving you with 95 gallons of oil in the tank at a price of \$2.15 per gallon. This equals \$204.25 worth of oil, so \$204.25 is added to the amount you owe the seller. Now you owe \$380,004.25 (\$379,800.00 plus \$204.25).

For taxes and other assessments, it could go either way for you. If you go to closing on June 15<sup>th</sup> and the seller has already paid the real estate taxes through June 30<sup>th</sup>, then you must add 15 days' worth of taxes to the amount that you owe the seller. On the other hand, if the seller has only paid the taxes through May 31<sup>st</sup>, then he or she has been living in the house for 15 days without having paid those taxes. Thus, the seller will owe you 15 days' worth of taxes, and that number would be subtracted from the amount you owe the seller. I thank you for permitting me to beat this point to death.

## **Don't Forget To Take These Things From The Closing:**

Well, at the end of the closing, you probably feel as though you have signed your life away. Your head is spinning, and your writing hand is cramped. However, there are a few things you should remember to take away from the table with you.

The lender's agent or attorney should supply you with an unsigned copy of every loan document you executed. You should demand a copy of the title report, the appraisal and the survey map. If there are any appliances in the house that are fairly new, you should ask the seller for the warranties. And finally, the big three:

1. *The Deed*: This is the document that serves as proof that you own the house. The title is to a car as the deed is to a house. Make sure that you have a copy of the deed to your new house. The original deed still has to be recorded in the local clerk's office, but in the meantime, you may have to use a copy of the deed as proof to someone of your new address.

2. *The HUD-1 Settlement Statement*. If you financed the house with a mortgage from an institutional lender, then you will have to sign a HUD-1 Settlement Statement. This is a government document that is filed by the lender. The statement provides pertinent information about the transaction and accounts for, in detail, each and every dollar involved in the transaction, from the contract price to the down payment, to the bank and title company charges, to the adjustments. It is important to keep this document handy, as your accountant will want to review it down the road.

3. *The Keys*. *The keys*. *The keys*. Even though you should change the locks soon after the closing, the handing over of the keys from the seller to you is symbolic of the transfer of possession of the house. It also prevents you from having to climb through the kitchen window. Don't forget to take them from the seller and to ask which key is for which lock.

***Congratulations!*** You now are the proud owner of the house. Soon you will be on a first name basis with the guys and gals down at the home improvement store. Have fun painting, replacing floor tiles, buying furniture, hanging pictures and gardening!



## **Chapter 12 - Miscellaneous Issues That May Affect You**

### **Short Sales**

There's always some hot celebrity being talked about in the real estate market, and at the moment, that celebrity is the short sale. When the seller of a house owes more on his or her mortgage (e.g., \$450,000.00) than the fair market value of the house (e.g., \$400,000.00), then the seller could seek to sell the house for the fair market value (\$400,000.00) and ask the lender to accept less than the \$450,000.00 mortgage balance as full satisfaction of the mortgage. As the buyer, of course, you would demand that two contingencies be put into your Contract of Sale (Purchaser Agreement). First, you want the Contract of Sale contingent upon your obtaining a mortgage commitment in the amount of X, or as in our hypothetical, \$320,000.00. Secondly, you want the Contract of Sale contingent upon the seller's lender committing to accept a payment of less than the \$450,000.00 balance it is owed. If either one of these two prongs is not met, then you, as buyer, will want the right to the refund of your down payment and relief from all liability under the Contract of Sale.

If you have been paying any mind to the news lately, you know that there is a widespread banking problem, due in part to residential home mortgages that no longer have the collateral to back them in full. Bank acceptance of short payoffs on the mortgages they hold and the resultant losses are part of the process of cleansing the bad loans from the system. However, because the short sale scenario is so prevalent, the departments of the lenders handling the approval process of these short sales are overwhelmed to say the least. Why does this fact affect you and your Contract of Sale? It affects you because you could be waiting anywhere from 3 weeks to 3 months for the seller's lender to give you an answer as to whether they will approve your Contract of Sale. You may be bypassing other opportunities only to have your Contract of Sale rejected. The time on your mortgage commitment or interest rate lock may be put in danger of expiring. You must have patience if you get involved in a short sale, and you will not have patience if you fail to understand the process.

### **Certificates of Occupancy (CO's) / Certificates of Compliance:**

Certificates of occupancy or certificates of completion ("Certificates") can be thought of as stamps of approval by a local municipality on the structures on real property. They are evidence that the structures have been designed and built in conformity with the local rules and regulations. Most Contracts of Sale (Purchase Agreements) make the seller responsible for producing a Certificate for the dwelling and all structures on the property that require a Certificate. In the past, adherence to this requirement was lax. In the last decade or so, however, lenders have forced the issue. Lenders regularly have their agents inspect the property to see if structures have been added. Then, the agents check the title report to see if the additions have Certificates.

For instance, suppose the seller added a bathroom and built a deck off the back of the house just three years ago. Many lenders will have the premises inspected, find the bathroom and deck, and check the title report to see if Certificates were necessary for the structures and if they have been issued by the local municipality. If Certificates are necessary but have not been issued, the seller usually must hire an architect, submit plans to the municipality for a permit, arrange for an inspection of the structures and await the approval and issuance of Certificates for the bathroom and

deck. This process can be time consuming and may hold up the transaction for several weeks. Of those lenders that thoroughly enforce these rules, some may allow the transaction to take place before the Certificates are issued on the condition that some of the sale proceeds be held back from the seller in an escrow account until the issuance of the Certificates.

As I've stated many times before, anything can be negotiated. What if you find out that the additional bathroom and deck do not have Certificates, and your demand for the Certificates are denied by the seller? Can you buy the house without the proper Certificates? Well, you might want your Contract of Sale to state that the seller will not be obtaining the Certificates unless the buyer's lender requires them and it becomes an impediment to closing. Perhaps the seller will only be willing to remove the deck rather than acquire the Certificate. Perhaps the seller would be willing to take something off the contract price in exchange for not acquiring the Certificate. In any case, if you buy the house with missing Certificates, then buyer beware of these things: (1) the uncertified structure may not be safe, (2) the uncertified structure may not work properly, (3) the uncertified structure is a potential building code violation, and (4) someday, you might be selling the house and find that your buyer requires that you obtain the Certificates.

As a rule of thumb, the older the home, the more likely that a previous homeowner altered the home without getting a stamp of approval by the local building department, and thus, the more likely the home is lacking a Certificate for an alteration. In contrast, new construction homes, these days, are always inspected by the local building departments, and issued a Certificate upon their completion.

### **Buried Oil Tanks:**

I do not like underground oil tanks for the simple reason that you cannot tell, by looking at them, if they are leaking oil into the soil. If the oil tank is seeping heating oil into the soil adjacent to the house, and you buy the house, you may end up paying a large sum of money to replace the tank and have the contaminated soil dredged. Even if this is not the case, if, down the line, you try to sell the house, an underground oil tank may become a major issue. In the real world, many people take the chance and buy houses without testing the underground oil tanks for leaks, mainly because of the expense. If the tank is old, however, and you'd like to do things right, have the tank disposed of properly by a licensed company and obtain the necessary paperwork from the local municipality crediting the work with being done in conformity with the law. It may be worth it. There are alternative avenues for resolving the issue, including selling the house "as is", but the well-planned sale obviates the issue beforehand.

### **Swimming Pools:**

In most locations in the United States, dealing with the issue of the functionality of a swimming pool depends upon time of year. If the pool is open, you can have the pool, its filtration system and its heating system (if applicable) inspected. If you are buying during winter, however, you may not be able to inspect the pool. Now, if the pool is an above-ground circular job, it may not be a big deal to you. On the other hand, an in-ground swimming pool may be the focal point of the yard and a substantial selling point of the house as a whole. Alas, you do not even know if it works.

I know of a couple of buyers who bought their house during the winter. The backyard was the pool area, or rather, the pool and patio consumed the whole backyard. The seller swore that the pool was operational. You know what? This concrete pool had a major crack, and when the buyers contacted the seller after the sale to tell her, she insisted that the pool was fine the prior year. People often parse the truth.

What could a buyer have done to prevent the situation? In the above instance, there probably was nothing the buyers could have done. The seller was ready to go to someone else if they pushed the pool issue. However, had they been willing to push, they could have tried to get the seller's pool company to represent that the pool was in good working order at the time of closing the previous autumn. One step better would have been to have the seller represent that the pool would be in working order when opened, and that such a representation would survive beyond the closing, giving the buyers the right to sue for damages. The most favorable solution for the buyers would have been to hold money in escrow until the pool was opened. Then, if there were repairs to be made, the buyers would have possessed the right under the escrow agreement, to be reimbursed for repairs with the escrow money.

### **Selling the Old House to Buy the New House:**

You may be selling your house and buying a new house at the same time. Your biggest opponent is time, or, better stated, the coordination of the two closings or settlements. Not only is coordination crucial to your moving plans, but if you are relying on the money from the sale of your home to be used for the purchase of your new house, coordination is crucial to your financing.

Sure, it could all go smoothly. But then again, you could end up selling your house and living out of boxes at your in-laws for a few months. This happened to my sister, her husband, their three kids and their dog. It was cramped living for a while. The people selling to my sister could not move because construction on their new house was delayed, and my sister did not want to look for another house because she had her heart set on this one. So, they suffered.

How can you ensure that the timing will be perfect? You can't. In fact, as I write this sentence, I cannot schedule a closing date for the buyers I represent because I can't schedule the closing for the sale of their house, and I can't schedule a closing for the sale of their house because the people who are buying my client's house cannot schedule a closing for the sale of their house! The chain of problems can have many links. If you want to cover yourself, you can only prepare a back-up plan. Where will you stay if you have to sell your house or leave your apartment but cannot yet move into your new house? Do you have a tolerant friend or relative with whom you can stay?

What if the sale of your house falls apart at the last minute? You may want to ask your lender or mortgage broker about a bridge loan or swing loan (a loan secured by the equity in your present house) which would enable you to purchase the new house even before selling your current house. The bridge loan would be paid back as soon as you obtained the proceeds from the sale of your old house. Check with your mortgage broker or lender to see if this would be acceptable. You probably will have to prove that you could carry the costs of both houses.

Alternatively, perhaps you could swing a provision in your Contract of Sale (Purchase Agreement) that states that the closing or settlement on your new house is conditional upon you selling your current house. It is rarely agreed upon, but it may be worth asking.

## New Construction (Buying from a Builder):

In many respects, buying a newly-constructed house from a builder varies from buying an existing house from an owner. First and foremost, you should investigate the builder. What is the builder's reputation? Can he give you references? Take a drive and look at the builder's prior work and check with the local chapter of the Home Builders Association.

If you've decided on a builder, the next step is to make sure that you and the builder have agreed on exactly what is to be built. Sounds silly, right? Of course, you are going to do this. Well, the meeting of the minds is not so easy. If you are buying from a model, the complications will be reduced significantly. You can look at the model and choose all the optional features. If you are working with plans and specifications, it is usually more difficult to pinpoint the builder's obligations. For instance, the design of the bathrooms may be obvious, but the builder may install sinks and faucets of a lesser quality than you would like. You've signed the contract and now you would like a better quality of sinks and faucets. The builder may tell you that it will be no problem, only that it will cost you a bit more. What about appliances, door knobs or floor tiles? Have you agreed on the brand, the durability, the type? The rule is that the more specific you and the builder are in the beginning, the less the chances are of costly changes during construction.

Many Contracts of Sale (Purchase Agreements) provide that the builder guarantee against defects in construction for at least one year. State statutes and case law may provide a lengthier guaranty. In many states, builders can provide you with a warranty or other insurance, the most popular of which is offered by the Home Owners Warranty (HOW) Corporation. The HOW Corporation offers a comprehensive 10-year warranty and insurance program for buyers of new constructions, and it is only available through member builders.

Also, as part of the Contract of Sale (Purchase Agreement), make certain that you agree with the builder on when the house will be completed and when you must pay for it. As a buyer, you should note that it is almost always the case that additional work will have to be done after the closing. Suppose the closing takes place when the house is substantially completed, but not fully completed. A "punch list" must be created, specifying each and every discoverable defect and omission that the builder must cure. The builder should be given a reasonable time frame within which to fix the punch list items (e.g., 30 days). Further, it is an excellent idea to have a portion of the sales price held in an escrow account until the punch list items are finished. Having money held in escrow - a neutral hand - provides an incentive to the builder to finish the punch list while also providing him security that the proceeds exist and will be available to him.

At the closing, the builder should also guarantee that the *street* will be paved and that the *curbs, sidewalks, drains, sewer or cesspool* will be installed. Additionally, the *utilities* must be installed and hooked up for service. The builder also must provide you *certificates of occupancy* for all structures on the premises that require certificates of occupancy and a *certificate for the electrical work* from the Board of Fire Underwriters. The builder also should deliver and assign to you all *guarantees and warranties* given to him by his sub-contractors and suppliers.

As a separate item, remember that the outside yards may be part of your deal. Did the builder complete the landscaping as promised? If applicable, has the sprinkler system been installed? Did the builder grade the soil so that rainwater will flow away from the house rather than accumulate in puddles at the edge of the basement? These items may be incomplete at the time of closing, so escrow monies should be deposited for their completion.

### **Nuances of Townhouses, Condominiums and Cooperative Apartments:**

Townhouses, condominiums and cooperative apartments (the last two are commonly referred to as condos and co-ops) are distinct from houses in several respects. First, the average townhouse, condo or co-op is less expensive than a house, making it ideal for you younger folk who don't have all that much of a lifetime savings. The living space may be limited, but younger people do not tote large families and older people may not wish to maintain a house and yard. On the other hand, age may have little to do with your decision. You know your lifestyle and needs. If you want an apartment-type dwelling but wish to own your dwelling, these types of units are for you. One similarity that these units do have with a house is value. The value of the units usually fluctuate right along with the houses in the area. I know many people who have started off in a townhouse, condo or co-op, only to sell and use the profit to buy a house.

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**NOTE: Townhouses and condominiums are considered real estate or real property. You, as the owner, retain a deed to the townhouse or condo. When you purchase a cooperative apartment, however, you are actually buying shares of stock in the corporation that owns the complex and you receive a stock certificate and a lease to the unit. Therefore, a cooperative apartment is personal property, not real estate.**

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Townhouses, condos and co-ops are usually part of a larger complex of similar units. Each complex has common areas, whether these common areas be as simple as a walkway or as elaborate as a recreational facility. The common areas, as well as the structural parts of the complex, are maintained by a corporation or board of managers. As an owner of the condo or co-op, you will be paying maintenance fees (common charges) or homeowner association fees for the upkeep of the complex.

Do you have to have a townhouse inspected by an engineer and a termite company? What about a condo or co-op? As a general rule, the more a unit appears to be its own structure, the more inclined I am to advise my client to have it inspected for soundness as well as wood-destroying insects. Co-ops and many condos exist as units in larger structures. I trust that the owners of the complex maintain the structure adequately and exterminate because it is in their own interest. A termite problem in one unit can wreak havoc for the corporate owners should the situation not be remedied. On the other hand, you, as the owner of a townhouse, could be responsible for exterminations, repairing the roof and other such things. Generally, I advise my clients to have townhouses inspected. However, liability for repairs on all the foregoing dwellings usually can be found in the rules or regulations issued by the corporate owners or associations.

If you wish to purchase a condo or co-op, you should request to see the most recent financial

statement of the corporation, the current budget, any offering plan if the corporation was formed fairly recently, copies of the rules or regulations (by-laws) by which owners and/or residents must abide and a description of the requirements of the condo or co-op with respect to selling the unit. Obtaining and reviewing these documents can be an arduous task and many who proceed without attorneys will ignore the first few steps with regard to reviewing the condo or co-op financials. Rather, they will buy the unit on faith that the underlying corporations really exist and will not go belly-up. However, if you'd like to make an informed decision . . . .

The rules or regulations of a corporation or association may instruct you on everything from whether you, as owner, are allowed to rent out the unit to whether you are allowed to have a pet. Information from the condo or co-op corporation regarding the sale of a unit is also important because there may be a fee due from the seller to the condo or co-op corporation, or the seller may even have to offer the unit for sale to the condo or co-op corporation first, giving it the "right of first refusal". As a last note, you actually have to interview with the board of managers to be allowed to purchase a co-op. The co-op board usually reviews you in person and may consider your financials and/or personal references in conjunction with the interview.

### **Capital Gains Tax Tip:**

The general law is that if you are selling property that was used as your principal residence for at least two of the last five years before the sale, then any gain on the sale up to \$250,000.00 for an individual (\$500,000.00 for a married couple) is not subject to federal taxation. The law can be found in Internal Revenue Code section 121. The new law took effect for sales occurring after May 6, 1997, and the old laws which one might recall as providing a "one-time, over the age of 55" exemption or requiring a necessary roll-over of sales proceeds to another residence have been repealed. Please be careful, however, to distinguish the capital gains tax, which is a federal income tax, from a transfer tax or recording tax. The latter are state and local taxes, which are still in full effect and are paid at or around closing or settlement. *The capital gains tax is an issue to be discussed with your accountant, preferably before you sell and definitely at tax time.*

# **Your Own Personal CheckList for the House Buying Process**

## **First Stage**

- ☐ Make an offer on the house you have decided to purchase.
- ☐ Have the house inspected by a licensed home inspector (aka engineer).
- ☐ Review the home inspector's report, pinpoint defects of concern and negotiate these points with the seller through the real estate broker or with the seller directly.
- ☐ Contact your attorney and give him or her the specifics regarding the transaction (i.e., address, names of the parties involved, purchase price, down payment, special terms that should be included in the Contract of Sale (Purchase Agreement), etc.).
- ☐ Review and sign the Contract of Sale (Purchase Agreement) and give the seller the down payment check.
- ☐ Have a licensed pest/termite inspector inspect the house for wood destroying insects.
- ☐ Apply for a mortgage through a mortgage broker or directly with a lender.
- ☐ Make sure that your attorney, lender, mortgage broker or the real estate agent orders a title report for you.

## **Middle Stage**

- ☐ Follow up on your mortgage application and find out (i) what documentation is still needed in order to complete your application and (ii) what interest rates are available to you on what terms.
- ☐ Keep your attorney's office informed of the progress of your mortgage application process.
- ☐ Shop for and obtain homeowner's insurance (aka hazard or fire insurance) for the house. You will have to pay one year's premium, in advance, from your pocket. You can procure the insurance ahead of time, and later, give the insurance company the commencement date for the policy when you have a closing date for the house. If necessary, obtain flood insurance from this company as well.
- ☐ Receive, review and sign your mortgage commitment (approval) letter.

## **Last Stage**

- ☐ Get a closing date (aka settlement date) from your attorney or whoever is scheduling the closing for you.
- ☐ Schedule the movers, the truck rental or your friends and family.
- ☐ Call the power company and telephone company. Open new accounts for the new house and close your old accounts.
- ☐ Change your mailing address with the post office.
- ☐ Coordinate a last-minute inspection of the house with the seller or the real estate broker. This is called a "walk-through". Walk through the house as soon before the closing as possible to make sure everything is as it was when you signed the Contract of Sale (Purchase Agreement).
- ☐ Make sure your money - the money that you intend to bring to the closing - is immediately available to you because you probably will have to bring a certified or banker's check to the closing.
- ☐ Call your attorney or whoever is working closely with you, and ask that person what you need to bring to the closing table (e.g.'s, identification, proof of homeowner's insurance, etc.)
- ☐ Attend the closing, sign the documents and don't forget to take from the closing table, (i) a copy of the deed, (ii) a copy of the HUD-1 Settlement Statement and (iii) the keys to your new house.

**Because the Mortgage Application Process Can Be Frustrating at Times,  
Here is a Notes Page to Help You Keep Track of Things**

DATE	THINGS DONE / THINGS TO DO