OFFICE OF THE STAFF JUDGE ADVOCATE
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BUYING A HOME

Looking for the Best Mortgage

Shopping around for a home loan or mortgage will help you to get the best financing deal. A mortgage, whether it's a home purchase, a refinancing, or a home equity loan, is a product, just like a car, so the price and terms may be negotiable. You'll want to compare all the costs involved in obtaining a mortgage. Shopping, comparing, and negotiating may save you thousands of dollars.

Obtain Information from Several Lenders

Home loans are available from several types of lenders: thrift institutions, commercial banks, mortgage companies, and credit unions. Different lenders may quote you different prices, so you should contact several lenders to make sure you're getting the best price. You can also get a home loan through a *mortgage broker*. Brokers arrange transactions rather than lending money directly; in other words, they find a lender for you. A broker's access to several lenders can mean a wider selection of loan products and terms from which you can choose. Brokers will generally contact several lenders regarding your application, but they are not obligated to find the best deal for you unless they have *contracted* with you to act as your agent. Consequently, you should consider contacting more than one broker, just as you should with banks or thrift institutions.

Whether you are dealing with a lender or a broker may not always be clear. Some financial institutions operate as both lenders and brokers. And most brokers' advertisements do not use the word "broker." Therefore, be sure to ask whether a broker is involved. This information is important because brokers are usually paid a fee for their services that may be separate from and in addition to the lender's origination or other fees. A broker's compensation may be in the form of "points" paid at closing or as an add-on to your interest rate, or both. You should ask each broker you work with how he or she will be compensated so that you can compare the different fees. Be prepared to negotiate with the brokers as well as the lenders.

Obtain All Important Cost Information

Be sure to get information about mortgages from several lenders or brokers. Know how much of a down payment you can afford, and find out all the costs involved in the loan. Knowing just the amount of the monthly payment or the interest rate is *not* enough. Ask for information about the same loan amount, loan term, and type of loan so that you can *compare* the information. The following information is important to get from each lender and broker:

1. Rates

Ask each lender and broker for a list of its current mortgage interest rates and whether the rates being quoted are the lowest for that day or week.

Ask whether the rate is fixed or adjustable. Keep in mind that when interest rates for adjustable-rate loans go up, generally so does the monthly payment.

If the rate quoted is for an adjustable-rate loan, ask how your rate and loan payment will vary, including whether your loan payment will be reduced when rates go down.

Ask about the loan's annual percentage rate (APR). The APR takes into account not only the interest rate but also points, broker fees, and certain other credit charges that you may be required to pay, expressed as a yearly rate.

2. Points

Points are fees paid to the lender or broker for the loan and are often linked to the interest rate; usually the more points you pay, the lower the rate.

Check your local newspaper for information about rates and points currently being offered.

Ask for points to be quoted to you as a dollar amount—rather than just as the number of points—so that you will actually know how much you will have to pay.

2. Fees

A home loan often involves many fees, such as loan origination or underwriting fees, broker fees, and transaction, settlement, and closing costs. Every lender or broker should be able to give you an estimate of its fees. Many of these fees are negotiable. Some fees are paid when you apply for a loan (such as application and appraisal fees), and others are paid at closing. In some cases, you can borrow the money needed to pay these fees, but doing so will increase your loan amount and total costs. "No cost" loans are sometimes available, but they usually involve higher rates.

Ask what each fee includes. Several items may be lumped into one fee.

Ask for an explanation of any fee you do not understand. Some common fees associated with a home loan closing are listed on the Mortgage Shopping Worksheet in this brochure.

Down Payments and Private Mortgage Insurance

Some lenders require 20 percent of the home's purchase price as a down payment. However, many lenders now offer loans that require less than 20 percent down—sometimes as little as 5 percent on conventional loans. If a 20 percent down payment is not made, lenders usually require the home buyer to purchase private mortgage insurance (PMI) to protect the lender in case the home buyer fails to pay. When government-assisted programs such as FHA (Federal Housing Administration), VA (Veterans Administration), or Rural Development Services are available, the down payment requirements may be substantially smaller.

Ask about the lender's requirements for a down payment, including what you need to do to verify that funds for your down payment are available. Ask your lender about special programs it may offer.

If PMI is required for your loan, (1) Ask what the total cost of the insurance will be, (2) Ask how much your monthly payment will be when including the PMI premium, and (3) Ask how long you will be required to carry PMI.

Obtain the Best Deal That You Can

Once you know what each lender has to offer, negotiate for the best deal that you can. On any given day, lenders and brokers may offer different prices for the same loan terms to different consumers, even if those consumers have the same loan qualifications. The most likely reason for this difference in price is that loan officers and brokers are often allowed to keep some or all of this difference as extra compensation. Generally, the difference between the lowest available price for a loan product and any higher price that the borrower agrees to pay is an overage. When overages occur, they are built into the prices quoted to consumers. They can occur in both fixed and variable-rate loans and can be in the form of points, fees, or the interest rate. Whether quoted to you by a loan officer or a broker, the price of any loan may contain overages.

Have the lender or broker write down all the costs associated with the loan. Then ask if the lender or broker will waive or reduce one or more of its fees or agree to a lower rate or fewer points. You'll want to make sure that the lender or broker is not agreeing to lower one fee while raising another or to lower the rate while raising points. There's no harm in asking lenders or brokers if they can give better terms than the original ones they quoted or than those you have found elsewhere.

Once you are satisfied with the terms you have negotiated, you may want to obtain a written lock-in from the lender or broker. The lock-in should include the rate that you have agreed upon, the period the lock-in lasts, and the number of points to be paid. A fee may be charged for locking in the loan rate. This fee may be refundable at closing. Lock-ins can protect you from rate increases while your loan is being processed; if rates fall, however, you could end up with a less favorable rate. Should that happen, try to negotiate a compromise with the lender or broker.

Remember: Shop, Compare, Negotiate

When buying a home, remember to shop around, to compare costs and terms, and to negotiate for the best deal. Your local newspaper and the Internet are good places to start shopping for a loan. You can usually find information both on interest rates and on points for several lenders. Since rates and points can change daily, you'll want to check your newspaper often when shopping for a home loan. But the newspaper does not list the fees, so be sure to ask the lenders about them.

The Mortgage Shopping Worksheet that follows may also help you. Take it with you when you speak to each lender or broker and write down the information you obtain. Don't be afraid to make lenders and brokers compete with each other for your business by letting them know that you are shopping for the best deal.

Fair Lending Is Required by Law

The *Equal Credit Opportunity Act* prohibits lenders from discriminating against credit applicants in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, whether all or part of the applicant's income comes from a public assistance program, or whether the applicant has in good faith exercised a right under the Consumer Credit Protection Act.

The *Fair Housing Act* prohibits discrimination in residential real estate transactions on the basis of race, color, religion, sex, handicap, familial status, or national origin.

Under these laws, a consumer cannot be *refused* a loan based on these characteristics nor be *charged more* for a loan or *offered less favorable terms* based on such characteristics.

Credit Problems? Still Shop, Compare, and Negotiate

Don't assume that minor credit problems or difficulties stemming from unique circumstances, such as illness or temporary loss of income, will limit your loan choices to only high-cost lenders.

If your credit report contains negative information that is accurate, but there are good reasons for trusting you to repay a loan, be sure to explain your situation to the lender or broker. If your credit problems cannot be explained, you will probably have to pay more than borrowers who have good credit histories. But don't assume that the only way to get credit is to pay a high price. Ask how your past credit history affects the price of your loan and what you would need to do to get a better price. Take the time to shop around and negotiate the best deal that you can.

Whether you have credit problems or not, it's a good idea to review your credit report for accuracy and completeness before you apply for a loan. To order a copy of your credit report, contact:

Equifax: (800) 685-1111
TransUnion: 1-877-322-8228
Experian: (888) EXPERIAN (397-3742)

VOCABULARY

The potential homebuyer will find this vocabulary helpful for understanding words and terms used in real estate transactions. There are, however, some factors that may affect these definitions:

1. Terms are defined as they are commonly understood in the mortgage and real estate industry.
2. The definitions are intentionally general, non-technical and short. They do not encompass all possible meanings or nuances.
3. State laws, as well as custom and use in various states or regions of the country, may modify or completely change the meanings of certain terms defined.

4. Before signing any documents or depositing any money preparatory to entering into a real estate contract, consult with an attorney of your choice to ensure that your rights are properly protected.

Abstract (Of Title). A summary of the public records relating to the title to a particular piece of land. An attorney or title insurance company reviews an abstract of title to determine whether there are any title defects that must be cleared before a buyer can purchase clear, marketable, and insurable title.

Acceleration Clause. Condition in a mortgage that may require the balance of the loan to become due immediately, if regular mortgage payments are not made or for breach of other conditions of the mortgage.

Agreement of Sale. Known by various names, such as contract of purchase, purchase agreement, or sales agreement according to location or jurisdiction. A contract in which a seller agrees to sell and a buyer agrees to buy, under certain specific terms and conditions spelled out in writing and signed by both parties.

Assumption of Mortgage. An obligation undertaken by the purchaser of property to be personally liable for payment of an existing mortgage. In an assumption, the purchaser is substituted for the original mortgagor in the mortgage instrument and the original mortgagor is to be released from further liability in the assumption, the mortgagee's consent is usually required. The original mortgagor should always obtain a written release from further liability if he desires to be fully released under the assumption. Failure to obtain such a release renders the original mortgagor liable if the person assuming the mortgage fails to make the monthly payments. An "assumption of mortgage" is often confused with "purchasing subject to a mortgage." When one purchases subject to a mortgage, the purchaser agrees to make the monthly mortgage payments on an existing mortgage, but the original mortgagor remains personally liable if the purchaser fails to make the monthly payments. Since the original mortgagor remains liable in the event of default, the mortgagee's consent is not required to a sale subject to a mortgage. Both "assumption of mortgage" and "purchasing subject to a mortgage" are used to finance the sale of property. They may also be used when a mortgagor is in financial difficulty and desires to sell the property to avoid foreclosure.

Building Line or Setback. Distances from the ends and/or sides of the lot beyond which construction may not extend. The building line may be established by a filed plat of subdivision, by restrictive covenants in deeds or leases, by building codes, or by zoning ordinances.

Certificate of Title. A certificate issued by a title company or a written opinion rendered by an attorney that the seller has good marketable and insurable title to the property that he is offering for sale. A certificate of title offers no protection against any hidden defects in the title that an examination of the records could not reveal. The issuer of a certificate of title is liable only for damages due to negligence. The protection offered a homeowner under a certificate of title is not as great as that offered in a title insurance policy.

Closing Costs. The numerous expenses that buyers and sellers normally incur to complete a transaction in the transfer of ownership of real estate. These costs are in addition to price of the property and are items prepaid at the closing day. The agreement of sale negotiated previously between the buyer and the seller may state in writing who will pay each of the above costs. On closing day, the formalities of a real estate sale are concluded. The certificate of title, abstract, and deed are generally prepared for the closing by an attorney and this cost charged to the buyer. The buyer signs the mortgage, and closing costs are paid. The final closing merely confirms the original agreement reached in the agreement of sale.

Deed. A formal written instrument by which title to real property is transferred from one owner to another. The deed should contain an accurate description of the property being conveyed, should be signed and witnessed according to the laws of the state where the property is located, and should be delivered to the purchaser at closing day. There are two parties to a deed: the grantor and the grantee. (See also deed of trust, general warranty deed, quitclaim deed, and special warranty deed.)

Deed of Trust. Like a mortgage, a security instrument whereby real property is given as security for a debt. However, in a deed of trust there are three parties to the instrument: the borrower, the trustee, and the lender (or beneficiary). In such a transaction, the borrower transfers the legal title for the property to the trustee who holds the property in trust as security for the payment of the debt to the lender or beneficiary. If the borrower pays the debt as agreed, the deed of trust becomes void. If, however, he defaults in the payment of the debt, the trustee may sell the property at a public sale, under the terms of the deed of trust. In most jurisdictions where the deed of trust is in force, the borrower is subject to having his property sold without benefit of legal proceedings. A few states have begun in recent years to treat the deed of trust like a mortgage.

Default. Failure to make mortgage payments as agreed to in a commitment based on the terms and at the designated time set forth in the mortgage or deed of trust. It is the mortgagor's responsibility to remember the due date and send the payment prior to the due date, not after. Generally, thirty days after the due date if payment is not received, the mortgage is in default. In the event of default, the mortgage may give the lender the right to accelerate payments, take possession and receive rents, and start foreclosure. Defaults may also come about by the failure to observe other conditions in the mortgage or deed of trust.

Downpayment. The amount of money to be paid by the purchaser to the seller upon the signing of the agreement of sale. The agreement of sale will refer to the downpayment amount and will acknowledge receipt of the downpayment. Downpayment is the difference between the sales price and maximum mortgage amount. The downpayment may not be refundable if the purchaser fails to buy the property without good cause. If the purchaser wants the downpayment to be refundable, he should insert a clause in the agreement of sale specifying the conditions under which the deposit will be refunded, if the agreement does not already contain such clause. If the seller cannot deliver good title, the agreement of sale usually requires the seller to return the downpayment and to pay interest and expenses incurred by the purchaser.

Earnest Money. The deposit money given to the seller or his agent by the potential buyer upon the signing of the agreement of sale to show that he is serious about buying the house. If the sale goes through, the earnest money is applied against the downpayment. If the sale does not go through, the earnest money will be forfeited or lost unless the binder or offer to purchase expressly provides that it is refundable.

Easement Rights. A right-of-way granted to a person or company authorizing access to or over the owner's land. An electric company obtaining a right-of-way across private property is a common example.

Encumbrance. A legal right or interest in land that affects a good or clear title, and diminishes the land's value. It can take numerous forms, such as zoning ordinances, easement rights, claims, mortgages, liens, charges, a pending legal action, unpaid taxes, or restrictive covenants. An encumbrance does not legally prevent transfer of the property to another. A title search is all that is usually done to reveal the existence of such encumbrances, and it is up to the buyer to determine whether he wants to purchase with the encumbrance, or what can be done to remove it.

Equity. The value of a homeowner's unencumbered interest in real estate. Equity is computed by subtracting from the property's fair market value the total of the unpaid mortgage balance and any outstanding liens or other debts against the property. A homeowner's equity increases as he pays off his mortgage or as the property appreciates in value. When the mortgage and all other debts against the property are paid in full the homeowner has 100% equity in his property.

Escrow. Funds paid by one party to another (the escrow agent) to hold until the occurrence of a specified event, after which the funds are released to a designated individual. In FHA mortgage transactions an escrow account usually refers to the funds a mortgagor pays the lender at the time of the periodic mortgage payments. The money is held in a trust fund, provided by the lender for the buyer. Such funds should be adequate to cover yearly anticipated expenditures for mortgage insurance premiums, taxes, hazard insurance premiums, and special assessments.

Foreclosure. A legal term applied to any of the various methods of enforcing payment of the debt secured by a mortgage, or deed of trust, by taking and selling the mortgaged property, and depriving the mortgagor of possession.

General Warranty Deed. A deed which conveys not only all the grantor's interests in and title to the property to the grantee, but also warrants that if the title is defective or has a "cloud" on it (such as mortgage claims, tax liens, title claims, judgments, or mechanic's liens against it) the grantee may hold the grantor liable.

Hazard Insurance. Protects against damages caused to property by fire, windstorms, and other common hazards.

Lien. A claim by one person on the property of another as security for money owed. Such claims may include obligations not met or satisfied, judgments, unpaid taxes, materials, or labor. (See also special lien.)

Marketable Title. A title that is free and clear of objectionable liens, clouds, or other title defects. A title that enables an owner to sell his property freely to others and that others will accept without objection.

Mortgage. A lien or claim against real property given by the buyer to the lender as security for money borrowed. Under government-insured or loan-guarantee provisions, the payments may include escrow amounts covering taxes, hazard insurance, water charges, and special assessments. Mortgages generally run from 10 to 30 years, during which the loan is to be paid off.

Mortgage Insurance Premium. The payment made by a borrower to the lender for transmittal to HUD to help defray the cost of the FHA mortgage insurance program and to provide a reserve fund to protect lenders against loss in insured mortgage transactions. In FHA insured mortgages this represents an annual rate of one-half of one percent paid by the mortgagor on a monthly basis.

Mortgage Note. A written agreement to repay a loan. The agreement is secured by a mortgage, serves as proof of an indebtedness, and states the manner in which it shall be paid. The note states the actual amount of the debt that the mortgage secures and renders the mortgagor personally responsible for repayment.

Mortgagee. The lender in a mortgage agreement.

Mortgagor. The borrower in a mortgage agreement.

Plat. A map or chart of a lot, subdivision or community drawn by a surveyor showing boundary lines, buildings, improvements on the land, and easements.

Points. Sometimes called "discount points." A point is one percent of the amount of the mortgage loan. For example, if a loan is for $25,000, one point is $250. Points are charged by a lender to raise the yield on his loan at a time when money is tight, interest rates are high, and there is a legal limit to the interest rate that can be charged on a mortgage. Buyers are prohibited from paying points on HUD or Veterans' Administration guaranteed loans (Sellers can pay, however.) On a conventional mortgage, points may be paid by either buyer or seller or split between them.

Prepayment. Payment of mortgage loan, or part of it, before due date. Mortgage agreements often restrict the right of prepayment either by limiting the amount that can be prepaid in any one year or charging a penalty for prepayment. The Federal Housing Administration does not permit such restrictions in FHA insured mortgages.

Principal. The basic element of the loan. In other words, principal is the amount upon which interest is paid.

Quitclaim Deed. A deed which transfers whatever interest the maker of the deed may have in the particular parcel of land. A quitclaim deed is often given to clear the title when the grantor's interest in a property is questionable. By accepting such a deed the buyer assumes all the risks. Such a deed makes no warranties as to the title, but simply transfers to the buyer whatever interest the grantor has.

Real Estate Broker. A middle man or agent who buys and sells real estate for a company, firm, or individual on a commission basis. The broker does not have title to the property, but generally represents the owner.

Restrictive Covenants. Private restrictions limiting the use of real property. Restrictive covenants are created by deed and may "run with the land," binding all subsequent purchasers of the land, or may be "personal" and binding only between the original seller and buyer. The determination whether a covenant runs with the land or is personal is governed by the language of the covenant, the intent of the parties, and the law in the state where the land is situated. Restrictive covenants that run with the land are encumbrances and may affect the value and marketability of title. Restrictive covenants may limit the density of buildings per acre, regulate size, style or price range of buildings to be erected, or prevent particular businesses from operating or minority groups from owning or occupying homes in a given area. (This latter discriminatory covenant is unconstitutional and has been declared unenforceable by the U.S. Supreme Court.)

Special Warranty Deed. A deed in which the grantor conveys title to the grantee and agrees to protect the grantee against title defects or claims asserted by the grantor and those persons whose right to assert a claim against the title arose during the period the grantor held title to the property. In a special warranty deed the grantor guarantees to the grantee that he has done nothing during the time he held title to the property which has, or which might in the future, impair the grantee's title.

Survey. A map or plat made by a licensed surveyor showing the results of measuring the land with its elevations, improvements, boundaries, and its relationship to surrounding tracts of land. A survey is often required by the lender to assure him that a building is actually sited on the land according to its legal description.

Title. As generally used, the rights of ownership and possession of particular property. In real estate usage, title may refer to the instruments or documents by which a right of ownership is established (title documents), or it may refer to the ownership interest one has in the real estate.

Title Insurance. Protects lenders or homeowners against loss of their interest in property due to legal defects in title. Title insurance may be issued to a "mortgagee's title policy." Insurance benefits will be paid only to the "named insured" in the title policy, so it is important that an owner purchase an "owner's title policy", if he desires the protection of title insurance.

Zoning Ordinances. The acts of an authorized local government establishing building codes, and setting forth regulations for property land usage.