HOME BUYING

PERSONAL FINANCIAL MANAGEMENT STANDARDIZED CURRICULUM - 2010

HOME BUYING

MODULE DESCRIPTION

Buying a house is the most significant purchase many people will ever make. This workshop is designed to increase the knowledge and comfort level of first-time homebuyers and serve as a refresher for repeat homebuyers.

Command Financial Specialists, Fleet and Family Support Center personnel, military housing personnel or a panel that includes a real estate agent, a mortgage lender and an insurance agent could teach this workshop. If taught in a panel format, guest speakers must agree not to solicit.

This module can easily be two hours long, and instructors may want to have a 15-minute break in the middle.

LEARNING OBJECTIVES

Terminal: Upon completion of this course, learners should be able to:

- Determine what type of home they want and how much they can afford.
- Choose a real estate agent and mortgage.
- Negotiate and close on the deal.

Enabling:

- Learners will correctly calculate their debt-to-income ratio given the *Debt-to-Income* worksheet.
- Using a role-play exercise, learners will illustrate the factors that mortgage lenders consider when approving or disapproving a loan.
- During a mock interview activity, learners will practice interviewing real estate agents.
- Learners will correctly answer 10 fill-in-the-blank questions on contracts, negotiation and closings.

Print Module

Print Module Handouts

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MODULE PREPARATION

Handouts:

- *Financial Planning Worksheet*
- *Setting Your Price Range*
- *Figuring Your Monthly Payment*
- *Calculating Your Debt-to-Income Ratio*
- *Checklist for Financing Your Purchase*
- *Mortgage Shopping Worksheet*
- *Interviewing Agents*
- *Checklist for Your House Hunt*
- *Ten Important Questions To Ask Your Home Inspector*
- *Closing the Deal*
- *Requesting a Quote for Homeowners Insurance*

Materials (varies depending on activities chosen)

- Paper
- Masking tape
- Pencils
- Calculators
- Copies of the *Mortgage Lending Role Play* script

SUMMARY OF LEARNER ACTIVITIES

***Are You Ready?* (optional):** An exercise for learners to assess their readiness to purchase a home.

***The Imaginary Line*:** Learners physically place themselves on an imaginary line to rank the importance of selected house features.

Calculating Your Debt-to-Income Ratio: Worksheet activity in which learners calculate their debt-to-income ratio.

Mortgage Lender Role Play: Role-play activity in which learners use prescripted scenarios to simulate the mortgage application process to show the factors mortgage lenders consider when approving or disapproving a loan.

Practice Interview: A mock-interview activity for learners to practice interviewing real estate agents.

Closing the Deal: A quiz activity in which learners test their comprehension of contracts, negotiation and closings.

***Home Buying Summary* (optional)**: A multiple-choice content review game..

CONTENT OUTLINE

1. Welcome and Introduction
   a. Agenda
   b. Optional Learner Activity: *Are You Ready?*
2. Are You Ready to Buy?
   a. Renting Versus Buying
   b. What Type Of Home Is Right For You?
   c. Location, Location, Location!
   d. Needs Versus Wants
   e. Learner Activity: *The Imaginary Line*
3. What Can You Afford?
   a. Calculate Your Budget
   b. Debt-to-Income Ratio
   c. Learner Activity: *Calculating Your Debt-to-Income Ratio*
   d. Credit Reports and Scoring
   e. Other Factors Influencing Financing
   f. Down Payments
4. Lenders and Loans
   a. Choosing a Lender
   b. Choosing a Mortgage Loan
   c. Borrower Beware
   d. The Mortgage Application Process
   e. Learner Activity: *Mortgage Lender Role Play*
5. Selecting a Real Estate Agent
   a. Real Estate Professionals

b. Interviewing Agents
c. Learner Activity: *Practice Interview*
d. Can You Do It Yourself?
e. Beginning the Search

6. Negotiating the Deal
   a. Property Values
   b. Home Inspection
7. The Closing
   a. Closing Costs
   b. Prepaid Costs
   c. The Closing
   d. Reducing Payback Time
   e. Learner Activity: *Closing the Deal*
8. Homeowner's Insurance
   a. Minimal Coverage
   b. Additional Coverage
   c. Reducing Premium Costs
9. Summary
   a. Optional Learner Activity: *Home Buying Summary*

CONTENT

WELCOME AND INTRODUCTION

SLIDE 1

A home is one of the most complicated and expensive purchases you will ever make. Getting the best deal on the purchase can reduce “life-of-the-loan” costs by thousands of dollars. This program will provide complete, objective and unbiased information so prospective military homebuyers will be confident in their decision to purchase a home, and be better able to negotiate the potential financial pitfalls they may encounter during the home-purchase process.

AGENDA

SLIDE 2

Some of the topics this workshop will cover include:

- Are you ready to buy?
- What can you afford?
- Lenders and loans
- Selecting a real estate agent
- Negotiate the deal
- Closings
- Homeowner’s insurance

Optional Learner Activity: Are You Ready?

Purpose: A brief opening exercise to get learners to introduce themselves and assess their readiness to purchase a home.

Time: 5-10 minutes

Preparation: Make two small signs, one saying “I’m Not Sure I Even Want to Buy a House” and one saying “I’ve Already Got a Contract on a House.” Post them on opposite sides of the training space.

Procedure: Ask learners to introduce themselves to the class. State, “Let’s go around the room and do quick introductions. Please tell everyone your name and tell us, on a scale of 1 to 10, with 1 being ‘I’m Not Sure I

Even Want to Buy a House,' and 10 being 'I've Already Got a Contract on a House,' where you are on the scale." Comment as appropriate

Close the activity by telling learners that by the time they leave this workshop they will feel much more comfortable with the home buying process.

Option: An optional way to conduct this activity would be to post a sign at each end of the training space or along a wall with the beginning and end of the scale on it ("I'm Not Sure I Even Want to Buy a House" and "I've Already Got a Contract on a House"). Have learners stand at a location somewhere between the signs that best indicates their readiness to purchase. While they are standing, they can introduce themselves to each other and the rest of the class. Conducting the activity in this way will increase their comfort level with the *Imaginary Line* activity coming up next.

SLIDE 3

ARE YOU READY TO BUY?

To evaluate whether renting or buying is best for your family, consider some of the pros and cons of each choice.

Trainer's note: Engage the learners by eliciting pros and cons from them on renting versus buying.

Renting Versus Buying

Renting may be a better choice if…

- You move a lot. Unless you live in one place at least a few years, you may lose money when selling your home. If you cannot sell, you may become a landlord by having to rent your home.
- You are unfamiliar with the area. Before taking the plunge and buying a home, you may want to identify a neighborhood and rent there first to determine its long-term desirability.
- You do not have enough money saved to cover the down payment and initial costs involved in purchasing a home. Renting a while to save for a down payment and closing costs makes sense.
- You do not care to commit the time, effort and expense of maintaining a home. The costs of maintaining a home greatly exceed those of renting. If you could not imagine fixing a backed-up drain in the bathtub yourself, you should rent.

- You prefer more fixed expenses. There are a lot of variable, unplanned expenses when you own a home.
- You do not want to lose any equity (you will not gain any, either).
- You do not mind living in a impersonal dwelling. Often with renting you take the dwelling as-is, and the landlord may not be willing to let you paint or change anything.
- You do not need or want the tax advantages that come with owning a home.
- You do not want to be a landlord. If you buy a home and have to move, you may be unable to sell it for a profit or be unable to sell it at all (depending on the home, location, market, etc.). As a result, many military homeowners become landlords. If you do not want to be a landlord, renting may be better.

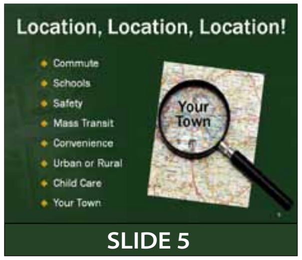
Buying may be better if…

- You want your equity to grow. If you are moving to an area that enjoys high appreciation in the value of residential property, your equity can grow and offset the costs of selling should you be transferred. Equity in a home is also an excellent source of retirement income, because the mortgage is paid off and equity in the home grows.
- You can afford to buy a home that will allow you to itemize deductions on your tax return. The home must be expensive enough that the interest paid and real estate taxes nearly equal or exceed the standard deduction.
- You are ready for stability and a sense of community. Buying a home automatically commits you to a region and a neighborhood. You become interested in the zoning laws, the tax rates, the city or county's plans for expansion and growth, and the appearance of your neighbor's property.
- You do not mind the possibility of becoming a landlord.
- You have money for the large initial investment involved in buying a home.
- You like to remodel and personalize your home.

What Type Of Home Is Right For You?

Your goals might seem obvious — your growing family needs a larger home or you need a place to live. Once you have made the decision to buy, you need to determine what type of house you want to purchase.

- Do you want a condominium, a duplex or a single-family home?
- Do you desire an older home or new construction?
- Do you prefer a ranch or two-story homes?
- How big of a home do you need or want: 1,500 square feet, 3,000 square feet, more or less?
- How many bedrooms do you need, and how many do you want?
- Big backyard or no lawn to mow?



Location, Location, Location!

There are many factors that go into determining the perfect location for a home.

- How far to work? Many people have strong feelings about the distance they drive from home to work. This defines the areas where they are willing to look for a home.
- What is the school system like? Do you have school-age children? Contact the local school administration or go online to determine which schools can meet your child's academic, athletic or special needs. If you do not have children, still consider the local school system, because that will affect the resale value of the home.
- How safe is the neighborhood? Contact the local police department to get crime statistics for different neighborhoods.
- City, suburb or country? How close do you want your neighbors to be?
- Will you need to use mass transit?
- Is child-care available?
- How close are schools, libraries, parks, shopping, highways, hospitals, fire stations and other services?

Sit down with the family and talk about your dream house. Make a list. Try to balance your needs and wants. Start by thinking about your present home and identify which features you really like.

Needs Versus Wants

Next, envision your new home and try to build it in your mind. Does it have more bedrooms than your present home or a workbench in the garage, a fireplace, a gas stove or an electric stove? Take the list you have created and divide it into "needs" and "wants." The "needs" list will narrow your search by eliminating the houses that are wrong for you. Your "wants" list will help you choose among the remaining possibilities. Examples of both include:

Needs

- Enough square footage for comfortable living
- Enough bedrooms to accommodate your family
- An adequate number of bathrooms
- An eat-in kitchen
- A garage or basement for storage needs
- Lot size to accommodate a children's play area
- Adapted to accommodate disabled family members
- Proximity to a specific school
- All living areas on a single floor due to health reasons

Wants

- Specific materials, paint colors, roof type, etc.
- Pool, Jacuzzi or hot tub (unless it is for medical reasons)
- Wood floors (unless it is for medical reasons)
- Bay windows or vaulted ceilings
- Specialty fixtures

Trainer's note: In lieu of giving a lecture on needs versus wants, you can use the Imaginary Line activity to cover the material and get learners involved.

- Granite countertops
- A great view, water view, seaside view, etc.
- Specific brand or type of appliances

It is common to hear that the three most important considerations in purchasing a home are *location, location and location*. Here are some steps to research the best locations:

- Find a good city map and the classified ads section of your local newspaper or the real estate section of the newspaper's website.
- Survey prospective neighborhoods.
- Get to know various areas by selecting a dozen homes from the ads and make a day of visiting them. The goal is not to find *the* house but to narrow your search to the most desirable neighborhood.
- Remember: It is much easier to fix up a house than a neighborhood.

Learner Activity: The Imaginary Line

Purpose: A short brainstorming exercise that helps learners focus in on their own needs and wants.

Time: 10-15 minutes

Preparation: Paper, pencils or pens, two small signs reading, "Must Have" and "Not Necessary" posted at opposite sides of the training space.

Procedure: Divide learners into small groups of five or six. Explain that as a group they are going to design their own perfect house. Ask each group to make two lists — one list of "needs" for their house (absolute must-haves) and one list of "wants" for their house. Tell learners you realize that everyone will not agree but encourage them to come to a consensus in their group. Individuals will have an opportunity to express their own personal views in a few minutes. After about seven minutes of group work, ask each group to share their needs and wants. The instructor should record the responses on a board or chart paper. Group responses will vary and may include any of the items listed in the content material.

Next, depending on the size of your audience and training space, have learners line up along the wall where the "Must Have" and "Not Necessary" signs are posted. If you have a large audience, select 10 to 15 people to participate in this activity while the rest watch.

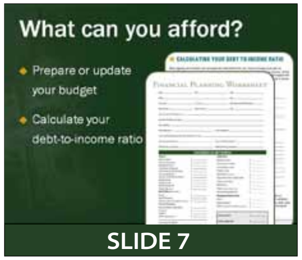
Tell learners, "Imagine this wall is a continuum. The left side of the room indicates an item is not important to you. As you move to the right side of the room, the item becomes more desirable.

The far left corner of the room is Not Necessary and the far right of the room is a Must Have. You may line up somewhere in the middle if the item I mention does not matter to you. As I say an item, place yourself on the continuum of how important the item is to you." (You can use the following list or some of the suggestions from the group brainstorming work.)

- Three bedrooms
- Two-story house
- House in a good school district
- House has a yard of 1 acre or more
- Formal dining room
- Deck
- Garage
- Fireplace
- Basement
- Right price

As you work through the list, note the differences in what learners in the workshop see as a need versus a want. If there aren't many differences, note that as well and comment on how this group has similar needs and wants. Invite learners to take their seats and suggest that as a group — and individually — they put some needs and wants in writing. Tell them that putting needs in writing and keeping this list with them will keep them focused throughout the home-buying process.

WHAT CAN YOU AFFORD?



Calculate Your Budget

You have decided to buy a house and determined your needs. Now you have to ensure your finances are in order before you begin looking at houses. If you do not already keep track of your income and expenses with some type of written budget, then your next step should be to take a long, accurate look at your family's income and expenses. How can you know how much you can afford if you do not know how much you spend? Use the *Financial Planning Worksheet* to construct your budget or cash flow statement. If you need help, make an appointment with your Command Financial Specialist or plan to attend the "Developing Your Spending Plan" workshop at your local Fleet and Family Support Center.

With the information from your budget, use the *Setting Your Price Range* handout to determine the price limits for your home search. Considering homes that are beyond a comfortable price limit will only result in frustration and wasted energy. The upper limit of your price range is the mortgage loan amount for which you qualify. However, keep one thing in mind — you may not want to purchase a home whose price is at your upper limit — some people refer to that as being "house rich and cash poor." Make an honest assessment of your lifestyle. There may be other things you like to do rather than put most of your budget into house payments and maintenance. You can use the handout *Figuring Your Monthly Payment* to determine what the monthly payment would be for any loan amount, or use an online calculator to help you crunch the numbers. Be advised that your mortgage payment will include Principal, Interest, Taxes and Insurance (PITI).

Debt-to-Income Ratio

Many lenders use a 28/36 qualifying ratio. This means that your mortgage payment (PITI plus any homeowners dues) should not exceed 28 percent of your gross monthly income. All monthly debt obligations, including your mortgage payment and other recurring debt, should not exceed 36 percent of your gross monthly income. The Department of Veterans Affairs and many other lenders will allow a higher monthly debt-to-income ratio than you may find comfortable, as high as 29/41. With these ratios, you can determine whether you are financially ready to take on a mortgage payment, or if you need to pay down some of your other recurring debt first.

Learner Activity: Calculating Your Debt-to-Income Ratio

Time: 10 minutes

Materials: *Debt-to-Income Ratio* handouts, pencils and calculators

Procedure: Distribute handouts and tell learners that you will now give them an opportunity to calculate their own debt-to-income ratio. Explain that they will estimate their income and payments. If they do not know specific figures, instruct them to use estimated figures and fill in the correct amounts at home. Reinforce that lenders use the debt-to-income ratio to help them decide if they will extend credit.

1. Have learners estimate their annual gross income and enter the amount on this line.
2. Have learners divide their annual gross income by 12 to calculate their monthly gross income, and enter the amount on this line.
3. Have learners multiple their monthly gross income, line 2, by .28 and enter the amount on this line. Explain that this is their estimated house payment.
4. Have learners multiple their monthly gross income, line 2, by .36 and enter the amount on this line. Explain that this is the total amount of all debt payments they should have to be within safe debt limits.
5. Have learners add up all of their monthly debt payments, including the estimated house payment they calculated on line 3, and enter the total on this line.
6. To calculate their current debt-to-income ratio, including their estimated house payment, have learners divide the amount on line 5 by the amount on line 2 and multiple the result by 100.

Ask learners to compare their current debt-to-income ratio with the recommended level of 36% — how does it compare? If it is too high, can they lower their debt? Are they willing to purchase a home for a lower payment than what they estimated in line 3?

SLIDE 8

Credit Reports and Scoring

Before applying for a mortgage loan, obtain a copy of your credit report. Americans can get one free credit report a year from all three credit reporting agencies by going to <http://www.annualcreditreport.com>. Lenders base mortgage loan decisions on both your credit score as well as their own professional judgment of your ability to repay. Their judgment may be based on the application you fill out, which will list income, expenses and assets, as well as a personal interview. Credit scores, compiled by credit scoring companies such as Fair Isaac Corp. (FICO) use information from your credit report. The score is based on a number of factors:

- 35 percent, payment history
- 30 percent, amounts owed
- 15 percent, length of credit history
- 10 percent, types of credit in use
- 10 percent, new accounts

Payment history considerations include:

- The number of accounts paid as agreed.
- Delinquent accounts:
    - The length of past-due status.
    - The total number of past-due items.
    - How long it has been since you had a past-due payment.
- Negative public records or collections.

Amounts you owe:

- How much you owe on accounts and the types of accounts on which you carry balances.
- How much of your available credit you have used (an indicator or your capacity to take on additional credit obligations).
- Amounts you owe on installment loan accounts versus their original balances (are you paying them down consistently?).

Trainer's note: If you can contact the learners in advance of the training, request that they bring a current copy of their credit report to the workshop. They can refer to their report as you cover the teaching points about credit reports and scoring.

- Number of zero-balance accounts.

Credit history length:

- The total length of time tracked by your credit report.
- The length of time since accounts were opened.
- The time that has passed since the last activity.
- The longer your (good) history, the better your scores!

Types of credit you use:

- The total number of accounts and types of accounts (installment, revolving, mortgage).
- A mixture of account types usually generates better scores than reports with only numerous revolving accounts (credit cards).

New credit:

- The number of accounts you have recently opened and the proportion of new accounts to total accounts.
- The number of recent credit inquiries.
- The time that has passed since recent inquiries or since new accounts were opened.
- If you have re-established a positive credit history after encountering payment problems.
- In general, checking to make sure you are not opening numerous new accounts.

SLIDE 9

What is a Good Score?

Credit scores usually range from 300 to 850. The higher your score, the less risk a lender believes you will be. As your score rises, the interest rate you are offered probably will decline. The U.S. average credit score in 2009 was about 692.

Here's an overview of credit scores among the US population in 2009:

- Up to 499: 2 percent

- 500-549: 5 percent
- 550-599: 8 percent
- 600-649: 12 percent
- 650-699: 15 percent
- 700-749: 18 percent
- 750-799: 27 percent
- More than 800: 13 percent

Other Factors Influencing Financing

As we mentioned earlier, credit-scoring software only considers items in your credit report. Lenders also will look at other factors that are not included in the report, such as income, specific employment history and the type of credit you are seeking. Based on all of this information, what do you think lenders are looking for in the perfect customer? A high credit score, which means a low level of recurring debt, a long history of repaying on time, steady and reliable employment, and sufficient assets, such as money in savings or investments, are some of the big things they like to see.

SLIDE 10

Down Payments

Another factor that influences financing is a down payment, or the money you agree to pay, usually in a cashier's check, at the time of purchase toward the price. Your down payment will probably affect your price range because the loan amount is based on the purchase price minus the down payment.

Typical down payments requirements for various loans are:

- Conventional: 20 percent of the loan amount, with a minimum requirement of 5 percent to 10 percent. Conventional loans are not guaranteed or insured by the federal government.
- Federal Housing Administration (FHA):
  - 3 percent to 5 percent

  - Available in all 50 states
  - Government insured
- Veterans Affairs (VA)
  - No down payment required
  - Loan amounts are generally higher than FHA
  - Both FHA and VA maximum loan amounts change periodically
  - Guaranteed by the Department of Veterans Affairs

LENDERS AND LOANS

SLIDE 11

Choosing a Lender

Finding a reputable lender with a variety of mortgages and attractive loan rates is important. Friends and co-workers can be an excellent source for finding a lender you are comfortable with. Your real estate agent also will make recommendations. Use a lender that offers several options, is knowledgeable about those options and takes the time to explain them to you.

The *Checklist for Financing Your Purchase* handout has the typical steps involved in obtaining a mortgage, including a list of documents to bring with you when you visit a lender. The *Mortgage Shopping Worksheet* handout provides an extensive list of variables you can use to compare loans and lenders.

When comparing loans, pay special attention to:

Annual Percentage Rate (APR): The total interest rate of a mortgage, including the stated loan interest as well as any up-front interest paid in starting the loan.

Discount points: A discount point is 1 percent of the loan amount, paid at closing; the lower the interest rate, the higher the number of points. Go for the lowest APR possible. A low APR is an attractive feature when it comes time for you to sell. Be sure you will own the house long enough to recover the cost of the points. In your offer to purchase, ask the seller to pay most of the points. If the seller will not pay points and you must have that house — and the lender will allow you to fold the points into the

Trainer's note: Distribute the handouts *Checklist for Financing Your Purchase* and the *Mortgage Shopping Worksheet*. Refer to them as the topics arise in the lecture.

loan — offer the seller a higher selling price, which includes the amount of the points. This allows you to finance the points, which adds to the tax-deductible amount of interest you pay.

Loan-origination fee: A loan-origination fee is a charge imposed by the lender for processing the loan and is payable at closing. The loan-origination fee is generally about 1 percent of the loan amount and is applied toward the lender's cost of making the loan. The buyer usually pays it. You may negotiate the payment of points and loan origination fees with the lender. In a hot buyers' market, many sellers will pay all or some of these closing costs.

Lock-in options: Lenders may offer different options to lock in the interest rate at the time you apply for the mortgage. Lenders usually honor guaranteed lock-in rates for a specific time, such as 45 or 60 days or more. If you close the transaction within that period, the lender guarantees to provide the interest rate you locked in, regardless of whether the rates rise or fall during the interim. Be sure to get a written lock-in agreement if you choose to lock in your rate. If rates are anticipated to fall before you close on the loan, you may prefer to let the interest rate and points "float," to give them time to go down.

Choosing a Mortgage Loan

There are many types of loans to choose from. A bank or credit union, and many educational and mortgage websites, can help you determine the best type of loan for you. Mortgage calculators can help you determine how much loan you can afford, what your monthly payments will be and can evaluate the different types of loans available. Common loan types include:

Fixed-rate loans: These are the most popular loans because they offer stable, consistent payments throughout the life of the loan. The most common is the 30-year fixed rate. Other options are the 15-year (save half the interest over a 30-year), the 20-year (saves thousands of dollars of interest over the 30-year), and the relatively new 40-year (reduces the payment below a 30-year but adds three times the loan amount in interest).

Adjustable-rate loans: These loans have a variable interest rate that fluctuates according to the financial index they are tied to and the type of adjustable-rate mortgage obtained. Some features that make them attractive, even when the fixed interest rate is low:

- The first-year rate (the teaser rate) is usually one or two points below the market rate.
- The interest rate is capped. It can rise only five or six points, depending on whether it is an FHA or conventional loan, over the life of the loan.
- The increase in interest rate is limited to one or two points a year, depending on type of loan.
- Research indicates that less interest is paid with an ARM than with a 30-year fixed-rate mortgage.
- Best for homebuyers who stay in a home no more than five to seven years.

FHA loans: Government-backed Federal Housing Administration loans are designed for first-time or lower-income homebuyers. The interest rate is usually less than conventional loans. FHA loans are available as fixed-rate and adjustable-rate mortgages. The down payment is 3 percent to 5 percent of the loan amount. There are limits to the maximum loan amount.

VA loans: These loans are available to veterans of the U.S. armed forces and backed by the Department of Veterans Affairs. Have your lender check the current VA funding fee. No down payment is required. The seller must pay points. If seller is reluctant to pay points, the buyer can increase offering price to include the cost of points. Congress controls maximum loan amounts. Check with your lender for current maximums. You may want to explore other mortgage loan options rather than use your VA entitlement. If you have to sell and a buyer comes along who wants to assume your mortgage, your VA entitlement will be unavailable to you until that mortgage is cleared by a home sale with a substitution of a new mortgage.

Assumptions: Consider assuming the seller's existing loan and interest rate if the rate on the assumable loan is lower than the prevailing rate for a new loan. By assuming a loan, you take responsibility for paying the mortgage owed by the seller.

SLIDE 13

Buy-down: If you cannot afford the prevailing interest rate, consider a buy-down mortgage. The seller or even a family member can pay extra points to buy down the mortgage for the first few years. For example, a 3-2-1 buy-down with a prevailing rate of 7 percent means that the first year you would pay 4 percent, the second year 5 percent, the third year 6 percent, and then in the fourth and remaining years the interest rate would be 7 percent.

Note: Buy-downs are common among new construction and first-time homebuyers.

Step loans: These combine the stability of a fixed-rate loan with the lower rates of an ARM. There are two options: 5/25 and 7/23: The interest rate is fixed for the first five or seven years, and then the loan adjusts once into a one-year ARM or a fixed-rate loan. Step loans offer lower interest than the prevailing rate for 30-year fixed-rate mortgages.

Balloon loans: Interest paid during the term of the loan does not fully pay off the mortgage. At the end of the loan term, the homeowner must pay the remaining principal in one lump sum. Balloon loans usually have lower interest rates than fixed-rate loans. Balloon loans are most useful to homebuyers who stay in home no more than the term of the loan but typically are not a good choice for a first-time homebuyer.

Seller financing: The seller takes on the role of lender and gives the buyer a loan to purchase the property. Generally, the seller owns the property outright and can finance the entire purchase or has significant equity and can "carry back" a second mortgage, which can be used to finance the buyer's down payment. The best bets for seller financing are elderly homeowners who do not need the cash from the sale of their home to finance their next home. The advantage for buyers is they get the prevailing interest rate or a better rate without paying points or fees. The advantage for sellers is they get a higher return on their money from the sale and receive a monthly stream of income.

State veterans program: Many states offer veterans benefits. These benefits may include educational grants and scholarships, special exemptions or discounts on fees and taxes, home loans, veteran's homes, free hunting and fishing privileges, and more. Each state manages its own benefit programs. Be sure to take advantage of the benefits you have earned by linking to your state department of veterans affairs.

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BORROWER BEWARE

The following practices and terms fall under the "predatory lending" category. Protect yourself by being aware of and avoiding these practices.

Interest-only mortgage: An interest-only mortgage allows you to pay only the interest for a specified number of years. Since there is no payment on the loan principle, a borrower who takes this type of loan is depending on the housing market to increase the value of the home. Most interest-only mortgages have adjustable interest rates, which means the interest rate and monthly payment will change over the term of the loan. The interest-only mortgage payment period is typically between three and 10 years. After that, your monthly payment will increase even if interest rates stay the same, because you must pay back the principal as well as the interest.

80/20 mortgages: An 80/20 mortgage is essentially two mortgage loans, which equal the total amount of the purchase price with the first mortgage being 80 percent and the second mortgage covering the remaining 20 percent. The first is typically at the going rate for a conventional mortgage, the second is usually significantly higher.

Subprime lending: Subprime lending, also called "B-Paper," "near-prime" or "second chance" lending, is a general term that refers to the practice of making loans to borrowers who do not qualify for market interest rates because of problems with their credit history. A subprime loan is offered at a rate well above the prime rate, which is a benchmark that banks set for establishing interest rates for other loans. Subprime lending encompasses a variety of credit instruments, including subprime mortgages, subprime car loans and subprime credit cards.

Subprime lending is typically defined by the status of borrowers. A subprime loan is made to someone who could not qualify for a more favorable rate. Subprime borrowers typically have low credit scores and histories of payment delinquencies, charge-offs or bankruptcies. Because subprime borrowers are considered at higher risk to default, subprime loans typically have less-favorable terms than their traditional counterparts. These terms may include higher interest rates, regular fees or an up-front charge.

Some common practices in the subprime market include:

- Excessive fees (fees of 5 percent or more are common).
- Abusive pre-payment penalties.
  - Effective for more than three years.
  - Cost more than six months of interest.
  - Only 2 percent of prime loans have prepayment penalties, while 80 percent of subprime loans have them.
- Kickbacks to brokers (yield spread premium).
- Loan flipping.
- Unnecessary products.
- Mandatory arbitration.
- Steering and targeting.

You can learn more about these loan products and how to avoid them at the Center for Responsible Lending <http://www.responsiblelending.org>.

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THE MORTGAGE APPLICATION PROCESS

Pre-qualification: Pre-qualifying is an informal way to see how much you may be able to borrow. You can be pre-qualified over the phone with no paperwork by telling a lender about your income, your long-term debts and how large a down payment you can afford. Without any obligation, this helps you arrive at an estimate of the amount you may have available to spend on a house. Prequalifying helps you figure your budget and the type of loan that would work best, but it is not a guarantee that a loan will be made. It usually takes only one or two hours to get pre-qualified, depending on the complexity of your finances.

Get pre-approved: Sellers like pre-approved buyers, because they know such buyers can get the money to purchase their house. This can work in your favor by putting you in a better negotiating position. Pre-approval, however, is different from pre-qualifying. Pre-approval is a lender's actual commitment to lend to you. It involves assembling the financial records and going through a preliminary approval process. Pre-approval gives you a definite idea of what you can afford and shows sellers you are serious about buying.

Formal application: If a buyer is not pre-approved when the offer to purchase is accepted by the seller, the buyer is expected to formally apply for financing within three to five days. If you have already pre-qualified, application time is minimal. If you have been pre-approved, then processing of your loan begins.

Processing time: Processing for conventional loans can take four to six weeks; for VA and FHA loans, it can take six weeks to two months. In some situations, processing can be sped up depending on successful completion of a title search, home inspection, termite inspection, well inspection, etc.

Learner Activity: Mortgage Lender Role Play

Purpose: To demonstrate the factors mortgage lenders consider when approving or disapproving a loan.

Time: 10-15 minutes

Preparation: Place three chairs in front of the class at an angle. Make four copies of the *Mortgage Lender Role Play Script*.

Procedure: Ask for three learners to volunteer to be mortgage lenders. Tell them that all they have to do is listen to the request for a loan and give a "thumbs up" gesture if they would lend the borrower money or give a "thumbs down" gesture if they would not. Lenders may not talk during the activity. Ask four other learners to come to the front of the room one at a time and read the script they have been given.

As each borrower is approved or not approved, briefly discuss the factors the lenders used in making their decision. When all four have gone, thank the learners and invite them to return to their seats.

Mortgage Lender Role Play Script

Potential Borrower 1

As you can see from my application, I am 26 years old, married for five years and have two kids. I was in the Navy for four years and got out last year. Since then, I've worked a couple of different jobs. We've lived in our apartment for two years. I've occasionally paid bills as late as sixty days past their due date, but I'm currently up-to-date on all three of my department store cards and both of my car loans. My wife does not work because the kids are young. We'd like to move into a house in the country to raise our boys. Will you give me a home loan?

Potential Borrower 2

I am divorced. I have been in the Navy for 12 years. I currently live on the ship but am planning to remarry and would like to buy a house for my wife. I had outstanding credit until three-and-a-half years ago. While on deployment in Afghanistan, my former spouse opened up a bunch of charge cards without my knowledge. She didn't pay any of our bills. When I got back from deployment, I found my car had been repossessed and the bank was foreclosing on my house. I had to file Chapter 13 bankruptcy. My finances are OK now. Will you loan me money to buy a house?

Potential Borrower 3

I'm 20 years old. I joined the Navy nine months ago. I am single and currently live on the ship. I have never had a loan or a credit card, unless you count the $1,000 my dad loaned me when I was 16 to buy a drum set. I paid it back in full, but it took two years.

My grandma recently died and left me some money. I'd like to buy a condo in town, but I need a loan in addition to the money my grandma left. Will you give me a loan?

Potential Borrower 4

I have been in the Navy for 14 years and married for 10. I have two kids and a dog. I have two credit cards that I pay in full each month. My car payments are done next month. I own a small home that we've lived in for the past five years. My spouse works, but we try to live on my check and put hers in savings. We'd like to get a bigger house. Will you lend us the money?

SELECTING A REAL ESTATE AGENT

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REAL ESTATE PROFESSIONALS

A real estate agent can help:

- Target suitable neighborhoods.
- Tell you which homes are available.
- Identify their cost.
- Compare the cost per square foot of nearby homes that have recently sold.
- Assess your financial situation.
- Manage the myriad details of your purchase.

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Professionals associated with real estate include:

Principal broker: A self-employed individual who is licensed to operate a real estate office. May work independently or hire other agents. All real estate professionals must work under a principal broker's license.

Realtor: A member of the National Association of Realtors, a state Realtor's association and a local Board of Realtors. The Realtor's Code of Ethics also binds them. Realtors may access the Multiple Listing Service (MLS), a local computerized database of for-sale homes, unavailable to most non-Realtors. Through the MLS, a Realtor can give you a detailed printout on each listed home you plan to consider.

Agent: The generic name for any licensed real estate professional (e.g., broker, Realtor). The three kinds of agents are:

- **Listing agent**: Signs up the home seller with a broker and "lists" the home with the MLS. As a buyer, you may never meet the listing agent. When the house sells, both the listing agent and the selling agent split part of their commission with their respective brokers.
- **Selling agent**: Usually learns about the for-sale house through the MLS, then finds the buyer. This agent works with the buyer but legally represents the seller and must get the best possible deal for the seller.

- **Buyer's agent**: Helps the buyer find the house, terms and conditions most favorable to the buyer. The relationship is defined in a contract. Buyer's agents usually split part of their commissions with their brokers or may charge a fee for services.

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INTERVIEWING AGENTS

No matter what kind of agent you use, take the time to find one you are comfortable working with. The *Interviewing Agents* handout lists information you should get from an agent before agreeing to work with them.

Trainer's note: Pass out the *Interviewing Agents* handout to learners.

Look for the agents and companies that have the most signs in the neighborhoods you like. However, the agent with the most for sale signs in the neighborhood may not be the best to work with buyers. They tend to concentrate on listing property.

Ask the managing broker to pair you with an agent who likes working with buyers. Ask friends and co-workers for a personal recommendation. It is still the best way to find a good agent.

Look for solid credentials. Find someone who listens well and can translate your wishes into homes and neighborhoods you like.

Do not be pressured to choose a neighborhood that does not suit you or a house after visiting only four or so prospective properties. Drop that agent and find another.

Once you have decided upon an agent:

- Arrange a meeting with the agent and your family to discuss house-hunting goals. The more the agent knows about your family, the more effective the home search.
- Review positive features of your previous homes.
- Discuss areas you have visited and ask for recommended neighborhoods you have not seen yet.
- Have the agent recheck your loan qualifications or pre-approval. Armed with this information, the agent will arrange appointments for you to see homes in your price range.

Learner Activity: Practice Interview

Purpose: To help learners feel comfortable conducting interviews and make better choices when selecting a real estate agent.

Time: 5 minutes

Materials: *Interviewing Agents* handout

Procedure: After reviewing the information in this section, give learners the chance to practice. Ask learners to turn to their neighbor and ask some of the questions on the handout. Allow a few minutes for the interview and, if time permits, have the couples switch roles. After five minutes, stop the interviews and ask learners how the exercise worked for them. Explain that practicing will help them make better choices when they choose their real estate agent.

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Can You Do It Yourself?

Many people prefer not to use a real estate agent to help them buy a home. The Internet is a helpful source. Also, networking with family and friends can help you find the right home for sale. Other sources include:

FSBO: This acronym stands for "For Sale by Owner." These homes can be excellent buys but are more difficult to find since they are not listed in the MLS and are not shown by agents. They are usually advertised in the newspaper or online (check <http:www.fsbo.com>, <http://www.craigslist.com> and <http://www.militarybyowner.com>, for starters). If you have found a house you wish to buy directly from its owner, you should seek the help of an attorney who specializes in real estate transactions.

Rent to own: Many rental properties give the option of purchasing the home and will even apply rent payments to the purchase price.

Foreclosures: Foreclosures can be downright bargains. Look in the newspaper for houses for sale by the Department of Veterans Affairs (VA), Department of Housing and Urban Development (HUD), Federal Housing Administration (FHA), Resolution Trust Corporation (RTC), Federal Deposit Insurance Corporation (FDIC) and other government agencies. Some local lenders may have foreclosed properties for sale. These are called Real

Estate Owned (REO). Some come with excellent terms; others are sold at public auctions and require cash payment or a letter of credit. Many foreclosures need repairs ranging from cosmetic to structural. Ask your local agent for lists and acquisition information.

Multiple Listing Service (MLS): Most real estate sales are listed in a Internet-based system called the Multiple Listing Service. The MLS is accessible to anyone at <http://www.mls.com>.

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Beginning the Search

Remember the Latin principle of commerce, caveat emptor (let the buyer beware). The *Checklist for Your House Hunt* handout will help you evaluate features you like — and dislike — in a home. It can help you develop your "needs" and "wants" list.

Trainer's note: Distribute the *Checklist for Your House Hunt* handout and review as an alternative way of covering the material in this section.

Make a copy for each home you consider. A Realtor likely generate computerized listings for you from the MLS; attach them to the back of the checklist. Some of the items on the checklist may be duplicated in a Realtor-provided printout. If possible, take pictures of the homes you are looking at and attach them to the checklist as well.

To highlight a few areas of the checklist:

- When comparing homes, it is important to know the price per square foot of each, especially if you are unfamiliar with local property values. To find the price per square foot, divide the home's asking price by its square footage. For example, a 2,000-square-foot home listed at $125,000 has a price per square foot of $62.50. Because of potential legal liability, some agents prefer not to disclose a home's estimated square footage. Others simple do not have this information. If your real estate agent does not provide these figures, get them from your local tax assessment agency or the home's builder. Price per square foot can serve as an objective benchmark to help you establish a home's value relative to other similar-sized homes in the area.
- You also should consider any unique features, which may affect the cost of insuring the home. Older homes and those built on a slope, for instance, may cost more to insure.

- Research the reputation of a home's builder. Start with the state consumer protection agency or the state's attorney general. You can also go to the Better Business Bureau website <http://www.bbb.org/> and look at a report on the home builder.
- Examine the previous owner's utility bills to get a sense of routine costs.
- Rural homes usually have a septic system and a well. Ask to see copies of the percolation (perc) test made before the septic system was built. It will show whether the drainage on the property is adequate to handle waste disposal. Also ask to see reports certifying the quality of the home's well water.
- Ask the seller to provide a homebuyers warranty. They can be purchased for $1,000 to $2,000 and cover major repairs such as the furnace, roof, plumbing, etc. The cost can be reflected in the purchase price of the house.

NEGOTIATING THE DEAL

PROPERTY VALUES

A list of comparable sales during the last six months is important to determine property values. Ask your agent for a list of "comps," which shows the price and square footage of neighborhood homes, which have sold recently. Besides the comps, there are intangibles that go into determining the asking price for a house, including the market (buyer's market or seller's market), location, buyers' emotional attachment to the home, and greed. If you plan to buy a home without the assistance of an agent (or, if you are looking for preliminary information), there are sources of information available online through your state and local offices of property taxation.

Use property value information to highlight or eliminate certain neighborhoods. If your budget limits you to $200,000, for example, it really makes no sense concentrating on (and perhaps falling in love with) a neighborhood where the average sale prices are in the $300,000 range. It is far better to focus on those areas where the average sale prices are well within your budget range, looking for a neighborhood that will give you the best value for your money.

When you find the home you want, the next step is to present an offer to purchase contract. After you make an offer, the seller may accept it, reject it or make a counteroffer. If a counteroffer is made, and they are quite common, you may accept it, reject it or make another counteroffer. This process continues until both parties agree or until one refuses to negotiate further. Be certain to put everything in writing.

- Set your price.
- List the personal property you may wish to have included, such as the refrigerator, washer and dryer, curtains, dining room ceiling fan, etc.
- List the needed repairs that you want the current owner to complete.
- List any contingencies, or circumstances, that must be met for you to go through with the sale, such as selling your current house, getting financing, a positive home inspection, etc.

You may be asked to put down an earnest-money deposit, which, although not required, shows your good faith while negotiating. The amount of the deposit may vary. It can be as little as $500 or as much as 10 percent of the sale price. If you cancel the contract, the earnest-money deposit is usually forfeited to the seller; therefore, try to limit the amount of the deposit. Earnest money is applied to the total purchase price of the home.

Home Inspection

Many home purchasers, either in the desire to save the $300 to $500 that a good inspection costs or due to simple ignorance, have spent enormous sums of money repairing items that any good home inspector would have pointed out. Any purchase offer you make should be contingent upon (subject to) a whole-house inspection with a satisfactory report. Do not let anyone — not the agent, not your family or friends, and especially not the seller — dissuade you from having the property thoroughly inspected! Not only will you sleep better after you have moved into the house, a professional inspection can give you an escape hatch from a contract on a defective house. If the contract is written contingent on an acceptable inspection, any defects in the home must be repaired or monetarily compensated for. If you are not satisfied, you have the option to cancel the contract.

Trainer's note: Distribute the *Ten Important Questions to Ask Your Home Inspector* handout and review the questions with learners.

Inspections are designed to disclose defects in the property that could materially affect its safety, livability or resale value. They are not designed to disclose cosmetic deficiencies (for example, an interior wall that needs repainting). You will need to determine on your own those types of items that will need attention: Do not expect a whole-house inspection to reveal them to you. You can find certified home inspectors by visiting <http://www.ASHI.org>. The *Ten Important Questions to ask your Home Inspector* handout will guide you through the selection process.

THE CLOSING

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Closing Costs

Closing costs are fees that are paid to complete the mortgage loan. They usually total approximately 3 percent to 6 percent of the loan amount and may be paid by the buyer or seller.

Examples of one-time types of closing costs and approximations of cost include:

Appraisal: An estimate of current value of a home ($300).

Attorney's or title company's fee: Whoever chooses usually pays the fees ($400 for an attorney, $300 for a title company).

Credit report: Furnishes lenders with information about the buyer's current indebtedness and payment history ($60).

Escrow company: Acts as a third party to both buyer and seller, handles the paperwork and collects and distributes the various money transactions, such as prepaids, real estate commissions and down payments ($300).

Home inspection: An independent, professional inspection of the property and its electrical, plumbing, heating, cooling and kitchen systems ($200).

Home warranty programs: Offers first-year protection from a breakdown of many household systems, including plumbing, water heater, disposal, heating and cooling, and appliances (up to $800).

Loan origination fee: A fee charged by the lender for making the loan; varies from zero to 2 percent.

Pest inspection: Separate from the home inspection; mortgage companies, particularly for VA loans, require a pest and water damage inspection ($100).

Recording fee: The cost to record your deed and your mortgage with the city or county in which the home is located ($75).

Survey: The measurement of the property by licensed engineers or surveyors to determine its area and attest to its boundaries ($250).

Title search and insurance: Researches the records and ensures that the property's title is free from any encumbrances and that the property will transfer with a clear title. The insurance protects the mortgage company (required) and the buyer (optional) against any claims on the property not found during the title search (cost is based on the loan amount).

In a buyer's market, the buyer can ask the seller in the offer to purchase to pay for all or a portion of the closing costs.

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PREPAID COSTS

At closing, the buyer will pay a number of recurring costs up front, with the money placed in escrow with the mortgage company and drawn when needed. Various prepaid costs are as follows:

Private Mortgage Insurance (PMI): Protects the lender against default on the loan. This can be a lump-sum payment, monthly payment added to the mortgage payment or a higher interest rate. Example: $200,000 purchase price, 10 percent down ($20,000), $180,000 loan amount, monthly PMI = .0052 x loan amount divided by 12 months = $78/month added to mortgage payment. PMI can be avoided by putting 20 percent down on the home purchase.

Mortgage Insurance Premium (MIP): FHA requires a mortgage insurance premium (MIP) for its home-buying programs. An upfront premium of 1.50 percent of the loan amount is paid at closing and can be financed into the mortgage amount. In addition, there is a monthly MIP amount included in the PITI of .50 percent. Condominiums do not require upfront MIP, only a monthly MIP.

VA Funding Fee: For the VA to guarantee the home loan, there is a closing cost assessed by the VA to originate the loan. This is called a funding fee. This fee will vary, depending upon the type of VA loan, the down payment, whether this is your first time to use your entitlement, if you are a disabled veteran, and whether you served active duty or in the guard or reserves.

Homeowners insurance: A total of 14 months' premium payments are collected, 12 of which are used to pay first year's policy premium. The extra two months are collected and placed in escrow account from which future premium payments are made.

Property taxes: Prorated buyer's first month's share of taxes and additional months of payments are placed in escrow from which future tax payments are made.

Interest: The buyer pays a prorated share of the first month's interest due on the loan amount depending on the closing date.

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The Closing

Closing is the final step in transferring home ownership from the seller to the buyer. It usually takes place at a lender's office, an escrow company, a title company or an attorney's office. It occurs when all of the promises in the purchase contract are fulfilled, the loan documents are prepared and the loan is finalized. Take possession, collect all keys and change all locks. Request from the seller:

- Operating instructions for appliances and heating and cooling systems.
- Names of contractors.
- Paint colors.
- Locations of utility shutoffs.
- Security system combinations, if applicable.

While rent payment is made in advance, mortgage payments are paid in arrears — they are due on the first of a month for the previous month. Set your closing date as close to the end of the month as possible. It will minimize the amount of pro-rated interest charges you have to pay and you can skip a month before your first house payment is due. For example, if you close on March 30, you will pay pro-rated interest for the days of March 30 and March 31 and your first house payment will not be due until May 1.

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Reducing Payback Time

Early Mortgage Payment

Many of us dream of retiring debt-free with a nest egg large enough to sustain us in our later years. For many, this dream involves paying off a home mortgage. Let's assume that you have available funds — from an inheritance, a lump-sum payment or the sale of property, for example. Should you use that money to pay off your mortgage?

There are two ways a buyer can reduce the payback time on a loan:

- Apply for a shorter-term loan. You can do this with a surprisingly modest monthly payment increase compared with a 30-year loan.

  For example: a 30-year mortgage of $100,000 at 6 percent interest carries a principal and interest payment of $600 a month; a 15-year mortgage with 5.5 percent interest has a principal and interest payment of $817. In most cases, lenders offer lower interest rates for loans with shorter maturities. A 15-year loan will generally have a lower rate than a 30-year loan.

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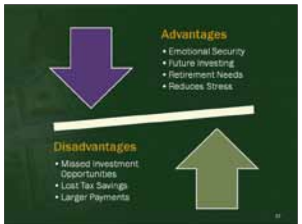
- Prepay the principal. This will reduce a 30-year fixed-rate loan's payback time to 20, 15 or even 10 years and will sharply reduce the amount of interest you pay over the life of the loan. If you are a disciplined money manager, and if your loan has no prepayment penalty, you may consider paying off a 30-year mortgage in 15 years and one month by doubling the principal payment each month. Or you can take a 30-year loan and pay it back in 20 years in one of the three following ways:
  - Make an extra lump-sum payment each year.
  - Increase monthly payment by one-twelfth.

- Pay bi-weekly; that means making one-half mortgage payment every other week.

Be sure to fully explore the cost of such prepayments, making sure there are no prepayment penalties or additional fees associated with prepayment.

The option of paying off your mortgage has advantages and disadvantages.



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Advantages

Emotional security: Paying off your mortgage provides emotional relief from the anxiety of owing money. You may simply feel more secure owning your home free and clear. This sense of security may matter a great deal if you plan live in your home when you retire. Also, you may desire to leave a debt-free home to your heirs.

Future investing: Without a mortgage payment, you will have more money to invest for the future. Your retirement savings can grow more quickly. Mortgage interest on a large or high-rate loan may be costing you a hefty sum. Instead of paying interest, you could be earning interest with your money.

Retirement needs: If you are retired, paying off your mortgage can free your money for other things. Experts recommend accumulating enough retirement savings to have at least 70 percent of your working income. If you're short of this goal, eliminating mortgage payments will free monthly income for living expenses. This approach is especially helpful if you have a large mortgage with high payments.

Reducing loan stresses: Paying off your loan removes loan-related stresses, too. Houses gain and lose value, depending on local conditions. These market changes affect the equity you've built in your home. Without a loan, you remove the risk of "owing more than you own." Also, you avoid being hit by climbing rates if the interest on your loan is variable.

Disadvantages

Missed investment opportunity: You can lose the opportunity to invest and build up a secure retirement nest egg. If you use your resources to pay off your mortgage, you will have less money to devote to growing your investments. If the interest rate on your loan is reasonably low, you may be able to earn more by investing. You can build wealth by investing in higher-rate earnings vehicles.

This drawback particularly applies if you have more than 10 years remaining before retirement. With this extra time, you could grow your money if it is invested well. So, paying off a mortgage may not make sense if you're focused on accumulating wealth at this point in your life.

Lost tax savings: Another disadvantage of paying off your mortgage is lost tax savings. The interest on your mortgage is tax deductible. This tax deduction may mean considerable savings for some homeowners. If you pay off your mortgage, you will lose the interest deduction. This could hurt, especially if you are or expect to be in a high tax bracket during retirement, when you could really use the deduction. It also has greater impact if you have more than 10 years left to pay on a 30-year mortgage. During the early years of repaying your loan, you pay more in interest and stand to benefit from a larger deduction.

Payments: Large monthly payments or more frequent payments.

Learner Activity: Closing the Deal

Purpose: Learners test their comprehension of contracts, negotiation and closings.

Time: 5 minutes

Materials: *Closing the Deal* handout, pens or pencils

Procedure: Pass out the *Closing the Deal* handout. Tell learners that they are to write in the answers to the questions on the handout. When learners have completed the handout, review the answers with the class.

Answers:

1. Closing costs
2. Title insurance
3. Escrow company

4. Lenders
5. Property value
6. Arrears
7. Home warranty
8. Principle
9. Purchase contract
10. Inspections

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HOMEOWNER'S INSURANCE

Since your home usually represents your largest purchase, it only makes sense to protect your investment from possible hazards. Many homeowners are underinsured; be sure to assess your needs and purchase adequate coverage. Of homeowner's policies, HO-5 policies are the most popular because of its broad-based, comprehensive coverage. Remember, if you are renting now or choose to rent later, always protect your possessions and liability to others with renters insurance.

Minimal Coverage

At a minimum, you need to cover the cost:

- To rebuild your house should it be destroyed.
- Of replacing contents of the dwelling.
- Of daily living expenses incurred when the homeowner is unable to stay in the home while repairs are under way.
- Personal liability up to a maximum for each occurrence, usually up to $100,000.
- Medical payment for injuries that occur on the premises.

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Additional Coverage

Replacement cost coverage: Allows for rebuilding the home with exactly the same materials with which it is currently constructed. Replacement cost coverage also allows you to replace your contents at current market prices rather than depreciated amounts.

Umbrella policy (usually for $1 million): Should be considered if the homeowner has a lot of assets, high earning potential or an attractive hazard (such as a swimming pool, trampoline or an aggressive dog) to protect property and future earnings from lawsuits.

Riders: Additional coverage can be added for valuable personal property such as gun collections, antiques and valuable jewelry. The insurance company may require appraisals.

Flood insurance: Mandatory at extra cost if a survey indicates your new home is in a flood zone. However, if you are not in a flood zone, have no flood insurance and your home is flooded by a freak storm, you will not be covered.

Earthquake insurance: This works in much the same way as flood insurance. If the new home is in an earthquake-prone area, the homeowner may be required to carry the extra insurance at an additional cost.

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Reducing Premium Costs

Trainer's note: Distribute the handout *Requesting a Quote for Homeowners Insurance.*

To reduce insurance costs:

- Shop around for the best rates. Be sure coverage quoted is identical and the company is financially sound and reliable.
- Raise the deductible to $1,000 or more.
- Ask about nonsmoker's discounts.
- Install fire and burglary detection systems.
- Use the same insurance company for homeowners, auto and life insurance.

SLIDE 31

SUMMARY

This workshop has covered a lot of material. Keep in mind these six main concepts as you begin the search for your new home:

- Identify your needs and your wants.

- Know what you can afford.
- Research homes, agents, lenders and loans.
- Get a home inspection.
- Adequately insure the home.
- Enjoy your new home!

Optional Learner Activity: Home Buying Summary

Trainer's note: For activity instructions, refer to the "Introduction to the Modules: PowerPoint Games"

Home Buying Question Bank

1. Which of the following statements about owning a home is not correct?
   a. Home ownership gives you a sense of community
   b. Home ownership provides tax incentives
   c. **Home ownership is worry-free**
   d. Home ownership requires money to be saved for unexpected repairs
2. Which of the following is an example of a housing "want" versus a "need"?
   a. **A chandelier in the dining room**
   b. A kitchen
   c. Plumbing
   d. Heat
3. Which of the following is an example of a housing "need" versus a "want"?
   a. A chandelier in the dining room
   b. Sea Foam Blue paint in the bedroom
   c. **Plumbing**
   d. Whirlpool tub in the master bath
4. Renting may be better if:
   a. You are OK with variable costs and large initial investments
   b. **You move a lot and do not care about the tax advantage**
   c. Your favorite show is "Trading Spaces" and you have a framed picture of Ty Pennington in your home woodworking shop.
   d. Property values are going up and you want to get in on the growth.
5. Which of the following is not on your credit report?
   a. **Your End of Active Obligated Service**
   b. Credit cards you have
   c. Credit obligations paid 30 days late or more
   d. Highest balances on charge cards
6. When figuring what you can afford, it is important to:
   a. Calculate your budget
   b. Calculate your debt-to-income ratio
   c. Neither a nor b
   d. **Both a and b**
7. A good debt-to-income ratio limit for getting a mortgage is:
   a. 16 percent
   b. 20 percent
   c. 30 percent
   d. **36 percent**

8. What factor does a mortgage lender not take into consideration when deciding whether to grant you a loan?
   a. New credit
   b. Types of credit
   c. **Your race**
   d. Credit repayment history
9. Which of the following is not a type of mortgage loan?
   a. Variable rate
   b. Balloon
   c. Fixed rate
   d. **Forward equity**
10. Which type of home loan typically requires a 3 percent to 5 percent down payment?
   a. **Federal Housing Administration loan**
   b. Veterans Affairs loan
   c. Bank loan
   d. Student loan
11. Which of the following is not an example of a closing cost?
   a. Pest inspection fee
   b. Appraisal fee
   c. **New homeowner fee**
   d. Credit report fee
12. Which of the following is not an example of a closing cost?
   a. Loan origination fee
   b. Title search fee
   c. Attorney or title company fee
   d. **Owner payback fee**
13. Which of the following is not a way to reduce the payback time of your home loan?
   a. Make an extra lump sum payment each year
   b. Increase the monthly payment by one-twelfth
   c. Pay bi-weekly
   d. **Pay monthly amount as required**
14. 14. A home inspection covers all but the following:
   a. Roof
   b. Plumbing
   c. **Cosmetic flaws**
   d. House structure
15. 15. Which of the following is ethically bound not to list and sell you the same house?
   a. Selling agent
   b. **Buyer's agent**
   c. Listing agent
   d. Broker

16. Which of the following types of insurance will protect your future earnings if your dog bites your neighbor and you are sued?

    a. **Umbrella**

    b. Replacement cost

    c. Rider

    d. Comprehensive

17. To reduce homeowner's insurance costs, do all of the following except:

    a. Raise your deductibles

    b. Install smoke alarms

    c. **Buy an older house**

    d. Buy a new house

18. FSBO stands for:

    a. Frequent Selling and Buying Options

    b. **For Sale by Owner**

    c. Foreign Students Bunking Opportunity

    d. Federal Standards for Buying Online

19. Predatory lending is:

    a. A type of lending in the subprime market that offers extremely competitive interest rates

    b. A type of lending in the subprime market that encourages prepayment

    c. **A type of lending in the subprime market that typically charges excessive fees**

    d. A type of lending in the subprime market for good credit risks

20. Which of the following websites can help you buy your home?

    a. www.hud.gov and www.homeloans.va.gov

    b. www.annualcreditreport.com and www.bankrate.com

    c. www.ashi.org and www.ambest.com

    d. www.schoolmatters.com and www.ffsp.navy.mil

    e. **(All are correct!)**