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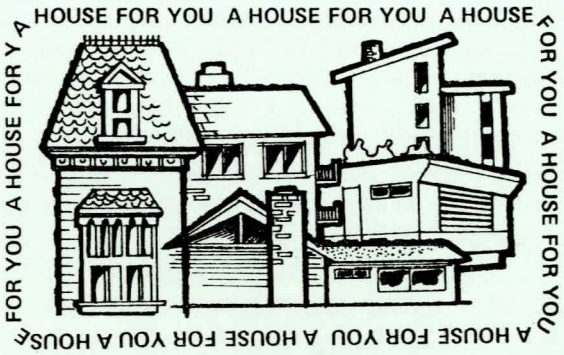

Financial and Legal Aspects of Buying a Home

You may have the picture of your dream home complete, but when it comes down to home financing, it's time to put the daydreaming aside. You need to be realistic about the costs of putting a roof over your head. Knowing key facts about buying and financing a home can prevent a strain on you—and a drain on your pocketbook.

HOW MUCH CAN YOU SPEND?

How much of your income is spent on housing is partly a matter of personal priorities. Some people may prefer to spend less on items such as travel, entertainment, or clothing, in order to buy a more expensive house. However, you need to evaluate your budget and consider how much of your income is spent for essentials. It is difficult to trim expenses for food, utilities, insurance, transportation, and other necessities.

A sound rule of thumb is that your total credit debt should not exceed about 35% of your **take home pay.** Credit debt would include your mortgage, car loans, school loans, other installment loans such as for furniture, and outstanding credit card balances. It is important to look at your monthly mortgage payment, as well as the purchase price of the house. This is especially true in periods of high or fluctuating interest rates.

This is a general guideline and should be used with considerable caution. It does not take into account specific facts about a particular family. For example, the size of the family, ages of children, or support of parents, may affect family spending.

To really know what you can spend on housing, you must carefully evaluate your financial situation, and then compare it with the cost of home ownership. The worksheet at the back of this pamphlet will help you.

As you evaluate your financial situation, be sure to consider the effect of home ownership on your tax liability. Mortgage interest and property taxes are two common costs of home ownership that are tax deductible. Many families, especially those with two incomes, find that home ownership reduces their income taxes. This increase in take-home pay can affect the size of mortgage payment the family can afford.

Whatever figure you finally select for your maximum housing budget, try to retain some margin for savings. Don't let your home destroy your other plans. It shouldn't interfere with building a college fund or investing for retirement.

YOUR MORTGAGE

Most people must finance the purchase of a house. A mortgage loan is required. A lender lays out the cash to buy the house. You sign a legal document binding yourself to pay the lender back regularly over a period of years. In reality, the mortgage loan represents one of the most favorable consumer loans of any kind, with the lowest overall interest rates of virtually all consumer loans.

An important key to remember is: don't bite off more mortgage than you can chew. It's tempting to choose a short-term mortgage with large monthly payments in order to pay off the mortgage as quickly as possible. It might be better for your peace of mind to choose a loan with smaller payments and a longer repayment period. In this way you don't dig too deeply into your reserves. Every family needs a rainy day fund—and because roofs leak and other catastrophes befall them—homeowners need one most of all.

LEGAL LINGO

Every business has its own "lingo." The housing business is no exception. Before shopping for your home, become familiar with the terms of the trade. In this way, you'll be able to discuss and understand more completely the arrangements you make. Here are some terms you'll hear used often:

ABSTRACT (or search) OF TITLE—This is a method of checking the safety of the title to a piece of property. It consists of a brief history of the ownership of the property prepared by a lawyer or other trained person. The abstract lists all former transactions affecting ownership, such as liens or claims, deeds, mortgages, sales and other matter that bears on the title of the property. An abstract makes the buyer reasonably sure that the title is free from defect.

CERTIFICATE OF TITLE—A declaration in writing that signifies ownership.

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Leo E. Lucas, Director

CLOSING COSTS—Expenses paid at the time the mortgage and note are signed. These costs are in addition to the price of the property.

DEED—This is a legal paper transferring the title of property from seller to buyer.

EARNEST MONEY—A partial payment of the selling price for the purpose of binding the cotract.

EQUITY—The part of the house and property you have paid for. This includes the down payment, monthly principal payments you have paid and any permanent improvements on the property.

ESCROW AGREEMENT—This provides that insurance and/or real estate taxes be paid by the lender. The monthly mortgage payment is increased by the necessary amounts to pay these costs. If the amount of taxes and insurance changes, an adjustment is made.

LAND CONTRACT—A contract to sell real estate on the installment plan plus a small down payment. The title remains with the seller or a trust until terms of the contract are met. It is also called a sales contract or a contract-for-deed.

AMORTIZED OR CONVENTIONAL MORTGAGE—Payments divided into fixed monthly payments including interest which reduces the principal of the mortgage. The early monthly payments include mostly interest and only small amounts of principal repayment. As the principal decreases, a larger percentage of the monthly payment is applied to repayment of the principal until the loan is repaid. This is sometimes called a standard or fixed-rate mortgage.

FHA MORTGAGE—A mortgage loan secured from a lending institution and insured by the Federal Housing Administration against loss to the lender. A lower down payment is required than for a conventional mortgage.

GRADUATED PAYMENT MORTGAGE—A mortgage where the amount of the monthly payment increases over a period of five to ten years before leveling off. This type of mortgage gives lower payments during the first years, and particularly benefits the first-time buyers who expect their income to rise.

M.G.I.C. MORTGAGE—A mortgage loan secured from a lending institution and insured by the Mortgage Guarantee Insurance Corporation against loss to the lender. A lower down payment is required than for a conventional mortgage.

RENEGOTIABLE RATE MORTGAGE—Sometimes called a "rollover" mortgage, this is actually a series of short term mortgages that are automatically renewable. The mortgages are renegotiated every three to five years at the current interest rate. There are maximum limits on the amount of increase or decrease in the interest rate.

VA MORTGAGE—A mortgage loan available only to qualified veterans and secured through a lending institution with low down payment, low interest rates and a long repayment period.

VARIABLE RATE MORTGAGE—This type of mortgage allows the interest rate to fluctuate with the market conditions. The rate may be adjusted semi-annually. There is a maximum amount the interest rate can increase per year and over the life of the mortgage.

PREPAYMENT CLAUSE—This states the terms under which you can pay off the mortgage before maturity without penalty (a waiting period may be specified). You may find you want to re-finance at lower rates or to pay off the mortgage in full before it is due.

POINTS—Discounts, 1 point being 1 percent, making the loan yield more to the lender to compensate for low interest rates. They are usually reserved for low down payment loans and are charged at the time the loan is made. Who pays the points may be negotiable.

TITLE INSURANCE— Insurance to protect ownership of the property, by insuring a clear title.

THE COST OF CLOSING THE DEAL

You've found the home that satisfies your dreams, and your budget. But buying a house and getting a loan

to finance it involves the completion of a number of transactions before the property officially becomes yours. The charges for these transactions are called closing costs or settlement costs. These are in addition to your down payment and in most cases must be paid in cash at the closing day. They may equal two to five percent of the loan, or more.

These costs are generally broken down as follows:

Buyer's Expenses	Seller's Expenses
Documentary stamps on notes	Cost of abstract
Recording deed and mortgage	Documentary stamps on deed
Escrow fees	Real estate commission
Attorney's fee	Recording mortgage
Title insurance	Survey charge
Appraisal and inspection	Escrow fees
Survey charge	Attorney's fee

Some charges likely to show up in closing costs are:

Credit Report—This check, usually through the local credit bureau, determines your financial and credit status in the community.

Survey—To make certain the property you buy matches that described in the deed. Boundary lines and the dimensions and locations of buildings are checked and described.

Title (Search and Examination)—Public records are searched to make sure that title to the property is undisputed and that the seller has the legal right to transfer title.

Title Insurance—For a one-time premium, this insurance protects the lender or buyer against financial loss from any title defects not revealed in the title search. It covers loss because of any valid claim and for the cost of legal defense against title attack.

Attorney Fees—These are the charges—unless reported elsewhere—for any or all services by lawyers.

Origination Fee—This sum, normally one to two percent of the loan, is the lender's charge for arranging the loan.

Preparation of Documents—Lumped together here are the miscellaneous fees charged for drawing up the mortgage, deed or note.

Closing Fee—This is the amount paid to an attorney, title company, or other party for handling the settlement transaction.

Recording Fees—When documents formalizing the transaction are entered upon the county's registry books, there will be a number of small fees and taxes to pay. Usually the notary fee is included here, although it may also appear under "preparation of documents."

Transfer Taxes—These are taxes levied when property changes ownership or when a real estate loan is made.

Escrow Fees—Included here are any amounts paid to a third party who may act as the custodian of money and documents to be held until transactions are completed.

At closing time, you may also be asked to make payments in advance for such items as property insurance and taxes.

Be prepared for these costs. Get a beakdown of the estimated costs as soon as possible before settlement. Make sure you understand each charge. Closing costs are not a small item!

COST OF LIVING IN YOUR HOME

There is one last consideration to make in discussing the financial aspects of housing. Many families do all the right things in shopping for a home except to check on how much it will cost to operate.

It is a good idea to check on the monthly operating costs of the previous owner. Local utilities and municipal offices can provide utility and tax information if the owner cannot. Are these likely to increase? Find out what your insurance premium will be. Estimate the cost of improvements or repairs you plan, such as redecorating, landscaping, or additional equipment.

This information will begin to give you only a general idea of your expenses. It is best to allow for unexpected expenses during the first year, until you can begin to determine your actual costs.

CONCLUSION

Take time to complete the worksheet. This procedure has been designed to help you establish a conservative, safe estimate of the amount you can spend for housing.

ESTIMATING YOUR HOUSING ALLOWANCE

Incomes and Expenses

	Amount
Income:	
Wages, salary	$ _____
Net profit from business, farm, profession	_____
Interest, dividends	_____
Other income	_____
Total	$ _____
Deductions withheld for:	
Income taxes	$ _____
Social Security, Retirement	_____
Other	_____
Total	$ _____
Total Take Home Pay	**$** _____
Housing Expenses:	
Mortgage payments	$ _____
Utilities, fuel	_____
Property Taxes	_____
House Furnishings	_____
Homeowners Insurance	_____
Other	_____
Total	$ _____
Non-housing expenses:	
Food, beverage	$ _____
Clothing, personal care	_____
Medical Care, Health Insurance	_____
Recreation, Education	_____
Car Expense, Transportation	_____
Gifts, Contributions	_____
Installment Payments	_____
Insurance - Life	_____
Savings	_____
Other	_____
Total	$ _____
Total Expenses	**$** _____

THINGS TO DO TO MAKE DECISIONS EASIER

1. Check with all loan agencies in you area. What does each offer? You may be surprised at the differences.

2. Find out if you qualify for a VA loan. What does this offer in terms of $ for you?

3. Find out what a FHA loan offers for your situation.

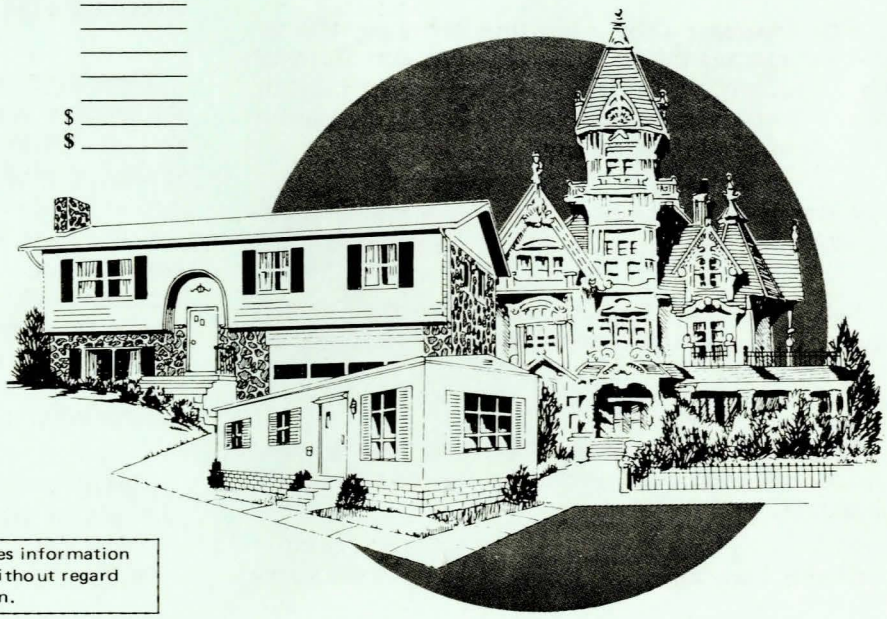
4. Call the regional Farmers Home Administration office. See what they might be able to offer you.

5. Make charts of all the different types of loans available to you to determine which would be the best.

6. Before talking to loan offices, have lists of questions to ask! Check off the list as you get each answer.

7. Do not sign anything without reading **AND** understanding it.

Prepared by Kathleen Parrott, Housing and Interior Design Specialist, from material developed by Extension Specialists in Housing and Family Economics and Management.



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