



the **home buyer**
and financing
e-book

Compliments of:

The Grangetto Group, Inc.
Your Personal Real Estate Consultants for Life

Office: (760) 525-4228

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The idea of purchasing a new home and getting financing is bound to bring many questions to mind. This is a natural reaction, because this is one of the biggest decisions you will ever make in your life. Rest assured, my team and I are here to assist you in understanding the process, and our ultimate goal is to make your experience a pleasurable one.

This e-book covers the basics about buying a home. It is designed to answer commonly asked questions and provide clear definitions of some terms you may be unfamiliar with.

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When you're ready to shop for a home...

**DO IT WITH
CONFIDENCE.**

Call us for your free consultation to discuss full loan approval before you start to shop.

You can save thousands of dollars by getting pre-approval in advance. It's the ultimate way to shop for a home.

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Rate Shopping

Shopping for the best interest rate possible has always been the consumer's primary objective when borrowing money. As well it should be! The challenge with this strategy is that there is much misleading information released on the subject by various media. Internet web sites and email marketing, along with other media such as radio, television and billboard advertising, has brought the importance of interest rates to the forefront of consumers' minds.

The problem for the consumer with this type of marketing is that it is designed to make the lender's phone ring. Often, the advertiser offers an interest rate at a ridiculously low price, with the intent of using a bait-and-switch technique once the client is reeled in. This is often done through *short pricing*. Short pricing is a term that is used when a lender offers an extremely attractive interest rate, but that rate is only locked-in for a very brief period of time.

Know up front that the average consumer enters into a purchase contract to buy a home for *at least* 30 days. Pricing on an interest rate locked in for a 10-day period is of no use to most prospective home buyers. It simply isn't enough time to complete the transaction. While the billboard advertising or Internet banner ad may boast a terrific rate, the lock-in period is often not realistic in terms of providing enough time to negotiate a purchase contract and close the deal. Be very careful when shopping for interest rates. Make sure that when you are quoted a rate, you are asking the broker what the lock duration is. Make sure that lock period allows you enough time to complete your purchase transaction.

Another common marketing ploy that makes interest rates appear attractive is geared around the manner in which fees are presented. All lenders are required by law to state the real cost of the financing through the



Annual Percentage Rate (APR) each time an interest rate is quoted in advertising. APR takes all fees associated with the loan into consideration, and it is usually listed in fine print as a disclaimer.

Advertisers often list a low interest rate in large bold type, but the higher APR indicates in fine print that one or two points are being charged to get that rate.

While APR can be helpful in comparing rates seen in advertising, it is important for consumers to know that all lenders do not calculate APR in the same way. Hence it is not an entirely failsafe method for comparing interest rates.

Additionally, the consumer must take into the consideration that the interest rate is not the only important factor in obtaining financing. An equally important question to answer is, "How long do you need to borrow this money?"

The length of time you need to borrow the money has a profound impact on whether or not you should be paying upfront fees (points), and likewise has bearing on your loan program selection.

The Nuances of Your Contract

The process of purchasing your new home is often much more complex than the average individual expects it to be. Items involved in your purchase contract can have a significant impact not only on the success of your purchase transaction, but on your stress level as well. We have listed out some of the important items you should be aware of, that require you to make decisions as a buyer entering into a purchase contract.



Loan Contingency

Loan contingency is the period of time the seller is giving you to obtain full, formal loan approval. This contingency is typically between 10 and 21 days depending on what you and your Real Estate Agent have negotiated on your behalf in the contract. The earnest money deposit that you put into an escrow account at the time the offer is accepted will be put in jeopardy once that contingency for the loan has expired. In fact, pursuant to the terms of the contract, if the loan contingency has expired and you fail to close the purchase transaction, you can lose your earnest money deposit and not have the failure of obtaining loan approval to lean on as an excuse.

For this reason that it is extremely important to make sure you are not agreeing to a loan

contingency in an offer negotiation unless you are *absolutely certain* you will be buying the home and you know you do not need to depend on financing approval to close the transaction. Formal pre-approval will help to eliminate any problems in this area.

Pre-Approval

Seeking complete pre-approval for financing prior to making an offer on a property is a sound strategy that can help you get the best deal possible, especially if you plan to make a minimal down payment. The seller is often leery of the stability and reliability of the buyer if the buyer is only capable of making a down payment of 10% or less. This can cause the buyer to lose a significant amount of negotiating ability, by being perceived as a weak buyer rather than a strong one. This is why it is very important to get full loan approval in advance, and provide a written confirmation of that loan approval when an offer is made on a property. This shows it is a done deal, and you are perceived to be a cash buyer.

Contract Period

The contract period is the period of time in which all due diligence must be completed, including obtaining loan approval, property appraisal, home inspection reports, termite inspection, etc. Give yourself enough time for all due diligence to be completed for this very important purchase you are about to make. Typically, purchase contracts are drawn up for a period of 30 days, 45 days or 60 days. However, it is really not uncommon for a purchase contract to be written with terms in excess of 60 days if the parties involved need that long of a grace period to complete all aspects of due diligence.

Home Inspection Contingency

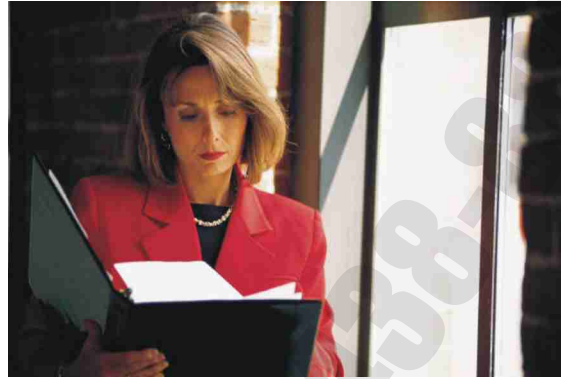
As part of the negotiation in your purchase contract you and the seller will mutually agree

upon the amount of time needed to complete all the home inspection procedures that are required. Utilizing an outside third party service to complete these inspections is highly recommended.

You will be provided with a report by the home inspection company that you should review very thoroughly to make sure there are no material defects in the property that you were not aware of, and which could subsequently have an impact on the value of the property. If there are material defects, you and your Real Estate Agent should go back to the negotiating table and discuss an ample reduction in the purchase price to offset the cost of any necessary repairs. Once your home inspection contingency has expired, you no longer have the leverage to go back and renegotiate the purchase price to resolve any issues revealed by the home inspection.

Termite Inspection

Termite inspection is required by the lender if it is listed in the purchase contract. One common fallacy in the home buying process is that the lender always requires termite inspection, regardless of what the contract states. This is not true. A lender only requires it if both the buyer and seller mutually agree to termite inspection and it is included in the terms of the contract. From there, it is up to both parties to determine who will be responsible for the remedy of the problem, if in fact termites are present. Most commonly, the solution is that Section 1 termite work will be covered by the seller, and Section 2 termite work to be covered by the buyer. Make sure when you negotiate your contract you state up front whether you want the property checked for termites.



Seller Rent Back

It is often the case that when the buyer and seller are unable to agree upon a specified closing date for the transaction, the Real Estate Agent involved will negotiate a “rent back” period. This means the transaction technically closes, the loan funds and ownership of the property is transferred into the buyer’s name, but the buyer does not take occupancy of the property until several days later. In this scenario, the buyer sets up a rental agreement, in which the property is leased back to the seller.

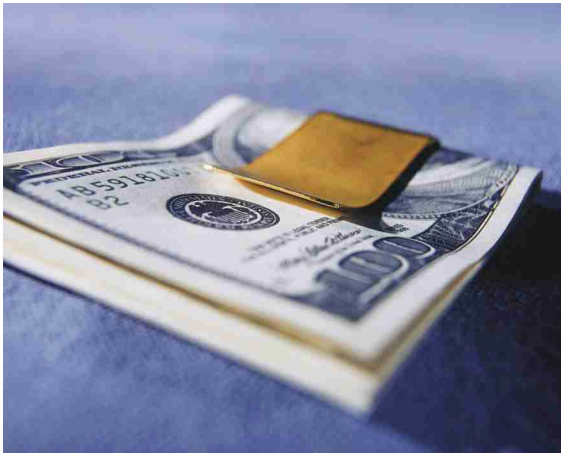
An important footnote to this somewhat common strategy is to make sure the seller is not occupying the property in a lease agreement for more than 30 days after the close of the purchase transaction. This would constitute a non-owner occupied purchase in the lender’s eyes, and would cause the terms of the loan to change radically.

Seller Contributions

Depending on the seller’s eagerness to close the transaction, the seller of a property will often become aggressive and offer to pay some or all of the non-recurring closing costs and/or origination points associated with the purchase on the buyer’s behalf. This common strategy can be very beneficial to the buyer, particularly if the buyer is short on funds to close. It can also be the vehicle that effectively drives the interest rate down and provides the buyer with a more affordable

monthly payment.

Note that there are limitations on how much the seller is permitted to contribute, depending on the loan-to-value ratio. The typical limitation stipulated by the lender is that the seller contributes no more than 6% of the purchase price. Seller contributions **MUST BE** isolated to non-recurring closing costs and/or origination points only. The lender will not permit the seller to contribute funds back to the buyer after the close of escrow to accommodate repairs to the property. Items such as roof leakage, new carpet, new paint, etc. cannot be covered by any seller contribution clause.



Points vs. No Points

Points are often a misunderstood concept for home buyers. Points are nothing other than interest paid up front (at the time of closing), to obtain a lower interest rate on a loan. One point is equivalent to 1% of the amount of money borrowed. If you are going to borrow \$300,000 on your loan, one point would equal \$3,000 up front. This generally generates 1/4 to 3/8 of a percent lower interest rate, depending upon the loan program.

When does it make sense to pay points? Paying points is a prudent financial move, if you are planning to be in the loan for a long period of time. Again, one of the most important questions to address when you

borrow money is, “How long do you need to borrow this money?” This will answer the two all-prevailing questions you will have, which are 1) Should I pay points? And 2) What loan program is best for me? Notice that the question is not geared to, “How long do I plan to live in the home?” But more appropriately, “How long am I likely to be in this loan?”

How long you will be in the loan is not only affected by the tenure that you own the home, but also the probability of seeking a refinance at some point in the future. As a general rule of thumb, you will need to be able recuperate the total cost of the points in a period of time that is *less than* the amount of time you will need to borrow the money for.

Here’s an example. Let’s say you are going to borrow \$300,000 for your mortgage, and choose to pay one point, which equates to an initial up front closing cost of \$3,000. If paying one point up front saves you \$100 a month, this means it will take you 30 months or 2.5 years, to recuperate the cost of the point that you paid. If you refinance the home anytime before that 30 month mark, or decide to sell the home, you will have effectively wasted money. However, if you stay in the home for longer than a 30-month period of time, it is a prudent financial move.

When deciding whether or not you should pay points, take into consideration where interest rates are at when you seek financing, and compare that to historical market trends.

When interest rates are at historical lows, it makes much more sense to pay points, especially if you think you will live in the property for an extended period of time. Historically low rates, combined with the fact that you know you do not intend to move would indicate you will have longevity in the loan. It is unlikely rates will go down, giving you incentive to refinance.

Rates are cyclical. When interest rates are off of their historical lows, and higher than they generally are, we know that there is a strong likelihood rates will eventually come down.

This is certainly no time to pay points. The chances of refinancing at some point in the future are extremely high, and therefore, you would not need to be in this loan for a long period of time.

Credit Scoring

Your credit score is a factor that will be considered by the lender when they look at your loan application. They want to know what your credit history is, and whether you have the ability to pay back the loan you are asking for. In short, good credit translates into lower rates for the home buyer and represents less risk to the lender.

Credit scores can range between a low score of 300 and a high of 850. Most commonly, we deal with scores ranging from 400 to 800 and the average FICO score is right around 720. The higher the client's score is, the less likely they are to default on their loan. We can run a credit report and determine what your credit score is, and if necessary, we can point out some simple ways to help you improve your credit score without enlisting the help of a credit repair service.

Once you fill out a loan application and enter into the loan process, you should not run up your charge cards! This would have an adverse effect on how the underwriter looks at your file.

If you have a poor credit score, it doesn't mean you can't qualify at all for a loan. While you may not get the interest rate you had hoped for, it is an opportunity to start building up your credit again. Once you begin making mortgage payments on time and in full, your credit standing will improve and you can seek to refinance at a lower rate as soon as the opportunity arises.



Pre-payment Penalties

Lenders attach pre-payment penalties to loans to ensure that the loan will be profitable for them. As a general rule of thumb, we do not suggest that you accept a pre-payment penalty as a part of your loan structure. One of the most important aspects of financial planning is to have options with your money. Restrictive clauses such as a pre-payment penalty can prohibit you from maneuvering when it is necessary and when other opportunities arise.

If you want to accept a pre-payment penalty clause in your loan, it is much more advisable to go with a "soft pre-pay." This only penalizes you in the event of a refinance, but not if you decide to sell the home.

Interest rates have dropped significantly many times over the last 15 years. Many home owners have not been able to take advantage of lowered rates by refinancing, because their hands have been tied by a daunting pre-payment penalty. Pre-payment penalties will generally provide you with a slightly lower interest rate in exchange for the pre-payment

penalty clause. Mortgage professionals will sometimes push the benefits of a pre-payment penalty so they can beef up their commission. Be very leery of this type of sales pitch!



Junk Fees

A junk fee is a derogatory term defining extra fees tacked on by the lender, which are charged as a dollar figure rather than a percentage. It is important to know that you can often negotiate these fees or have them removed if they have not been properly disclosed to you. The lender is required to provide you with a Good Faith Estimate disclosing their fees within three days of your application.

Other fees that are NOT considered junk fees are the appraisal fee, credit report fee, escrow or attorney fee, title insurance fee, recording fee, notary fee and transfer taxes. These are legitimate fees that are paid to third parties and are necessary to complete the transaction.

Choose a Real Estate Professional that will help you make the right choices.

The Grangetto Group has helped over 400 families in the last 15 years get their dream home. It's not just a matter of doing a job. It's about building the community.

The Grangetto Group, Inc.

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Glossary of Loan Terms

Adjustable Rate Mortgage (ARM)

A mortgage in which the interest rate is adjusted periodically based on a pre-selected index. Also referred to as the *renegotiable rate mortgage*.

Amortization

Means of loan payment by equal periodic payments calculated to pay off the debt at the end of a fixed period, including accrued interest on the outstanding balance.

Annual Percentage Rate (APR)

An interest rate reflecting the cost of a mortgage as a yearly rate. This rate is likely to be higher than the stated note rate or advertised rate on the mortgage, because it takes into account points and other credit costs. The APR allows home buyers to compare different types of mortgages based on the annual cost for each loan, however all lenders do not calculate APR the same way.

Broker

An individual in the business of assisting in arranging funding or negotiating contracts for a client, but who does not loan the money himself. Brokers usually charge a fee or receive a commission for their services.

Buydown

When the lender and/or the home builder subsidizes the mortgage by lowering the interest rate during the first few years of the loan. While the payments are initially low, they will increase when the subsidy expires.

Construction Loan

A short-term interim loan for financing the cost of construction. The lender advances funds to the builder at periodic intervals as the work progresses.

Discount Points

Prepaid interest assessed at closing by the lender. Each point is equal to one percent of the loan amount. (e.g. two points on a \$100,000 mortgage would cost \$2,000.)

Earnest Money

Money given by a buyer to a seller as part of the purchase price to bind a transaction or assure payment.

FHA Loan

A loan insured by the Federal Housing Administration open to all qualified home purchasers. While there are limits to the size of FHA loans, they are generous enough to handle moderately priced homes almost anywhere in the country.

FHA Mortgage Insurance

Requires a small fee (up to 3% of the loan amount) paid at closing or a portion of the fee added to each monthly payment of an FHA loan to insure the loan with FHA. On a 9.5% \$75,000 fixed-rate FHA loan, this fee would amount to either \$2,250 at closing, or an extra \$31 per month for

the life of the loan. In addition, FHA mortgage insurance requires an annual fee of 0.5% of the current loan amount in the years the fee must be paid.

Impound/Escrow

That portion of a borrower's monthly payments held by the lender or servicer to pay for taxes, hazard insurance, mortgage insurance, lease payments, and other items as they become due. Also known as *reserves*.

Index

A published interest rate against which lenders measure the difference between the current interest rate on an adjustable rate mortgage and that earned by other investments (such as one-year, three-year, and five-year US Treasury Security yields, the monthly average interest rate on loans closed by savings and loan institutions, and the monthly average Costs-of-Funds incurred by savings and loans) which is then used to adjust the interest rate on an adjustable mortgage up or down.

Margin

The amount a lender adds to the index on an adjustable rate mortgage to establish the adjusted interest rate.

Mortgage Insurance

Money paid to insure the mortgage when the down payment is less than 20%. See *Private Mortgage Insurance* or *FHA Mortgage Insurance*.

Negative Amortization

Negative amortization occurs when the monthly payments are not large enough to pay all of the unpaid balance of the loan, therefore increasing the loan balance and going in a "negative" direction. In this particular scenario, a borrower can literally end up owing more money than they originally borrowed. The reason that this occurs is because on a negatively amortized loan, the borrower is given several different payment options.

Origination Fee

The fee charged by a lender to prepare loan documents, make credit checks, inspect and sometimes appraise a property; usually computed as a percentage of face value of the loan.

PITI

Principal, interest taxes and insurance. *Also called monthly housing expense.*

Piggy Back Loan

"Piggy Back Loan" is a slang term, which really is another way of describing a 1st and 2nd Trust Deed that are closed concurrently at the close of escrow. This combination of a 1st and 2nd Trust Deed can be effectively utilized to avoid the need to pay private mortgage insurance. The borrower may apply for a loan at 90% with the same 10% down payment. A 1st Trust Deed at 80% and a 2nd Trust Deed at 10% could be procured concurrently. The interest rate on the 2nd Trust Deed is typically higher, often a double-digit figure. However, the fact that the interest can be deducted on the 2nd Trust Deed often makes this a prudent financial option for the borrower. The net result is often cheaper than borrowing 90% of the financing as one loan and incurring a private mortgage insurance payment. See *Private Mortgage Insurance*.

Pre-payment Penalty

Money charged for an early repayment of debt. Pre-payment penalties are allowed in some form (but not necessarily imposed) in most states in the US, as well as the District of Columbia.

Private Mortgage Insurance (PMI)

In the event that you do not have a 20% down payment, the lender will allow a smaller down payment, sometimes as low as 3%. However, with a smaller down payment, borrowers are usually required to carry private mortgage insurance on the loan. Private mortgage insurance will require an initial premium payment of 1% to 5% of your mortgage amount and may require an additional monthly fee, depending on your loan structure. On a \$75,000 home with a 10% down payment, this would mean either an initial premium payment of \$2,025 to \$3,375, or an initial premium of \$675 to \$1,130 combined with a monthly payment of \$25 to \$30.

Title Insurance

A policy usually issued by a title insurance company, which insures a home buyer against errors in the title search. The cost of the policy is usually a function of the value of the property, and is often borne by the purchaser and/or seller.

Underwriting

The decision whether to provide funding to a potential home buyer, based on credit, employment, assets, and other factors, while matching this risk to an appropriate rate and term or loan amount.



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My team and I specialize in providing exclusive service to each and every one of our clients.

We act as consultants to guide you in finding the solution which is right for you.

We can also provide a full pre-approval to give you the negotiating power of a cash buyer, which can save you thousands of dollars!

Thank you allowing my team the opportunity to improve your long term financial position.

Frank Grangetto Broker/Owner

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