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MVP CONSULTING GROUP, LLC
Financial & Real Estate Services

BUYERS GUIDE

Introduction

The idea of purchasing your first home is bound to bring many questions to mind. This is a natural reaction, as it 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 loan process with our goal being to make your experience a pleasant one. This book covers the basics about buying your first home. It is designed to answer commonly asked questions and provide clear definitions of terms you may be unfamiliar with.

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. However, due to the 2007 Financial Crisis, the government now strictly

regulates and supervises lenders to provide greater consumer protection.



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.

Statistically, a first time home buyer usually stays in their new home between 4 and 7 years. First time buyers are often solicited with FHA loans which require a 3.5% down payment and are contingent upon 30-year financing. The interest rates offered now on an FHA Loan are lower than they've been for many years.

The Nuances of Your Contract

The process of purchasing your first 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 15 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 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 the loan approval when an offer is made. 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 in most cases on an FHA loan and if it is listed in the purchase 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 on FHA loans and 3% on conventional loans. 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 first time 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 to 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.

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 350 and a high of 850. The higher the client's score is, the less likely they are to default on their loan. We will 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. There are loan programs available even if you've had a recent bankruptcy. 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 we can seek to refinance you at a lower rate as soon as the opportunity arises.

Pre-Payment Penalties



on international and hard equity loans.

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 prepayment penalty can prohibit you from maneuvering when it is necessary and when other opportunities arise. The pre-payment penalty was used on subprime loans back in 2007; now we don't often see this restriction. On FHA and conventional loans, there is no prepayment penalty. However you can still encounter it

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.

Negative Amortization



Negative amortization loans were responsible for the catastrophic financial crisis of 2007. We no longer see this type of loan.

In a regularly amortized mortgage payment, part of the payment goes toward a portion of the principal and part goes toward interest payment. In a loan that involves the potential for negative amortization, you have several payment options each month. You can make a low introductory rate payment, an interest-only payment, or a fully amortized payment.

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.



Glossary of 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)

The interest rate that reflects 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.

Buydown

This is when the lender and/or 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 increase when the subsidy expires.

Construction Loan

This is 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, i.e., 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 or down payment (up to 3.5% 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. In addition, FHA mortgage insurance requires an annual fee of 1.25% (MIP) and 1.75% Up Front Fee that is financed in your loan amount.

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.

Loan Originator

This person assists you in all your mortgage needs, helps you in the application, processing and funding of your loan, but does not loan the money himself. Loan originators usually charge a fee or receive a commission from the lender for their services.

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.

OPTION 1: To pay what is known as the fully indexed payment. This is the margin plus index on the adjustable. This payment, which is typically the highest of the options, will prevent you from going negative.

OPTION 2: An interest only payment. You would not be going negative by making this payment either, but you would not be decreasing the principal balance that you owe on your loan. This is because you are paying only the interest portion and no additional principal to your loan.

OPTION 3: (And the one that most often gets people into trouble...) The negatively amortized payment. This is a payment that not only does not cover the principal, but doesn't cover all of the interest owed on the monthly payment, therefore accruing negative equity as a result.

Origination Fee

The fee charged by the lender for issuing a loan; usually computed as a percentage of face value of the loan.

PITI

Also known as monthly housing expense, this is the principal, interest, taxes and insurance.

Piggy Back Loan

"Piggy Back Loan" is a slang term, which really is another way of describing a 1st and 2nd mortgage that close concurrently at the funding of a loan. This combination of a 1st and 2nd mortgage 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 mortgage at 80% and a 2nd mortgage at 10% could be procured concurrently. The interest rate on the 2nd mortgage is typically a higher rate that can be a double-digit figure. However, the fact that the interest can be deducted on the 2nd mortgage often makes this a prudent financial option for the borrower if the lender allows a 2nd mortgage. The net result is often cheaper than borrowing 90% of the financing as one loan and incurring a private mortgage insurance payment. However, you may want to seek the advice of an accountant as to which option is best for your needs. 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. However, with a smaller down payment, borrowers are usually required to carry private mortgage insurance on the loan. Speak with a trusted mortgage specialist for specific examples.

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

Provides (or declines) funding to potential home buyers, based upon factors such as credit, employment, assets, etc., and matches approved risks with appropriate rates, terms and loan amounts.