SIRKIN PAUL ASSOCIATES

# First-Time Home Buyers Top 10 Issues

**By Andy Sirkin**

The process of buying and selling real estate is full of terms and procedures that are completely new to first-time buyers. This article will help you mastering the basics.

## REAL ESTATE AGENTS

### What Agents Do

A real estate agent can give you an overview of the buying process and make you feel secure with the knowledge that an expert will prevent you from making costly mistakes. He/she can help you select a mortgage loan and prequalify for that loan, and determine how much house you can afford. Using this knowledge, your agent can help you decide the size, configuration and features you need in a home, and develop home search criteria.

Using these criteria, your agent can survey the market for homes that match. An agent's time and resources allow him/her to show you more homes than you could find on your own. The agent can use computer databases (often not available to the general public) containing the features of every home available, then pre-screen these homes so that you will not waste time looking at homes that don't match. As you shop, the agent can help you evaluate property by showing you features, pointing out drawbacks, spotting repair problems, and describing the characteristics of neighborhoods.

Once you find a property you like, your agent can prepare a survey of similar homes that have recently sold in the same neighborhood, and help you use the survey to determine the price you should offer. He/she can then prepare a risk-free purchase offer, and present the offer to the seller and the seller's real estate agent. During the presentation, your agent can use his/her knowledge and experience to sell you and your offer, increasing the chance that the offer will be accepted. If the seller responds with a counter-offer, your agent can help you develop and implement a successful negotiation strategy.

After you strike a deal with the seller, your agent can help you through the loan application process, set up professional home inspections, and handle any re-negotiation of price or terms following inspections. As the transaction progresses, your agent can make sure the seller is complying with the terms of the contract, and facilitate title searches, escrow and closing.

Given unlimited time and patience, you could successfully buy your first home without an agent just as you could repair your own television. But buying a home is likely to be as complicated and important as anything you do in your lifetime. There is every reason to get all the expert help you can, especially where the help costs you nothing.

### Payment Of Agents

One of the best things about using a real estate agent is that you don't have to pay him/her. Your agent is paid by the seller's agent. Here's how it works: a seller enters into a **listing agreement** or **lists** his home with a real estate agent, and agrees to pay the agent a commission (usually 6% of the sale price) if the home sells. The seller's agent advertises the property and holds weekend open houses. If the buyer has an agent, the seller's agent splits his commission with the buyer's agent.

First-time buyers often wonder how their agent can be loyal when he/she is being paid (indirectly) by the seller. In fact, divided loyalty is rarely a problem for the buyer's agent. He/she develops a close working relationship with the buyer during the home search but has no working relationship with the seller; in fact, he/she does not even meet the seller until the day an offer is presented. Moreover, he/she knows that the key to repeat business and word-of-mouth referrals is the buyer, not the seller who already has an agent. As long as your agent is not also the seller's agent, you should get loyal and devoted representation.

### Selecting An Agent

Buying a home is a major financial and emotional step, and success or failure will rest largely in the hands of your agent. Select an agent just as deliberately as you would a doctor, lawyer or accountant. Never work with an agent just because he/she happens to be holding an open house at a home you like. Make a list of candidates using referrals from friends and family. If you have encountered an agent at an open house or seminar who seemed knowledgeable, add him/her to your list. Then interview the candidates regarding their qualifications, experience, and services. Make sure you check with at least three past-client references for each agent.

You will get the best service and loyalty working with a single good agent who knows you are also loyal. You will know your agent is doing a good job if you hear from him/her regularly, the advice he/she gives makes sense, and you are aware of him/her working hard on your behalf. If your agent is not giving you the service and attention you want, fire him/her and find someone else.

## WHAT CAN YOU AFFORD?

### The Components Of Payment

Almost no one pays cash for real estate. Instead, they pay with a combination of cash, called the **down payment**, and a loan, called a **mortgage**. The maximum price you can pay for a home is controlled by your maximum down payment and your maximum mortgage amount.

### Down Payment Sources

To calculate what you can afford, begin by calculating your maximum down payment. Remember this important fact: to reduce the risk you will abandon the home, most mortgage lenders will require the down payment to be your own money. This means it can come from bank accounts, retirement funds, or gifts, *but it cannot be borrowed.* When you calculate your maximum down payment, do not include any money you plan to borrow.

### Mortgage Loans

The next step in determining what you can afford is calculating your maximum mortgage amount. A mortgage is a loan **secured** by a **lien** on the property. This means that if the borrower does not make payments, the lender can force the property to be sold and use the money to repay the loan. The forced sale process is called **foreclosure**. Most mortgage loans are due in monthly payments over 30-40 years, but can be repaid sooner if the borrower sells the home or **refinances** by getting a new loan to pay off and replace the old one.

Your maximum mortgage amount is limited by the maximum monthly house payment you can afford. Monthly house payments are often called PITI, which stands for mortgage **principal**, the portion of the mortgage payment that actually reduces the amount you owe, mortgage **interest**, **property taxes**, and homeowners **insurance**. Your maximum PITI will be different for each lender and each loan. The best way to determine your maximum mortgage amount is to shop for your mortgage *before* you shop for your home. I have another article that explains mortgages and provides a step-by-step shopping guide. After you choose a loan, the lender will set your maximum monthly PITI, loan amount and home price through a process called **prequalification**.

## SEARCH, COMPARE, AND OFFER

### Finding The Right Home

Once you know what you can afford, develop home search criteria. These should include neighborhood, size, features and price. Remember that asking prices are usually higher than selling prices, especially in a slow market. Set your search price above the amount you actually want to spend. Have your real estate agent make a list of every property on the market that meets your criteria. Include properties that meet most but not all the criteria; you don't want to overlook something special because match exactly. Either you or your agent should view every one of these homes. If none seem right, continue your search by having your agent call you immediately each time something new comes on the market that meets most of your criteria. You may also want to broaden your search criteria, check new neighborhoods, or visit random open houses. It's easy to be mistaken about what you want.

### How Much To Offer

When you find a home you like, have your agent provide a **comp survey**, a list of the size, features and sale price of every similar home recently sold in the same neighborhood. Decide how much to offer based on the survey. Never base your offer on the asking price. If the asking price is much too high, 5% or 10% less may still be too much. If the asking price has been reduced for a quick sale, 5% or 10% less may insult the seller and end negotiations before they start. Asking price doesn't matter; value matters.

### Anatomy Of An Offer

Once you determine value, have your real estate agent prepare a written **purchase offer**. The purchase offer is your promise to buy the home if the seller agrees to your terms *and* if the **contingencies** are fulfilled. Contingencies are requirements and conditions you set that must be satisfied before your promise to buy the home becomes binding.

The most common contingencies are financing, inspection, and title. The financing contingency describes the mortgage loan for which you intend to apply, and states that if you are not approved by the lender within a certain number of days, you do not have to buy the home. The inspection contingency gives you the right to have the home inspected by professional inspectors (typically a termite or structural pest control inspector and a general contractor) within a certain number of days, and states that if you are not satisfied with the condition, you do not have to buy the home. The title contingency gives you time to determine from government records whether the seller really owns the home and whether anyone else might have any interest in it, and states that if you are not satisfied with the seller's ownership, you do not have to buy the home.

Any contingency can be included in an offer. You might require that the seller provide financing, paint the house to your satisfaction, or rent the house until you are ready to move in. You might delay purchase until you successfully sell your old home or find a new job. You might even condition your offer on the seller's agreement to equity share, or on your ability to find another equity sharing investor.

Your offer and its contingencies will either be accepted, rejected or met with a counter-offer. If and when you and the seller agree, you make a **good faith** deposit of $500-2,000 to show your commitment to the transaction. As more of the contingencies are satisfied, you will increase this deposit.

Some purchase contracts provide for **liquidated damages**. This means that if all the contingencies are satisfied, but you still refuse to complete the purchase, the seller keeps some or all of your deposit as damages. Liquidated damages guarantee you will lose some or all of your deposit if you don't perform, but limit your losses by preventing the seller from suing for a larger amount.

## ESCROW AND CLOSING

### Title and Deeds

**Title** is legal ownership of real estate as shown in government ownership records. It is established by a **deed**, the document which represents real estate ownership and is recorded in the records. You will become owner of your new home when the seller signs a deed in your name, delivers it to you, records it in the government records. At that point, you **hold title** to the property.

### Escrow Agents

Most real estate transactions involve an **escrow agent**, a third party who acts as a "neutral zone" between buyer, buyer's lender, seller, and seller's lender. Escrow agents act on written escrow instructions from each of these parties. If there is conflict between any of the **escrow instructions**, the escrow agent cannot act until the conflict is resolved.

The escrow agent performs different services for each party. For the buyer, the escrow agent holds the good faith deposit and down payment until **closing**, then delivers the deed and records the transaction in the government records. For the seller, the escrow agent holds the deed until closing, then gives the seller the sale price less any amount the seller owes on his old mortgage. For buyer's lender, the escrow agent holds the mortgage money until closing, then creates the lender's lien by recording the mortgage in the government records. For the seller's lender, the escrow agent collects the money the seller still owes, then releases the property from the old mortgage lien by recording a release document in the government records.

### The Closing Process

The closing process begins at least a week before the actual closing. The escrow agent gathers all the required documents and instructions from all four parties. If the are no conflicts between the instructions, he/she has the seller sign the deed, and the buyer sign the mortgage documents and deposit the down payment. he/she then sends the signed mortgage documents to the new lender for approval, and waits for the lender to return the approved documents plus a check in the amount of the new mortgage. When he/she has all the money and all the documents, the money is dispersed, the documents are delivered and recorded, and the closing process ends.

**Title Insurance**

In many states, the role of escrow agent is played by a **title company**. In addition to acting as escrow agent, title companies provide **title insurance** which reimburses the buyer's lender and/or the buyer for any losses they suffer if a third party claims that he/she has an interest in the property.

**Closing Costs**

**Closing costs** are the expenses of a real estate transaction and generally include:

- Inspection Fees;
- Loan Fees and Points;
- Escrow Agent Fees;
- Title Insurance Premiums;
- Government Recording Fees;
- Real Estate Agent Commissions; and
- Transfer Taxes or Stamp Fees (a tax based on a percentage of the sale price).

Local customs vary as to which closing costs are paid by buyer, and which are paid by seller. Often, the buyer will also need to prepay some portion of the insurance or property tax at closing.

WHAT IS EQUITY?

In real estate, **equity** is the difference between property value and mortgage amount.

Property Value - Mortgage Amount = Equity

When you first buy, your equity is the same as your down payment. But over time your equity changes as the property value rises or falls, and the mortgage is paid down.

**About the Author**

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