

The Homebuyer's Booklet

A Guide to IHDA's First-Time Homebuyer Program and Answers to Often-Asked Questions



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Joe & Jane Confront Their Fears About Buying a First Home

It's 11:30 p.m. on Saturday night. Joe and Jane are trying to get some sleep. After a long and difficult work week and doing all the housework Saturday, they're exhausted. But outside their apartment, they hear car doors slamming and people laughing. Inside, they hear hallway voices, water running and stereos blaring. All in all, another noisy Saturday night.

After an hour of sleepless fidgeting, Joe turns and says, "We have to get our own home. I'm tired of this noise. I'm fed up with apartment living, paying rent and getting nothing for it!"

Wide awake herself, Jane replies, "I'm burned out with apartments, too. But we can't afford to buy a house. It's such a big financial obligation."

"I know it's a big and intimidating decision," says Joe. "But we've got to do something. This situation is really getting to me."

"You know," says Jane, "I've heard something about a First-Time Home Buyer Program offered in Illinois. In the morning, I'm going to check it out. That will at least get us started."



Have you ever had a conversation like this? Don't feel alone. The thought of buying your own home can be exciting, yet stressful! In fact, buying homes two, three and four can generate the same feelings. It is a process that can be intimidating, as well. When our parents bought their first home, they only had a couple of choices of banks and loan products. Today, there are thousands of choices with hundreds of options. Which one do you choose? Is it the best choice for your personal situation? How do you choose a lender. . . a real

estate agent. . . a loan product? How much can you afford? How much down payment do you need?

These questions and many others are important. They must be answered. The good news is there **are** answers and a number of resources to help you learn more about purchasing your first home. This booklet attempts to answer some questions and directs you to resources that may be of further assistance. It will devote most of its attention to the Illinois Housing Development Authority's (IHDA's) "First Time Home Buyer Program." It also will try to acquaint you with the language and terms used in buying a house. So, if you're ready, let's begin.

Getting Started

Generally, a good place to begin is with people who have gone through the process. Depending upon how many people you talk to, you will probably hear about a few home-buying nightmares, as well as about all the transactions that went relatively well. Keep in mind: buying a home typically requires the involvement of several people, each doing their respective job in a timely and efficient manner. If any participant "drops the ball," the whole process can stop.



How many people are we talking about? Let's count: two Realtors® (one for the buyer and one for the seller), one buyer (count Joe and Jane as one), one seller, one loan originator, one loan processor, one loan closer (usually a title company employee), two attorneys (optional but recommended, one for the buyer and one for the seller), one appraiser, one credit bureau, one flood certification service and one home inspector (optional but recommended). That makes 13 people involved in a normal home purchase. No wonder problems occasionally crop up. And remember, your deal is not the only one all these people are working on. So *PATIENCE* is the word of the day. That, coupled with organization, can make the process manageable. In fact, buying a new home can actually be fun and exciting.



We always recommend that new buyers begin by doing some research. By virtue of the fact you are reading this booklet, you have started the process. In the back of this booklet is a listing of several other

sources, particularly Web sites, that can assist you in getting information. IHDA has a Web site of its own: www.ihda.org. By checking out our site, you can become familiar with our loan programs and qualification standards. You also can locate links to other sites for homebuyers.

To facilitate your fact-finding, start a file folder. Begin with your last three years of **federal** tax returns. (Joe and Jane have filed jointly since they married two years ago, but prior to that, they filed individually. Since they are married, IHDA needs all three years of returns for both Joe and Jane.) IHDA will be looking at the returns to verify

income and to determine whether you are a first-time buyer. Also, get your last two pay stubs from each of your jobs. (Jane has a full-time and a part-time job, and Joe works one job full-time.) We need the pay stubs from **all** of your jobs.

Next, write down the name, address and account number for your checking and savings accounts (a deposit slip from each will do). If your pay stubs do not identify your employer with an address and phone number, write that

down, too. Also write down all credit cards on which you have open accounts and note the balances remaining, even if they are zero. Finally, list the account numbers,



names and addresses and monthly payment amounts for all car loans, student loans, credit union loans, etc. If your eyes begin to glaze over about now, take a break, but don't panic. Make a checklist while you re-read this paragraph, and you'll find the required information is not that difficult to obtain.

How Much House Can You Afford?

In order to begin answering this question, IHDA recommends a visit to its "Help for Homebuyers" section of its Web site at **www.ihda.org**. Here you can gain access to the Fannie Mae mortgage calculators. Play with them. You will soon have an idea of how much house you can afford. If you don't have access to a computer, here is what you can do:

First, you need to understand your debt ratios. There are two types of debt ratios: front-end and

back-end debt ratios. The front-end debt ratio represents your estimated monthly house payment, including taxes and insurance, and should not exceed 28–33 percent of your monthly gross income. A back-end debt ratio represents your monthly mortgage payment and adds to it your monthly installment loan payments and 5 percent of your credit card balances. This should not exceed 36 to 38 percent of your gross monthly income.

Once the terms are understood, you need to calculate your own front-end and back-end ratios and determine how much of a mortgage payment you can afford. The process is as follows:

1. Add up your GROSS (before tax) monthly income. Multiple this number by 30 percent. The result is known as your “front-end debt ratio.” The number you get represents the highest allowable house payment you can afford. This monthly house payment includes payment toward the **Principal** amount of the loan, **Interest** on the loan, a monthly payment toward real estate **Taxes**, and a monthly payment toward homeowners **Insurance**. This is referred to as the “**P.I.T.I.**” (Sometimes, but not always, a monthly payment toward mortgage insurance also is required.) **In the back of this booklet, you’ll find a glossary of this and other mortgage jargon.**



2. Next, add to the number you just calculated your monthly car payments, student loan payment and all other installment loan payments, as well as 5 percent of the grand total of your credit card balances.



3. Then, take this new number and divide it by your “Gross Monthly Income.” This is known as your “back-end ratio.” This calculation helps to make sure that your back-end ratio does not exceed the 38 percent maximum recommended limit

for first-time homebuyers. However, keep in mind that these debt ratios are only guidelines, and that there is some flexibility as to the percentages that may be acceptable.

If all of this confuses you, don’t feel bad. There is an easier way. Ask around and get the names of some good mortgage lenders. Call a lender and ask if it does “pre-qualifications for mortgage loans.” Most offer this service free of charge. Take the file you have created to the lender. They will do all of this math for you and advise you of the price range that you can afford. Let them know that you want to get an IHDA First-Time Homebuyer loan.

Now comes your next decision point. Knowing how much “house” you can afford, do you think you can find a house available that falls within that range, or do you need to put things “on hold” until you can accumulate a bigger down payment? **Buying a home is a major financial investment. You want to be happy with your home—not feeling as if “this is the best I can get.” If it means you have to wait a little longer to get what you want, you should do so.**

What Should You Do Next?

Let's assume you have decided to venture further down the "happy home buying trail." The next step is to decide whether you want a "new" home or an "existing" home. If you want a new home but don't know where to look, there are four primary sources: newspapers, your local home-builders association, friends and relatives, and local governments, particularly community development departments and building commissions.

If you are looking for an existing home, it is usually best to seek out a licensed Realtor.[®] You can find "good" Realtors[®] through recommendations of friends, relatives and neighbors. Another good way to find a Realtor[®] is to pay attention to "For Sale" signs in front of houses. If you see a lot of signs from the same firm, you have some comfort they do a lot of business.

Don't be afraid to interview your prospective builder or Realtor[®]. You want to be comfort-



able and have a certain degree of trust. Not all builders and Realtors[®] are alike. Some are more aggressive than others. This is *your* choice, so be fussy. And don't be surprised if the Realtor[®] asks you to sign an agreement to work exclusively with that firm for a period of time. This is a common practice in Illinois. It assures agents that if they work hard, they get the deal.

Now Comes the Fun Part. . . Looking at Homes

New Homes: Generally, builders have "model homes" you can walk through to get a feel for the

layout and quality of work. These models can be deceptive, in that the builder may build them with all the upgrades and add-ons. They're also professionally decorated. Still, you can get an idea of what to expect. Next, drive through an area in which the builder is currently constructing and take a look at the houses already occupied. How do they look from the street?. Do current residents appear younger, older or a mix of ages? Is the location close to shopping and schools? Are you near mass transportation? Are you close to highways for getting to work? What are the traffic patterns?



Basically, is this a good location for your individual needs?

Also, be sure to ask the builder for references and check them out. References should include past customers, as well as current suppliers of materials. If available, go see homes by several builders. This gives you a better base from which to make a decision. In most instances, you will **never** find the perfect house. It is a game of tradeoffs. One of the biggest advantages of buying a new home is, as it's name implies, everything about it is **new!** Also, you get a say in choosing what goes into the house, what options you want and what colors are selected.

Existing Homes: Your Realtor® will be of tremendous help in your search for houses in which others have already lived. Most medium- to large-size communities have a "Multiple Listing Service" (MLS). What's so good about the MLS is that it represents a central database showing most, if not all, homes for sale in the neighborhood in which you want to buy. By looking at the listings with your Realtor®, you can dramatically narrow your search without ever having to leave the office.

This way, your walk-through time is more efficient and less tiring. *(In the back of this booklet is a “Walk-Through Checklist.” Look past decorating and color schemes. It’s amazing what a gallon of paint and wallpaper can do. Your focus should be on layout, neighborhood, safety and soundness of the property.)*

Negotiating the Deal

New Construction: With new construction, there isn’t as much negotiation as there is selection of amenities. The sales agent for the builder will give you the base price on the home and a list of “options.” Usually, you want all the options, but can only afford a few. So. . . it’s decision time again!

The best way to get past the this dilemma is to ask the builder to price out each of the options. Then begin your elimination process. In selecting options, keep in mind re-sale. For example, if you think you can live without a fireplace but everyone else in the subdivision has one, you may want to reconsider because you could find it more difficult to sell your home a few years from now without one.

Existing Homes: When buying an existing home, negotiation is a very important part of the process. If you have looked at several properties (this is true with new construction as well), then you should have a pretty good idea of what prices



the market seems to demand. Your Realtor® can also be of tremendous assistance in this stage, as well. (But keep in mind that many times a Realtor®, even though they're working with you, is legally obligated to represent the seller. That's why there are "buyer agents" and "seller agents." When you interview your Realtor®, ask for an explanation of the difference. It usually shouldn't matter which one you work with. If they're professional and you're comfortable, chances are they won't let you get out on a limb.)

When sellers specify prices for their homes, they take many variables into consideration. What is the price for which similar homes sell? How much do they believe they need to get for the home? How fast do they want to sell it? These are just some of the questions considered when setting the sale price. You want to get the best deal in town, but so does the seller.

What typically occurs is that the buyer and seller settle on a price with which both can live. The question is not so much, "Is this a great deal?" but rather, "Is this a fair and reasonable deal?" (*Again, your Realtor® can be very helpful in this process.*)



Tip: When settling on a price for either new construction or an existing house, make sure you have a few dollars left over for unexpected expenses. Typical items you will have to pay for after closing are decorating, appliances, lawn mowers, etc. You're likely to become a repeat customer at your local hardware and other stores as you turn your "house" into a "home."

Obtaining a Mortgage

Hopefully, you have kept your lender updated all along about your home-seeking adventures. In doing so, you will benefit from their insights, as well. The mortgage process is pretty straight forward. If you have taken our advice and gone through a pre-qualification, you will already be moving along. Depending upon how long it has taken you to get to the official loan application, you may need to update your file with your most



recent pay stubs and any new tax returns, credit card or installment loans. During the mortgage application process, you are going to be introduced to a whole new language. Terms like “mortgage, note, title, deed, title insurance, PMI insurance, APR, RESPA, Truth-in-Lending, Recapture” and others will become second nature.

(Remember the glossary at the back of this booklet? It might be a good time to read that now.)

If you have been pre-qualified, completing the loan application is just a matter of updating what you provided earlier. You will be asked to pay an application fee of approximately \$350–\$400. This pays for the cost of a credit report and covers the cost of an appraisal. You will be asked to sign the application and various other forms, some of which authorize the lender to contact your employer to verify your work status and salary, verify your savings and checking balances, and authorize a credit report.

If you are getting an IHDA loan, you also will

see forms unique to IHDA. Unfortunately, these forms are necessary because the federal tax code, which authorizes IHDA programs, requires them. The extra forms are: Affidavit of Buyer; Affidavit of Seller; Recapture Notice; and PMI Acknowledgment. These may sound intimidating, but don't let them scare you. The glossary explains each one. At this point, the lender will call IHDA to reserve a loan. You will have various rate and



“point” options. You'll also be given options to help you cover closing costs. Your lender will assist you in choosing which option best meets your specific needs.

Underwriting:

When any mortgage loan application is reviewed, lenders try to answer three basic questions: 1. Does the borrower make enough monthly income so the debt ratios we discussed earlier are within the appropriate range (pay stubs and tax returns)? 2. Has the borrower demonstrated an ability to pay bills (credit report and FICO score)? 3. Does the home the borrower is buying appraise to value (appraisal)?

Once the lender has collected all pertinent documentation, it will be reviewed and sent to underwriting. At this stage, the lender may need additional information from you to support or explain issues that surface. For example, something may have shown up in your credit report that requires explanation. You may sometimes feel the lender is prying, but this information is needed to make a sound decision which is best for you. Remember, you will be getting a lot of money. Lenders want to ensure you stay in your new home and are able to pay them back.

If your loan-to-value is greater than 80 percent (you have less than a 20 percent down payment),

you also will need “PMI insurance.” You must pay the cost of this insurance, which typically adds \$30–\$40 to your monthly payment.

Compliance Review: In addition to the lender review of your file, there also will need to be a “compliance review” by IHDA to determine whether you meet three additional requirements:

1. Are you (and spouse, if married) a first-time buyer, meaning you haven’t owned a home in the last three years (verifiable through tax returns)?
2. Is your household income below the income limits for your county and family size (verified through pay stubs with year-to-date earnings and your tax returns)?
3. Are you purchasing a home which does not exceed the maximum income limit for your county (verified via a sales contract)?

Because IHDA will be looking at your loan file, too, the entire loan process can take a few extra days.

Closing: By this time, you may have experienced a few panic attacks, accompanied by chills and sweating. The scary feelings may grow as you write and sign some of the biggest checks in your life. Known as “buyer’s remorse,” this is to be



expected. But don’t worry. It’s all a normal part of the process. And remember: You’re not the first and won’t be the last to make the big decision called “buying a home.” Many others have survived, and you will, too.

When your loan is approved, you will be advised by the lender and your Realtor® that a “closing” must be scheduled. This is when a good Realtor® and lender can be truly appreciated. They will advise you what to bring to closing, where to be, and at what time. If an attorney

assists you, you need to let the lender know that you want your attorney to review all of the closing documents.

At the closing, all final legal documents are signed. Then, money and deed are exchanged. You will be told to sign your name to what seems to be an endless stream of very intimidating and legalistic documents. This is why it is wise to use an attorney. Most documents will be standard, uniform forms used industry-wide. It's nice to have the assurances of a lawyer as you go along. You will sign a mortgage, note, HUD 1, re-sign the Affidavit of Borrower, mortgage rider, etc. What you need to pay attention to is that the loan amount, interest rate, property address and borrower names are consistent from one document to the other. Further, if you are using one of IHDA's closing cost assistance programs, make sure the credit is reflected on the HUD 1.

Completing the Process

You have just purchased a new home. Now, all you have to do is move in, tie up any loose ends back at your apartment, restructure your bill payments to accommodate your new mortgage, and enjoy a lifetime of quiet Saturday nights.



(Please note: Nothing in this booklet is intended as, nor should be construed as, legal advice. The contents are designed solely to familiarize first-time homebuyers with the process and to answer their basic questions. For binding legal advice, you should always consult an attorney.)

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A Homebuyer's Glossary

Following are definitions of key terms found in this booklet. They may not be familiar to you but are commonplace in the mortgage industry. They are **not** intended to be exact “legal” definitions. These terms are defined to help you understand basic homebuying concepts in simple, understandable language.

Affidavit of Buyer – An IHDA-specific document the lender will provide, which asks you basic information about the sales transaction.

Affidavit of Seller – An IHDA-specific document the lender will send to the seller seeking basic information about the sales transaction. (Hopefully, it matches terms in the Affidavit of Buyer).

APR (Annual Percentage Rate) – A somewhat complicated formula that factors all costs associated with obtaining a mortgage into a single interest rate that lasts over the life of the loan. It does not affect your note rate, but it does show you how all of the points and fees, added together, can impact your overall rate.

Appraisal – A process by which a trained, certified individual inspects a property and determines its relative value compared to similar properties in the market.

Credit Report – A report provided by a credit bureau which lists an individual's credit references and payment history.

Credit Score – A mathematical scoring of your credit which ranks the quality of your credit and/or predicts the likelihood of default.

Deed – The document that transfers ownership of land from one party to another.

Escrow – A portion of your mortgage payment that is accumulated over the year and is used to pay your real estate taxes and homeowner's insurance when they are due.

FICO – A nationally recognized scoring system that assigns a numerical value or ranking to the quality of an individual's credit.

Home Inspector – Someone contracted to inspect the property and assess any serious problems with the structure or mechanics of the home (such as heating, wiring, etc.).

Homeowner's Insurance – An insurance policy purchased by a homeowner that insures property and belongings against losses due to certain events.

HUD 1 (RESPA Statement) – A legal document which requires the lender to clearly identify every and all charges to the borrower and specify where the proceeds are to be disbursed.

IHDA (Illinois Housing Development Authority) – A governmental body established by state law and granted authority to sell tax-exempt bonds for the purpose of assisting low- and moderate-income individuals in obtaining housing.

Loan-to-value (LTV) – The mortgage loan amount divided by the purchase price.

Mortgage – A legal document that establishes a lien against the property. If you do not live up to the terms of the Note, the lien holder (usually a lender) may take the property back.

Note – A legal document that states a borrower agrees to pay to a lender a certain amount of money, at a specified interest rate, over an agreed period of time and at what intervals.

P.I.T.I. – The term used in describing the four basic parts of a house payment: **P**rincipal, **I**nterest, **T**axes and **I**nsurance.

Point – An amount equal to 1 percent of the principal amount of the mortgage loan. Points are a one-time charge assessed by the lender at closing to cover its costs.

Primary Mortgage Insurance (PMI) – Insurance paid by the borrower which provides some coverage for losses which may occur in the event of a foreclosure. This insurance is required for all loans that are greater than 80 percent LTV.

PMI Acknowledgment – A document explaining the terms and conditions that must be satisfied before the borrower can cancel PMI insurance.

Realtor® – A licensed, trained professional who assists individuals in buying or selling property.

Recapture Notice – An IHDA-specific notice which informs homebuyers about a potential tax to which you may be subject if you sell your house within nine years, realize a capital gain upon sale and have had annual growth in income greater than 5 percent per year.

Title – The evidence of the right of ownership in property. In the case of real estate, the documentary evidence of ownership, in most cases, is the title policy that specifies in whom the real estate is vested, along with a history of ownership and transfers.

Title Insurance – Insurance paid by you and the seller (seller pays about 80 percent) which assures the investor that there are no other liens which have been placed on the property (e.g., unpaid taxes). Also referred to as having “clean title.”

Truth-in-Lending Statement – A document which estimates the total costs and charges to the borrower when obtaining a loan. This document is issued prior to closing.

Walk-Through Checklist

Here are things you should look for when you're house hunting. Don't limit your observations to the house and its immediate surroundings. Consider the big picture, too. Thus, as you drive to the **neighborhood**, check for the following:

- How far is the nearest shopping?
- How long will it take to get to work?
- How far are the nearest schools?
- Are the streets well lighted?
- Are there parks in the area?
- How are the surrounding homes maintained?
- If you have children, do you see signs of kids?
- Ask your Realtor® about recent sales in the neighborhood. How long were the houses on the market? Is there high turnover?
- How far is public transportation?

As you arrive at the property, resist the urge to go inside immediately. First, take time to check **the house from outside** by looking around for the following:

- How does the house look from the street? This is known as "curb appeal." How does it look in comparison to others around it?
- Check the roof. Do you see any missing or raised shingles? In what condition are the gutters and down spouts? Is there peeling or cracking exterior paint?
- What type of siding does the house have? Is it maintenance-free (aluminum/vinyl) or will you need to paint (immediately or sometime in the future)?
- Check the windows. Are they maintenance-free, or will they need painting? Look for dry rot around the sill of the windows and exterior doors.

- ❑ Look at the foundation, especially where the down spout discharges. Are there cracks in the foundation or excessive erosion?
- ❑ If there is a porch, check for dry rot and maintenance requirements.
- ❑ What does the landscaping look like? Is it consistent with the neighborhood?
- ❑ If there is a detached garage, check it out. Turn lights on, check for leaks in the roof and operate the garage door to see if it opens and closes. Can you lock the garage? Is there storage for lawn mowers, etc.?

Now it's time to **enter the house**. Remember to be courteous. Although you may be the next owner, it's still someone else's home. Act like a guest. Here are things to look for inside:

- ❑ You should not decide on a house based on decorating, but you do need to think about what you will want to change as soon as you move in. What will it cost? Can you afford it?
- ❑ Observe the room layout. Is it convenient? Does it appear that the house has been well-maintained? Imagine where you would place your own furniture. Find out how often the furnace and/or air conditioning have been serviced and when it was done last. How old is the furnace?
- ❑ Ask if there have ever been termite or other pest infestations. What was done to address the problem?
- ❑ Your eyes, ears and nose are wonderful tools. Does the house smell musty or damp? Do the floors squeak when you walk on them? Are the floor coverings acceptable?
- ❑ Flip the light switches on and off. Do the same with the water. Smell it and taste it. Flush the toilets. If the house is serviced by well and septic, find out when they were tested last and when they are scheduled for service again.

- Go in the basement and look for water stains. Don't be afraid to ask whether there has ever been water in the basement due to flooding. If so, how often? What has been done about it? If there is a sump pump, does it work? Also, look for possible infestation signs such as wood dust or animal droppings.
- How old is the hot water heater and well pump (if applicable)?
- Ask about the average monthly electric, water and gas bills and type of insulation.
- What is the current electrical service: 60 amp, 100 amp or more? While 100 amps or more is preferred, many houses have 60 amp service. If this is common in a particular area, it won't stop the sale. However, understand a 60-amp system has been used for many years and will probably need upgrading in the future.
- Do you have adequate closet and other storage space? Where do the current owners store their things?

This is not an exhaustive checklist, but it will get you started. Good Realtors® will be more than happy to assist and advise you as you go through the house. Use their skill and knowledge, and take notes as you go. This will help you remember details of each house you visit—details you'll want to be sure of when you begin comparing houses. Finally, if you like a house but are unsure about something, you can negotiate your sales contract to include home inspections, termite inspections, well and septic inspections, etc.

Federal Resources

Fannie Mae

www.fanniemae.com
(800) 732-6643

Fannie Mae Homepath Site

www.homepath.com
(800) 732-6643

Freddie Mac

www.freddiemac.com
(800) 972-7555

Freddie Mac Homesteps

www.homesteps.com
(800) 972-7555

U.S. Department of Veteran's Affairs

www.va.gov
(800) 827-1000

State Resources

Illinois Housing Development Authority

401 N. Michigan Ave., Suite 900
Chicago, IL 60611
(800) 942-8439
www.ihda.org

Homebuilders Association of Greater Chicago

635 Butterfield Road, Suite 100
Oakbrook Terrace, IL 60181-4000
(630) 627-7575

National Association of Home Builders

1201 15th Street NW
Washington, D.C. 20005
(800) 368-5242
www.nahb.com *or* www.nahb.net

Home Builders Association of Illinois

112 W. Edwards St.
Springfield, IL 62704
(800) 255-6047

Illinois Association of Realtors®

3180 Adloff Lane
Springfield, IL 62703
(800) 752-3274
www.illinoisrealtor.org

City Resources

Chicago Department of Housing

318 S. Michigan Avenue
Chicago, IL 60604
(312) 747-9000
www.ci.chi.il.us