

Kenneth Lieberman, ESQ.

Real Estate Guide

AMHERST, MASSACHUSETTS

© 2007 *First published in the Daily Hampshire Gazette website*

Kenneth Lieberman, ESQ.

Real Estate Guide

AMHERST, MASSACHUSETTS

© 2007 *First published in the Daily Hampshire Gazette website*



Real Estate Guide

My real estate series entitled "*The Real Estate Digest*" ran on the Daily Hampshire Gazette's (Northampton, Mass.) website. This thirteen-chapter column is designed to be an educational guide for buyers and sellers to demystify the complexities and details of buying and selling real estate.

I hope you enjoy reading my articles, and if you have any additional questions, please do not hesitate to call me at 413 549-4448 (Western, Mass.) or 508 696-9640 (Martha's Vineyard, Mass.)

CONTENTS

	CHAPTER 1
1	Hiring Your Listing Broker
	CHAPTER 2
3	Listing Broker Expectations
	CHAPTER 3
7	The Purchase Offer
	CHAPTER 4
10	The Purchase and Sale Agreement - Part 1
	CHAPTER 5
13	The Purchase and Sale Agreement - Part 2
	CHAPTER 6
16	The Purchase and Sale Agreement - Part 3
	CHAPTER 7
19	Financing A Residential Real Estate Purchase
	CHAPTER 8
22	Types of Loans
	CHAPTER 9
25	Mortgage Lenders & Mortgage Brokers
	CHAPTER 10
29	Title Examinations
	CHAPTER 11
31	Title Insurance
	CHAPTER 12
32	Appraisals
	CHAPTER 13
36	The Closing

Hiring Your Listing Broker

We'll start from the perspective of a seller who is considering which real estate company and/or broker to engage to list the property. The listing broker helps establish the market value and a reasonable asking price for the property. He or she will explain aspects of the selling process to the seller such as the most effective way of showing the property, what sort of advertising will be used and how to make the property most attractive to potential buyers.

The listing broker is responsible for placing the property on the Multiple Listing service (MLS) so that the property is exposed to all realtors in the market. The listing broker will handle inquiries from other realtors and should actively assist in the negotiating process with potential buyers. In the next chapter, I will expand upon the aforementioned responsibilities of the listing broker and how to accomplish the result of getting the seller the highest price.

When interviewing prospective realtors, remember to ask the following questions, especially if you never used a realtor before:

- Ask them what factors they consider in preparing a comparative market analysis in order to arrive at an asking price.
- Sellers should ask the realtor to get a printout of selling prices of homes listed in the past year AND the original listing prices. Selling price is useful, but knowing what they originally listed for and how much the sellers dropped the price is important information.
- Ask the realtor if the commission is negotiable. In addition, ask how much of the commission will be split with buyers brokers. If buyers brokers have more incentive, more potential buyers will be brought to your home.
- Ask the realtor how they plan to market and sell your house. Get it all in writing and never rely on verbal promises.

- Ask the realtor to accept a contract for 90 days. Many realtors will ask you for a longer contract. It's best to avoid long-term contracts. If the agent is doing a good job you can always renew the contract.
- Try to negotiate a contract where the seller reserves the right to sell the property to a buyer who was not introduced to the property by the realtor and the seller does not have to pay a broker's fee.

Of paramount importance in any transaction is that a buyer or seller has confidence that his or her broker and attorney maintain good communication with all parties. It is also important that your broker and attorney provide moral support. Buying and selling property is a very emotionally charged experience for most people, particularly if a party is both selling and buying property and must coordinate two transactions.

Listing Broker Expectations

In the previous chapter, I posed questions that should be asked a potential listing broker and/or realtor before signing a listing contract. These questions addressed pricing and market value, showing the property, marketing and advertising. The first question posed was to inquire as to what factors are considered in preparing a comparative market analysis in order to arrive at the asking price.

Pricing to Sell and Market Value

The probability of receiving an acceptable offer on your home and completing a sale decreases significantly when your asking price is higher than the current market value. To keep your asking price within the current market value range, an analysis of the factors that affect value must be made. These factors include:

- Your property and its strongest selling points. These include location, condition of property, size of home, size of lot, special amenities and property attributes
- Buyer demand
- Seller motivation
- Financing available and interest rates
- Recent selling price of comparable homes in your neighborhood or community
- The asking price of other homes for sale in your community
- Expired listings that show homes offered for sale that did not sell

The asking price should be based on the information in the marketplace and your comfort level. After the above analysis is made,

your realtor should suggest a competitive price range that will entice maximum buyer activity. With this information, you can make an informed decision about your asking price.

Keep in mind there is danger in overpricing. Prices that are too high for the market attract lookers, not legitimate buyers. High pricing can imply that you are not motivated to sell. It will reduce the number of showings and it helps make the competition look better. In addition, if the property doesn't appraise at the higher price, the buyer may not be able to secure a loan and the deal can fall apart. You may face the uncomfortable reality of dropping your price below market value in order to sell.

Showing Your Property

Doing whatever you can to put your house's best face forward is very important if you want to get close to your asking price or sell as quickly as possible. Short of spending a lot of money, here are several ideas for making your home show better:

- Sweep the sidewalk, mow the lawn, prune the bushes, weed the garden and clean debris from the yard.
- Be sure that the doorbell works.
- Clean and spruce up all rooms, furnishings, floors, walls and ceilings. It's especially important that the bathroom and kitchen are spotless.
- Organize closets.
- Make sure the basic appliances and fixtures work. Get rid of leaky faucets and frayed cords.
- Make sure the house smells good: from an apple pie, cookies baking or spaghetti sauce simmering on the stove. Hide the cat litter.
- Put vases of fresh flowers throughout the house.
- Pay special attention to pets, particularly dogs. They can be intimidating. Put them on a leash and in the backyard. Better yet, when possible, take them with you. And be keen to pet odors. They can turn buyers away.

- Having pleasant background music playing in the background also will help set your stage.
- Once your home is being shown strive to keep it in tip-top shape.

Advertising and Marketing

One of the primary advertising tools a realtor utilizes to market your home to the widest buyer group possible is the Multiple Listing Service. The MLS is a service that real estate agents subscribe to in order to share information about their listings. All real estate agents with MLS membership can access information and photos of every property listed in the MLS. The statewide MLS (MLSPIN) covers all counties in Western Massachusetts.

With the increasing use of the web as a real estate search tool, you may think you can simply post your home on the Internet and buyers will find you. They might, or they might not. But having your property listed in the MLS guarantees it will receive the widest possible exposure, since agents from member firms can show all of the properties placed in the MLS, regardless of who the listing agent is. An advantage the MLS has over listing information on the Internet is accuracy. The MLS is updated continuously, but Internet information may be weeks old.

Some discount brokerages are also not members of the MLS, which means their listings are not available for other agents to see or show. If you hire one of these firms, remember that it reduces the exposure your property will get.

The MLS is a great tool for exposing your home to the largest pool of potential buyers. If you'd like more information about the benefits of the MLS or how it can work for you, contact me.

The Multiple Listing Service is a cooperative marketing system set up by Realtors to facilitate real estate transactions. Under this arrangement, Realtors register all of their listings in a central index. With this index, any Realtor, regardless of their agency affiliation, is able to sell any house listed by any agency.

In addition, the listing agency you choose should have a marketing plan to review with you in detail as to how they will market your property.

Marketing Plan

Services your listing broker should provide:

- Prepare a Comparative Market Analysis to establish the fair market value of the house.
- Prepare and sign a listing contract.
- Register property with the Multiple Listing Service so that it is exposed to all real estate agents in the area regardless of their agency affiliation.
- Schedule the property for the Multiple Listing Service agent tour.
- Arrange showings for other agents.
- Place a "FOR SALE" sign on the property.
- Place advertisements in the local papers and real estate magazines.
- Hold open houses.
- Contact you regularly with written and verbal reports about the showings of your house as well as any changes in the real estate market.
- Periodically review marketing activities with you.
- Present and discuss all offers with you.
- Negotiate the transaction with the other agent and/or attorney.
- Solve any problems that may arise.
- Confirm that all contingencies on the contract have been finalized.

The Purchase Offer

Sellers and buyers of residential real estate often believe that an offer to purchase is a formality that creates few obligations. This article will address the obligations created by an accepted offer to purchase as well as the terms that should be included in any offer to purchase.

The question of what constitutes a contract for the sale of real estate is often more complex than it sounds. Many brokers, sellers and buyers have the mistaken notion that an accepted offer to purchase is not enforceable and that only an executed purchase and sale agreement will be recognized as legally binding. Due to this misconception, offers to purchase have been subject to much litigation.

Whether an accepted offer constitutes a contract depends on the following:

1. The requirements of the Statute of Frauds have been met (G.L. Chapter 259, Section 1). The Statute of Frauds requires that a contract for the sale of real estate must be made in writing and signed by the party to be bound. In addition, the land must be described in sufficient detail so that it can be located with certainty.
2. The parties intended to be bound
3. The parties have agreed to all essential contract terms. Essential terms do not include the specific time the contract will be consummated, the quality of title the seller must deliver, and in some cases even the price, which may be proved by legal evidence.

The language in the offer to purchase that refers to the execution of a purchase and sale agreement is important in determining whether the parties to an accepted offer intend to be “presently bound”. An offer to purchase that contains a provision that the parties “*shall execute the Standard Purchase and Sale Agreement*” or a “*mutually satisfactory Pur-*

chase and Sale Agreement” has been held by Courts in Massachusetts that the parties intended to be bound. In order to guarantee that an offer to purchase will not bind the parties, the following “*site harbor*” provision is recommended:

The purpose of this Offer is to memorialize certain business points. This Offer is not intended to create nor does it create any binding legal obligation on the part of either party other than the obligation to negotiate in good faith towards execution of a mutually satisfactory purchase and sale agreement by *(insert date)*. If a mutually satisfactory purchase and sale agreement has not been executed and delivered by Buyer and Seller by *(insert date)*, then all deposits paid hereunder by Buyer shall be refunded, Buyer shall have no further rights with respect to the property described herein, and this Offer shall be null and void and neither party shall have any recourse against the other with respect to this Offer.

It is important to note that other essential contract terms can be used by the buyer to get out of the deal. I will discuss the reality in the context of describing the other essential terms in an offer to purchase.

The buyer’s contingencies are essential to almost every residential real estate transaction. Most buyers and sellers agree to some variation of the following language, which is usually handwritten on the offer to purchase:

1. ***“Subject to a home inspection of the property that is satisfactory to Buyer on or before an agreed date.”***

The agreed date is then written into the offer to purchase. This date can be extended by written agreement between the parties. The extension must be agreed to before the expiration date.

2. ***“Subject to Buyer’s obtaining a firm written commitment for financing in the amount of (\$) on or before an agreed date.”***

This date can also be extended by written agreement as described above.

Buyers can usually get out of the deal by exercising the inspection contingency after a written inspection report has been prepared. Clearly, the inspection report would have to document some problems that the buyer can recite as the reason to backing out of the deal. In addition, if the buyer cannot obtain financing and the proper written notice is given, the buyer can similarly void the contract.

The Offer to Purchase will include a provision for the amount of deposit required to bind the contract. This amount is usually \$500 to \$1,000. Standard offer to purchase forms usually include a liquidated damage provision in the event a party, particularly the buyer, defaults. Liquidated damages means that if the buyer does not perform under the offer, the seller's retention of the deposit is the seller's sole remedy against the buyer.

The Purchase & Sale Agreement Part 1:

In this chapter, I will explain the connection between the Offer to Purchase and the Purchase and Sale Agreement (a.k.a. the P & S). This is Part 1 of a 3-part series on the Purchase and Sale Agreement due to its complexity.

Execution Of The Purchase And Sale Agreement

The offer to purchase contemplates that a purchase and sale agreement will be executed by a certain date. It is good practice to execute the purchase and sale agreement by the contemplated date. In reality, however, the contemplated date is often not met. As I outlined in my previous article on offers to purchase, if the parties intended to be bound, the fact that the purchase and sale agreement was not executed by a certain date, will not void the contract.

Typically, sellers want the P & S agreement to be executed as soon as possible. This is due to the basic fact that the seller wants the full deposit to be paid, giving the buyer greater incentive to avoid default and to close on the property. A buyer, however, would like to delay the signing of the P & S until the inspection has taken place in order to avoid paying a large deposit until he/she knows the condition of the property. Most offers to purchase are bound by deposits of between \$500-\$1000. A typical P & S agreement will require at least 5% of the purchase price to be paid as a deposit.

Essential Terms

The essential terms from the offer to purchase will be incorporated into the P & S agreement. The P & S agreement, however, is a much more detailed legal document than the offer to purchase.

The first paragraph of a purchase and sale agreement identifies the parties. The party identified as the seller should be owner of record of the property. If the party identified as the seller or buyer is a corpora-

tion, an executor, administrator, trustee, fiduciary or agent, their legal authority to enter into a P & S agreement must be determined. The party named as the buyer must be correctly identified. It is helpful in identifying the buyer to set forth his or her complete address.

Subsequent paragraphs in a P & S agreement do not have to follow a set pattern as long as the essential terms are incorporated into the document. Typically the next paragraph will be a description of the property. A description of the property's street, number and approximate area, and a reference to the seller's deed are usually sufficient for the sale of residential property to be valid. It is good practice to incorporate the deed into the P & S agreement.

Fixtures and personally property that are included in the sale should be identified, although an integral part of a residence, such as a furnace, is considered part of the real estate and is automatically included in the sale, even if not mentioned by name. Items that are not integral parts of the residence such as television antennas, lighting fixtures and window shades are often the subject of disputes and therefore the agreement should be specific as to what is included. It is also important to specify which appliances are included in the sale. This paragraph should be thought about carefully as you do not want to get to the closing and suddenly find yourself in a dispute as to whether or not the children's playground set in the backyard is part of the sale.

Conveyance Of Title – Two Types Of Deeds

There are two types of deeds normally involved in a real estate transaction. A warranty deed provides covenants to the buyer that at the time the deed is delivered, the seller-grantor owns the land in fee simple (the highest form of ownership) free from encumbrances, other than those specifically set forth in the deed. The seller-grantor and any heirs will warrant and defend the title of the buyer-grantee against the lawful claims and demands of all persons. See G.L. Ch. 183, Sections 10 & 16.

The quitclaim deed is most frequently used in Western Massachusetts. This deed conveys whatever title to land the seller-grantor acquired and covenants to the buyer-grantee that the seller-grantor has not made any encumbrances on the land other than those specifically

set forth in the deed. The seller-grantor and any heirs will warrant and defend the buyer-grantee only against the claims and demands of all persons claiming through the seller-grantor. See G.L. Ch. 183, Sections 11 & 17.

Preparation Of The Purchase And Sale Agreement

Many realtors prepare standard form purchase and sale agreements that they procure from real estate associations such as the Realtor Association of Pioneer Valley. In Western Massachusetts, realtors in Hampden County typically prepare the purchase and sale agreement on behalf of the seller. In Hampshire County, the attorney for the seller usually prepares the P & S agreement. The explanation for this difference in procedure is not legal but rather customs that have evolved in the different counties. If a P & S agreement is prepared by a realtor it should be reviewed by attorneys for both the seller and buyer.

The Purchase & Sale Agreement Part 2

In Chapter 4, I wrote about Purchase and Sale Agreement basics, such as its essential terms, execution, methods of title conveyance, and preparation of the agreement. In this chapter, I explain the two major buyer contingencies which if not met, can allow the buyer to legally and without penalty back out of the deal. This is Part 2 of a 3-part series on the Purchase and Sale Agreement due to its complexity.

The General Inspection Contingency

Even though general inspection contingencies are found in the purchase and sale agreement, one should also be included in the offer to purchase. The inspections should be completed PRIOR TO the execution of the purchase and sale agreement. If, however, inspections cannot be completed or the results obtained prior to the execution of the P&S agreement, a detailed inspection contingency must be added to the P&S agreement. Please also note that regardless of whether the buyer has decided to have the premises inspected, the following should be added to protect the seller.

“Buyer acknowledges that he or she has had the opportunity to have the premises inspected by a professional home inspector of his or her choice, and accepts the premises as they are in ‘AS IS’ condition.”

The following is an acceptable variation of an inspection contingency:

“This agreement is subject to the right of the BUYER to obtain, at the BUYER’S expense, inspection(s) by consultants of the BUYER’S choosing. Such inspections may include, but are not limited to, the structural condition of the dwelling, swimming pool, if any, the condition of all systems in or upon the Premises, the existence and condition of underground storage tanks, if any, the presence of hazardous materials in or on the Premises or the likelihood of release of such hazardous materials on or from the Premises, the presence of asbestos, the presence of urea-formaldehyde foam insulation,

the presence of lead-based paint, plaster or other lead material, the presence of radon, the adequacy of the sewage system and that the premises are free of termites and other wood-destroying pests and organisms. The BUYER and his consultant(s) shall have the right of access to the Premises at reasonable times and in the presence of the SELLER or his authorized representative, upon giving twenty-four (24) hours advance notice for the purpose of such inspections. If the BUYER is not satisfied with the results of such inspection(s), the BUYER may terminate this agreement by giving written notice thereof and by furnishing copies of all written reports stating the results of such inspection(s) to the SELLER on or before December 16, 2005 at 3:00 p.m., in which event all deposits made hereunder shall be forthwith returned to the BUYER and thereafter all further obligations of all parties hereto shall thereupon terminate. If such written notice and report(s) are not furnished on or before the expiration date set forth above, the BUYER shall be bound to perform his obligations under this Agreement. IN CONSIDERATION OF THE BUYER'S RIGHT OF INSPECTION AND RIGHT TO TERMINATE UNDER THIS PARAGRAPH, THE SELLER IS HEREBY RELEASED FROM LIABILITY RELATING TO DEFECTS IN THE PREMISES WHICH WERE DISCLOSED TO THE BUYER OR ABOUT WHICH THE SELLER HAD NO ACTUAL KNOWLEDGE."

Some of the inspections listed in the aforementioned clause must take place. For example, if the premises contains an on-site sewage disposal system, the P&S agreement must contain provisions regarding the existence of such a system and the inspection of the system as required by 310 C.M.R. (Code Massachusetts Regulations) Section 15.00 et. Seq.

If the property was constructed prior to 1978, Buyers should have a lead inspection. Chapter 111, Section 197 of the General Laws of Massachusetts, as amended, provides that:

"Whenever any residential premises containing dangerous levels of lead paint, plaster or other materials undergoes a change of ownership and as a result thereof a child or children under six years of age will become a resident therein, the new owner shall remove or cover said paint, plaster or other material so as to make it inaccessible to such children."

It is now very common for the Buyer to undertake some form of radon test. Radon levels above 4.0 picocuries per liter have been proven to increase the risk of certain types of cancer. Many buyers do not take advantage of the opportunity to procure this test.

Additional inspections must take place if there is an underground storage tank or any issues related to hazardous waste.

At the time of closing there must also be a certificate issued by a professional exterminator stating the premises are free of termites and other wood-boring insects, and any damage caused by them.

Mortgage Finance Contingency

Some form of mortgage finance contingency is found in every P&S agreement unless the property is being purchased for cash. An example of a typical mortgage contingency clause reads as follows:

“Performance by the BUYER hereunder is contingent upon BUYER obtaining first mortgage financing in the amount of (mortgage loan) at prevailing interest rates and terms, which commitment must be obtained by (date). If the BUYER is unable to obtain such mortgage commitment prior to the above date, then the BUYER shall give notice to this fact in writing to the attorney for the SELLER, (attorney’s name), by that date, upon timely receipt of which any funds paid hereunder shall be refunded to the BUYER and the obligations of both parties shall cease. Failure to give the notice as above stipulated shall be deemed a waiver of this provision by the BUYER and BUYER’S performance shall not otherwise be excused.”

The smaller the percentage of the purchase price that the Buyer needs to borrow clearly gives the Seller added incentive to enter into an agreement. It is IMPORTANT to note that Buyers must give the proper notice required by the Inspection and Mortgage Contingency clauses in order to avoid the loss of the deposit.

The Purchase & Sale Agreement Part 3

The previous chapter was more specific about the two main buyer contingencies of the P & S Agreement that allow a buyer to legally back out of the transaction - the home inspection and mortgage financing clauses. In chapter 6, we delve into other important provisions of the P & S Agreement. This is the final part of a 3-part series on the Purchase and Sale Agreement due to its complexity.

Time and Place of Performance

Specifying a time, place and date of performance of the contract is advisable so that both parties know exactly when and where they must tender their performance. In the absence of a clause specifying the date of performance of a real estate contract, the law will imply that a reasonable time is intended. Even if the date of performance is specified, courts of equity will not hold the parties to that date unless the contract expressly states that time is of the essence. This clause should only be used when the seller must close on a certain date because he or she has a contract to buy another piece of property on that date or shortly thereafter. A buyer will use this clause if the buyer wants to guarantee that he or she will be in the home on a certain date. This clause is rarely used by buyers.

Although the Registry of Deeds is where the deed is to be recorded is usually specified as the place for closing the transaction, an attorney's office is usually more quiet and convenient, particularly if last minute corrections to typed documents must be made.

Often both the place and time for performance are changed by mutual agreement of the parties. This agreement is often made orally but good practice is to confirm the change in writing.

Possession and Condition of the Premises

There should be a provision entitling the buyer to enter the premises before the closing to inspect the condition just before the purchase takes place. The condition of the premises should be similar to that of the time of execution of the P & S Agreement, except for reasonable wear and tear.

The seller assumes any risk of loss to the real estate by fire or other casualty occurring subsequent to the execution of the P & S Agreement, but prior to the closing. If the damage to the property is substantial and the property has not been restored to the condition at the time of the execution of the P & S Agreement, the contract should give the buyer the option to void the contract and have the deposit returned. In some instances the parties to the agreement can try to negotiate a lower price and consummate the transaction.

Given the above reality, the seller must keep the property insured through the date of closing. The buyer must have an insurance policy in effect on the date of the closing in the event a casualty loss occurs that day. In addition, the bank providing the mortgage will require that the buyer have an insurance policy in effect. The insurance is evidenced by a document called an insurance binder, naming the bank as loss payee.

Adjustments

Provisions should be made for the adjustment of real estate taxes, water, fuel and other bills on the date of closing. The purpose of this clause is to properly account for all bills so that the parties can go their separate ways without the need for future accounting. The agreement, however, should provide that if the real estate taxes for the year the sale occurs are not known as of the closing date, the parties will apportion taxes on the basis of the previous year's taxes and re-adjust the apportionment when the year's taxes are ascertained.

There should also be an agreement signed at closing that specifies that if any errors in calculating adjustments are made, the parties will pay the appropriate amount when ascertained. In addition, occasionally utility bills other than fuel are not properly apportioned because final readings have not been made by the time of closing.

Payment of Broker's Commission

It is desirable for the seller (who is usually the party employing the broker) to expressly provide in the agreement that the broker will be entitled to a commission only if the sale is consummated. Sellers should pay careful attention to the listing agreement they sign with the broker, to be certain that a commission will be due only if the sale takes place.

The commission is usually split between realtors from two different companies as it is not common, except in smaller markets, that the listing broker and/or realtor will also be representing the buyer. Be aware that in the event of this dual agency, the parties must specifically sign off on this arrangement. The seller will pay the agreed commission, but the split between the real estate companies usually does not involve any input from the seller.

Remedies in the Event of Default

In the event of default by either party, both seller and buyer may bring an action in equity for specific performance of the contract or sue at law for damages, unless the contract provides otherwise. Typically, the P & S Agreement will provide that the buyer's deposit will be forfeited to the seller as liquidated damages if the transaction is not consummated as a result of the buyer's default. It is rare for a seller to default, as the primary reason for the seller to not close the transaction is because there is a defect in title. The P & S Agreement will provide that the seller can back out of the deal if the defect cannot be cured. The buyer usually has the option to complete transaction if he or she is willing to accept the title with the known defect.

Financing A Residential Real Estate Purchase

It is important for home buyers to have an accurate understanding of all costs associated with purchasing the property.

The 28/33 Rule

The borrower (defined as all those who will be liable on the mortgage) must not spend more than 28% of his, her, or their verifiable taxable income for house expenses. These expenses include principal and interest on the loan, taxes, insurance and condominium or homeowners fees, if applicable.

By verifiable, the lender and also the secondary market investor is looking for the following proof of income:

- A verification of employment form (“VOE”) signed by the employer attesting to the applicant’s gross monthly wages, plus expected overtime pay and bonuses.
- If self-employed, tax returns for at least two prior years, including all schedules are required

In addition to subjecting housing expenses to a fixed ratio, the secondary market guidelines for the typical one to four family residential dwellings allow no more than 33% of verifiable taxable gross income to be spent for all fixed debt, including housing costs. Thus, a borrower applying for a mortgage which would necessitate 28% of monthly income being spent on home ownership expenses is not allowed to have other debts (i.e. credit cards, other mortgage loans, car loans, personal loans etc.) that require monthly payments exceeding 5% of gross monthly income.

There are other more liberal underwriting requirements and loan products that can be obtained through other lenders or mortgage brokers, but adhering to these guidelines will allow you to qualify

for the best loan products and programs through your local banks, resulting in the best rates and lowest costs available to you.

The Down Payment

Will the down payment come from savings, a gift, or will it be borrowed from other family members? A borrower should understand that the “earnest money” of typically \$500-\$1,000, which was paid with the offer, must be followed by an additional deposit of 5-10% of the purchase price upon the signing of the P & S Agreement. Federal programs under the Veterans Administration (VA) or Federal Housing Administration (FHA) make down payments ranging from zero to 5% possible for those who qualify. However, if the borrower puts down less than 20% of the sales price, the role of mortgage insurance must be understood. Mortgage insurance protects only the lender in the event that the borrower defaults and the foreclosure sale of the property does not bring enough to pay off the loan in full. Typically the borrower must pay for this insurance as part of the monthly payment and it will be charged to the borrower at least until the loan to value (LTV) ratio equals 80%.

Closing Costs

Generally, closing costs are paid at the time of the actual closing for escrows and for lender, attorney and transfer fees. Escrows can include payment in advance for real estate taxes, homeowner’s insurance, and/or private mortgage insurance. Please note that some lender costs such as appraisal, credit report, points, rate lock fees must be paid in advance. Most lenders provide prospective buyers with an information sheet that outlines these costs, and therefore, comparison shopping is always a good idea.

Funding Sources

There are numerous options available to borrowers when planning to finance the purchase of real estate. For residential real estate the major options are as follows:

- personal savings
- gifts

- sale of current home
- sale of assets
- the seller providing a mortgage (seller financing)
- borrowing against existing collateral (i.e. 401k or home equity loans)
- conventional depository institutions such as banks (savings and commercial) and credit unions
- mortgage companies, either corporate subsidiaries of banks or independent companies with no bank affiliation
- mortgage brokers and correspondent lenders

When deciding which option is best, it is always prudent to know ALL costs associated with the financing.

Points

Points are bank charges based on a percentage of the loan amount (i.e. two points on a \$100,000 loan equals \$2,000.00). The amount of points are no longer regulated in Massachusetts. Points are now subject to what the market will bear. However, regulations that require disclosure of finance charges in credit transactions apply to points charged in a real estate transaction. The applicant should confirm if the points being charged are simply costs of the loan or if they are refundable. Please also be aware if there are point charges for rate locks, rate buy-downs and extensions of the commitment period.

I will discuss interest rates, types of mortgage products, and other detailed aspects of mortgage loans in the following chapter.

Types of Loans

In the residential context, there are three types of loan products available: fixed rate, adjustable rate and interest only loans. A fixed rate loan guarantees that principal and interest (but not the taxes, insurance, private mortgage insurance if necessary, or other escrow amounts) remains fixed for the life of the loan. Usually, this product has a higher interest rate because the lending institution or investor will not be able to see any adjustment over the term based on interest rate changes. In addition, because this loan almost always is sold in the secondary mortgage market to “Fannie Mae”, “Freddie Mac”, or other mortgage investment groups, underwriting requirements tend to be the most rigorous.

In contrast, an adjustable rate mortgage (a.k.a. “ARM”) is one in which there is an initial short-term fixed period, followed by a long-term adjustable period. During this adjustable period, interest rate increases or decreases over the term of the loan drive the monthly payment up or down depending on the movement of the index to which the rate is tied. Usually the rate (and the monthly payment) will change at one, three, or five year intervals, but there are other options available as well. Terms of the note will indicate caps on how much the rate can adjust each payment period, and also set caps for the life of the loan, both the highest amount of interest that could be charged, and the lowest amount (a.k.a. “ceilings” and “floors”). Some adjustable rate loans contain an option to convert to a fixed rate at certain intervals.

Recently, loans with no amortization feature, called “interest only” have garnered popularity. This type of loan can be beneficial in situations where the borrower has substantial equity in the property, and is borrowing money primarily for income tax purposes. This type of loan can be very risky for borrowers or investors who are trying

to purchase a more expensive home than they typically could with a conventional fixed rate or adjustable loan. In the event of declining home prices, the consequences could be disastrous if the buyer needs to sell, as no principal would have been reduced, as with an amortized loan that contains interest AND principal reduction in the monthly payment.

Interest Rates

Some important questions need to be asked and answered:

1. Is so much of the applicant's income dedicated to housing costs that they will no longer qualify for financing if interest rates increase between the date of application and closing?
2. Does the applicant want the stability of a fixed rate mortgage or is the generally lower starting rate on an adjustable note preferred?
3. If the adjustable rate is the buyer's preference, does he or she fully understand how often the rate will change, what rate caps if any will be included in the note, and whether or not the note maturity date coincides with the amortization of the loan or requires a balloon payment at an earlier date?
A balloon payment requires repayment of the full principal amount with interest at a date earlier than that which would be established solely by amortizing the monthly payment over a fixed term of years.
4. Over what term will the note be payable? Fifteen, twenty and thirty year terms are commonly available, but the accompanying increase in the payment may make the shorter term less attractive.
5. Does the buyer want the option of locking in a rate at some point in the application process? What costs, if any, are associated with this option? Does the lender offer the option of "buying down" the rate, wherein the applicant pays additional points in order to get a lower rate?

Rate locks provide protection for the borrower if the rates increase during the period of the loan closing. Rate locks effectively "lock" the rate applied for from the date of application until the expiration of the

rate lock period, usually 30 days. Some lenders are different and the actual rate lock agreement and its terms should be read carefully.

Mortgage Lenders & Mortgage Brokers

There are many considerations for borrowers in choosing whether to pursue a mortgage loan through a local bank, or through a mortgage broker. In this chapter, I will attempt to explore the pros and cons of each, and provide information useful to you if you are in the market for a mortgage loan for your new house, or if you are considering refinancing.

Borrower Considerations

Loans that require understanding of unique circumstances affecting either the property or the borrower will be harder to place and should be carefully matched with the right lender to avoid needless frustration and wasted application fees. A borrower can have complex or unorthodox financial issues, such as being self-employed with harder-to-prove income sources. In the same vein, a property can have unusual attributes which may make it harder to fit into the standardized format conventional lenders apply to their underwriting guidelines which can lack a certain amount of flexibility.

The borrower should be honest with potential lenders about any unique issues and confirm that the lender has a loan program that fits the borrower's needs. Obvious examples are borrowers who have recently filed for bankruptcy protection or borrowers who are planning to act as their own general contractor in the building of a new house. Hiding important information that you believe may negatively affect your ability to obtain a mortgage loan will only result in wasted time for you, your banker, lender, or mortgage broker, depending on your circumstances. It is best to put everything out in the open up front.

Local Banks and Mortgage Lenders

If you have strong credit and either have or are willing to put 20% cash down into the purchase of your new home, it is my advice to

clients to try and establish relationships with local financial institutions. Smaller banks and credit unions offer personalized service and it is always helpful to know your banker. In addition, these institutions offer the strongest terms available in the mortgage markets. Of particular importance, many local financial institutions in the Pioneer Valley will work with you if you have financial problems in the future. Foreclosure is very rare when dealing forthrightly with a known institution in the Valley.

Mortgage Brokers

Mortgage brokers do not lend their own money. They have established relationships with a wide variety of lenders, banks, and investors who have a myriad of loan programs available. The benefit of working with a mortgage broker is that they can literally access hundreds of programs in the market to find the best one for your needs. However, many people believe that by shopping nationally for mortgages on the internet, they will get the best deal. This is not necessarily the case, and sometimes if you come across an unscrupulous broker, they can charge exorbitant points and other fees, so be sure to review this with them up front.

It is important to note that not every borrower fits the strict criteria for conventional mortgage loans, but may qualify for these “non-conforming” or “sub-prime loans”. These include stated income loans for self-employed borrowers, or other loan products that require less money down, and more liberal debt-to-income ratios (a.k.a. “DTI”, which is the ratio between your proposed monthly housing expense and your monthly gross income). Even people with credit problems can qualify.

However, it is important to be sure you can meet your monthly obligations with your new mortgage. There are predatory lenders in the industry, and it is important to know the difference between getting a more creative loan product that suits your needs vs. setting yourself up for an obligation you cannot meet, and ultimately default and foreclosure.

In the event of future financial stress, it can be stressful to deal with an unknown voice on the telephone. Remember to review your Good Faith Estimate to see if your mortgage will be owned and serviced by

the financial institution you are dealing with, or if they plan on selling (a.k.a. “assigning”) your loan to investors in the future.

Loan Origination and Servicing

Many mortgage loans originate for the purpose of being sold into the secondary mortgage market. This market, which is commonly (albeit incorrectly) known as the Federal National Mortgage Association (FNMA or “Fannie Mae”) and the Federal Home Loan Mortgage Corporation (FHLMC or “Freddie Mac”), purchases mortgage loans from the institutions that originate them, whether banks, credit unions, or mortgage companies, and in so doing, provides liquidity to the originating lender. Some mortgage loans are sold to investors as soon as they close. Typically these loans were originated by mortgage brokers. Others are held by the original lender for a period of time, and then sold.

A mortgage loan can be divided into two components – the servicing rights, which is the right, for a fee, to collect monthly payments, pay taxes and other escrow impounds, and remit the principal and interest to the investor, and the note (the right to collect the interest and principal generated by the loan). This reality in the way loans are handled after they close can mean that the loan could be owned by an out-of-state investor (i.e. FNMA or FHLMC, or those groups who bundle or “pool” mortgages together into securities to be sold off to other investors) and serviced by the loan originator. Alternatively, your loan could be owned and serviced by an out-of-state investor; or owned by a semi-public agency such as a state pension fund and serviced by a company in another state. This new complexity in the mortgage market has spawned anecdotes about lost payments, unpaid taxes and insurance premiums, and a general lack of understanding of local customs and the local economy by out-of-state investors. It is important for any borrower who will be pledging a mortgage to a lender to read their documents carefully, and have an attorney review them so they understand what they are agreeing to, as mortgages are complex, multi-page documents with terms that are important to comprehend.

The Federal Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. Section 2601, requires disclosures to be given a borrower within three days of application as to the likelihood that the originat-

ing lender will sell the loan servicing based on past performance, or sell the entire loan outright.

To reiterate, if possible, and if a local bank has a program that fits your particular financial situation, consider exploring the mortgage products of local financial institutions that will both hold and service your loan.

Title Examinations

To ensure marketable title, a title search must be performed. A title search is a process where someone searches the public records in the Registry of Deeds in the county where the property is located.

Title examinations are often performed by attorneys but can also be undertaken by title examiners who are not subject to licensure or insurance requirements. Ultimately, however, it is the lawyer who must sign the certificate of title and be responsible for any problems that might arise.

There are 21 different registries of deeds in the Commonwealth of Massachusetts. A title examiner must have experience not only doing titles but experience in a particular registry. Each of the registries has its own way of doing things, not only in terms of hours of operation and hours of recording, but in terms of available indexes and different computer programs. If the title examiner will also do the recording, the examiner should also understand issues they may have to face when recording in that particular registry (e.g. the land bank forms in Nantucket, Martha's Vineyard and the higher tax stamp rate in Barnstable).

The title examiner will go through the grantor and grantee indexes and examine the documents recorded in the land registry concerning that particular piece of property. A grantor is the person by whom a grant is made, a transferor of property. A grantee is one to whom a grant is made, a transferee of property. In simple terms, grantor refers to the seller, and grantee refers to the buyer.

A title search generally includes mapping a chain of title by examining all the recorded documents concerning the property. A chain of title is established by determining that the present owner received valid title from the prior owner, and the prior owner received valid title down the line for a period of at least 50 years. If you want to

learn more, see the Massachusetts General Laws (M.G.L.) Chapter 93, Section 70.

A title examination can disclose many types of liens such as easements (e.g. utility and telephone access) which run with the land and are not discharged at closing. Temporary liens such as mortgages, attachments, IRS liens and other encumbrances are typically paid off at closing. Finally, hybrid liens that include restrictive covenants can require approval of building plans but otherwise remain in effect, or can contain orders of condition that require a certificate of compliance that may need to be taken care of at the closing.

If the title examination discloses liens that should have been taken care of at a prior closing, a competent attorney must rectify the problem in order to certify marketable title. This can be a frequent occurrence given the proliferation of bank insolvencies and merges over the past 25 years. Finding the proper legal entity to discharge the mortgage can be painstaking work.

It must be noted that title examiners can only research recorded documents. Issues can surface after the closing regarding fraudulent documents, improperly executed documents and a myriad of other problems not readily identifiable at the Registry of Deeds. This is why title insurance is essential.

Title Insurance

Title insurance provides the best protection to you and your lender against possible title defects that could result in claims against your property. For a one-time premium, an owner's policy protects you against potential title defects that could ultimately deprive you of your ownership rights to your home. Similarly, a lender's policy issued to your lender protects its mortgage interest in your property. In the event of a claim, the title insurance company will either correct the covered title problems or will reimburse you and/or your lender for insured losses up to the amount of the policy and will defend against any lawsuit attacking the property.

Coverage under an owner's and lender's policy are not the same. Owner's and lender's must be insured under their own separate policies to be protected. A lender's policy insures only the lender against title defects that could affect its mortgage interest in your property and only up to the amount owed on the mortgage. The loan policy premium is required by lenders in Massachusetts and is included in your closing costs. The owner's policy is not required but is the primary way to protect the owner's interest in the property beyond the amount of the mortgage. If the owner's and lender's policies are issued simultaneously, there is a substantial discount rate on the premium.

Title insurance also provides coverage for matters that predate a title search. Under Massachusetts law, Chapter 93, Section 70, the starting point for a title search is 50 years. For example, if a missing heir came forward and their interests were determined to have arisen prior to the starting point of the title search (which would be 1956 for the current calendar year), their claim if proven would be covered under the title insurance policy, but possibly not under an attorney's certification of title. This means that if no owner's title insurance policy was in effect at the time of the claim, the owner could be at

risk of losing their entire equity in the property beyond the amount owed on the mortgage.

An attorney's certification of title is an opinion of the quality of the "record" title based on a review of the public records at the registries of deeds and probate. The certifying attorney, however, may not be responsible for numerous title defects that would not be found despite the most thorough search of public records, such as:

forged documents

unknown creditors

undisclosed missing heirs

missing signatories

mistakes in recording

incapacity of grantor/seller

unauthorized deeds from partnerships, corporations and trustees

deeds executed under falsified power of attorney

There are over 60 or so ADDITIONAL legal reasons not listed above that can adversely affect the title. All of these hidden defects are covered by the title insurance policy.

Title insurance can also help when you want to sell or refinance your property. Potential buyers or lenders may refuse to purchase or finance your property if they believe the title is unmarketable. The title insurance policy insures against loss or damage suffered by the insured due to the marketability issue and title insurance may enable the sale or financing to go through by offering to insure the buyer or lender against any title defects that may be known to exist. In addition, title insurance companies have in-house counsel who are experienced in correcting title defects. If the claim is covered by the title insurance policy, all work to remove the defect will be paid for by the title insurance company, including representation of the insured in a lawsuit to establish the title as insured or to remove the encumbrance.

Title insurance can save you and your lender thousands of dollars in legal costs, and more importantly, the emotional nightmare of

waking up one day to find out that some stranger has a potentially enforceable claim against your property – a property to which you believed you had full ownership rights.

For most people, a home is their most valuable possession. It is my strongest advice that paying a one-time premium to protect this asset is both prudent and necessary.

Appraisals

A real estate appraiser is an important, independent third party who provides an appraisal of real property, an objective report on the estimate of value of real estate. Real estate appraisers are subject to licensure in Massachusetts by the Board of Registration of Real Estate Appraisers. Rules and regulations can be found at 264 CMR (Code of Massachusetts Regulations) and in the licensing statutes, M.G.L. Chapter 112, Sections 61 to 65 and 173 to 195.

The value of real estate is reflected in the amount the buyer is willing to pay as set forth in the purchase and sale agreement and is further substantiated by an appraisal of the property obtained by the lender, usually at the borrower's expense. Although the buyer's decision to pay a certain price may reflect the buyer's personal likes and dislikes, the appraisal is based on objective criteria. In general the appraiser establishes a value based on the cost of replacing the existing structure and on the recent (i.e. past six months) sales prices for comparable properties of the same general type of construction, style, size, and geographic area. As a result of the appraisal, the buyer may find that an amenity that convinced him or her to offer a higher price (i.e. a finished basement or beautiful view) has minimal bearing on the value assigned by the appraiser. In the event that the appraisal is less than the sales price, the borrower should expect that the loan amount offered by the lender will be reduced accordingly. Lenders usually will not lend more than 80% of the property's value without mortgage insurance, but this is not a fact for every lender or mortgage program in the market. Therefore, the appraisal must show a value of at least 1.25 times the proposed loan amount. In the event that the appraisal is not high enough, the applicant will have a choice of either negotiating a lower sales price, paying mortgage insurance, putting more money down, or backing out of the deal due to the inability to satisfy

the terms of the mortgage commitment as spelled out in the purchase and sales agreement.

To help the appraiser complete the appraisal, the owner, buyer or realtor can provide information that is useful to the appraiser. Please tell the appraiser if there is a pending purchase and sale agreement on the property and the agreed upon price. Point out amenities and improvements that can add value, particularly if these improvements can help distinguish between comparable properties that have recently sold in nearby subdivisions. It is always a wise idea, as a seller, to spruce up any cosmetic work BEFORE the appraiser comes to your doorstep, as this will help you to obtain as high an appraised value as possible.

The Closing

The real estate closing is the culmination of the real estate purchase and sale, where all the many documents and purchase funds are brought together with the oversight of licensed attorneys to successfully transfer the ownership rights and property (the deed) from the seller to the buyer. It is mandatory that a licensed attorney oversee closing services in Massachusetts.

At the closing, careful consideration must be given to the many documents which must be signed. The parties must be assured that all the obligations described in the Purchase and Sale Agreement have been fulfilled. In addition, items such as water and sewer charges and real estate taxes must be adjusted between the buyer and seller. Sometimes it is necessary for money to be held in the attorney's escrow account to assure compliance with all the obligations of the Purchase and Sale Agreement. For example, money for a Title V compliant private sewer system repair that the seller agreed to, but could not complete due to frozen ground as a result of a closing in mid-Winter.

The lender/buyer's counsel acts as the settlement agent and prepares the settlement statement (a.k.a. "the HUD" or "HUD1") which itemizes the closing costs, the expenses of the seller and buyer, and the adjustments between them. In Western Massachusetts, the buyer's counsel usually acts in the dual capacity of representing both the buyer and the lender. There is a mutual interest in that both the buyer and lender must be assured that there is clear and marketable title to the property. In addition, the lender has legal obligations to the buyer regarding notifications, such as truth-in-lending disclosures and good faith estimates of closing costs.

It is of paramount importance that buyers are educated as to the legal significance of the documents they sign. Although many attorneys have been involved in hundreds if not thousands of closings, every

transaction is significant and involves large sums of money. A closing should not be a legalistic formality where the buyer is given papers to sign without adequate explanation. In particular, the mortgage and promissory note should be explained in detail.

The purchase of a home, condominium, investment or commercial property is usually the single most important investment that person makes. By retaining competent legal counsel early in the process, the buyer and seller can minimize the chance for any error and ensure a smooth and orderly closing.