



In our society, each person is responsible for managing his or her own life and finances. If you don't look out for your own finances, chances are nobody else will. Most Americans have had only minimal training in financial management. Some people are highly skilled at wealth management, while others are not. Some people trust others to manage their wealth, others take care of it themselves, and still others don't have any wealth to manage. Those who blindly trust others to do what is best sometimes find themselves disappointed and may even become victims. For many people, the problem is not a lack of knowledge but a groundless trust in other people. One of the goals of this book is to illustrate when putting your trust in your fellow man may or may not be a good idea, especially if that person is paid on commission.

The main goal of this book is to provide an objective, unbiased guide for making smart decisions throughout the home-buying process. In the recent housing crisis, some homebuyers have been taken advantage of by real estate and mortgage lending professionals. The Appraisal Institute, a trade organization of real estate appraisers, believes in empowering homebuyers with the knowledge necessary to make smart home purchases. The book's author, who is an Appraisal Institute member, is not endorsing or offering any other products or services. As you read this book, you may notice that different players in the real estate and mortgage lending industries are discussed and their biases are explained. Unlike these individuals, the appraiser should be an objective, unbiased professional and in a unique position to educate homebuyers.

This book explains the duties and obligations of various participants in the home-buying process. It is not intended to bolster the position of any



What You Need to Know Before Making an Offer

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The process of buying a house should ideally be analytical, logical, and predictable. However, this is usually not the case. Emotional forces often dominate home buying decisions and can sometimes cause a buyer to pay too much for a home. On the other hand, if you buy a house at a great price but it is not what you want, that's no good either. The goal of this chapter is not to make you into a fierce financial negotiator but to help you make sure you are paying a fair price for the house you want.

Shop the Market Completely

Once you own a house, it's too late to do anything about what the market will pay for it when it's time to resell. You won't make money in real estate if you are cavalier about what you pay for it in the beginning. There is no substitute for shopping the market, buying when the time is right, and waiting when it is not.

Don't Buy at the Top of the Market

EXAMPLE

Lisa's friends told her about how much money they've made from buying and selling real estate. Lisa has watched some late-night TV infomercials that make claims about how easy it is to get rich in real estate. Lisa's friends and the infomercials have said that you can't lose money when you invest in something that increases in price by 10% per year. Lisa bought six houses in Mediumburg for \$1,900,000 as an investment. However, she didn't realize that she was buying these properties when real estate prices were at their peak. Soon after Lisa made her purchases, home prices in Mediumburg began to decline. Lisa sold all of her houses over the next few years for a total of \$1,300,000. She lost \$600,000 of her own money because she bought at the top of the market.

The purchase transaction generally begins with the buyer looking at the various options available. You can visit Web sites such as www.realtor.com, tour new model homes, and go to open houses for existing homes. It's important to consider all your options. While you may not have time to personally visit every property that fits your criteria, you can narrow down your choices by viewing some properties online or driving by them.

Shopping the market diligently has two benefits. First, it prevents you from paying too much for a house. Second, it allows you to see all of your options. Buyers sometimes start shopping with a specific set of criteria but these criteria can change once they see what is available or what everyone else is doing. Generally speaking, if you shop the market well, you usually will not pay too much for a house. Looking at new homes from only one builder or searching sale listings that are being represented by only one real estate agent can be dangerous because these properties don't represent the entire market. Try to look at as many options as you can, within reason. A hidden benefit of shopping many properties is that you may change your mind about the necessity of certain features depending on whether you see them in many houses or not.

It is also a good idea to work with a real estate agent that you know, like, and trust. It is not advisable to constantly switch agents because you may come across some untrustworthy people along the way. As mentioned in Chapter 3, look at an agent's background and qualifications before deciding to work with him or her. Most people aren't able to tell if a person is honest or trustworthy from just one meeting.

Make Sure You're Qualified to Buy

Most buyers can't afford to pay cash for a home. Before you start shopping for a home, make sure you are qualified for a mortgage loan and know the price range for the homes you are qualified to buy. Taking these steps can prevent a lot of wasted effort and can also give you power in sales negotiations. If the seller or the seller's agent thinks you are a questionable buyer and may be turned down for a loan, your offer is less likely to be accepted.

You may want to consider getting prequalified or preapproved for a mortgage loan through a lender before you choose a particular home. Prequalification involves a general review of your finances to determine how much you can afford to borrow. Prequalification does not include a formal application process. It is non-binding, which

means there is no guarantee you will actually get the loan for the determined amount. Prequalification provides a general idea of how much house you can afford. Preapproval involves a more in-depth review of your finances and a formal application, but it is still non-binding. Preapproval can, however, give you a more definite idea of what you can afford. These processes will give you clout with a seller who may be concerned about taking the property off the market while waiting to see if you get approved for a mortgage.

Some real estate agents may offer you an initial qualification screening. While this type of screening can be helpful, it is better to get prequalified or preapproved directly through a lender. After all, your agent isn't the one who is going to give you a loan, the lender is.

You don't have to, nor should you, lock yourself in with one lender too early in the process. Shop around to see which lenders have good interest rates and, more importantly, good reputations. Don't let your real estate agent lock you in with a lender that he or she chooses or recommends, either. Competition between lenders can be a wonderful thing if you take advantage of it. As a buyer, you have the option of working with a mortgage broker—who can find a lender for you based on your criteria and finances—or working directly with a mortgage company, national bank, or savings bank. We'll talk more about lenders in the next chapter, which focuses on financing.

Don't "Fall in Love" with One House

Buyers who get excited about a single house or condo can become attached to that property and end up paying too much for it. If the price negotiation with the seller goes badly, a buyer who is emotionally attached to a particular house is less likely to walk away and consider other options. A smart buyer is flexible in his or her criteria and willing to move on when better options are available. This advice also applies to situations when the home inspection uncovers repair or maintenance problems that lead to a renegotiation of the sale price and the buyer and seller are not able to come to an agreement.

You probably don't want to tell your friends and family about the house you are buying until the loan has been approved, the home inspection has been done, and the sale price is final. If something goes wrong somewhere in the process, it's difficult to have to go back and tell your friends and family that the deal didn't go through. This can also make you reluctant to walk away from a bad deal even if you know you should.



Don't Ignore Other Options

Ann is an officer in the U.S. Army and has been transferred every two years for the last 10 years. As a result, she has become quite skillful at negotiating real estate purchases and has developed her own strategy. When she needs to buy a house in a new area, she usually starts by looking at everything in the area that is for sale in her price range via the Internet and a local real estate agent. She then asks the agent to show her the five best properties according to her criteria. After visiting these properties, she narrows down her options to her top three choices. Ann then writes a purchase agreement for the one she likes best considering her criteria and the asking price, as most buyers do. However, she offers the sellers at least 10% less than the asking price.

When she gets a counteroffer, Ann then moves on to her second choice and offers that seller 10% less than the asking price. Once she gets a counteroffer from her second choice, she does the same thing with her third choice. She then selects the one that has come down the most in price and gives that seller a counter-counteroffer. The logic behind this strategy is that the best option is the house with the most motivated seller who is most willing to lower the price.

Know the Marketing History

One helpful option that many homebuyers don't know about is that most real estate agents can provide you with the marketing history of the house or houses you are considering buying. This history can help you determine the seller's motivation and what a fair price for the house would be. Knowing about a property's marketing history can help you feel comfortable about your purchase decision. Consider the following example.

Historical References

Arthur is shopping for a house. He has looked at 54 houses online through an Internet database and walked through nine houses with his real estate agent. He has a good idea of what he wants and what is available. He has narrowed down his top three choices and asked his agent for the marketing history of all three houses.

The agent provided Arthur with the following information:

- Listing 1 was originally purchased four years ago for \$374,000. It has been on the market for 389 days. It was first listed at an asking price of \$459,000, which was then lowered to \$439,000, then to \$429,000, and finally to \$399,000. This asking price was reduced every three months. The listing has just rolled over to a new agent.

- Listing 2 was originally purchased seven years ago for \$411,000. It has been on the market for 444 days at a steady asking price of \$425,000.
- Listing 3 sold for \$333,000 four years ago. It has been on the market for 94 days at a steady asking price of \$399,000. The listing indicates that the owner is motivated to close, and the desired closing date was last Thursday. The listing has not been updated since then.

Arthur decided that since the seller for Listing 1 was aggressively lowering the price from time to time, the seller was probably motivated. Listing 2 has not shown any aggressiveness toward selling and is most likely not particularly motivated to sell. Listing 3 has been on the market for only 94 days, which means that the seller may not be motivated enough to accept a low price. However, this house has most likely been on the market long enough for the seller to at least have lowered expectations. The listing indicated that the seller was motivated, but the seller's deadline for closing was not met. This seller is showing some signs of motivation, though perhaps not the strong signs shown by the seller for Listing 1.

Arthur decided to write a purchase agreement on Listing 1 first. He offered \$360,000, which was 10% less than the asking price. The seller countered back at \$395,000. Arthur then offered \$375,000, and the seller countered back at \$392,000.

Arthur then made an offer on Listing 3 for \$360,000, and the seller immediately accepted it. It turned out that the seller of Listing 3 was the most motivated. Because Arthur never fell in love with one property and researched the marketing history, he was able to select the best option.

The Purchase Agreement

Most real estate agents are not attorneys but are empowered by state laws to help the buyer write a purchase agreement. A purchase agreement is also known as a *sale contract* and is often abbreviated in the business as "P/A." A purchase agreement is a legal contract and is binding for both parties who sign it (buyer and seller), which means that the courts can enforce the various duties and promises made in it. In most areas, real estate contracts must be made in writing.

Most real estate agents use a general purchase agreement template with blank lines to be filled in for each particular sale. Ask your agent for a copy of this template before you make an offer so you can see what is pre-printed on the contract and the blank lines that need to be filled in. If you don't understand parts of the contract, ask your agent for clarification. If you have outstanding concerns, speak with

a real estate lawyer. A house is too large a purchase to leave up to chance. Ten minutes of an attorney's time is not very expensive and may save you a lot of money later.

The templates used by most agents have been created by their associations, such as the National Association of Realtors®. These templates are usually designed to serve both sides of the purchase. Because many real estate agents work with both buyers and sellers during the course of their careers, they usually don't want to use a template that favors only buyers or only sellers. However, once your agent personalizes your purchase agreement, it should be designed to serve your interests.

Keep in mind that once you write a purchase agreement for a specific house, you cannot write another agreement for another house until the first contract is rejected or countered. If you do write two purchase agreements, you may end up buying two houses. Also, you cannot walk away from a valid purchase agreement once it is signed just because you find something better. Talk with your agent or real estate lawyer to make sure you are clear on the obligations of a purchase agreement before you sign it.

Including Personal Property

Including personal property in a real estate transaction usually creates problems. Most lenders only want to make loans on houses and don't want to include boats, cars, sofas, or other personal items in the deal. By including personal property, you are essentially asking the loan underwriter to lower the loan amount by the cost of that personal property. If you really want to buy some piece of personal property along with the house, keep that sale separate from the real estate transaction. However, including personal property does not create problems when the buyer is financially prepared to make a down payment of more than 20% on the deal. Consider the following example.

EXAMPLE

The Man Who Really Wanted a Boat

Steve wanted to buy a lakefront house at 99 Waverly Rd. in Smallville. He also wanted to buy a boat and some furniture from the seller, so he included these items in the purchase agreement. Steve figured that since he could make a 5% down payment on the house, he needed to apply for a mortgage for 95% of the home's sale price. However, he didn't include the boats and furniture in this calculation. The lender refused the loan because Steve would need to pay an extra 8% up front to cover the costs of these personal items, and Steve's financial information showed that he wouldn't be able to afford this expense.

Steve found a similar lakefront house at 111 Waverly Rd. and decided to go about the purchase process differently this time. He still wanted to buy a boat and furniture from the seller. This time he offered the seller \$29,000 more than the asking price for the house and presented a side contract to the seller to sign that stated, “If you buy my house for \$X, I will sell you the following personal property for \$1.” The seller agreed and signed both contracts.

When it was time for the appraiser to come out and value the property so the loan could go through, the appraisal report indicated that the sale price of the house exceeded the known market value for similar homes in Smallville and the most recent list price. Because of this, the mortgage application was not approved.

A similar scenario arises when the buyer asks the seller to pay for his or her financing or closing costs. Sellers who agree to these conditions usually just raise the asking price to compensate. If the seller was asking for a fair price before, he or she would now be asking for a fair price plus the extra costs. This also increases the likelihood of problems arising once it’s time for the appraisal to be done, as shown in the previous example. Asking the seller to pay the buyer’s financing or closing costs often causes appraisal problems and should be avoided.

Setting Dates

In any purchase agreement, the buyer must specify when he or she will be able to complete the conditions set forth in the contract—the home inspection, the mortgage approval, and the document review—and set a closing date. If the buyer conditions the closing on a favorable home inspection, he or she must specify in the contract how much time is allowed to get the inspection done and make any needed repairs. If the time period specified is too long, the seller will usually not agree to it because he or she will have wasted time and missed out on other offers if something goes wrong. If the time period specified is too short, you may not be able to find an inspection service that can do the job quickly enough.

The amount of time needed to get mortgage loan approval should also be considered. Longer time periods are good for the buyer but bad for the seller. The seller will want to put the property back on the market if the buyer cannot get approval. On the other hand, the buyer will not want to lose the property after much work and money have been spent just because there wasn’t enough time to process all the documents needed by the lenders. It’s a good idea to talk to your

mortgage lender at your first meeting about how long the approval process will take. Your real estate agent may also be able to give you a fairly accurate time estimate.

In some areas, real estate agents for sellers do not take a house off the market while the inspection and mortgage approval processes are going on, but note the existence of the pending offer in the MLS system. This allows a house to stay on the market while everything is being sorted out. While other potential buyers can usually view the listings for these houses online, many agents won't show these properties because doing so is often a waste of time.

Contingencies

The goal of writing up a purchase agreement for a house is, of course, to persuade the seller of that house to accept the contract. Any contingencies, or conditions, that you add to the contract—such as conditioning the sale on you selling your current home—can make your purchase agreement less attractive and less likely to be accepted. If you own a home already and clearly cannot pay two mortgages, you may want to wait until your current house sells before making an offer on a new one.

Some buyers get “bridge loans” to borrow money to use during the time period after they have bought their new house and before their old one sells. This type of loan may be a reasonable option if homes are selling well in your area. However, if the market shows signs of declining, you may not be able to sell your house and repay the loan. Keep in mind that you cannot rely solely on a real estate agent's advice about the condition of your market. Agents are salespersons and are often optimistic about all markets. Remember that they often have a bias because of the way they are paid—i.e., no closing, no pay. You may also want to talk to a real estate appraiser for another opinion about market conditions. An investment of a few dollars for an appraiser's time may save you a lot on the real estate purchase. You need to get good, unbiased advice before writing a purchase agreement if you have not sold your current house first.

Stuck with Two Houses

EXAMPLE

The Dyson family owned a house with a very popular design in an area that is popular with homebuyers. The Dysons' real estate agent told them that they should buy a new home in the same area and then sell the old one after they have moved into the new one. The Dysons decided to take their agent's advice. What they didn't realize, however, was that

the agent was biased because he was primarily interested in the commission he would earn from helping them buy a new home and sell their existing one. If the Dysons bought a new house and were able to sell their old house, he would get commission on two sales. However, even if the Dysons bought a new house but were still unable to sell their current one, the agent would still get the commission on one sale.

The Dysons never considered that their agent might be biased and proceeded to buy a new house when prices in the area were at their highest. They then tried to sell their old house as the market plummeted. The agent never told the Dysons that the market was going to decline and may not have known that it was. The Dysons had to make two mortgage payments for five years before the market got better and they were able to sell their old house.

Unfortunately, any buyer who already owns a home and wants to buy a new one faces risks. If the buyer waits until his or her current house sells before buying a new one, he or she may have to move into an apartment or some other type of temporary housing during the interim period. On the other hand, the buyer who purchases a new house before selling the old one faces the possibility of not being able to sell the old house.

What You See May Not Be What You Get

Smart sellers create an image of a certain kind of lifestyle when marketing a property. They may hire professional decorators to redefine their house for the type of buyer they are hoping to attract. This “staging” is done to make a buyer’s emotions work in the seller’s favor. Later, buyers are often surprised when the vacant house they moved into doesn’t elicit the same emotions as the fully decorated house did. The house may be dirty or have stained carpets or other flaws that were hidden by well-placed furniture during the showing process.

The main thing to keep in mind when shopping for a home is that

One way to avoid any serious surprises after closing on a house is to require a *pre-closing inspection*. A pre-closing inspection is usually conducted by the buyer and the buyer’s real estate agent on the closing day or very soon before the closing day. This inspection is usually conducted in addition to the home inspection performed by a professional inspector. The pre-closing inspection gives the buyer one last chance to view the property, most likely after the former occupants have already moved out, and make sure no significant defects have been concealed. If you want to do a pre-closing inspection, include a provision for this in the purchase agreement.



the house you eventually move into will be vacant. It will most likely not have furniture or other decorative items. Try to envision what the houses you are considering will look like when they are vacant. Don't fall into the emotional trap of paying more for the decorating and furniture, which is not going to be included in the sale. While it can be hard to maintain an analytical frame of mind when you're excited about finding a great house, you will need to keep your head if you want to pay a fair price and be able to resell your house in the future.

Buyer's Remorse

No discussion of the psychology of a sale would be complete without mentioning the emotional rollercoaster that buyers go through when they are writing purchase agreements, waiting for responses, and making counteroffers. Buyers, especially first-time buyers, see this negotiation process as a life-changing event, while real estate agents see it as just another deal. Sellers and/or buyers may get angry along the way. They may even become impossible to negotiate with or withdraw from the deal altogether. Consider the following example.

Too Little, Too Late

EXAMPLE

The Larsens wanted to move from their suburban subdivision to a rural area. They were currently living on a 0.5-acre site but wanted 10 to 20 acres of land and a smaller home. They also disliked their current neighbors. Properties with 10 to 20 acres of land and small houses were somewhat rare in their area, so the Larsens were excited when they noticed a new listing for a house on 14 acres of land with features they wanted that was located in an area they liked.

This property was listed for \$399,000. The current owner of the property was a bank, so the property was what is known as *real estate owned*, or "REO" for short. The Larsens made an offer of \$375,000, and their agent emailed the seller's agent within four days of the new listing being put on the market. The seller's agent did not acknowledge the offer at all, so the Larsens' agent called the seller's agent to confirm receipt. The seller's agent only said that he forwarded the offer to his client, the bank. The offer expired in 36 hours, but the seller's agent did not make any further response. The Larsens and their agent assumed that their offer was unacceptable to the seller since the agent confirmed that the offer was received but did not reject it or make a counteroffer.

Four days later, the Larsens' agent received an e-mail from the seller's agent saying that the seller (the bank) was now making a counteroffer of \$392,000, but the bank would rather not put anything in

EXAMPLE

writing until a final price was agreed to. The Larsens were so upset that they moved on to other properties and never considered that one again. Even though they were initially excited, the excitement faded once they were ignored by the seller for four days. The seller could have taken advantage of the buyer's emotional state and could have possibly gotten the Larsens to agree to a higher sale price.

A change in attitude after the sale negotiations are over is called “buyer’s remorse.” Any buyer who has made a big and exciting decision like buying a new home may have a change of heart that will cause him or her to second-guess the decision and even push toward renegeing on the deal. Don’t fall into this emotional trap. Since you know it may be coming, be prepared to work through it.

To Do List

Before you make an offer on a house, make sure you take the following steps:

- Decide if you want to get prequalified or preapproved for a mortgage through a lender. If you do, shop around for lenders that have low interest rates and good reputations. Keep your options open and don’t settle on one lender right away. Also, talk with your lender to get an idea of how long the actual mortgage approval process will take.
- If you are selling your current house, make sure you have a clear idea of the state of your local real estate market. You don’t want to find yourself in a situation where you have a signed sale contract for a new house but cannot sell your current house. Talk to a real estate appraiser to get an unbiased opinion of the market.
- Ask your real estate agent for the marketing history of the properties you are seriously considering. This can help you get an idea of which sellers may be the most motivated and most likely to agree on a lower price.
- Review the purchase agreement template used by your real estate agent thoroughly. Clear up any confusion regarding the language used in the template with your agent or a real estate lawyer, if needed. Make sure you are clear on what your obligations will be once the contract is signed.
- Decide if you want to include a provision in the purchase agreement that would allow you to conduct a pre-closing inspection.



participant in the process, but rather illustrates how each player should help facilitate the home purchase. Every attempt has been made to expose possible conflicts of interest that can arise throughout the process. However, some conflicts may have been overlooked. Don't assume that if a conflict of interest is not discussed in this book, it doesn't exist. Homebuyers must always be on the lookout for the latest scam.

This book explains various ways of looking at real estate to illustrate the benefits that exist as well as risks of things that may go wrong. It is intended to help homebuyers get a wider view of the home-buying process and avoid overlooking key points.

It is common for homebuyers to develop an emotional attachment to a house when they make an offer. A significant effort has been made in this book to deconstruct this "love affair." Using logic and reasoning, rather than emotion, will prevent you from paying too much for your home. While homebuyers should be motivated to buy, they should not find themselves in a position where they will do anything to get a particular house or property.

Keep in mind that the final decision to buy a home will be a personal one. Smart buyers try to get all the information they can about the process and the property, but ultimately it is up to the individual buyer to decide whether or not to buy a particular home. Sometimes the best thing to do is walk away from a deal if the negotiations don't go well.

Making prudent real estate purchases isn't easy. It's hard work. Shop, compare, and analyze all your options if you want to be successful. Buying a house is usually fun, but the process should not be short-circuited once it becomes boring. Smart buyers look at many alternatives before buying. There are plenty of real estate sellers who are looking for a "sucker" who will pay too much. Don't be that person.

The purpose of this book is to help protect you from abuse. The themes of ethics and consumer protection run throughout this material. Biases that exist in the industry are explained and clues to potential problems are revealed. Significant financial losses that result from lack of knowledge in the buying process can be prevented. Real estate is a very complicated subject and it will most likely not get any simpler. Instead, it looks like the future of real estate will bring more challenges.

The goal of this publication is to help homebuyers ask the right questions. In many cases, people wish they had asked a few more questions before making significant decisions. Because the real estate industry is constantly changing, buying real estate requires you to stay current, research popular trends and attitudes, and become an informed buyer.