

## Why buy a foreclosure home?

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Foreclosure homes are less expensive to buy and less expensive to own on average than any other type of home purchase. For instance, if you purchase and finance a foreclosure home through the VA (Veteran's Administration), there is no charge for mortgage insurance. [Note: you do not need to be a veteran to purchase a foreclosure home through the VA.] The savings on mortgage insurance alone will save you \$45.00 per month every month as long as own that mortgage. (Based on \$100,000.)

HUD foreclosure homes do not require that the homebuyer pay for an appraisal if the foreclosure home is financed with an FHA mortgage. Remember that FHA (Federal Housing Administration) is part of HUD (Housing and Urban Development).

Is it always better to finance a foreclosure home through the bank or branch of government selling the home?

Most of the time this is the best option. For example, the bank that foreclosed on the home has lost money 99% of the time. The bank can regain some of their losses by financing the foreclosure home again. It is strongly advised, however, to contact the real estate agent or mortgage lender in your area familiar with foreclosure homes.

## What Are Escrows?

Mortgage lenders generally take over responsibility for the payment of taxes and insurance so that they can be sure that the payments are made. They require that an escrow account be established with the borrower's funds, from which the mortgage lender makes the payments as they come due. The escrow account is established with a deposit that the borrower provides at closing. Mortgage lenders ask for more than they actually need as a "cushion" in order to assure themselves that there will always be enough money in the account.

Since mortgage lenders usually get to keep the interest on escrow accounts, in years past many of them maintained unreasonably large cushions. To deal with that, the Department of Housing and Urban Development (HUD) issued a ruling that placed a ceiling on the size of escrow accounts, which in turn limited the amount the lender could ask the borrower to deposit at closing.

The rule is that the deposit cannot exceed the amount needed to prevent the balance from falling below an amount equal to two months worth of tax and insurance payments at its lowest point during the year. Although HUD does not do a lot of enforcement, all but a handful of mortgage lenders follow the HUD rules.

How do I calculate the maximum initial deposit?

1. Add the annual taxes and insurance premiums and divide by 12. This is the amount that will be added to your mortgage payment every month.
2. List 12 months running down the page beginning with the month in which your first mortgage payment is due.
3. In the second column, enter the tax and insurance payments next to the month in which they are due.
4. In the third column, show the amount in the escrow account assuming there is no initial deposit. The monthly payments made by you add to the account while the tax and insurance payments made by the lender reduce it.
5. Scroll down to the month that has the largest shortfall. To the shortfall add two months of payments (the allowable cushion). The total is the maximum deposit under HUD's rules.

Here is an example:

Assuming no upfront deposit, the low point of the escrow account is reached in August when school taxes are due. Through August, total payments from the escrow account are \$3468 whereas only 10 payments have been made into the account totaling \$2890. The account would therefore be short by two monthly payments, or by \$578. The lender is also allowed a cushion of two months, which is \$578. Hence, the total required deposit to the escrow account would be \$1156.

Borrowers who don't want to be bothered checking the mortgage lender's calculation of the required escrow deposit are unlikely to be taken advantage of because lenders can't do it without violating the law. Focus your attention on the many legal ways that mortgage lenders and mortgage brokers can pick your pocket.

At the same time, unintentional mistakes do occur at the closing table that can affect the allocation of costs between sellers and buyers. A recent letter described a \$500 mistake of this sort, which the letter-writer discovered by accident. It is a good idea, therefore, to check out every number.