Legal Matters®

Real Estate
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'No closing costs' mortgages can be smart…but you have to be careful

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A lot of lenders these days are offering a "no closing costs" option if you take out a mortgage. With this option, the lender pays the closing costs for you, but you pay a slightly higher interest rate on the loan.

This can be a good idea in some circumstances. But you have to run the numbers to find out if it's right for you.

The appeal of a "no closing costs" loan is obvious: Closing costs can be expensive! The national average of closing costs for a $200,000 purchase-money mortgage is more than $4,000, according to a survey by Bankrate.com. And that figure can vary considerably by state: In New York, the most expensive state, the average total of closing costs for the same mortgage is $6,183.

On very expensive homes, it's possible to have closing costs that are north of $10,000.

For many people who are struggling to come up with a 20% down payment, the idea of avoiding closing costs is very attractive.

On the other hand, if you accept a loan with a higher interest rate, you'll be paying the higher rate for the entire life of the loan, which means you could be paying many thousands of dollars extra as the years go by.

How to decide

In order to decide whether a "no closing costs" option is right for you, the first step is to determine which closing costs the lender will actually pay. While the option is typically billed as "no closing costs," some lenders actually only pay for certain of the closing costs, and you'll still have to pay for others.

Find out, for instance, if you'll still be on the hook to pay for such items as a title search, title

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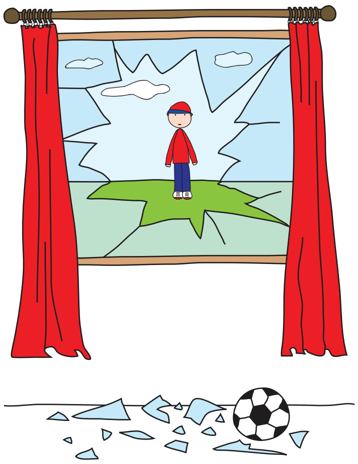
What can a landlord collect if a tenant damages a property?



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Most of the time, when an apartment is rented, the tenant pays a security deposit that can be applied if he or she damages the property. Usually, unless the lease says otherwise, the tenant is liable only for *damage* to the property…not for ordinary wear and tear. The landlord is typically supposed to maintain the property and perform routine upkeep.

Security deposits are normally a small matter, but in some cases, tenant damage can be a big issue. Two recent cases at opposite extremes show that it's important to speak with an attorney if you have any questions or concerns.

In one case, a Tennessee landlord leased a house and 25 acres to a married couple. The couple agreed in the lease to return the property in the same condition in which they received it. This was important, because while a tenant usually isn't liable for ordinary wear and tear, this couple agreed to maintain the property even if it suffered the typical effects of use.

The couple paid $1,500 a month for the house and land. But when they moved out, the landlord claimed the property had deteriorated. For instance, the landlord provided photos showing that the pasture and barn area had lush grass at the beginning of the lease term, but many bare spots when the tenants left.

The case went to court, and a judge ordered the couple to pay almost $16,500 to restore the property to its original condition.

In another case, a man rented a townhouse in rural upstate New York to a woman for 12 years. When the woman died, the man sued her estate for more than $58,000 in alleged damage to the apartment… including broken parquet floors, cracked bathroom and kitchen tiles, chipped countertops, nail holes in the walls, broken appliances, a dirty refrigerator, a deteriorated driveway and a missing cabinet drawer.

When the case went to trial, the man acknowledged that he had performed virtually no maintenance on the townhouse during the 12 years of the lease.

The court sided with the woman's estate, finding that the vast majority of the problems with the townhouse were the result of ordinary wear and tear. A landlord cannot simply fail to maintain a building for many years and then perform a complete renovation at the tenant's expense, it said.

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'No closing costs' mortgages can be smart…but be careful

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insurance, appraisal fees, credit check costs, and so on.

Next, once you know exactly what items you *won't* have to pay for, determine how much you'll save by not paying for them.

Then figure out how much more you'll pay each month with the higher interest rate. Divide your total savings by the extra payment each month, and you'll have the number of months it will take you to break even.

For instance: If you save $6,000 in closing costs and you pay an extra $50 a month with the higher interest rate, then you'll break even in 120 months… which is 10 years. But if you save $3,600 in closing costs and pay an extra $100 a month on your mortgage, then you'll break even in 36 months…which is only three years.

In general, you'll come out ahead if you plan to get rid of the mortgage – by selling the home or refinancing – before the "breakeven" point.

So if your breakeven point is 10 years, and you plan to live in the house for only five to seven years, the "no closing costs" option might make good financial sense. But if the breakeven point is three years and you plan to live in the house much longer than that, you're probably better off paying the closing costs and enjoying a lower interest rate.

Taking the "no closing costs" option is often a good idea if you plan to refinance in a short time. But with interest rates at historic lows, it's not clear that refinancing a few years from now is a safe bet.

Even if you expect to keep your loan beyond the breakeven point, the "no closing costs" option might still be worthwhile if it's the only way you can come up with a 20% down payment. The higher interest rate might still be better than what you'd have to pay if you can't put down 20%.

One other thought is that if you expect to keep your loan beyond the breakeven point, but you'll use the money you save on closing costs to improve the property, and you would otherwise take out a home equity line of credit for this purpose, you might be better off with the "no closing costs" option. That's because the additional interest you'll pay on the mortgage might be less than the interest you'd pay on the home equity line.

‘Mortgage contingency’ required applying for a mortgage

A Nebraska couple put down a $45,000 deposit on an $885,000 home, and signed an agreement saying the purchase was contingent on the couple’s being able to get a mortgage for the remaining $840,000. Sometime later, the couple told the builder that they weren’t going to apply for a mortgage and weren’t going to go through with the deal.

The builder refused to return the deposit, and the case went to court. The result? The builder got to keep the $45,000 deposit.

If a “mortgage contingency” in a contract says that the purchase is contingent on the buyer’s being able to obtain a mortgage, this creates an obligation on the buyer’s part to actually apply for a mortgage, the Nebraska Appeals Court decided. A buyer can’t just change his or her mind and renege on the deal without applying.

In this case, the couple claimed that they had signed the contract assuming that a separate business deal would go through, and when it fell apart, they didn’t apply for a mortgage because they figured they wouldn’t be able to get one. The couple also claimed the builder knew the sale depended on the business deal going through.

However, there was nothing in the purchase-and-sale agreement that made the real estate contract contingent on the business deal. And even if the couple didn’t think they could still obtain a mortgage, that didn’t release them from their legal obligation to apply for one, the court said.

While the law varies from state to state, the moral of the story is that if your ability to finance a real estate deal depends on something else – a separate deal, a gift, a family loan, or whatever – this needs to be taken into account when you sign a purchase-and-sale agreement. If you don’t say anything about the separate contingency in the agreement, then you may be on the hook if it doesn’t happen.

A couple couldn’t back out of a deal just because their income went down and they thought that they could no longer get a loan.

Know the rules if you rent space in your home

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The number of people who rent out space in their home…an extra room or an apartment…is skyrocketing. But many people don’t realize that doing so can create legal problems.

Craigslist reports that the number of people offering to rent a room in a home has nearly doubled over the last year or so.

But often, people who rent out a room or convert a garage into a studio apartment don’t understand the complexities of landlord-tenant law. Even if you only have one apartment, or even if you only rent to “friends,” you still need to have a formal lease and understand the legal rules for tenancies.

For instance, you’ll need to make sure that everything in the rental space is up to code – loose steps, lead paint, and other issues can cause problems. And remember that if anything breaks in the rental area, you’ll need to promptly repair it.

You’ll want to talk to your homeowner’s insurance company about any issues that might be created by having a rented space, and whether your insurance will cover damage to your home that is accidentally caused by a tenant.

You’ll need to think through the rules you want for the tenancy – such as pets, smoking, noise, storage areas, and utility payments – and put those in writing. You’ll also want a security deposit, and you’ll need to know the sometimes-complex rules that can apply to handling security deposits.

Many people don’t realize that rental payments are taxable as income – so you’ll need to determine not just how much you’ll receive as rent, but how much you’ll get to keep after taxes.

The good news is that you can often offset your taxable income by your expenses, which could include advertising, cleaning, maintenance, insurance, repairs, supplies, utilities, and depreciation. But you’ll need to know what’s deductible and what isn’t, and keep careful records.

Also, many communities have zoning ordinances that limit rental apartments or the number of unrelated people who can live together in a structure. You’ll need to make sure that the rental is legal, and if it is, whether you need to obtain a permit.

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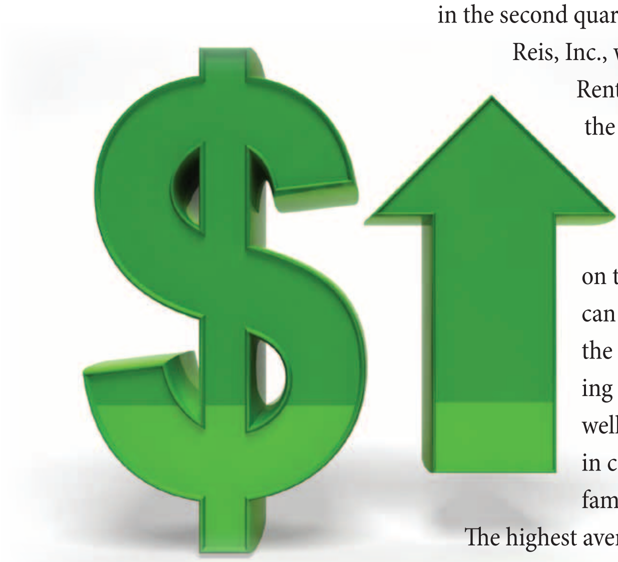
Apartment rents are on the increase, along with apartment building values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The cost of renting an apartment hit record levels in the second quarter of 2012, according to a study by Reis, Inc., which tracks real estate data.

Rents increased in all 82 markets in the U.S. that the company tracks, and set new records in 74 of them, the company said.

And while national data on the value of apartment buildings can be hard to come by, it appears the value of these buildings (including multifamily homes) is spiking as well, at least in many markets. This is in contrast to the market for single-family homes in the last few years.

The highest average rent in the study was in New York City, at $2,935 a month. Average rents topped $1,000 a month in 27 markets, including Baltimore, Miami, San Diego and Seattle.

The lowest rents were in Wichita, Kansas, where they averaged just $510 a month.

The apartment vacancy rate plummeted to just 4.7% in the quarter, the lowest level in more than 10 years. The company says this is only the third time in the past 30 years that the vacancy rate has fallen below 5%.

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Presumably, as the demand for rental units has spiked and vacancies have dropped, landlords have felt comfortable raising rental rates, and the value of apartment buildings as an investment has increased.

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