

How to buy real estate for nothing down

Avoid 'dreaded' private mortgage insurance

When Robert G. Allen wrote his best seller real estate book "Nothing Down" more than 20 years ago, he taught home buyers and realty investors it was possible to buy property without cash from the buyer's pocket.

But a nothing-down purchase doesn't mean the property seller won't receive cash. In fact, sellers often receive 100 percent cash. However, that cash didn't come from the buyer in a nothing-down sale.

Today, buying real estate with little or no cash from the buyer's pocket has become almost routine even if you have bad credit.

A few years ago, the nation's largest buyer of home loans in the secondary mortgage market, Fannie Mae, agreed to buy 103 percent home loans. The extra 3 percent is to pay home-purchase closing costs. Competitor Freddie Mac has a similar program.

Although VA (Veterans Administration) no-down-payment mortgages have been around for many years, you or your spouse must be a qualified veteran. Additional VA mortgage drawbacks are the lending limits are too low for many high-cost communities and there is burdensome extra paperwork. For this reason, many lenders no longer handle VA mortgages.

PMI (PRIVATE MORTGAGE INSURANCE) IS AN EXPENSIVE FLAW

Many of the low- and no-down-payment home loan programs from institutional mortgage lenders include an expensive flaw. It's called "private mortgage insurance" (PMI).

High-risk institutional home loans exceeding 80 percent loan-to-value are, by law, required to have mortgage insurance to protect the lender from loss on the riskiest portion of the home loan exceeding the traditional 80 percent loan limit.

PMI insurance companies jump fast to insure lenders for the top 20 percent of these risky mortgages. But the borrowers dearly pay the PMI premiums, often \$100 to \$200 or more extra per month. Depending on the size of the home loan, PMI can add roughly 1 percent extra to the cost of a mortgage.

For example, if a home loan costs 6 percent interest, adding the approximate 1 percent PMI premium costs the borrower roughly 7 percent. Unfortunately, the PMI premium is not tax deductible, as is home loan interest. A bill has been proposed in Congress to make PMI premiums tax deductible, but it is unlikely to be enacted anytime soon.

HOW SOME LENDERS ADD TO BORROWER PMI WOES

To make matters even more costly for borrowers, many PMI lenders make it very difficult or impossible to cancel PMI after it is no longer needed. Even when home values appreciate substantially or the homeowner adds capital improvements to increase the residence value, many lenders impose unreasonable rules.

A favorite lender ploy is to tell borrowers they must pay down their mortgage by at least 20 percent from its original balance before canceling PMI.

Lenders know this is almost impossible for most borrowers. These lenders refuse to consider the home's increased market value due to appreciation in market value and/or capital improvements added by the homeowners.

Additional excuses used by many lenders for refusing to cancel PMI are (a) the mortgage be at least 24 months old and (b) the borrower must never have had a late payment (even if the late fee was paid) before PMI can be cancelled.

In addition, most lenders will insist only their approved appraiser be hired to justify current market value, although the borrower pays the appraiser's fee even if the appraised value is unacceptably low.

HOW TO AVOID DREADED PMI

Thankfully, many enlightened lenders have created new methods for home buyers to purchase for little or nothing down but without the dreaded PMI expensive premiums.

For example, some lenders "self insure" 100 percent home loans by adding an extra ½ percent interest to the normal home loan interest rate. The major advantage to the home buyer is the entire interest rate is tax deductible, and there is no non-deductible PMI cost.

A more popular alternative is many lenders now offer combination 80 percent first mortgages plus 20 percent home equity loans for 100 percent financing with no PMI cost.

Still another possible nothing down combination is 80-10-10, such as an 80 percent first mortgage, 10 percent home equity loan, and a 10 percent home-seller-carry-back third mortgage.

TWO MAJOR REASONS TO BUY FOR NOTHING DOWN

There are two primary reasons smart home buyers and realty investors want to purchase for nothing down.

The first reason is the home buyer doesn't have cash for a traditional 20 percent down payment. Savvy home buyers often become discouraged as they realize they can't save for a down payment as fast as home prices are going up in their communities. According to the National Association of Realtors, residential market values are appreciating at about 6 percent annually.

The second reason is the leverage advantage of buying a home for nothing down. Real estate leverage means controlling property benefits with little or none of the owner's cash.

For example, suppose you pay \$100,000 cash for your \$100,000 house or condo. If it appreciates in market value at the current 6 percent average annual rate, it will be worth \$106,000 in 12 months. That's a 6 percent yield on your \$100,000. Not bad.

Instead, suppose you paid zero cash down payment for the same house or condo and it appreciates 6 percent in market value during the next year. Now your return on zero investment becomes "infinite." Of course, you will have mortgage payments, but they will be roughly equivalent to the cost of renting similar housing, after considering the income-tax deduction benefits.

MORE WAYS TO BUY FOR NOTHING DOWN

Highly motivated property sellers will often sell for little or no cash from the buyer's pocket.

For example, some "bootstrap" buyers of fixer-upper houses either buy "subject to" or "assume" an existing mortgage and pay their down payment with cash borrowed on their bank credit line or even from high-cost credit card loans.

This nothing-down method works especially well when the buyer plans to quickly fix up the house within a few months and then refinance to pay off the existing mortgage and the down-payment financing.

Another nothing-down home acquisition method is to lease the residence with an option to buy for two or three years. The key to success here is to negotiate a substantial rent credit toward the down payment. This technique works especially well when searching in the newspaper classified ads under "homes for rent" or "condos for rent" because the rental market in many communities is currently very slow.

CONCLUSION

Buying a house or condo for nothing down is not as difficult as it might seem. Enlightened mortgage lenders have eased the quest by offering easy financing.