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Buying a Home

SATTLER & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

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There's no doubt about it--owning a home is an exciting prospect. After all, you've always dreamed of having a place that you could truly call your own. But buying a home can be stressful, especially when you're buying one for the first time. Fortunately, knowing what to expect can make it a lot easier.

How much can you afford?

According to a general rule of thumb, you can afford a house that costs two and a half times your annual salary. But determining how much you can afford to spend on a house is not quite so simple. Since most people finance their home purchases, buying a house usually means getting a mortgage. So, the amount you can afford to spend on a house is often tied to figuring out how large a mortgage you can afford. To figure this out, you'll need to take into account your gross monthly income, housing expenses, and any long-term debt. Try using one of the many real estate and personal finance websites to help you with the calculations.

Mortgage prequalification vs. preapproval

Once you have an idea of how much of a mortgage you can afford, you'll want to shop around and compare the mortgage rates and terms that various lenders offer. When you find the right lender, find out how you can prequalify or get preapproval for a loan. Prequalifying gives you the lender's estimate of how much you can borrow and in many cases can be done over the phone, usually at no cost. Prequalification does not guarantee that the lender will grant you a loan, but it can give you a rough idea of where you stand. If you're really serious about buying, however, you'll probably want to get preapproved for a loan. Preapproval is when the lender, after verifying your income and performing a credit check, lets you know exactly how much you can borrow. This involves completing an application, revealing your financial information, and paying a fee.

It's important to note that the mortgage you qualify for or are approved for is not always what you can actually afford. Before signing any loan paperwork, take an honest look at your lifestyle, standard of living, and spending habits to make sure that your mortgage payment won't be beyond your means.

Should you use a real estate agent or a broker?

A knowledgeable real estate agent or buyer's broker can guide you through the process of buying a home and make the process much easier. This assistance can be especially helpful to a first-time home buyer. In particular, an agent or broker can:

- Help you determine your housing needs
- Show you properties and neighborhoods in your price range
- Suggest sources and techniques for financing
- Prepare and present an offer to purchase
- Act as an intermediary in negotiations
- Recommend professionals whose services you may need (e.g., lawyers, mortgage brokers, title professionals, inspectors)
- Provide insight into neighborhoods and market activity
- Disclose positive and negative aspects of properties you're considering

Keep in mind that if you enlist the services of an agent or broker, you'll want to find out how he or she is being compensated (i.e., flat fee or commission based on a percentage of the sale price). Many states require the agent or broker to disclose this information to you up front and in writing.

Choosing the right home

Before you begin looking at houses, decide in advance the features that you want your home to have. Knowing what you want ahead of time will make the search for your dream home much easier. Here are some things to consider:

- Price of home and potential for appreciation
- Location or neighborhood
- Quality of construction, age, and condition of the property
- Style of home and lot size
- Number of bedrooms and bathrooms
- Quality of local schools
- Crime level of the area
- Property taxes
- Proximity to shopping, schools, and work

Making the offer

Once you find a house, you'll want to make an offer. Most home sale offers and counteroffers are made through an intermediary, such as a real estate agent. All terms and conditions of the offer, no matter how minute, should be put in writing to avoid future problems. Typically, your attorney or real estate agent will prepare an offer to purchase for you to sign. You'll also include a good faith or earnest money deposit. If the seller accepts the offer to purchase, he or she will sign the contract, which will then become a binding agreement between you and the seller. For this reason, it's a good idea to have your attorney review any offer to purchase before you sign.

Other details

Once the seller has accepted your offer, you, your real estate agent, or the mortgage lender will get busy completing procedures and documents necessary to finalize the purchase. These include finalizing the mortgage loan, appraising the house, surveying the property, and getting homeowners insurance. Typically, you would have made your offer contingent upon the satisfactory completion of a home inspection, so now's the time to get this done as well.

The closing

The closing meeting, also known as a title closing or settlement, can be a tedious process--but when it's over, the house is yours! To make sure the closing goes smoothly, some or all of the following people should be present: the seller and/or the seller's attorney, your attorney, the closing agent (a real estate attorney or the representative of a title company or mortgage lender), and both your real estate agent and the seller's.

At the closing, you'll be required to sign the following paperwork:

- Promissory note: This spells out the amount and repayment terms of your mortgage loan.
- Mortgage: This gives the lender a lien against the property.
- Truth-in-lending disclosure: This tells you exactly how much you will pay over the life of your mortgage, including the total amount of interest you'll pay.
- HUD-1 settlement statement: This details the cash flows among the buyer, seller, lender, and other parties to the transaction. It also lists the amounts of all closing costs and who is responsible for paying these.

In addition, you'll need to provide proof that you have insured the property. You'll also be required to pay certain costs and fees associated with obtaining the mortgage and closing the real estate transaction.

Applying for a Mortgage

With all of the paperwork and questions that you need to answer, applying for a mortgage can be stressful. But knowing what's involved in the process can make things a lot easier. Here's some information to get you started.

Before you apply

Do some homework before you apply for a mortgage. Think about what type of home you want, what your budget will allow, and what type of mortgage you might seek. Get a copy of your credit report, and make sure it's accurate; dispute any erroneous information to get it corrected. Be prepared to answer any questions that a lender might have of you, and be open and straightforward about your circumstances.

What you'll need when you apply

When you apply for a mortgage, the lender will want a lot of information about you (and, at some point, about the house you'll buy) to determine your loan eligibility. Here's what you'll need to provide:

- The name and address of your bank, your account numbers, and statements for the past three months
- Investment statements for the past three months
- Pay stubs, W-2 withholding forms, or other proof of employment and income
- Balance sheets and tax returns, if you're self-employed
- Information on consumer debt (account numbers and amounts due)
- Divorce settlement papers, if applicable

You'll sign authorizations that allow the lender to verify your income and bank accounts, and to obtain a copy of your credit report. If you've already made an offer on a house or condo, you'll need to give the lender a purchase contract and a receipt for any good-faith deposit that you might have given the seller.

Prequalification and preapproval

In many cases, you'll want to know how much mortgage you can get before you look at homes. Your potential lender can either prequalify you or preapprove you for a mortgage.

Lenders use several standard ratios to determine how much mortgage you're eligible for. Generally, if you're applying for a conventional mortgage, your monthly housing expenses (mortgage principal and interest, real estate taxes, and homeowners insurance) should not exceed 28 percent of your gross monthly income. In addition, your total long-term debt (monthly housing expenses plus other debt payments that won't be repaid within a year) should be no more than 36 percent of your gross monthly income. Government mortgage programs, such as FHA and VA mortgages, have higher qualifying ratios.

Keep in mind that qualifying ratios vary among lenders, and you may still qualify for a mortgage even if you exceed the ratios listed above. For example, some lenders will allow higher ratios if you have excellent credit, a large down payment, or substantial savings, or meet other conditions.

Prequalifying for a mortgage is simply a matter of a lender crunching these numbers to tell you how large a mortgage you'll qualify for based on those ratios. Remember, what you qualify for may not be what you can afford--only you can determine that after examining your own budget and lifestyle. Because the lender has not verified your income or examined your credit report, prequalification promises you nothing; it simply tells you how much mortgage you might get.

Preapproval, however, means that the lender has checked out your income and credit. You'll get a letter of commitment stating that you'll be given a mortgage up to a certain amount. Preapproval lets you know exactly how large a mortgage you can get. In addition, it gives you more credibility as a buyer, since a seller can see in the lender's letter that you're going to get the mortgage if he or she accepts your purchase offer.

> ***Remember, what you qualify for may not be what you can afford--only you can determine that after examining your own budget and lifestyle.***

Finalizing the application

As your mortgage application is processed and finalized, your lender is required by law to give you several documents. Within three business days of applying for the loan, the lender must inform you of the mortgage's effective rate of interest, or annual percentage rate (APR). If relevant, the lender must also give you consumer information on adjustable rate mortgages. In addition, the lender is required to give you an itemized good-faith estimate of your closing costs and a government publication that explains those costs.

Since the home that you're purchasing will serve as collateral for the loan, the lender will order a market value appraisal of the property. The lender will not lend you more than a certain percentage of the value of the property. If your down payment will be less than 20 percent of the value of the property, your loan will require private mortgage insurance, and the lender will obtain insurer approval. If the lender has not already done so as part of a preapproval process, it will verify your employment and bank accounts as well as obtain and evaluate your credit report.

The Down Payment

How much do you need for a down payment?

In the past, lenders usually required a down payment of at least 20 percent of the purchase price of a home. Nowadays that's no longer the case. Instead, the amount of your down payment will depend on a variety of factors, such as your credit history and the type of mortgage you're applying for.

Can you get a low down payment mortgage?

Today, many lenders are approving loans with lower down payments. In addition, certain private and government entities have low down payment programs.

FHA mortgages

You may be able to get a Federal Housing Administration (FHA) mortgage with a down payment of as little as 3.5 percent. Qualification standards are relatively lenient for FHA mortgages, and the terms of these mortgages are generally very attractive, making them ideal for first-time homebuyers. Keep in mind, however, that FHA loans require borrowers to pay mortgage insurance premiums.

VA mortgages

Department of Veterans Affairs (VA) mortgages are another low down payment option. VA mortgages are available to qualified veterans and their surviving spouses. VA mortgage terms are also generally very attractive, and in many cases, little or no down payment is required.

Conventional mortgages

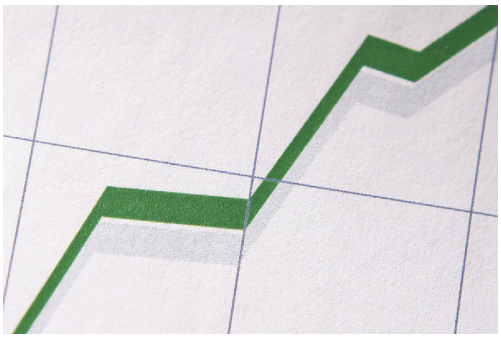
You may be able to obtain a conventional mortgage with a down payment of less than 20 percent with the help of private mortgage insurance (PMI). Low down payment mortgages are somewhat risky for lenders, because they believe you are more likely to default on a loan in which you have very little invested. For this reason, lenders generally require PMI if you are borrowing more than 80 percent of the value of the home you are purchasing (i.e., your down payment is less than 20 percent).

If you are concerned about taking on PMI payments, keep in mind that you may not have to pay PMI forever. For loans originated after July 29, 1999, your lender is obligated to cancel your PMI once you have reached 22 percent equity in your home, provided you have a good payment history. Or, you can petition your lender to remove the PMI if you have a good payment history and reach 20 percent equity in your home.

Tip: *In addition to requiring PMI, lenders sometimes have stricter qualification standards and offer lower loan limits and higher interest rates if your down payment is less than 20 percent.*

Caution: *Some mortgages, such as interest-only and payment-option mortgages, appear attractive because they require low down payments and offer low initial monthly mortgage payments. However, they are structured to lead to higher monthly payments later on. Be sure you understand how these mortgages work if you're considering them.*

> ***If you are concerned about taking on PMI payments, keep in mind that you may not have to pay PMI forever.***



If you don't have at least 20 percent for a down payment, consider asking if your lender would be willing to increase your mortgage interest rate a quarter of a point rather than require PMI coverage. Your monthly payment will increase by roughly the same amount as the monthly insurance premium. However, mortgage interest is generally tax deductible; PMI payments are not.

Tip: *There is a limited exception to the general rule that PMI payments are not deductible. For amounts paid or accrued in 2007 through 2010, qualified mortgage insurance payments can be deducted in the same manner as qualified mortgage interest, but only for mortgage insurance contracts issued after December 31, 2006 and before January 1, 2011. In addition, the deduction is phased out for taxpayers with adjusted gross income exceeding $100,000 ($50,000 for married individuals filing a separate return).*

Tip: *If you opt to pay a higher interest rate instead of taking on PMI, remember that you may be able to cancel your PMI sometime in the future, whereas you'll have to pay the higher interest rate until the mortgage is paid off or you refinance.*

Another alternative to PMI is to obtain 80-10-10 financing, where a lender provides a traditional 80 percent first mortgage, and you then obtain a 10 percent second mortgage and make a 10 percent down payment.

What about larger down payments?

If you have more than 20 percent to put down, you may still want to take the time to weigh your down payment options. With a larger down payment, you will reduce the amount of your mortgage and thus the amount of interest you will pay. And since a larger down payment usually means less risk, lenders often offer lower interest rates and are more lenient toward borrowers who provide larger down payments. Also, a larger down payment gives you instant equity in your home, which can be accessed through a home equity loan or home equity line of credit.

Keep in mind, however, that there may be situations where you might not want to make a large down payment. For example, you may want to keep the money in your emergency cash reserve. Or, you may want to put the money toward other investment opportunities.

Investing money for a down payment

If you're saving for a down payment, you may be wondering where you should invest your money. The answer depends on how soon you'll need the money, since the more time you have, the more risk you may be willing to accept in considering investments. If you're going to need the down payment within the next few years, you'll probably want to minimize risk. For many, this means a bank savings account. However, you'll also want to consider money market accounts as well. Money market accounts are low-risk, and generally pay slightly higher interest rates than bank savings accounts.

Popular Types of Mortgages

Like homes themselves, mortgages come in many sizes and types. The type of mortgage that's right for you depends on many factors, such as your tolerance for risk and how long you expect to stay in your home. Here are some characteristics of various popular types of mortgages.

Conventional Fixed Rate Mortgages	Adjustable Rate Mortgages (ARMs)
• Low risk • 10- to 40-year terms • Interest rate doesn't change • Large down payment (compared to government mortgages) may be required • Payment remains the same	• Higher risk • Initial interest rate often lower than conventional fixed rate mortgage • Interest rate may go up or down • Interest rate usually adjusted annually • Rate adjustments may be limited by cap(s) • Payment caps can result in negative amortization in periods of rising interest rates
Government Mortgages	**Hybrid Adjustable Rate Mortgages (ARMs)**
• FHA, VA, or bond-backed • Interest rate sometimes lower than conventional fixed rate mortgage • Variety of programs available • Low down payment requirements • Liberal qualifying ratios • Attractive to first-time homebuyers • Higher insurance costs may apply for FHA loans • Payment remains the same	• Higher risk • Initial interest rate often lower than conventional fixed rate mortgage • Fixed term for 1-10 years, then becomes a 1-year ARM • May have option to convert to a fixed rate mortgage before becoming a 1-year ARM • Interest rate may go up or down • Rate adjustments may be limited by cap(s) • Payment caps can result in negative amortization in periods of rising interest rates
Jumbo Loans	
• Any loan over $417,000 or $729,750 in high-cost areas ($625,500 or $938,250 in Alaska, Guam, Hawaii, and the U.S. Virgin Islands) for a single-family home or condo (2009 and 2010) • Size of loan increases lender's risk, so interest rates are generally higher than for conventional fixed rate mortgages	

Tax Benefits of Home Ownership

In tax lingo, your principal residence is the place where you legally reside. It's typically the place where you spend most of your time, but several other factors are also relevant in determining your principal residence. Many of the tax benefits associated with home ownership apply mainly to your principal residence--different rules apply to second homes and investment properties. Here's what you need to know to make owning a home really pay off at tax time.

First-time homebuyer tax credit

You may qualify for a federal income tax credit of up to 10% of the purchase price of a principal residence (subject to the dollar limitations described below) if you meet certain requirements:

- The home must be purchased on or after January 1, 2009 and before May 1, 2010. If you enter into a written binding contract before May 1, 2010, you can still qualify if you close on the home before July 1, 2010. (The time period is extended for members of the uniformed services and others who receive government orders for qualified official extended duty.)
- If you, and your spouse if you're married, haven't owned a principal residence in three years, you may qualify for a credit of up to $8,000 ($4,000 if you're married and file a separate return).
- For home purchases after November 6, 2009, you may qualify for a credit of up to $6,500 ($3,250 if you're married and file a separate return) if you, and your spouse if you're married, have maintained the same principal residence for at least five consecutive years in the eight years preceding the purchase.
- For home purchases after November 6, 2009, you can't claim the credit if the purchase price of the home exceeds $800,000.

Special rules relating to the first-time homebuyer credit, not discussed here, apply to home purchases made on or after April 9, 2008, and before January 1, 2009.

Generally, you won't have to pay back the credit (prior to January 1, 2009 the credit had to be paid back over 15 years in equal installments). There's one important exception, however: If the home ceases to be your principal residence in the 36 months following the purchase, you'll have to pay the credit back. If you're married at the time of purchase, the home must remain the principal residence of *either* you or your spouse for the 36-month period.

The credit is reduced or eliminated for individuals with higher modified adjusted gross income ("MAGI"). The income levels that apply depend on your filing status and when the purchase is made:

	Qualifying home purchase:	
Filing status:	**1/1/09 through 11/6/09**	**11/7/09 through 4/30/10**
Married filing joint	Credit reduced if MAGI exceeds $150,000, eliminated when MAGI reaches $170,000	Credit reduced if MAGI exceeds $225,000, eliminated when MAGI reaches $245,000
All others	Credit reduced if MAGI exceeds $75,000, eliminated when MAGI reaches $95,000	Credit reduced if MAGI exceeds $125,000, eliminated when MAGI reaches $145,000

Additional restrictions apply as well. For example, you can't claim the credit if you're a nonresident alien. And, for purchases after November 6, 2009, you can't claim the credit if you're under age 18 at the time of the purchase (unless you're married and your spouse is at least 18), or if you can be claimed by someone else as a dependent.

If you purchase a qualifying principal residence in 2009, you can elect to treat the purchase as if it occurred on December 31, 2008. Similarly, a qualifying purchase in 2010 can be treated as if it occurred on December 31, 2009, allowing you to claim the credit on your 2009 federal income tax return.

Temporary standard deduction for non-itemizers

For tax years 2008 and 2009, homeowners are able to claim an additional standard deduction for property tax if the taxpayer does not itemize. The additional amount that can be claimed is the lesser of:

- The amount of real estate property taxes paid during the year to state and local governments or
- $500 ($1,000 if married filing jointly)

Deducting mortgage interest

One of the most important tax advantages of home ownership is the deduction of mortgage interest. If you itemize deductions on Schedule A of your federal income tax return, you can generally deduct the qualified residence interest that you pay on certain home mortgages taken on your principal residence. (This also applies to second homes.) That is, you may be able to deduct the interest you've paid on a mortgage to buy, build, or improve your home, provided that the loan is secured by your home. Such a mortgage is known as acquisition indebtedness by the IRS. Your ability to deduct interest depends on several factors.

Up to $1 million of acquisition mortgage debt ($500,000 if you're married and file separately) qualifies for interest deduction. (Different rules apply if you incurred the debt before October 14, 1987.) If your mortgage loan exceeds $1 million, some of the interest that you pay on the loan will not be deductible.

Although this deduction also applies to certain home equity loans secured by your home, the rules are different. Home equity debt involves a loan secured by your main or second home that exceeds the outstanding mortgages on the property. Home equity debt is limited to the lesser of:

- The fair market value of the home minus the total acquisition debt on that home, or
- $100,000 (or $50,000 if your filing status is married filing separately) for main and second homes combined

The interest that you pay on a qualifying home equity loan is generally deductible regardless of how you use the loan proceeds. For more information, see IRS Publication 936.

Tip: *There is a limited exception to the general rule that PMI payments are not deductible. For amounts paid or accrued in 2007 through 2010, qualified mortgage insurance payments can be deducted in the same manner as qualified mortgage interest, but only for mortgage insurance contracts issued after December 31, 2006 and before January 1, 2011. In addition, the deduction is phased out for taxpayers with adjusted gross income exceeding $100,000 ($50,000 for married individuals filing a separate return).*

Tax treatment of real estate taxes

Along with mortgage interest, you can generally deduct the real estate taxes that you've paid on your property in the year that they're paid to the taxing authority. Only the legal property owner can deduct the real estate taxes. In some cases, prepaid real estate taxes can be deducted in the year of the prepayment. Taxes placed in escrow but not yet paid to the taxing authority, however, generally aren't deductible.

Tax treatment of home improvements and repairs

Home improvements and repairs are generally nondeductible. Improvements, though, can increase the tax basis of your home (which in turn can lower your tax bite when you sell your home). Improvements add value to your home, prolong its life, or adapt it to a new use. For example, the installation of a deck, a built-in swimming pool, or a second bathroom would be considered an improvement. In contrast, a repair simply keeps your home in good operating condition. Regular repairs and maintenance (e.g., repainting your house and fixing your gutters) are not considered improvements and are not included in the tax basis of your home. However, if repairs are performed as part of an extensive remodeling of your home, the entire job may be considered an improvement.

If you make certain improvements to your home that improve your home's energy efficiency, you may be eligible for one or more federal income tax credits.

Deducting points and closing costs

Buying a home is confusing enough without wondering how to handle the settlement charges at tax time. When you take out a loan to buy a home, or when you refinance an existing loan on your home, you'll probably be charged closing costs. These usually include points, as well as attorney's fees, recording fees, title search fees, appraisal fees, and loan or document preparation and processing fees. You'll need to know whether you can deduct these fees (in part or in full) on your federal income tax return, or whether they're simply added to the cost basis of your home.

Before we get to that, let's define one term. Points are costs that your lender charges when you take a loan secured by your home. One point equals 1 percent of the loan amount borrowed. As a home buyer, you can deduct points in the year that you buy your home if you itemize your deductions. However, you must meet certain requirements. You can even deduct points that the seller pays for you. More information about these requirements is available in IRS Publication 936.

Refinanced loans are treated differently. The points that you pay on a refinanced loan generally must be amortized over the life of the loan. In other words, you can deduct a certain portion of the points each year. There's one exception: If part of the loan is used to make improvements to your principal residence, you can generally deduct that portion of the points in the year that the points are paid.

And what about other closing costs? Generally, you cannot deduct these costs on your tax return. Instead, you must adjust your tax basis (the cost, plus or minus certain factors) in your home. For example, if you're buying a home, you'd increase your basis with certain closing costs. If you're selling a home, you'd decrease your amount realized from the sale (i.e., your sale price). For more information, see IRS Publication 530.

Exclusion of capital gain when your house is sold

Now let's see what happens when you sell your home. If you sell your principal residence at a loss, you generally can't deduct the loss on your tax return. If you sell your principal residence at a gain, however, you may be able to exclude from taxation all or part of the capital gain.

Generally speaking, capital gain (or loss) on the sale of your principal residence equals the sale price minus your adjusted basis in the property. Your adjusted basis is the cost of the property (i.e., what you paid for it initially), plus amounts paid for capital improvements, less any depreciation and casualty losses claimed for tax purposes.

If you meet the requirements, you can exclude from federal income tax up to $250,000 ($500,000 if you're married and file a joint return) of any capital gain that results from the sale of your principal residence, regardless of your age. In general, an individual, or either spouse in a married couple, can use this exclusion only once every two years. To qualify for the exclusion, you must have owned and used the home as your principal residence for a total of two out of the five years before the sale.

For example, you and your spouse bought your home in 1981 for $200,000. You've lived in it ever since and file joint federal income tax returns. You sold the house yesterday for $350,000. Your entire $150,000 gain ($350,000 - $200,000) is excludable. That means that you don't have to report your home sale on your income tax return.

What if you fail to meet the two-out-of-five-years rule? Or what if you used the capital gain exclusion within the past two years with respect to a different principal residence? You may still be able to exclude part of your gain if your home sale was due to a change in place of employment, health reasons, or certain other unforeseen circumstances. In such a case, exclusion of the gain may be prorated.

Additionally, special rules may apply in the following cases:

- If your principal residence contained a home office or was otherwise used partially for business purposes
- If you sell vacant land adjacent to your principal residence
- If your principal residence is owned by a trust
- If you rented part of your principal residence to tenants, or used it as a vacation or second home (i.e., uses considered "nonqualifying" under the Housing and Economic Recovery Act of 2008
- If you owned your principal residence jointly with an unmarried taxpayer

Note: *Members of the uniformed services, foreign services, intelligence community, as well as certain Peace Corps volunteers and employees may elect to suspend the running of the 2-out-of-5-year requirement during any period of qualified official extended duty up to a maximum of 10 years.*

Consult a tax professional for details.

Opening the Door to Homeowners Insurance

Your home is your castle, so the saying goes. And you're going to want to protect it. Homeowners insurance can give you just the protection you need. It provides coverage if your home is damaged or destroyed. It also covers your family's possessions and provides you with compensation for liability claims, medical expenses, and other expenditures that result from property damage and bodily injury suffered by others.

Why you need it

You may need homeowners insurance because your mortgage lender requires it. But even if you own your home outright, you still need homeowners insurance to protect that which you can't afford to lose. It's really that simple. After all, you've spent years building up a solid financial foundation for you and your family. Without homeowners insurance, all of that hard work can go down the drain in a matter of minutes when, for example, a tornado devastates your house, a burglar robs and vandalizes your home, your dog bites and severely injures your neighbor, or your mail carrier slips on your front steps and breaks his leg.

Property coverage

The main purpose of homeowners insurance is to protect your home and other structures, like a shed or detached garage. Your policy will cover not only the cost of the damage (the exact amount depends on your policy) but also your living expenses (up to a limit) while you wait for your home to be repaired.

In addition to protecting your home, the typical homeowners policy covers your personal property, both on and off premises. Your personal property consists of the contents inside your home (e.g., furniture, appliances, clothing, jewelry) as well as outdoor items (e.g., sporting equipment, lawn tools). It's important to note that homeowners policies set specific dollar limits for certain types of personal property (e.g., jewelry, coins).

Although policies vary, a typical homeowners policy provides coverage for damage to property caused by:

- Fire and lightning
- Windstorm and hail
- Explosions
- Theft or vandalism
- Vehicles
- Smoke
- Falling objects
- Weight of ice, snow, and sleet
- Freezing of plumbing, heating, or air conditioning system
- Riots

But be aware that homeowners insurance does not cover a wide variety of perils (e.g., flood, earthquake damage). You may need to purchase an endorsement or separate insurance policy to ensure adequate coverage in these instances.

When reimbursing you for a loss, insurance companies use one of two methods to determine the value of property:

- Replacement cost: This pays you the cost of replacing damaged property, with no deduction for depreciation, but with a maximum dollar amount
- Actual cash value: This pays you an amount equal to the replacement value of damaged property minus a depreciation allowance

Keep in mind that before an insurance company reimburses you for a loss, you'll need to satisfy a deductible.

Liability coverage

In addition to insuring your property, the typical homeowners policy includes liability protection that provides coverage for damages caused by your negligence. Medical payments to third parties and your legal costs for any lawsuits brought against you are also included. Most homeowners policies provide a standard amount of liability coverage (usually $100,000) per accident.

Purchasing homeowners insurance

Homeowners insurance policies are written individually, typically at the time you purchase a home or when you take out a mortgage on a home. For the most part, you'll want to purchase enough property coverage to cover the replacement cost of your home and its contents. The amount of liability coverage you'll need to purchase will depend on the assets you would like to protect (e.g., home, car, investments).

The cost of homeowners insurance depends on the amount of your coverage, any endorsements you add to the policy, and policy deductibles. But since premiums for similar policies vary from company to company, it pays to shop around and compare rates.

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