Home Sweet Home

Consumer Alert!

1-888-995-7856 ALLIANCE Credit Counseling

By Edward Tonini, Director of Education.

"The average homeowner is 34 times richer than the average renter"
David Bach (Author of *The Automatic Millionaire*)

While the difference in net worth between a homeowner and a renter is explained through more than the sole element of ownership, the opening quote should affirm anyone's desire to own a home. Here are some points to help you decide whether to buy and some steps you'll want to think about if "the American dream" is in your sights.

Rent or Buy?

The decision to buy or rent involves a comparison of the costs of the many alternatives and will be influenced by your personal values.

The **costs** in renting include: rent for first and last month, security deposit, insurance (for belongings), and possibly utilities or furnishings. The costs in buying include: down payment, mortgage payment, closing costs, insurance (for property and contents), utilities, furnishings, annual real estate taxes, maintenance and repairs. However, the costs in buying are offset by several factors: tax deductions (from mortgage interest and property taxes paid), appreciation (increase in the home's value), and tax free profits (up to $500,000 for a married couple). Financially, the cost of renting is less in the short run but homeowners usually win in the long run.

Values related to your lifestyle also affect the decision to rent or buy. Consider your wants and needs on these issues: how much privacy you have, how much control you have over your living space and property, and what level of stability you have from your work or from your community.

The following lists reveal the spectrum among key reasons for renting/owning.

Reasons for **renting**:
- ✓ Don't have a down payment or can't qualify for a down payment assistance program.
- ✓ Can't qualify for a mortgage loan.
- ✓ Able to get a monthly payment that is lower (though it can increase).
- ✓ Employment is unstable; need easier mobility.
- ✓ Don't want responsibilities of a property (maintenance, repairs).

Reasons for **buying**:
- ✓ Have savings for a down payment or can qualify for a down payment assistance program.
- ✓ Able to qualify for a mortgage loan (payment can be fixed).
- ✓ Want to have something to show for monthly payments (build equity).
- ✓ Employment is regular; want stable community.
- ✓ Want to be able to customize property to your liking; greater independence and privacy.

Steps To Homeownership

If you decide that homeownership fits your goals, there are several steps to anticipate.

1. Create A Plan For Homeownership
Once you've decided you want to be a homeowner, the first thing to do is create a plan to make it happen. It's hard to plot a course without a map and knowledge of the rules of the road. During this step, a smart buyer will learn all they can about homeownership before buying. You can find free Homebuyer Education resources at: www.hud.gov/buying/ and www.fanniemae.com/homebuyers/.

2. Find Your Financial Readiness
How can you know when you're ready for homeownership? You'll want the following to be **true**.
- ☑ Your income has been steady for at least the last 2 to 3 years.
- ☑ You plan to keep the home for at least 3 years.
- ☑ Your money management has been reasonable (good history of bill payment, few outstanding long-term debts).
- ☑ You have decent savings: money saved for a down payment, ability to pay the monthly mortgage plus 30% (insurance, taxes, maintenance), emergency fund equal to at least two mortgage payments.

Credit Rating. To accurately assess your money management ability, you'll want to obtain your credit reports and scores from all three credit bureaus. Lenders rely heavily on these scores to decide whether to offer you a mortgage and at what interest rate. To allow yourself some time to work on any credit issues you find, it would be best to check your reports at least six months before applying for a mortgage. For information on obtaining your credit reports, clearing up errors, and raising your score, read our publications listed in the *To Find Out More* section below.

Financial Control. The best way to assess your financial control and see your financial picture is to review your monthly budget. For assistance with this, read our publication *The Spending Plan*.

3. Pick A Range To Fit Your Budget

After you have reviewed your monthly spending plan (budget), you will see what price range you could realistically handle. If you don't think you'll find a satisfactory home in that range, you'll need to find ways to increase your monthly income and lower your expenses. For assistance with this, read our publication *More With Less*.

4. Pre-qualify For A Mortgage

Once you have completed your financial tune up and settled on a price range, you'll want to begin shopping mortgages and see if you can pre-qualify. One place to start your search is the credit union or bank where you have your checking and savings accounts. Many people use a mortgage broker to try to find the lowest rate. The internet provides a convenient way to compare mortgages. Visit: www.bankrate.com, or www.hud.gov/buying, or www.homepath.com.

Types Of Financing

Three factors determine your monthly mortgage payment: amount borrowed, interest rate, and term.

Fixed-Rate

A **Conventional Mortgage** has a fixed interest rate, fixed term, and fixed payment. A 30 year term will have a monthly payment that is about 30% lower than a 15 year term, however, you'll pay more than double the interest if you take the full 30 years. If you pay extra towards the principal, you can shave years off the term and save thousands of dollars in interest.

Adjustable-Rate

An **Adjustable-Rate Mortgage (ARM)** has an interest rate that will increase or decrease according to some index and at intervals determined by the lender. There should be a cap limiting how much the rate can change per year (typically 2%) and over the whole term (typically 5%). There are several varieties of ARMs (convertible, reduction-option, price-level-adjusted, two-step, hybrid). You should be financially prepared to handle the worst case scenario terms with any ARM you choose.

Alternative

Most other lending options aim at providing a low monthly payment, especially in the first years. These include: graduated-payment, lender buy-down, rollover, and shared-appreciation. Be sure to understand all the conditions.

Be aware of the two **ratios** lenders use to estimate the maximum mortgage you can afford. The first is called the "front-end ratio" - your total annual expenditures (principal, interest, taxes, insurance) should not exceed 28% of your gross annual income. The second is the "back-end ratio" - your monthly debt payments (mortgage, taxes, insurance, loans, debts) should not exceed 36% of your gross monthly income.

Several **programs** exist to encourage homeownership.

FHA Mortgage Insurance. The Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD) offers insurance on loans that meet its standards – borrowers must be creditworthy and the homes must meet quality minimums. With this insurance, a smaller down payment is required (typically 3%). To find out more, visit: www.hud.gov/buying/loans.cfm.

VA Mortgage Insurance. The federal Department of Veterans Affairs (VA) provides insurance on loans that meet their criteria – borrowers must be military veterans and homes must meet VA standards. Little or no downpayment is required. To find out more, visit: www.homeloans.va.gov.

To look for programs that help with the downpayment and/or closing costs, visit: www.hud.gov/buying/localbuying.cfm.

5. Choose A Few Homes

There are many types of housing – detached, semi-detached, condominiums, cooperatives, manufactured, and mobile. Consider the location and neighborhood as much as you consider the home and property. Resist falling in love with any one home. If you give yourself some options, your price negotiations won't be clouded by emotions.

Be aware of the role of a realtor. A realtor has a legal obligation to the one paying his/her commission. If they're acting as a *listing agent* or *selling agent*, they're on the seller's side. If you pay a realtor to act as a *buyer's agent*, they're on your side. A realtor can't be on both sides.

6. Negotiate The Purchase

Once you've decided on your first choice, you'll make an offer to buy (purchase offer). This offer will probably be less than the asking price and will include all conditions for the sale and a deposit of "earnest money" to show the seller you're serious. If the seller doesn't accept your offer, they may respond with a counteroffer. The amount of your purchase offer and any negotiating the seller entertains will depend on the current state of the real estate market in that location. If you reach an agreement, you will sign a purchase contract containing a contingency clause allowing you to get your earnest money back if your financing falls through or the house fails to pass inspection.

7. Complete The Mortgage Application

After your lender receives your signed purchase contract, your mortgage loan application will be formally processed. If you encounter any issues here, you may need to revisit the activities from step 4.

8. Close The Deal

At a meeting called the "closing," all required documents are signed and payments are made. Be certain to compare the costs and fees listed in the "good-faith estimate" you received with the ones listed in the "uniform settlement statement." Challenge any discrepancies you find before signing.

9. Protect Your Investment

Your lender will have required that you insure the home against fire or other calamity. Timely repairs, proper maintenance to the home and property, and home improvements, are essential actions you can take to maximize the appreciation value of your home.

Finding Live Help

If you would like help taking steps to manage your finances, pay down debt, save for a down payment, or learn about your housing rights, call us and ask to speak with a housing counselor. Or visit: www.knowdebt.org and click on the Home Ownership link.

To Find Out More

- *Personal Finance* (Garman & Forgue, Houghton Mifflin Co. 2006)
- Read the following articles available at *our website* www.knowdebt.org/education.php:
  - *The Spending Plan*
  - *How To Check Your Credit Reports*
  - *How To Dispute Errors On Your Credit Reports*
  - *Raising Your Credit Scores*