Buying Your First Home

Buying your first home can be a thrilling experience. For most people, it is the most expensive purchase they've ever made. In addition, it also may be one of the most complex. The legal jargon, government regulations, and numerous mortgage options that are a part of the home buying process often require new knowledge and new sources of information. Seek out reliable sources about how to buy a house and accurate, up-to-date information about the housing market.

Take time to carefully weigh the information you've gathered against your needs and wants. Mistakes can be costly and frustrating. Understanding your needs and wants, seeking out reliable information, and careful planning will help you make a satisfying decision.

This booklet contains several worksheets that will help you apply the information presented in the "Buying Your First Home" seminar to your personal situation. You are encouraged to complete the worksheets and discuss them with your family.

The worksheet topics include:

- Evaluating the decision to buy or rent, pages 2 and 4
- Estimating the amount you can borrow, page 6
- Calculating the amount of monthly mortgage payment you can afford, page 8
- Deciding on the features in a home that are important to you, page 10
- Comparing features among houses, page 11.

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Renting vs. Buying

Is buying or renting the best choice for you? What are the advantages and disadvantages of each? The following table can help you compare. Check the features that are important to you. Some of the items are personal preferences, others are financial.

	Renting	Buying
Ease of mobility	❑ Offers ability to move easily without major time or money costs	❑ Has limited mobility ❑ Relocating will involve substantial time and money costs
Control over property	❑ Little or no responsibility for upkeep ❑ Limited ability to make alterations ❑ Rental agreement subject to change or termination	❑ All responsibility for upkeep ❑ Ability to decorate and renovate
Maintenance costs	❑ Little or none	❑ All costs
Upfront expenses	❑ Security deposit and other initial expenses may be required ❑ Return of security deposit may be subject to landlord's discretion	❑ Usually substantial costs
Possibility of gain or risk of loss in market value	❑ No chance for capital gain ❑ No chance for market value declining	❑ Potential for capital gain due to increase in market value ❑ Possibility of falling home prices
Income tax benefits	❑ No chance for housing deduction on tax return	❑ Can deduct mortgage interest and property taxes
Control over long term housing costs	❑ Rents may rise annually	❑ Fixed mortgages offer stable principal and interest payments
Financial advantages	❑ Money not tied up in house and available for other uses ❑ No concern about foreclosure if income changes	❑ Can borrow against equity ❑ Can be a form of forced savings

Is renting or buying a better choice for you?

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Renting vs. Buying

The table below will help you compare the costs and savings of renting and buying. Renters do not pay property taxes and usually don't pay for maintenance. Home buyers give up the use of the money spent on the down payment and closing costs, therefore the interest lost on that money is included as a savings to renters. However, income taxes must be paid on the interest earned. Although the expenses of buying are higher, there are some savings as well, including the amount of the principal paid down and reduced income taxes due to the deduction for mortgage interest and property taxes. The tax advantages are more significant for those in high tax brackets. This example assumes that the value of the house appreciates 2 percent annually. Occasionally, homeowners experience depreciation in the market value of the house.

COSTS and SAVINGS	RENTING	BUYING
Annual Expenses		
Annual Rent ($950/month) or Mortgage ($798.36/month)	$ (11,400)	$ (9,580)
Property and Liability Insurance	$ (270)	$ (500)
Property Taxes	$ 0	$ (3,400)
Maintenance	$ 0	$ (1,000)
Total Annual Expenses	$ (11,670)	$ (14,480)
Savings Due to Tax Deductions, Appreciation and Interest Earned		
Principal repaid on mortgage	$ 0	$ 1,219
Interest on funds not used for down payment @ 2% (1 – MTR) x savings interest rate x down payment (1 - .15) x .02 x $30,000	$ 510	$ 0
Tax Savings on Mortgage Interest (first year) .15 x $8,361	$ 0	$ 1,254
Tax Savings on Property Taxes .15 x $3,400	$ 0	$ 510
Appreciation on Dwelling (assumes annual appreciation of 2%) .02 x $150,000	$ 0	$ 3,000
Net Cost for the First Year	$ (11,160)	$ (8,497)

The previous comparison assumes the following:

- The house is being purchased for $150,000 and the down payment is $30,000.
- The mortgage amount is $120,000.
- The mortgage interest rate is 7%.
- The term is 30 years.
- The purchaser's marginal tax rate (MTR) is 15%.

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Are You Ready to Buy?

If you're considering the purchase of a house, you'll need to examine your financial readiness. Read the following statements and check YES or NO depending on your current situation.

Yes	No	
❑	❑	I have steady income and employment.
❑	❑	I do not plan to relocate in the next couple of years.
❑	❑	I have looked at my past expenditures and my spending plan to determine what I am able to afford.
❑	❑	I have established a good credit record.
❑	❑	I have started to save for the down payment and closing costs.
❑	❑	My existing debt is low and I can comfortably manage a mortgage payment in my monthly spending plan.

If you can answer YES to the entire list, you are well on your way to being prepared to buy a home.

Review the questions to which you answered NO and consider whether buying a house is appropriate for you at this time.

Mortgage lenders can provide information about housing programs for which you may qualify and can calculate the maximum amount of mortgage they would be willing to lend. However, consider whether you are comfortable spending that large a percentage of your budget on housing.

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What Determines the Monthly Mortgage Payment?

There are three factors that affect the amount of the monthly mortgage payment:

- **Amount Borrowed** - The larger the down payment you pay, the less you need to borrow. The less you borrow, the smaller the monthly payment.
- **Interest Rate** - The higher the interest rate, the higher the monthly payment.
- **Term of the Mortgage** - The longer the term to repay, the smaller the monthly payment.

The following chart will show you how changing the factors will affect the monthly mortgage amount.

A) Changing the amount borrowed

Mortgage Amount	Interest Rate	Term (yrs.)	Monthly Payment
$100,000	7%	30 yrs.	$665
$120,000	7%	30 yrs.	**$798**

B) Changing the interest rate

Mortgage Amount	Interest Rate	Term (yrs.)	Monthly Payment
$100,000	7%	30 yrs.	$665
$100,000	**8%**	30 yrs.	**$734**

C) Changing the term - number of years

Mortgage Amount	Interest Rate	Term (yrs.)	Monthly Payment
$100,000	7%	30 yrs.	$665
$100,000	7%	**15 yrs.**	**$889**

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How Much Can I Borrow?

Many lenders use the Front End Ratio to determine the amount of mortgage they are willing to lend to you. The following exercise will help you estimate the total mortgage amount you would be allowed to borrow. The amount lenders are willing to lend may be more than you can comfortably afford considering your other expenses.

To complete the exercise you need to know:

- Front End Ratio calculated using gross (pre-tax) annual income, 28% in this example
- Estimate of Monthly Tax and Insurance
- Cost of the Home Interest Rate on a 30 year mortgage

Line		
1	Gross annual income	$
2	Gross annual income divided by 12	$
3	Multiply Line 2 by 0.28 (this equals the amount you can afford with a 28% loan ratio)	$
4	Estimate monthly taxes and insurance on the property	$
5	Subtract Line 4 from Line 3 to find the monthly mortgage payment	$
6	Interest rate (mortgage rate you expect to get)	%

To determine an estimated amount that you would be approved to borrow, use the figure from Line 5, the interest rate from Line 6 and the chart on the next page. Looking in the column that most closely matches your interest rate, move down the column until you find the amount on LINE 5 (your estimated monthly mortgage payment). Once you have found the number, follow it to the left and record that amount on LINE 7.

7	Estimated amount of mortgage a lender may be willing to lend	$

This amount is the ESTIMATED MORTGAGE AMOUNT that a lender may be willing to lend you based on a front end ratio of 28%. However, lender's ratios are not a substitute for careful consideration of individual needs and resources when considering the question, “What mortgage amount is RIGHT for my budget?”

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Determine Your Monthly Mortgage Payment

Use the chart below to determine your estimated monthly mortgage payment of principal and interest based on a particular interest rate and total mortgage amount. The figures in this chart are based on a conventional 30-year mortgage.

$	5%	5.5%	6%	6.5%	7%	7.5%	8%	8.5%	9%	9.5%	10%	11%	12%
20,000	107	113	120	126	133	140	147	154	161	168	175	190	206
25,000	134	142	150	158	166	175	183	192	201	210	219	238	257
30,000	161	170	180	190	200	210	220	231	241	252	263	286	309
35,000	188	199	210	221	233	245	257	269	282	294	307	333	360
40,000	215	227	240	253	266	280	293	308	322	336	351	381	411
45,000	242	256	270	284	299	315	330	346	362	378	395	429	463
50,000	268	284	300	316	333	350	367	384	402	420	439	476	514
55,000	295	312	330	348	366	385	404	423	443	462	483	524	566
60,000	322	341	360	380	399	420	440	461	483	505	527	571	617
65,000	349	369	390	411	432	454	477	500	523	547	570	619	669
70,000	376	397	420	442	466	489	514	538	563	589	614	667	720
75,000	403	426	450	474	499	524	550	577	603	631	658	714	771
80,000	429	454	480	506	532	559	587	615	644	673	702	762	823
85,000	459	483	510	537	566	594	624	654	684	715	746	809	874
90,000	483	511	540	56S	599	629	660	692	724	757	790	857	926
95,000	510	539	570	600	632	664	697	730	764	799	834	905	977
100,000	537	568	600	632	665	699	734	769	805	841	878	952	1,029
110,000	590	624	660	695	732	769	807	846	885	925	965	1,048	1,132
120,000	644	681	720	758	798	839	880	923	966	1,009	1,053	1,143	1,234
130,000	698	738	780	822	865	909	954	1,000	1,046	1,093	1,141	1,238	1,337
140,000	752	795	840	885	931	979	1,027	1,076	1,126	1,177	1,229	1,333	1,440
150,000	805	852	900	948	998	1,049	1,101	1,153	1,207	1,261	1,316	1,428	1,543
160,000	859	909	960	1,011	1,064	1,119	1,174	1,230	1,287	1,345	1,404	1,524	1,646
170,000	913	965	1,020	1,075	1,131	1,189	1,247	1,307	1,368	1,429	1,492	1,619	1,749
180,000	966	1,022	1,080	1,138	1,198	1,259	1,321	1,384	1,448	1,514	1,580	1,714	1,852
190,000	1,020	1,079	1,140	1,201	1,264	1,328	1,394	1,461	1,529	1,598	1,667	1,809	1,954
200,000	1,074	1,136	1,200	1,265	1,330	1,400	1,470	1,540	1,610	1,680	1,755	1,905	2,060

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Determine Your Monthly Mortgage Payment

A) Average monthly income

Take-home pay (1)	
Take-home pay (2)	
Other	
Other	
Total income (a)	

B) Average monthly non-housing expenses

Food	
Clothing, Laundry, Dry Cleaning	
Car Payments, Insurance, Gas,	
Maintenance and Repairs	
Life Insurance	
Health - Medical & Dental Insurance,	
Out-of-Pocket Expenses	
Home Furnishings	
Education/ Child Care	
Savings	
Entertainment	
Gifts, Holidays	
Recreation, Vacations	
Personal Expenses	
Debt Payments (list at right)	
Emergency Fund	
Other	
Total expenses (b)	

List monthly debt payments	
Creditor	**Amount**
⇦**Total**	

C) Money available for all housing expenses

Total income (a)	
Total Non-housing expenses (b)	
MONEY AVAILABLE (c)	

D) Money available for mortgage payment

Money available for all housing expenses (c)	
Less utilities estimate for new house	
Less taxes & insurance estimate	
Less maintenance reserve estimate	
Less water, sewer & trash estimate	
MONEY AVAILABLE FOR MORTGAGE PAYMENT (Principal & Interest)	

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The Mortgage Payment

The mortgage payment usually has four parts: principal, interest, taxes, and insurance. This is commonly referred to as PITI.

Principal	The part of the mortgage payment that reduces your mortgage balance, also the total amount borrowed.
Interest	The fee charged for use of someone else's money.
Taxes	Property taxes to local government.
Insurance	This component may contain two different types of insurance. Property insurance provides coverage against a wide range of damages, such as fire and theft. Private Mortgage Insurance (PMI) may also be included. PMI is required if your down payment is less than 20% of the purchase price of the house. Thus, if you default on the loan with limited collateral, the lender is protected by PMI.

Some lenders require taxes and insurance to be collected each month as part of the mortgage payment. Others allow homeowners to pay taxes and insurance themselves. When lenders collect taxes and insurance premiums, the funds are held in an escrow account until the bills come due.

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My Wish List

This chart is for you to list your top ten wishes for your new house in the right column. For example, do you want a new house or an older home? How many bedrooms do you want the home to have? Is having a garage essential to you? Once you have completed this, rank your wishes from 1 - 10 in the left column.

Rank	Wishes

Remember, there may not be a house that has ALL of your wishes. By completing this list prior to looking at houses, you will be able to determine which features are most important to you. When you do start choosing houses to look at, you can select those that best match your criteria.

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House Touring Checklist

Most people look at an average of 15 houses before purchasing one. This checklist may help you focus on your requirements when you are looking at houses. By taking notes when you are viewing the house, you will be more likely to remember which features each house contains.

Address

Asking Price $____________	Yearly Taxes $____________		
Lot Size ____________	Square feet of Living Space ____________		
Neighborhood	❑ Ideal	❑ Acceptable	❑ Unacceptable
Type of House	Year built ____________	Style ____________	
Condition	❑ Excellent	❑ Good	❑ Poor
Heat	❑ Forced hot air	❑ Baseboard	❑ Radiators
Fuel	❑ Gas	❑ Oil	❑ Electric

Rooms

Bedrooms	#____________	Sizes____________	
Bathrooms	#____________	Sizes____________	
Kitchen	Features __________________________________		
Dining Room	❑ Yes	❑ No	
Living Room	❑ Formal	❑ Family	
Basement	❑ Finished	❑ Not finished	
Other	____		

Exterior

Landscaping	❑ Good	❑ Needs work	
Porch/deck	❑ Front	❑ Back	
Yard size	❑ Large	❑ Small	
Fence	❑ Yes	❑ No	
Garage	❑ Yes	# Cars________	❑ No
Remarks	____		
	____		
	____		
	____		

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What to Take With You to See a House

When you begin looking at houses to purchase, there are certain things you should bring with you, and certain things you should look for. It is also recommended that you bring someone who is knowledgeable and objective on your visits. He or she may notice something that you did not and may be more objective because they are not personally involved.

Flashlight

Tape Measure

Pencil

Checklist

Things to do

- Keep good notes on each house
- After looking at a few, compare your notes
- Narrow down the houses and take a second look at the ones that best meet your needs
- Take someone else to get a second opinion

Things to look for

- stains on basement walls
- moss, mildew, stains on siding
- eroded areas in yard, walkway, or driveway
- lifting roof shingles
- porches or decks that sag
- hollow sound when walking on floor
- leaking pipes, low water pressure (flush toilet and turn on water)
- lack of insulation in the attic
- signs of termites, ants, bees nests etc.
- flaky paint on window sills or trim

If you do find any of these problems, consider the costs of repair. A professional home inspection report may help you decide if you should have the seller correct the problem, or if you will assume the cost of the repair as the homeowner.

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Purchase and Sales Agreement

The Purchase and Sales Agreement (sometimes called the P & S) is a legal document that serves as your official offer on the property once the seller and buyer have signed the contract and agreed on all the terms. This document contains information about your offer and what must occur before the purchase can be completed. The following items are contained in the P & S:

Financial terms

- amount of earnest money
- price offered
- size of down payment
- maximum interest rate and terms acceptable for mortgage
- length of time you have to obtain the mortgage
- house meets appraisal requirements

Additional items

- legal description of the property
- proposed closing date
- length of time the offer is valid
- items of personal property in the house that the seller will leave
- satisfaction of specific contingencies
- clear title

Contingencies

- inspections
    - termite
    - professional home
    - environmental hazards (lead, radon, asbestos)
- repair work - who is responsible for current problem areas

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Glossary

Adjustable-rate mortgage	A mortgage whose interest rate is changed periodically based on changes in a specified index.
Appreciation	An increase in value of a property due to changes in market conditions or other causes.
Closing	The final step in the sale of a property when title is transferred from the seller to the buyer, and the buyer signs mortgage documents and pays settlement costs. Also called "settlement."
Contingency	A requirement in the purchase offer that must be met before a contract is legally binding.
Conventional mortgage	A mortgage that is not insured or guaranteed by the federal government; usually a fixed term, fixed rate, fixed payment mortgage loan.
Credit report	A report prepared by a credit bureau or consumer reporting agency to describe an individual's credit use history; used by credit and mortgage grantors to determine a loan applicant's creditworthiness.
Down payment	The portion of the purchase price that the buyer pays up-front in cash and does not finance.
Earnest money	A deposit offered by the potential buyer to show that he or she is serious about negotiating the purchase of a property.
Lock-in	A written agreement that guarantees a set interest rate for a homebuyer if the loan is closed within a specified period of time. The number of points to be paid at closing is also usually set in the lock-in agreement.
Mortgage	A legal claim in which a property is pledged to the lender as collateral for a debt.
Title insurance	Insurance that protects the lender (lender's policy) or buyer (owner's policy) against losses due to legal disputes over ownership of a property.

The Center for Personal Financial Education is an educational resource and research center whose mission is to advance the adoption of sound personal financial practices by developing and delivering personal financial education programs and conducting related research. The Center, established in 1996, is a joint venture between the University of Rhode Island and the Consumer Credit Counseling Service of Southern New England.

Development of the Getting Fiscally Fit program was made possible by a grant from the CDNE Foundation.