

# Are You Ready to *Buy a Home?*





# *1: Are You Ready to Buy a Home?*

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## *Introduction*

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Welcome to “Are You Ready to Buy a Home?”

You are taking an important step toward realizing the dream of many Americans: owning a home of your own. If you dream of owning your own home, it can become a reality if you set realistic goals, get sound advice, plan carefully and clearly understand the costs. As with any new endeavor, the more you know about homeownership, the better able you will be to reach your goals. Enrolling in a homeownership education class is a good start for any first-time homebuyer.

Education helps you learn about the entire homebuying process and make wise choices about one of the largest purchases you may ever make.

This section gives you an overview of the homebuying process, helps you decide if home-ownership is right for you and lets you know whether you can afford to buy a home now. It will help you understand:

- The advantages and disadvantages of owning a home
- The steps to buying a home
- The key members of your homebuying team
- The mortgage payment and other costs of homeownership
- How lenders determine creditworthiness and affordability
- If you are ready for homeownership

Owning a home is not for everyone. Some people do not want the responsibility; others do not want to change their spending habits so they can afford to make monthly payments on a home. By the end of this section, you will have a good idea about whether you want to own a home. Start by thinking about the advantages and disadvantages of homeownership.

## ***Is Owning a Home Right for You?***

Some people rent housing because they think they cannot afford to buy their own home. Many other people are renters by choice. They like to have the freedom to move from place to place and want the landlord to have responsibility for maintenance and repairs. As you decide if you want to become a homeowner, consider the pros and cons of owning a home.

### **ADVANTAGES OF HOMEOWNERSHIP**

#### **STABLE HOUSING COSTS**

You can live in your own home for your whole life if you wish. If you have a fixed-rate loan, your principal and interest payments will never go up, although the amount you pay for taxes and insurance may increase each year.

#### **Tax Benefits**

You may pay less income tax because all home loan interest and property taxes you pay each year are deductible from your taxable income. This benefit generally works when your itemized deductions for mortgage interest and other costs associated with homeownership in a given tax year exceed the standard deduction. This is a dollar amount based on your filing status that reduces the amount of income on which you are taxed. More information on tax deductions is provided in the Protecting Your Investment section. It is always a good idea to consult a tax advisor for the latest IRS information.

#### **Equity**

Your mortgage payments are like an investment. When you buy a house, your monthly mortgage payments act as a scheduled savings plan. Over time, you accumulate equity, which represents your ownership interest in the property. You may be able to borrow against or convert your equity into cash by selling the home. Aside from gaining equity as your mortgage balance is reduced, your house may increase in value, thereby providing you with additional equity.

#### **Control Over Your Environment**

Having a home of your own gives you the freedom to live as you wish. You can have pets and make changes to your home to suit yourself. If you make improvements wisely, they often add to the value of your home.

#### **Stability**

A home is a place you can call your own. It often comes with feelings of permanence, pride and involvement, and many homeowners form deeper roots in the community. Homeownership can provide a stable environment for you and your family that adds to the security and comfort of your day-to-day life.

## **DISADVANTAGES OF HOMEOWNERSHIP**

### **Monthly Costs**

Often, the monthly cost of a mortgage, utilities and maintenance is higher than rent. However, in some communities, owning a home may actually be less costly than renting.

### **No Guarantees**

There are no guarantees that your house will increase in value. Changes in market conditions, wear and tear on the property or other factors can cause the value of your home to decline. If you move before your loan is paid off when your home has depreciated in value and the balance of the home is now more than the sales price, you will have to pay the difference between your net proceeds from the sale of the house and the payoff balance on your mortgage to the lender.

### **Maintenance and Repairs**

When you rent, repairs are the landlord's responsibility. When you own a home, you have to make the repairs yourself or pay someone else to do them. You must quickly fix small problems, like loose shingles and clogged drainpipes, or they can eventually cause bigger, costlier problems.

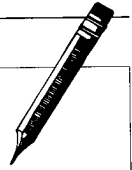
### **Decreased Mobility**

When you own a home, you often can't move until you sell it or rent it. Selling can take several months – or more. If you stop making your mortgage payments, the lender may foreclose on your house and force the sale of your property to repay the loan. If that happens, you could lose your entire down payment and any equity you have earned over the years. Your credit rating will be affected for up to seven years or more.

### **Fewer Features**

Some apartments have pools, laundry facilities, playgrounds and other features that you pay for as part of your rent. Unless you buy in a co-op or condominium, you may have to do without some of the features apartments have or pay extra to have them.

Owning your own home has many advantages, but it comes with a lot of responsibility. It's up to you to decide if homeownership is right for you. Use the "Pros and Cons of Owning a Home Worksheet" to help you determine whether owning or renting is more appealing to you.



## Worksheet: Pros and Cons of Owning a Home

Read the following statements about renting vs. owning, and decide if they would be good or bad for you. Put a “+” in the box for what you think is a good thing and a “-“ in the box for what you think is bad.

Rent	Own
<b>Monthly Costs</b>	
<input type="checkbox"/> Monthly costs may be lower, especially if utilities (gas, water and electricity) are included, but there are no tax advantages.	<input type="checkbox"/> Monthly payments are generally higher, but interest and property taxes can be deducted when you file federal income taxes if you itemize your deductions.
<b>Home Maintenance and Repairs</b>	
<input type="checkbox"/> Repairs are the responsibility of the landlord. Repairs will be made when the landlord has time.	<input type="checkbox"/> Repairs are your responsibility. You have to make the repairs yourself or pay someone to make them. Broken things must be fixed or they will cause bigger problems and cost more later.
<b>Equity</b>	
<input type="checkbox"/> When you make your monthly payment, the money is gone.	<input type="checkbox"/> Your mortgage payment is like a savings account. Over time, you accumulate equity, ownership interest in the property that you may be able to borrow against or convert into cash by selling the home. You could also gain equity if your house increases in value and becomes worth more than you owe. However, there are no guarantees that your house will increase in value. If you sell a house that is worth less than you owe, you must pay the lender the difference.
<b>Freedom vs. Responsibility</b>	
<input type="checkbox"/> You can move when your lease ends.	<input type="checkbox"/> You cannot move until you sell or rent your home. If you fail to make your mortgage payment, you could lose your home and all the money you put into it and could ruin your credit rating.
<b>Privacy/Security</b>	
<input type="checkbox"/> You may not have privacy.	<input type="checkbox"/> Your home is all yours.
<input type="checkbox"/> The landlord may sell the property. You may be evicted. Your rent may be raised.	<input type="checkbox"/> With a fixed-rate mortgage, your principal and interest payments remain the same.
<b>Total + for renting:</b> _____	<b>Total + for owning:</b> _____
<b>Total - for renting:</b> _____	<b>Total - for owning:</b> _____

## ***How Do You Buy a Home?***

Buying a home is a big job that includes a number of tasks, which can take several months or even longer to complete. The main steps to buying a home are basically the same for everyone, but details may vary according to individual circumstances.

### **STEPS IN THE HOMEBUYING PROCESS**

#### **Step 1: Prepare for homeownership.**

The decision to buy a home should be made thoughtfully, because owning a home requires a significant investment in time, money and energy. A good way to begin the homebuying process is to take a realistic look at what you can expect from homeownership and what owning your home really means. There are many good reasons to buy a home, provided you're ready for the increased responsibilities. Determine whether you should rent or buy by carefully evaluating the pros and cons of homeownership and your current situation.

The more you know about homeownership, the easier it will be for you to become a homeowner. Homeownership can be a complicated and intimidating process, and education can give you the tools and knowledge you need to successfully navigate it. Sign up for homeownership education classes from a reputable source, such as a nonprofit organization, to help you learn as much as you can about the home purchase process and make informed decisions about one of the largest and most important investments you will ever make. Classes usually include information on money management, credit, selecting a home, mortgage financing and home maintenance. Also, nonprofit organizations often offer individual counseling to help you resolve any barriers to achieving homeownership. Although homeownership education and counseling won't guarantee that you'll get a mortgage loan, they can increase your skills, knowledge and confidence about the whole process, as well as the likelihood that you will one day become a homeowner if you work on it.

#### **Step 2: Determine how much you can afford to spend.**

Before you begin searching for your dream home, analyze how much you can afford to spend on a monthly mortgage payment by preparing a realistic budget, or spending plan, that includes all your monthly obligations and regular expenses. The amount that you can afford for a mortgage payment plus available cash for a down payment and closing costs (either your own funds or through down-payment and/or closing cost assistance) gives you your affordable price range.

#### **Step 3: Get your loan pre-approved.**

Most homebuyers have their first contact with a lender before they start looking for a house, to find out how much they can afford to spend. After taking a close look at your budget, shop around for a reputable lender and a loan product with the best rates and terms. When you find the right product for you, visit a lender to get pre-approved. Prequalification is the process lenders use to calculate how much mortgage you can afford, based on unverified information. It is not, however, a guarantee. Pre-approval,



on the other hand, is where you actually apply for the loan before you have found the house you want to buy. You provide all the same information as when you apply for a loan after you have made an offer on a house, except for information about the house. Pre-approval guarantees that the lender will lend you a certain amount, as long as you buy within a specified time period and the house appraises for the amount of money for which you are qualified. There may be a fee for pre-approval, but it helps you shop with confidence to know how much you can afford based on your finances and credit.

**Step 4: Decide what kind of home you want and need.**

Knowing how much you can afford to spend on a house helps you realistically evaluate your wants. Other than affordability, you should consider the type of home and features you want, the size of your family, your lifestyle and special circumstances.

**Step 5: Shop for a home.**

Shopping for a home often involves comparing and examining many homes on the market. Most people shop for homes by working with a real estate agent, a trained professional who can help you find a home that fits your needs and budget. Your agent can also protect you throughout the sale by explaining all the steps in the purchase process. Your agent will take you to see the homes he or she thinks will interest you, based on what you say about your wants and needs. House hunting can be fun. This is the time when you and your family can explore new neighborhoods, visit many different kinds of homes and compare features. Take your time, look at many houses, take notes and ask questions. Once you narrow your choices to a few houses, take a closer look.

**Step 6: Make an offer.**

When you find a home in your price range that you would like to buy, you probably will want it to be yours as quickly as possible. After you decide what you are willing to pay, you **prepare a purchase offer with the assistance of your real estate agent or an attorney.** The offer is a written purchase proposal and is usually accompanied by earnest money, a kind of deposit to show your intention to complete the transaction. In some states, if a seller accepts your offer, the signed proposal becomes a purchase contract. In other states, your real estate agent or settlement attorney will prepare a real estate purchase contract that includes all the terms you and the seller agreed to in the offer. Once you and the seller sign the offer, you have a binding contract, even if the final purchase contract is not yet written.

Your contract to purchase a home should allow you to cancel the deal and get your money back if a professional inspection reveals problems with the house, if you are unable to get financing or if other conditions, or contingencies, written into the contract are not met.

**Step 7: Get a professional home inspection.**

As soon as possible after your offer has been accepted, you should find a professional home inspector and make an appointment to meet him or her at the property. Some homes are sold “as is.” After the sale, the seller moves away and any problems with the house are the new owner’s responsibility. However, if you make your purchase contract contingent on a home inspection, you have options to address any problems with the house before you have to live with them. A housing inspector checks the structural soundness of a property. If the inspection shows major problems, you can cancel the sale and get your earnest money back. If you don’t want to cancel, you can ask the seller to make the repairs, or the seller can give you a credit for the amount it would cost you to make them.

**Step 8: Apply for a mortgage loan.**

Once the seller has accepted your offer and you have a satisfactory home inspection, you should apply for a mortgage loan. If you aren’t already pre-approved, shop around for a reputable lender and loan product with the best terms and rates. Once you decide on a lender, you will complete a formal loan application at the lender’s office. After the lender takes your application, your request for credit is processed and underwritten.

**Step 9: Buy insurance and get additional inspections.**

Between the time the seller accepts your offer and the time the sale closes, your contract is pending or in escrow. Many things happen during this period to close the sale by the date agreed to in the contract. You will be responsible for completing some of the tasks, while the professionals you hire will help you complete others. For example, prior to closing, you will have to obtain a homeowners insurance policy to protect the home against casualty and liability. During the escrow period, a title company or attorney will conduct a title search to verify proof of ownership of the property you are buying. A title insurance policy will be issued to protect the lender against defects



in the title, and you should consider purchasing the additional owner's title policy. Depending on your situation, there may be additional tasks you need to complete before closing.

**Step 10: Close the loan.**

The closing, or settlement, is the date on which the seller receives the check and the buyer receives the deed to the property. In some areas, the closing is a formal meeting at which both the buyer and the seller must sign the many papers that are required for sale. In other areas, the papers are signed in advance, and the closing can be done by mail or handled by agents or attorneys. Generally, the seller moves out and turns the keys over to the buyer on the closing day.

Buying a home, which is the largest and most important investment most people ever make, is a complicated process, with many steps involved. The sale of property is controlled by federal, state and local laws. The purchase requires a legal contract between the buyer and the seller. Long-term financing through a bank or mortgage company is standard, and there are several kinds of insurance involved in the average home purchase. Before you begin to look for the perfect house for you and your family, you might find it comforting to know that there are many professionals available to help you.

## ***Your Homeownership Team***

Below are brief descriptions of the jobs of each member of a typical homeownership team:

- Homeownership counselor
- Real estate agent
- Lender
- Attorney
- Escrow officer
- Title insurance officer
- Housing inspector
- Appraiser
- Surveyor
- Insurance agent

All of these housing professionals are not necessarily involved in every real estate transaction. Depending on your situation and the state in which you live, your homebuying team may include only some of them.

### **THE HOMEOWNERSHIP COUNSELOR**

A certified homeownership counselor is a trained professional who works for a non-profit housing agency or community development corporation. Some Realtors® are also designated as Certified Homeownership Counselors. The counselor may provide homeownership education classes or individual counseling sessions to teach you about the home purchasing process and help you overcome any barriers to successfully achieving homeownership.

### **THE REAL ESTATE AGENT**

The real estate agent is an important member of your team who is licensed by the state and has been specially trained to sell houses, other buildings and land. Real estate agents earn their living by matching buyers and sellers. Agents are usually paid a commission from the money the seller makes from the home sale. When one agent represents the buyer and a different agent represents the seller, the commission is usually split. If the agent works with **both** the buyer and the seller on a sale, **this is referred to as dual agency and is prohibited in some states.**

### **Listing Agent**

A listing agent is the person who has a contract (called a listing) with the seller of a house to advertise the property for sale and represent the seller when offers are made. In legal terms, the agent has an agency relationship with the seller. A listing agent works for the seller and is most concerned about helping the seller get the desired sales price.

### Buyer's Agent

A buyer's agent has entered into a contract or agency relationship with the buyer. The buyer's agent typically gets paid by splitting the sales commission with the selling agent, so there is no cost to the buyer. However, the buyer usually agrees to work only with the buyer's agent and may owe the agent money if he or she buys a home through another agent. In exchange for this promise, the agent tries hard to help the buyer get the best deal.

As a buyer, you should expect your agent to help you find a house that fits your needs and your budget and protect you throughout the sale by explaining all the steps in the purchase process.

Whether an agent is a listing agent or a buyer's agent or is representing both sides in a sale, the agent has a legal obligation to be fair and honest to both the buyer and the seller. **All agents are required to disclose any material defects present in the house even if this may affect making the sale. State laws vary as to what other disclosures about the property must be made. For example, many states require the seller to complete a Property Disclosure.**

### THE LENDER

Almost everyone who buys a home gets a home loan, called a mortgage loan, from a lender. Lenders can be banks, savings associations, credit unions, mortgage companies, mortgage brokers, government agencies or even private individuals. Because houses are so expensive, the process of getting a mortgage is far more complicated than applying for a credit card or buying a refrigerator on installment payments. This entire process is explained in detail in the Obtaining a Mortgage Loan section.

### THE ATTORNEY

Attorneys who specialize in real estate law can provide valuable assistance as you are making your home-purchase decision. A few states require that a lawyer write the real estate contract, search the title and conduct closings. In other states, real estate agents and title insurance companies do these jobs and attorneys are used to settle disputes or review the terms of any documents being signed.



## IMPORTANT NOTE

Each state establishes procedures for licensing individuals as real estate agents, brokers, or other designation. A broker is one who may operate a real estate company. Agents work under the supervision of a broker.

A Realtor® is an agent who has chosen to become a member of the National Association of Realtors and is pledged to subscribe to the NAR Code of Ethics.



### **THE ESCROW OFFICER**

During the time between the date the purchase contract is signed and the date the closing takes place, your sale is in escrow. Many things need to happen in escrow to make sure that your sale closes on time and that both sides live up to all the terms of the contract.

The person who manages the escrow is the escrow officer, an independent person who works for both the buyer and the seller. The escrow officer has three specific functions:

- 1) Retains the original purchase contract and other documents
- 2) Holds the earnest money deposit
- 3) Makes sure all the people involved in the sale are doing their jobs. The escrow officer is paid a fee at closing, half of which usually is paid by the buyer and half by the seller. In different states, the job of an escrow officer is done by an attorney, a title insurance company, an escrow company or a real estate agent. In states where the job of the escrow officer is done by another transaction entity, such as a real estate agent, there may be an independent fee structure for this service.

### **TITLE INSURANCE OFFICER**

Title is another word for ownership of a property. Usually, it is simple to determine who holds title to a house: it is the person whose name is on the deed. However, there are issues that cloud a title or make it difficult to tell who owns a property. When you buy a house, you will want a title officer to research the chain of title and give you a history of who owned your home so you can be sure that the person selling you the house really has the right. The title officer researches the public records and issues a title report that shows the ownership and gives you other important information about the property. In some states, a title search is performed by an attorney rather than a title officer.

The title officer works for a title insurance company that sells insurance to guarantee that the title report is accurate and that you can rely on it. All lenders require the buyer to pay for a lender's policy of title insurance up to the amount of the mortgage. This protects the lender if there is an error in the title report. There is also an owner's policy of title insurance to protect the buyer's ownership share of the home. In some areas, it is common for the seller to pay for the owner's policy. You can have your real estate agent or attorney write that condition into your purchase contract. If the seller is not willing to pay for the insurance, it is important that you buy the insurance to protect your equity in the property if a problem shows up later with the title.



### **THE HOUSING INSPECTOR**

A housing inspector checks the structure and the mechanical parts of a property. The inspector then writes a report describing major problems. Especially if this is your first home, it is a good idea to go with the inspector when he or she does the inspection. Inspectors can point out important features of your new home, like the main water shut-off valves and the location of the electrical boxes. The inspector can also give you good advice on normal maintenance, such as changing the furnace filters to cleaning the gutters.

### **THE APPRAISER**

When you apply for a loan, the mortgage lender hires an appraiser to estimate the value of the house you want to buy. The appraiser's job is to determine the fair market value of your house by comparing the house with houses like it that have sold recently in the same area. You do not work directly with the appraiser. Lenders use the appraisal to determine how much money they are willing to lend you.

### **THE SURVEYOR**

A surveyor is a licensed professional who checks the measurements of a property and the land around it. Every property has a legal description that defines the property lines. Depending on the state you live in and the type of property you are buying, the mortgage lender may require you to get a survey of the property you want to buy. The survey tells you how big the property is, if there are any property easements or encroachments, what the placement and dimensions of improvements on the property are, and whether any improvements are over the property lines. Even if not required by the lender, a survey is a good idea.

### **THE INSURANCE AGENT**

Many people have car and life insurance. When you become a homeowner, you will also need homeowners insurance. Usually the same agent who handles your other insurance can insure your home to protect it from casualty and liability. Your insurance agent may visit your new home to recommend how much insurance you should have. **Insurance in areas that are prone to natural disaster (hurricane, tornado, earthquake, flood, fire) will have higher rates and may be more difficult to obtain. It is a good idea to obtain at least three quotes.**

you can correct it before the lender gets the report. Most credit reports do contain some blemishes, and they can show wrong information. You may find that an item you thought was resolved is still on your credit report. For a small fee, you can get copies of your own credit report from any of the three national credit reporting bureaus – Experian, TransUnion and Equifax – by sending a request in writing or online. See below for contact information for all three bureaus. All three of the agencies provide free reports to people who have been denied credit recently as a result of information contained in their credit reports, and residents of certain states are entitled to one free credit report each year. You can also go online to [www.annualcreditreport.com](http://www.annualcreditreport.com) for a free copy of your report once a year from each of the three major credit agencies.

### **Collateral**

The house you are buying will be collateral, or security, for the loan. Because homes cost so much, when you borrow money to buy a home, you give the lender your promise to repay the mortgage and the right to take the house and sell it if you cannot, or do not, pay back the loan. The lender looks carefully at the value and condition of the collateral for two reasons. First, the lender wants to make sure that you are not buying a house that is in such bad condition that it will take all of your money just to keep up with the repairs. Second, the lender wants to make sure that the property is worth a little more than the amount of the loan, so that if the house is sold, there is at least enough to pay off the loan. The lender determines the value by getting an appraisal.

The guidelines that lenders use to analyze the 4 C's of credit are explained in detail in the Obtaining a Mortgage Loan section.



## **HOW TO OBTAIN A COPY OF YOUR CREDIT REPORT AND CREDIT SCORE**

To obtain a copy of your credit report and credit score, contact one of the credit agencies below. Call first for information on fees. There is usually a charge for obtaining a credit score.

### **EXPERIAN**

1-800-831-5614  
www.experian.com  
P.O. Box 2002  
Allen, TX 75013

### **TRANSUNION LLC**

1-800-888-4213  
Consumer Disclosure Center  
www.transunion.com  
P.O. Box 1000  
Chester, PA 19022

### **EQUIFAX**

1-800-685-1111  
www.equifax.com  
P.O. Box 740241  
Atlanta, GA 30374

You must include all the following information with your request and may use the form on the next page:

1. Full name, including middle initial and generation, such as Jr., Sr., II, III
2. Current address with zip code (no P.O. boxes)
3. Any previous addresses with zip codes for the past five years
4. Social Security number
5. Year of birth
6. If married, the first name of your spouse
7. Verification of your current address, such as a copy of your driver's license, current billing statement or other valid document that shows your current address, plus a daytime or evening phone number

Allow two to three weeks to receive your report and score.

If you have questions about your report or score after you receive it, please follow the instructions included with the report.

## Credit Report and Credit Score Order Form

Credit Reporting Agency \_\_\_\_\_ Date \_\_\_\_\_

Address \_\_\_\_\_

City \_\_\_\_\_ State \_\_\_\_\_ Zip Code \_\_\_\_\_

Please send to me a copy of:  My credit report  My credit score

I have enclosed a check in the amount of \$ \_\_\_\_\_

First Name \_\_\_\_\_ Middle Initial \_\_\_\_\_ Last Name \_\_\_\_\_ Generation \_\_\_\_\_

Spouse's First Name \_\_\_\_\_

Current Address \_\_\_\_\_

City \_\_\_\_\_ State \_\_\_\_\_ Zip Code \_\_\_\_\_

Previous Address \_\_\_\_\_ City \_\_\_\_\_ State \_\_\_\_\_ Zip Code \_\_\_\_\_

Previous Address \_\_\_\_\_ City \_\_\_\_\_ State \_\_\_\_\_ Zip Code \_\_\_\_\_

Previous Address \_\_\_\_\_ City \_\_\_\_\_ State \_\_\_\_\_ Zip Code \_\_\_\_\_

Previous Address \_\_\_\_\_ City \_\_\_\_\_ State \_\_\_\_\_ Zip Code \_\_\_\_\_

Social Security Number \_\_\_\_\_ Date of Birth (Month/Day/Year) \_\_\_\_\_

Enclosed is the following for verification of my current address and phone number:

Copy of my driver's license  Copy of current statement  Other: \_\_\_\_\_

Signature \_\_\_\_\_ Date \_\_\_\_\_

Thank you.

## ***How Much Can You Afford?***

If you are curious about how much house you can afford, here is a quick rule of thumb:

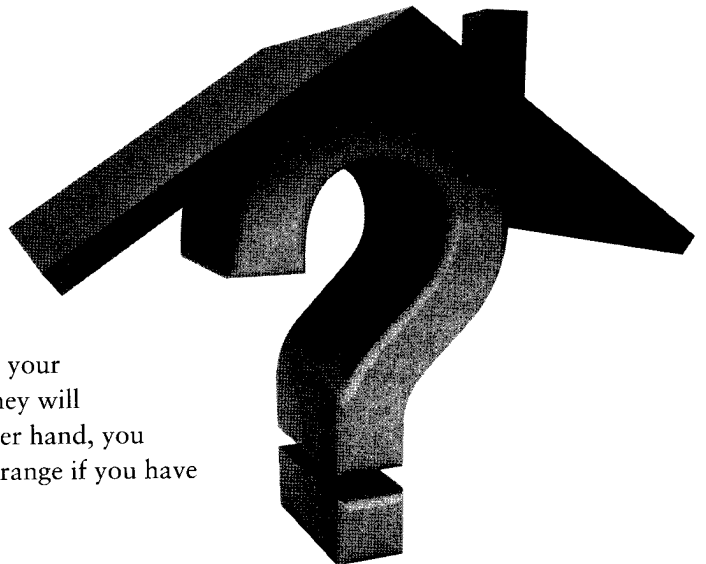
Most people who have good credit and a steady income and do not owe a lot of money can afford to buy a home that costs two-and-a-half to three times their annual income. For example, a family earning \$30,000 a year, with monthly credit card and car payments of less than \$200 (about 8 percent of their income) and a good credit rating, will probably qualify for a mortgage loan to buy a house that costs between \$75,000 and \$90,000. Use this rule to estimate roughly how much house you can afford.

Use the “Housing Affordability Worksheet” on the next page to figure your gross annual income, using the amount of your paycheck before taxes, insurance and other expenses are taken out. Next, figure the gross annual income of your spouse or any other co-borrower on your loan. Finally, include steady income you get from any other source, such as:

- Retirement
- Disability
- Child support
- Aid to Families with Dependent Children (AFDC)
- Social Security
- Alimony
- Commissions and bonuses
- Second job or home business income

For most types of income, you must be able to show a history of at least two years and the likelihood that the income from a given source will continue.

Remember that this worksheet only gives you an estimate. The actual amount you can pay for a home varies with the type of loan program, interest rates and your own situation. For example, if you have many debts, they will reduce the amount you can afford to repay. On the other hand, you can afford to buy a home closer to the top of the price range if you have few debts and a lot of savings.





## Housing Affordability Worksheet

### If you are paid:

Weekly	\$ _____ pay before deductions	x 52	\$ _____ annual income
Twice a Month	\$ _____ pay before deductions	x 24	\$ _____ annual income
Once a Month	\$ _____ pay before deductions	x 12	\$ _____ annual income
Other Monthly Income	\$ _____ other monthly income	x 12	\$ _____ annual income

### Total Gross Annual Income

(Add annual income from all borrowers  
to other monthly income)

\$ \_\_\_\_\_

\$ \_\_\_\_\_ x 2.5  
Gross Annual Income

\$ \_\_\_\_\_  
**Low Range of Housing Cost**

\$ \_\_\_\_\_ x 3  
Gross Annual Income

\$ \_\_\_\_\_  
**High Range of Housing Cost**

## RATIOS

Lenders take risks when they lend money. For this reason, they want to be sure that your house payment is within your means – in other words, that you can afford to make your payments. Therefore, lending institutions set limits on borrowers' monthly debt payments. These limits are called the housing ratio (often referred to as the front-end ratio) and the debt-to-income ratio (often referred to as the back-end ratio). Let's look at these ratios in more detail.

### Housing Ratio

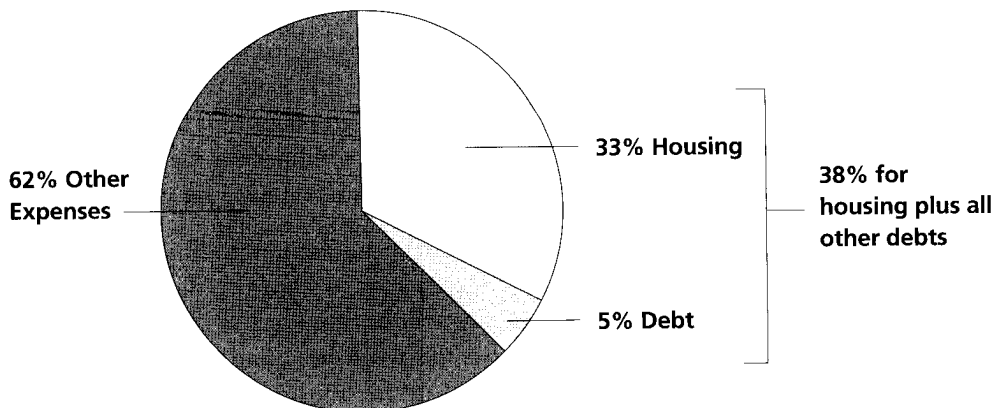
The housing ratio is the maximum percentage of a borrower's gross monthly income that can be used to make the monthly mortgage payment. Different types of loans have different preset percentages. The maximum monthly payment, as determined by the housing ratio, includes principal, interest, taxes and insurance. Depending on which loan you choose, the housing ratio could be 25 percent, 28 percent, 31 percent, 33 percent or more.

For example, let's say your gross monthly income is \$4,000 and the loan you selected has a housing ratio of 33 percent. The maximum limit you could spend each month for the house payment (PITI payment) is \$1320 ( $\$4,000 \times 33\% = \$1320$ ).

### Debt-to-Income Ratio

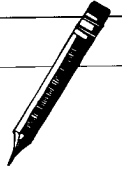
The debt-to-income ratio is the maximum percentage of a borrower's gross monthly income that can be used for the house payment, plus all other debts. This percentage is also preset depending on the loan type and could be from 36 to 41 percent.

For example, let's say that the loan program you selected has a 38 percent maximum limit on the amount you can spend monthly for the house payment, plus other debts. Let's also assume your gross monthly income is \$4,000. This means that the most you could spend for the house payment plus all creditor debts is \$1520 ( $\$4,000 \times 38\% = \$1520$ ).



Remember that high debt will reduce the amount you can borrow. The higher your monthly debt payments, the smaller the amount you can borrow for your home purchase. You may need to reduce your debt before you apply for a mortgage loan.





# Total Monthly Debt Worksheet

## Your Total Monthly Debt Payments

Car Payment \$ \_\_\_\_\_

Credit Cards

Card:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Monthly Payment

\$ \_\_\_\_\_  
\$ \_\_\_\_\_  
\$ \_\_\_\_\_  
\$ \_\_\_\_\_

Total monthly debt from credit cards \$ \_\_\_\_\_

Loan Payments

Lender:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Monthly Payment

\$ \_\_\_\_\_  
\$ \_\_\_\_\_  
\$ \_\_\_\_\_  
\$ \_\_\_\_\_

Total monthly debt from loans \$ \_\_\_\_\_

Child care

\$ \_\_\_\_\_ x 52 ÷ 12 \$ \_\_\_\_\_

Weekly cost for all children

**Total Monthly Debt** \$ \_\_\_\_\_

(Add monthly car payment, total monthly debt from credit cards,  
total monthly debt from loans, and monthly child care payment)



## Prequalifying Worksheet

### Your Gross Monthly Income

Your weekly pay (before deductions) \$ \_\_\_\_\_ X 52 ÷ 12 \$ \_\_\_\_\_

or

Your twice-a-month pay (before deductions) \$ \_\_\_\_\_ X 2 \$ \_\_\_\_\_

Your spouse's weekly pay (before deductions) \$ \_\_\_\_\_ X 52 ÷ 12 \$ \_\_\_\_\_

or

Your spouse's twice-a-month pay (before deductions) \$ \_\_\_\_\_ X 2 \$ \_\_\_\_\_

Your Monthly Gross Pay (Your pay + your spouse's pay) \$ \_\_\_\_\_

Other Gross Monthly Income \$ \_\_\_\_\_

### Total Gross Monthly Income

(Monthly Gross Pay + Other Gross Monthly Income) \$ \_\_\_\_\_

### Ratios and Debt

Total Gross Monthly Income X \_\_\_\_\_ % (housing ratio) \$ \_\_\_\_\_ (2)

Total Gross Monthly Income X \_\_\_\_\_ % (debt-to-income ratio) \$ \_\_\_\_\_ (3)

Total Monthly Debt Payment (any installment debts with 10+ months remaining) \$ \_\_\_\_\_ (4)

Subtract Line (4) from Line (3) \$ \_\_\_\_\_ (5)

### Maximum Mortgage Loan Payment Allowed

Enter whichever is less, Line (2) or Line (5) \$ \_\_\_\_\_ (6)

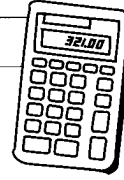
Multiply Line (6) by 20% (estimated taxes and insurance) \$ \_\_\_\_\_ (7)

Subtract Line (7) from Line (6) (maximum principal and interest payment allowed) \$ \_\_\_\_\_ (8)

Divide Line (8) by factor from sample factor table \$ \_\_\_\_\_ (9)

### Maximum Mortgage Loan Amount

Multiply Line (9) by \$1,000 \$ \_\_\_\_\_



## Sample Interest Factor Table

### COST FOR EACH \$1,000 OF A MORTGAGE LOAN

Interest Rate	15-Year Loan	20-Year Loan	30-Year Loan
4.00	\$7.40	\$6.09	\$4.77
4.50	\$7.65	\$6.36	\$5.07
5.00	\$7.91	\$6.60	\$5.37
5.50	\$8.18	\$6.88	\$5.68
6.00	\$8.44	\$7.17	\$6.00
6.50	\$8.72	\$7.46	\$6.33
7.00	\$8.99	\$7.76	\$6.66
7.50	\$9.28	\$8.06	\$7.00
8.00	\$9.56	\$8.37	\$7.34
8.50	\$9.85	\$8.68	\$7.69
9.00	\$10.15	\$9.00	\$8.05
9.50	\$10.45	\$9.33	\$8.41
10.00	\$10.75	\$9.66	\$8.78
10.50	\$11.06	\$9.99	\$9.15
11.00	\$11.37	\$10.33	\$9.53
11.50	\$11.69	\$10.67	\$9.91
12.00	\$12.01	\$11.02	\$10.29

Source: McGraw Hill's Interest Amortization Tables, Third Edition, 2006

## Self-Test: Are You Ready to Buy a Home?

This self-evaluation should give you an idea of whether you are ready to buy a home. Please circle your answers to the following questions, and try to be as honest as possible:

1. Are you sure you want to buy a house?  Yes  No
2. Do you have steady income and stable employment (at least two years)?  Yes  No
3. Do you plan on remaining in the same area for the next few years?  Yes  No
4. Have you created a budget so you know how much you can realistically afford to pay for housing?  Yes  No
5. Do you have an established credit history or records of payment to previous landlords and utility companies?  Yes  No
6. Do you pay your bills on time or before the due date?  Yes  No
7. Do you have enough money saved for a down payment, closing costs and cash reserves?  Yes  No
8. Is your debt low enough not to limit your ability to qualify for a mortgage?  Yes  No
9. Are you ready to care for and maintain a home?  Yes  No
10. Have you been prequalified by a lender, so that you know how much you can borrow based on your income and debt?  Yes  No
11. Have you looked into the benefits of numerous financing programs?  Yes  No
12. If you have had bankruptcy, did it happen more than 3 years ago?  Yes  No

If you answered "yes" to the majority of questions listed above, you are probably near-ready to buy a home.

If you answered "no" to the majority of questions listed above, particularly questions 2, 3, 5, 6, 7, 8 and 12, you probably need a longer time to get ready to buy.

## Summary

If you have completed this section, you should have a good idea of what it takes to become a homeowner. You learned about:

- The advantages and disadvantages of homeownership
- The key steps and housing professionals involved in the homebuying process
- The mortgage payment and other costs of homeownership
- How lenders determine your creditworthiness and decide how much money to lend to you
- Prequalification to get an idea of how much you can afford to spend on a loan payment

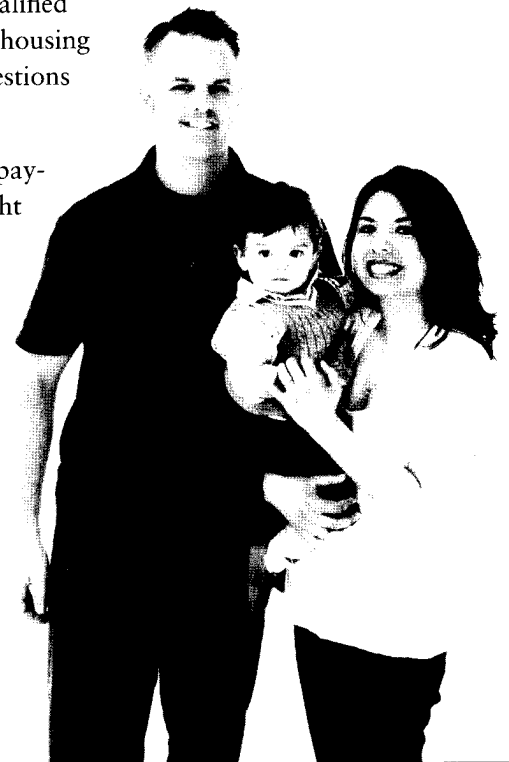
Are you ready to buy a home? Try the self-test on the previous page to test your homeownership readiness.

## Next Steps

First, you need to determine how ready you are to buy a home. Take a look at the “Prequalifying Worksheet” and the “Self-Test: Are You Ready to Buy a Home?” to determine if you are a near-ready or down-the-road buyer. If you prequalified yourself with a house payment that is comfortable, matches the cost of housing for sale in your community, and you answered “yes” to most of the questions on the self-test, you are probably close to being ready to buy a home.

If you prequalified yourself for a house payment that is lower than the payment needed to buy a house in your neighborhood or it feels like it might be too much for you to spend every month, or if you answered “no” to many of the questions on the self-test, you may take months or even years to buy a home. However, do not be discouraged. Homeownership education and individual counseling from a nonprofit organization can help you overcome obstacles and achieve homeownership. It will take some time, energy and work, but in the end, you will be rewarded with a home of your own.

No matter if you are a near-ready or a longer-term buyer, the next step you should take is to sign up for housing counseling sessions and/or homeownership education classes. Many nonprofit organizations offer different types of classes and counseling sessions to meet different needs. This session was merely an overview of the process. The classes and counseling sessions will cover



the details of buying a home and give you helpful tips on the home purchase process. The homebuying process is complex, and education will provide you with the tools and knowledge to successfully navigate the process and make a wise investment in what probably will be your largest and most important purchase.

Around the same time you sign up for classes, be sure to order copies of your credit report from Experian, TransUnion and Equifax and review them for inaccuracies and problems. If there are any problems, this will give you plenty of time to resolve them before you meet with a lender.

After you attend homeownership education classes and work through any barriers to homeownership, you will be ready to begin shopping for your new home by getting prequalified or pre-approved by a local lender and contacting a real estate professional to show you properties in your price range.

Good luck!

## ***Resources***

Estes, Jack and Dennis Kelley, *McGraw-Hill's Interest Amortization Tables, Third Edition, 2006.*

### **WEB SITES**

<a href="http://www.bankofamerica.com">www.bankofamerica.com</a>	First-Time Homebuyer Learning Center
<a href="http://www.fanniemae.com">www.fanniemae.com</a>	For Homebuyers and Homeowners
<a href="http://www.freddiemac.com">www.freddiemac.com</a>	Buying and Owning a Home
<a href="http://www.homebuyingguide.com">www.homebuyingguide.com</a>	
<a href="http://www.keystomyhome.org">www.keystomyhome.org</a>	
<a href="http://www.annualcreditreport.com">www.annualcreditreport.com</a>	