Buying a home is a huge commitment. Monthly payments, care, and maintenance need to play a large part in your budget calculations.

The Buying Process

Can you afford it?

- **Steady income**
- **Steady employment**
- **Good credit history**
- **Down payment**
- **Shopping for a mortgage**

We have talked about the benefits of home ownership, but can you afford a house? This depends on several factors: your monthly income, the size of your down payment, the interest rates, the price of the house, how much non-mortgage debt you have, your employment and credit histories, and how long you intend to own the house. Usually, lenders don't want your total monthly payment for a house to be more than 30% of your gross income before taxes. The monthly payment includes more than just the mortgage loan payment. It also includes property taxes, interest on your loan, and insurance. The monthly payment is commonly called PITI. This stands for principal, which is the amount of the loan, interest on the loan, taxes, and insurance. Lenders differ on how much they will allow for housing costs. You will probably need an income of about three times your monthly mortgage payment in order to qualify for a loan, depending on how large of a down payment you plan to make. In other words, if your mortgage payment will be $1,500 a month, your monthly income needs to be at least $4,500 before taxes in order to qualify for a loan. Lenders will also look at all of the debt you have, not just the mortgage debt. They usually set a limit of 35 to 36 percent of your gross income for all of your debt including the mortgage.

You need to have steady employment for several years before you apply for a loan. Lenders don't like to see people who change jobs frequently. They want to see that you have stable employment and income. Your credit history is very important as well. The credit module will cover this in depth, but you need to pay all of your bills on time every month. Lenders like to see that you pay more than the minimum and that you regularly put money into savings. Don't apply for other credit when you are considering buying a home.

In addition, the bigger the down payment that you can make, the better you will look to lenders. Remember, you learned earlier that you will need 5 to 20% for a down payment on a house. The more you are able to put down, the better your chances are to qualify for the loan. A larger down payment also reduces the amount of the loan you will need, which, in turn, reduces your monthly payment amount. You can't go wrong with a big down payment!

When you begin looking for a mortgage, you need to shop around. Look in newspapers and on the Internet for current lender offers. Get several quotes, or good faith estimates, and negotiate the terms of the loan with various lenders. This whole module has been about making wise decisions when shopping. A house is probably going to be the most expensive purchase you make in your lifetime. So, you really need to use those comparison shopping skills for this purchase! Interest rates are critical when looking for a mortgage. When mortgage interest rates are low, lenders will qualify you to buy a bigger house, and the amount of your monthly payment drops significantly as interest rates drop. You can figure out what you can afford to pay for a house when you know how much a lender will lend you and how much you will put down on the loan. The size of the loan plus the down payment equals the price of the house you can afford to buy.

When you begin this process, you will need to have several types of records available for lenders. Make a file of these documents in order to make this process easier. You will need two to three years of pay stubs, W-2 forms for the previous two years, tax returns for the past two years, a list of major assets and their current values, and a list of any long-term debt you currently have. Long-term debt is anything that will take longer than ten months to pay off. A good example of a long-term debt is your school loan for college. You will need to list your current monthly payment on the debt, the current balance of the debt, and the projected payoff date. You also need to have recent bank statements in your file and proof of any additional income you may receive, like child support, alimony, etc.

Remember, banks want to make money. A bank or a mortgage company calculates the amount it believes you can afford each month. You may not want to borrow the highest amount a lender will give you. You need to look at your budget and consider how much you feel comfortable paying. Be sure to consider your other monthly obligations and your investing goals. This is a huge commitment for a long period of time. This monthly amount is future income you are committing to pay for many years, usually 15 to 30 years! Stick to your budget. When you begin looking, remember also that a realtor (real estate agent) is a salesperson who is paid on commission. Just like the bank, the more you spend, the more the real estate agent makes. The realtor works for the seller not the buyer! The realtor can't legally misrepresent the property, but they are not obligated to tell you everything they know, like whether the owner will take a lower price than the asking price. Throughout this entire process, you need to look out for yourself! That is why this course is so important. Knowledge is power!

Types of Mortgages

- **Fixed rate mortgages**

Mortgage	Percentage	Duration	Interest Paid	Monthly Payment
$100,000.00	8%	30 years	$164,000.00	$734.00
$100,000.00	8%	15 years	$66,500.00	$991.00

$257.00 MORE PER MONTH = $97,500.00 INTEREST SAVINGS

A mortgage is a loan from a bank or mortgage company to someone buying real estate. The mortgage is “secured” by the property. The home is the collateral for the loan. This means that if you don’t make your monthly payments, the bank or mortgage company can take your home through a process called foreclosure.

There are three basic types of mortgages. The first is a fixed rate mortgage. With this type of mortgage the interest rate of the loan is fixed for the life of the loan and isn’t affected by changes in the overall interest rates. Monthly payments never change, and you will always know how much to budget for your monthly housing. When interest rates are low, it can be a great advantage to get a fixed-rate mortgage because your interest rate doesn’t go up even if the interest rates in the economy go up. These types of mortgages are generally for 15 or 30 years. With a 15 year fixed-rate mortgage, you will have larger monthly payments but you pay back a whole lot less in interest over the life of the loan. Thirty year loans are much more common because the monthly payments are more affordable than 15-year loans, but you will pay back a lot more in interest by the end of your loan. Look at this example: If you get a $100,000 mortgage at 8% for 30 years, you would pay back $164,000 in interest over the 30 years and you would have monthly payments of $734. For the same $100,000 at 8% for 15 years, your monthly payment would be $991 with total interest paid back of $66,500. For $257 more per month, you would save $97,500 in interest! So if you can afford the higher monthly payment, the 15 year loan makes more sense.

Types of Mortgages

- Fixed rate mortgages
- Adjustable rate mortgages (ARM)

The second type of mortgage loan is an adjustable rate mortgage or ARM. This type of loan has an interest rate that periodically adjusts based on the rising or falling interest rates in the overall economy. Even though interest rates change constantly, most ARMs have adjustment periods written into the loan. This means that your loan will change at set periods, usually once or twice a year. Some loans allow changes monthly! This means your monthly housing payments can change every year or even every month! Your payment can go up or down depending on the interest rates in the economy. This makes it really hard to budget for housing. This type of mortgage is popular because the beginning rate is usually lower than you can get with a fixed mortgage. Many people like the idea of starting off with a low rate but they fail to budget for the increased rate after the initial period ends. Some ARMs have a maximum interest rate or rate cap. This is a ceiling built into the loan that is the most the lender can charge regardless of what happens with interest rates. You should look at the maximum allowed and decide if you can afford that rate. If not, rethink the loan! Some ARMs also have a maximum amount of change allowed per year. Some of these loans also allow you to convert to a fixed rate mortgage after a certain period of time. ARM loans include all kinds of complicated factors, like that lower initial interest rate, or start rate. The start rate is temporary and is much lower than you will actually be paying. If you decide on this type of loan, it is best to ignore the start rate and budget for the rate you will pay after the start rate expires. Be very careful with adjustable rate mortgages!

Types of Mortgages

- Fixed rate mortgages
- Adjustable rate mortgages
- Balloon mortgages

The third type of mortgage is a balloon mortgage. Just the name of this one should give you pause for thought! Balloons get bigger and bigger, so guess what this type of loan does! With this type of loan, the borrower has to pay off the mortgage in full at the end of the loan term. Payment at the end "balloons" to a large amount. Typically these mortgages are five to seven years long with interest rates at three quarters to one full percentage point below a fixed rate. So, you would make very low payments on your loan for five to seven years and then have to pay the rest of the loan at the end of that time. This type of mortgage is popular with people who expect to move at the end of the mortgage period. If you decide to stay after the loan period, you will have to pay the balance of the loan or get another mortgage to cover the rest of the mortgage. Many people get into trouble with this type of loan. They make their payments for the first few years and fail to plan for the upcoming balloon payment. It is very important to know that when you get a loan, the first few years worth of payments go mostly to the interest on the loan. So, even though you are making payments, you are really not paying down the amount of the loan itself. You end up with very little equity in your home and have a huge payment at the end of the loan. It is best to avoid balloon loans.

Although these are the three basic types of mortgages, lenders do have flexibility in the loan they can offer you. You can negotiate some. Banks compete for their mortgage customers. They will compete on interest rates, so shop around for the best interest rate you can find. As we talked about earlier, the more you know, the better prepared you are to make wise spending decisions. You can save a lot of money if you do your research. There are lots of books out there for first-time home buyers. You can find them at your local bookstore or library.