Buying a Home

by Sophia

WHAT'S COVERED

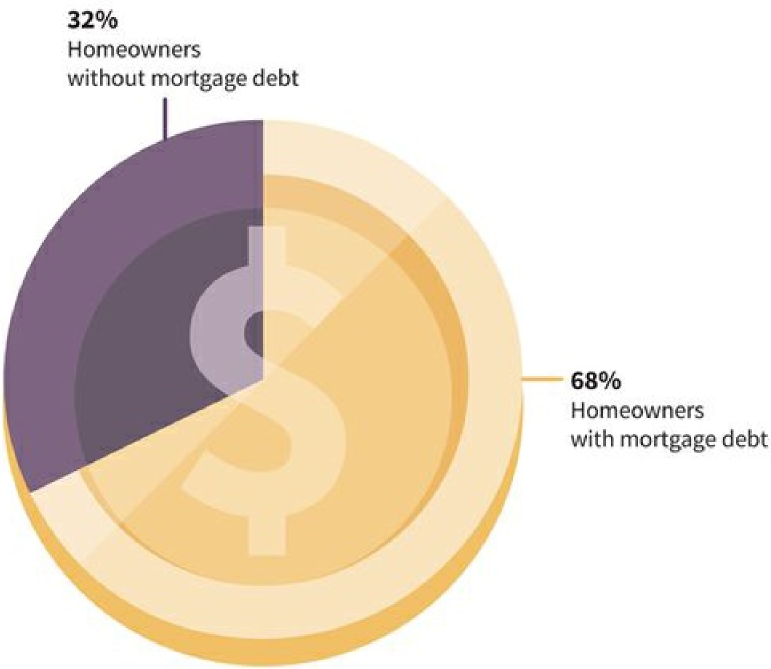
In this lesson, you will examine the necessary considerations and benefits associated with purchasing and owning a home. You will also explore how strong agility and productivity skills can benefit you along the way. Specifically, this lesson will cover:

WATCH

Do you think you have what it takes to buy your own home? According to one group of friends, being productive is the key to home ownership. Watch this video to see some of the rewards that come with the purchase of a new home.

1. Owning a Home

Housing wealth represents more than half of many Americans' total net worth. According to a recent U.S. Census Bureau report, about 65% of households in the United States own their home. As shown in the following pie chart, nearly 68% of homeowners still owe money on their home, while only 32% own their home free of any debt. Home debt is known as a mortgage.



1a. Mortgage

A **mortgage** is a special type of loan that is secured by real property – land and all improvements on a piece of land, including a personal residence.

- Generally, mortgages have long repayment periods, most commonly 15 or 30 years.
- Because the loan is secured by the real property – in this case a house and associated land – if the homeowner fails to make the monthly mortgage payments, the lender can take possession of the house and sell it to another buyer in a process known as **foreclosure**.

Although there are tremendous benefits associated with homeownership, such as wealth accumulation, housing stability, neighborhood and community enhancement, and benefits to children, there are certainly risks associated with homeownership as well. These most notably include possible foreclosure and financial strain from high monthly mortgage payments. In this discussion, we focus on how to make homeownership a positive experience rather than a negative one.

Purchasing a home is one of the single biggest financial decisions people make in their lives. So it's important to understand how economic concepts like mortgage loans and housing costs can impact your short-term or long-term financial goals. And, no matter how much you plan ahead, surprises both exciting and challenging are going to create obstacles in your life. To continue to perform your best and meet your goals, you'll need effective strategies that can help you reassess your priorities and make adjustments as needed.

TERM TO KNOW

Mortgage
A special type of loan that is secured by real property – land and all improvements on a piece of land, including a personal residence.

Foreclosure
The process of a mortgage lender taking possession of a house and any equity in the house because a borrower did not meet payment obligations under the loan agreement.

1b. Determining What Is Affordable

If your job and income are stable and you plan to live in the same community for several years, then homeownership may be a good choice (see Hint). The key to having a good homeownership experience is knowing what you can afford and finding a home that doesn't exceed your ability to make payments.

HINT

The U.S. Department of Housing and Urban Development (HUD) website has extensive information on how to buy a house.

- Many of the financial tools that you have already learned, such as budgeting and managing your credit, are essential to knowing what houses are within your price range and obtaining an optimal loan.
- With your budget, you can see how steady your income and expenses are from month to month, which will help you better estimate an affordable mortgage payment.
- Your budget should also include the associated extra expenses of owning a home, such as maintenance, homeowner's insurance (also referred to as hazard insurance, which is an insurance policy that will reimburse you if your home and belongings are destroyed or stolen), and property taxes. A **mortgage insurance premium**, which is an insurance policy that protects lenders from nonpayment of the loan, is required if more than 80% of the value of the home is borrowed.
- Before you start looking for a home, you will also want to make sure your credit report is clean of errors

and negative events so that you can qualify for the best interest rate on your mortgage.

It is important to have a financial plan in place before purchasing a home. Then, if unexpected bills come your way, you could utilize your productivity and agility skills to maintain an agile mindset and form a new plan for the future.

TERM TO KNOW

Mortgage Insurance Premium
An insurance policy that protects lenders from nonpayment of the loan.

1c. Real Estate Agents and Mortgage Loan Officers

Once you know how much you can afford, you may want to use the help of a real estate agent to help you find a home.

- Real estate agents can represent the buyer, the seller, or both.
- Their experience can be quite helpful, especially when making an offer on a house.

You'll also need to work with a mortgage loan officer when you are looking for houses.

- A mortgage loan officer specializes in mortgages and can help you get **preapproved** for a loan so that when you find the house you want, you know you can afford it.
- To be preapproved for a loan simply means that the lender has verified your credit, income, and other important facts and has indicated how much you are able to borrow for the purchase of a house.

HINT

Remember that there is no contract to purchase a house until the seller and buyer have agreed to every point within the legal agreement. Preapproval simply helps to speed up the process.

TERM TO KNOW

Preapproved
The lender has verified your credit, income, and other important facts and has indicated how much you are able to borrow for the purchase of a house.

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2. Shopping for a Mortgage

When shopping for a mortgage, it is best to get at least three quotes from different lenders to make sure you are getting a fair rate. Some mortgage loan officers are captive agents, which means they only represent one lender and will only quote you rates from that lender. On the other hand, mortgage brokers do not represent any lender and can shop many different lenders to find the best mortgage rates. Be sure to request a **good faith estimate** from each of the lenders. A good faith estimate (GFE) details the following information:

- Loan type.
- Loan amount.
- Interest rate.
- Expected monthly principal and interest payment.

- **Closing costs**, which include all of the associated loan and purchase fees associated with buying a house, such as **appraisal fees** (to pay for a written document describing the value of the property),**title insurance** (insurance that protects either the lender or the borrower in case someone says they have a claim on the property after you've purchased it), loan origination fees and points (discussed below), governmental taxes, and some prepaid taxes and insurance.

HINT

If you're borrowing money to purchase a home, your closing costs will also include fees charged by the lender and mortgage broker.

GFEs come on a standardized form provided by HUD. The standardized format allows borrowers to easily compare loan terms. Closing costs are often referred to as *settlement costs* because they are due when the sale takes place. Closing costs are typically several thousand dollars and usually average about 3% of the home's purchase price.

If you don't have a lot of money for a down payment and closing costs, you should consider an FHA loan. FHA loans are insured (for the lender) by the government so that lenders are more willing to make loans to borrowers that (1) have less money available for closing costs and down payments, and (2) may also have slightly lower credit scores than are necessary to qualify for conventional mortgages. However, in exchange for the greater flexibility in qualifying for a mortgage, FHA loans have a maximum amount that can be borrowed based on the local housing market.

TERMS TO KNOW

Good Faith Estimate
A document that details the following information: loan type; loan amount; interest rate; expected monthly principal and interest payment; closing costs, which include all of the associated loan and purchase fees associated with buying a house, such as appraisal fees, title insurance, governmental taxes, and some prepaid taxes and insurance.

Closing Costs
All fees and related expenses associated with the purchase of a home, including mortgage origination fees, points, legal costs, taxes, transfer fees, and other expenses.

Appraisal Fee
Cost for a written document describing the value of property.

Title Insurance
Insurance that protects either the lender or the borrower in case someone says they have a claim on the property after you've purchased it.

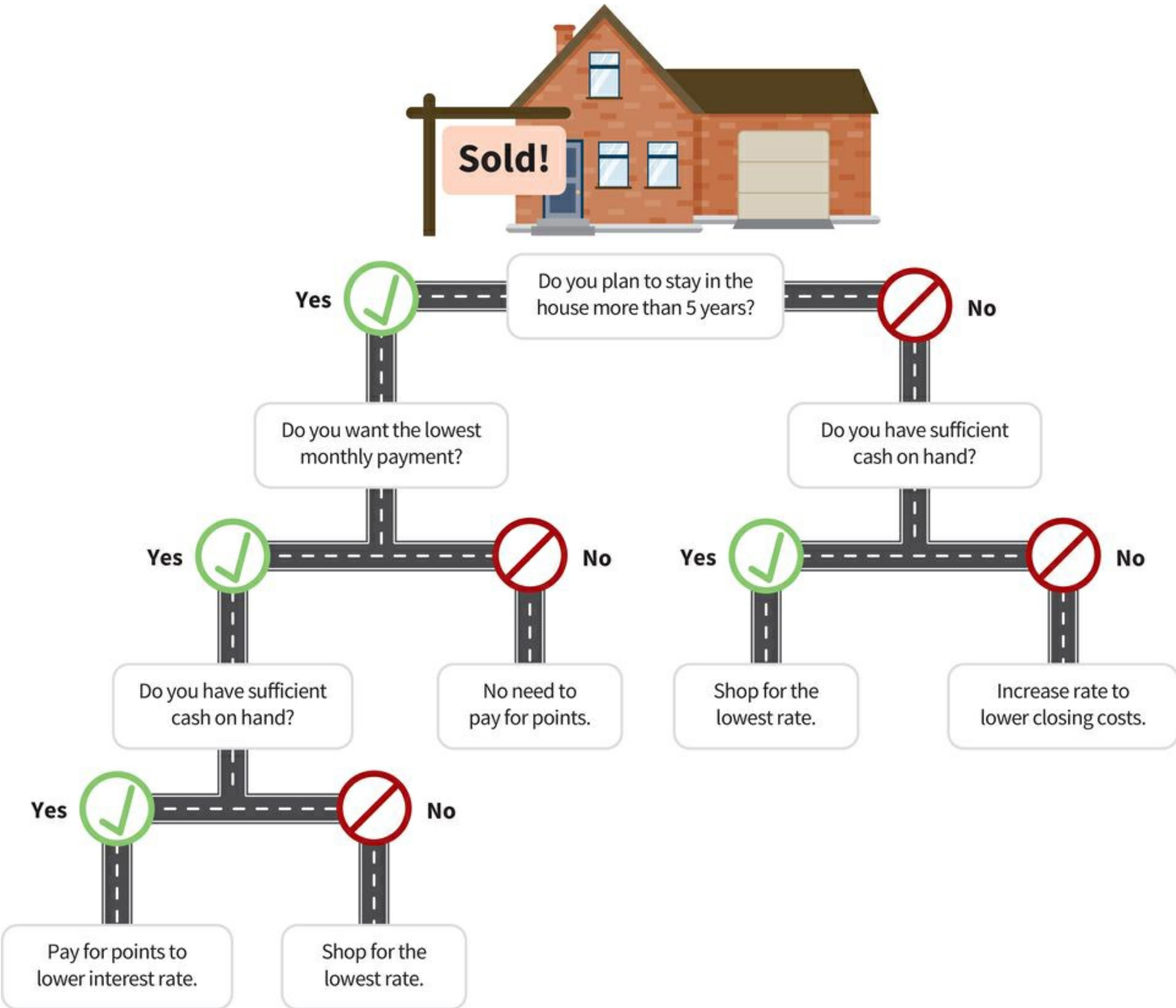
2a. Loan Origination Fees and Points

The single largest closing cost item is the **loan origination fee**. Loan origination fees are paid to the lender for providing a loan. Borrowers generally have two options regarding loan origination fees:

1. If borrowers want a lower interest rate on their mortgage, they sometimes have the option of paying a large upfront fee in exchange for a lower interest rate; this fee is referred to as **loan points**. A point is equal to 1% of the loan amount. So paying one point on $100,000 would be equivalent to writing a check for $1,000. The reduction in the mortgage interest rate associated with purchasing a point is based on the prevailing lending environment and the lender. If you are considering paying points on a mortgage, it pays to shop around for the largest reduction in the interest rate.

2. If borrowers accept a slightly higher mortgage interest rate, the lender may eliminate the loan origination fee and perhaps many of the closing costs. This makes it easier for cash-strapped buyers to qualify for a mortgage.

As you can see, there is a trade-off between closing costs and the interest rate on the loan. A slightly higher interest rate can significantly reduce closing costs; this is a good strategy if you will be in the home for only 5 to 7 years. On the other hand, by paying loan points and higher closing costs, borrowers can lock in a lower interest rate, which is a good thing if they plan to stay in the home long-term. These trade-offs are illustrated in the following decision tree.



TERMS TO KNOW

Loan Origination Fees

An expense paid to a lender for providing a loan.

Loan Points

A fee paid to reduce a mortgage interest rate; if borrowers want a lower interest rate on their mortgage, they sometimes have the option of paying a large upfront fee in exchange for a lower interest rate; equal to 1% of the loan amount.

2b. Closing the Deal

The last step in the home-buying process is closing the deal, commonly referred to as settlement or **closing**.

- This is the time when the property is formally sold and transferred from the seller to the buyer and when all closing costs must be paid.
- Because many forms must be reviewed and signed, this process is generally conducted by a title company or an attorney.
- Any down payment must be paid at this time, as well as final closing costs. A final listing of closing costs will be shown on the HUD 1 Settlement Statement, which details the flow of money between the buyer, seller, and lender. This form also details all of the actual closing costs (mortgage broker fees, lender fees, points, appraisal fee, title insurance, government fees and taxes, etc.) and provides a side-by-side comparison of these estimated expenses from the GFE and the actual cost.
- If the difference between the GFE and HUD 1 Settlement Statement is more than 10%, then the lender may have to reimburse some of those costs to the borrower.
- If the down payment is less then 20% of the purchase price, the borrower will generally need to pay for primary mortgage insurance (PMI), which is an insurance policy that protects the lender.

HINT

PMI increases the monthly mortgage payment and will be removed from the monthly payment once the mortgage has been paid down to 80% of the fair market value of the home.

TERM TO KNOW

Closing

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SUMMARY

Owning your own home can have long-term benefits, but it can also cause financial strain. In this lesson, you learned that to enjoy the benefits of home ownership, it's important to know the language and economics of the housing market. It is also important to maintain an agile mindset to be as productive as possible. For example, if you need a housing loan, you'll obtain a **mortgage**, which is a special kind of loan tied to a piece of land. You begin your housing search by finding the home and neighborhood right for you and **determining what is affordable**. **Real estate agents and mortgage loan officers** can help you with these decisions.

When **shopping for a mortgage**, there is a trade-off between closing costs and the interest rate on a loan. **Loan origination fees** make up a large portion of the closing costs. Purchasing **loan points** is one way to help strike a financial balance between closing costs and interest rates before **closing the deal** on your new home.

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