

Topic of the Month

April

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Home Buying 101 – What You Need to Know About Buying A Home

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Everyone wants to buy a home and that is often a good choice. Why spend thousands of dollars a year in rent paying off someone else's mortgage when you can take that money and build equity in your own investment? But like any other major endeavor, one must not enter into the arena of home buying without a concrete plan. While speaking to experts is key, here are some helpful tips to guide you along the way:



How Much Mortgage Can You Afford?

The first thing that needs to be done is to calculate a monthly budget. Write down your monthly net income, the amount you actually take home. Then calculate all needed expenses, minus rent – you won't be needing to pay that anymore, discretionary expenses that you won't forego and set aside an amount for savings. The amount you have left will pay for your mortgage, insurance and any other fees. As a rule of thumb, one should not purchase a house that costs more than three years worth of gross income.

Advantages of Buying Home

Owning a home has many benefits. When you make a mortgage payment, you are building equity, and that's an investment. Owning a home also qualifies you for tax breaks that assist you in dealing with your new financial responsibilities-like insurance, real estate taxes, and upkeep- which can be substantial. But given the freedom, stability, and security of owning your own home, they are worth it.

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Tax Advantages. If you have a mortgage loan, each year you can deduct the interest you pay on your loan from your federal income taxes if you itemize your deductions. Also, if you paid points at closing you may also deduct these from your federal income taxes. In addition, you can usually deduct the amount you pay for local real estate taxes.

Stability and Freedom. By owning your own home you can decorate and renovate your home whichever way you like. Also staying in a common location for a number of years will provide a stable environment for children growing up.

Financial Credibility. Owning your own home helps you establish financial credibility with banking institutions which can help if you intend to finance in the future.

Independence. Provides you with independence and privacy from landlords with inspections of your home. Landlord limitations on pets, renovations etc will not longer apply.

Pride. Owning your own home provides you with the sense of pride and satisfaction knowing that you created, renovated and enjoyed times in it and more.

Build Equity. As you are making your mortgage payment, you're building equity. Equity is the portion of the property that you actually own through your payments, versus the portion that you still owe the mortgage lender. The longer you stay in your home and the more mortgage payment you make, the more equity you'll have. This may assist you in using your equity in purchasing another property or another useful investment.

Appreciation of housing value. Over time housing prices gradually increase, although this may fluctuate. According to the **National Association of Realtors**, houses typically appreciate 3.8% annually over the course of 30 years. Homeowners can take advantage of that appreciation using leverage, that is using a little of your own money in conjunction with the funds already granted by the mortgage lender to get a larger return on your home investment.



ARE YOU HAVING DIFFICULTY MAKING YOUR MORTGAGE PAYMENT?
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Remember - Your Mortgage Payment is Not Your Only Payment

Most mortgage payments consist of principal, interest, property taxes and insurance (PITI). The principal portion is the repayment for the funds that you actually borrowed. Interest is the cost of borrowing the principal amount, which is paid to the lender. The first payments made will consist mainly of interest with a little bit of principle. As you make more payments, more will go toward principle. Property taxes are annual city and county taxes paid to a local government agency and are assessed based on your property value. Homeowners insurance, if not covered by the **Homeowners Association**, is required by most lenders in order to insure the property owner against loss from fire, smoke and other hazards that may happen to the property. **Private mortgage insurance (PMI)**, which may be required, depending on the lender, is paid to protect the mortgage company.

Aside from annual property taxes, you may need to set aside money for association fees, and emergency repairs. **A New Horizon** encourages everyone to set aside six months worth of income (in a guaranteed, interest bearing or dividend earning account) as an emergency fund, but when buying a house it's crucial that at least \$1,000 be available in case of needed repair. Find out how much your property taxes are in advance and make sure to budget for these as well.

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Is the Housing Market Rising or Falling?

The answer isn't as simple as the question. In some geographic areas the price of housing is over inflated. In others it is either level or even undervalued. Furthermore, even in some of the overvalued areas, increased demand and other factors may continue to push housing prices up, albeit at a far slower rate than seen in recent years. In either situation it's always good to look for homes selling below market value. Such deals are available in almost every city. It takes a bit of research and viewing multiple properties, but the hours spent doing this can save you tens of thousands of dollars.

Inspections – When Your Roof Becomes Your Flooring You Know Something's Upside Down

You've found a house at a reasonable rate. It's affordable and you'd like to move in. It meets all of the above criteria so why not buy it? Well, because you don't yet know how much work needs to be done on it. A simple inspection will uncover everything from leaky pipes to mold and even latent termites. The whole idea may sound frightening, but it shouldn't be. An inspection is your protection when you buy a home. It's an easy but all important step in the buying process.

Using the First Mortgage Broker That Comes Along is Like Buying the First Used Car You See with a For Sale Sign on it.

Here's where your homework really pays off. The first broker you meet may offer you an interest rate that's a full percent higher than the next. Getting a second opinion may save you hundreds of dollars a month. Another thing to look for are "points". There are two types of points, **discount points**, and **broker points**. A discount point is a payment made at closing that is one percent of the mortgage amount. A discount point will "buy" down the interest rate and is tax deductible. Broker points are upfront fees that a broker may charge to facilitate the loan. **These points are not tax deductible.** As a rule of thumb check your bank first to see what they can do for you. Whether dealing with a bank, or an independent broker, ask for a "Good Faith Estimate," a paper that specifies all fees that will be charged should you close with the lender. This will allow you to compare rates and fees and come up with the best mortgage for your situation.

Types of Mortgage Loans Available



There are two major categories of mortgage loans: **fixed** and **adjustable**. Conventional loans are "fixed" for a specific term (**usually 15-30 years**) and have a fixed interest rate (e.g. 6.25% or 7.25%). The fixed term and interest rate remains the same for the life of the mortgage or until paid off. These loans are great for people that plan to stay in their home for more than 5 years. They are safe and give the homeowner a sense of security knowing that their fixed interest rate will remain the same. If interest rates decrease below their fixed rate, the homeowner can refinance (**take out a new loan**) their fixed loan for another loan with a lower interest rate.

Adjustable loans, also known as **ARMs (Adjustable Rate Mortgages)**, also have fixed terms (15-30 years) but have interest rates that will adjust up (e.g. 6.25%) or down (5.25%) according to the current interest rates levels that the market is offering. Most **ARMs** come with a low starting interest rate (like 4.25%), called a teaser rate. These loans may be useful if you are only buying the property for a short period of time. These loans have serious drawbacks (**see below**).

In general, a 30 year mortgage will give you a lower monthly payment than a 15 year mortgage. Additionally, if you make your monthly payments every two weeks instead of monthly (paying half the monthly amount each time) you will end up making the equivalent of an extra payment a year that will go solely toward paying off your principal and could reduce the 30 year mortgage to 22 years.



Pitfalls to be Prepared For

Once you have bought a home and have a mortgage, there are some pitfalls to be aware, and they should be taken into account prior to obtaining the mortgage.

First, your taxes and insurance costs are subject to change and can cause your monthly mortgage payment to increase dramatically. Each state is different when it comes to property taxes, but the general rule is that the property's taxable value is re-assessed after the property changes hands. If you purchase a home from someone who has lived in the home for many years, the taxable value after you purchase it can double, triple, or increase even more which means that your tax bill will increase as well. **This could mean that your tax payment can increase by hundreds of dollars the second, or third year that you own the home.**

Secondly, if you get an **ARM**, your monthly payment will increase when the first assessment is done on the index rate discussed earlier. Most lenders give a teaser rate (**a rate below the index rate**) at the beginning of the mortgage, so even if interest rates go down, the interest rate on the mortgage will probably go up. This is why this type of mortgage is good for someone not planning on staying in the home for many years.

Furthermore, **Interest Only (IO) loans** do not build equity in your home. Your monthly payment does not include any principle. If home prices decline while you have an **IO**, you will actually be building negative equity. These mortgages should only be considered for the short term and only in certain situations. **If you are considering one of these types of mortgages, please consult a financial advisor, or someone you trust with knowledge in this area to avoid some very costly mistakes.**

Now That You've Done Your Homework, Go Out and Buy!

Unless you haven't yet set aside enough to care for emergencies and a few extra expenditures (in which case you need to start saving toward this goal), live in an area that seems headed for a real estate downturn or are planning to live somewhere for only a very short time, the advantages of homeownership far outweigh any of the effort involved in planning to make it happen.



For non-biased advice on the purchase of your home, tailored to your unique situation, contact **A New Horizon** today at **1 800 556-1548**

