Eastwood
WEALTH

Buying a Home

Buying a home is one of the most exciting undertakings anyone will experience. Being able to enjoy the slice of paradise you create, design and carve out for yourself is deeply fulfilling. It is a highly emotional time bringing with it renewed feelings of promise and anticipation, relief, pride, fun and stress to name a few. It is important to stay grounded and have a process in place to make wise choices and decisions. A home is the single largest purchase most people will make during their lifetime, and it will likely impact a family's financial position and quality of life for years to come.

Virtually all real estate markets are about location. Homes in big cities, near water and in destination locations are likely to be more expensive.

Most people obtain a mortgage because it is simply too expensive to buy a home outright. A mortgage adds additional costs, but it also provides leverage. With relatively small payment you can leverage a larger asset. When your home increases in value, it does so on your home's full price not the monthly payment. Through home ownership, it is possible to enjoy compounding growth and substantially increase your net worth.

Many different types of mortgages are available including traditional fixed rate mortgages, adjustable-rate mortgages (ARMs) and interest only options. A mortgage specialist will be able to help you decide what type of loan is right for you and your family. No matter what you choose, it is critical you focus on buying the home and not the monthly payment.

Buy the home not the monthly payment.

The price of a home is just the beginning of the story. Let us look at two fixed rate mortgage scenarios and how interest can affect the long-term cost of a home.

Assumptions:

Home price: $300,000

Down Payment: Assume a 20% down payment or $60,000.

A 20% downpayment provides the luxury of not having to purchase private mortgage insurance also known as PMI. PMI protects the lender from the homeowner not paying their mortgage resulting in the home going into foreclosure.

PMI typically runs around $75/month for every $100,000 borrowed and ranges from .50% to 1.50% of the loan amount.

A 20% down payment makes the home more affordable and removes PMI from the equation.

In some cases, a buyer will include an upfront good-faith gesture to the seller in the form of a small amount of earnest money. Depending on the specifics of the negotiation process, a seller may keep the earnest money if the buyer backs out of the purchase.

Mortgages and Interest Rates based on our assumptions: $300,000 home, 20% ($60,000) down makes the loan amount $240,000. First, we will review a 15-year mortgage at 5.25% and, second, a 30-year mortgage at 6.25%. Note, it is less risky for banks to make shorter loans therefore the shorter the length of the loan, usually the lower the rate.

The 15-year mortgage's principal and interest monthly payment at 5.25% is $1,930. Assuming no extra payments are made to the principal, the homeowner will pay an additional $107,275 in interest over the course of the loan. The home increased from $300,000 to $407,275 or an additional 36% of the purchase price.

The 30-year principal and interest monthly payment at 6.25% is $1,478, notice the lower payment, but longer term. Assuming no extra payments are made to the principal, the homeowner will pay an additional $291,980 in interest over the course of the loan. The home increased from $300,000 to $591,980 or an additional 97% of the purchase price.

The difference between the 15-year loan and 30-year loan, when taken to full term, increases the total cost of the home by $184,705 ($407,275 vs. $591,980) and 15 additional years of monthly payments.

Also note, a homeowner is making mortgage payments with after-tax dollars though they may be able to deduct a portion of the interest on their tax return. Home costs of principal, interest, taxes and insurance can balloon quickly.

A home also comes with additional costs such as loan closing costs, property taxes, insurance, renovation costs, repair and maintenance costs, management costs such as homeowner's association (HOA) fees and assessments, weather related costs, legal costs, opportunity costs of a homeowner's time and resources that could be spent pursuing other activities, social costs such buying items to fit in a certain neighborhood and liquidity concerns among others.

Thoughts on Renting

You are likely not behind in the game of life if you are or have been renting. A common misconception of renting is that you are wasting your money. There is nothing wrong with renting if your goals and lifestyle deem it necessary. One of the most often used justifications of buying a home is because the rent and mortgage payments cost about the same. There is much more to owning a home than the monthly payment. It could make more financial sense to rent for an extended period of time due to life and career circumstances, location or the desire to have more lifestyle flexibility.

Rental markets are especially sensitive to increases in the cost of living. As prices rise and properties are bought and sold, rent payments are likely to increase to make the numbers work for the landlord. The rent keeps increasing over time while the renter is not building equity. This scenario leaves a long-term renter on the wrong side of the equation. Renting is still the smarter move until you are in the financial position to purchase a home.

How much home can you afford?

It is helpful to get preapproved for a loan before you go house hunting. Homes typically in the range of affordability are two to two and a half times the homeowner's annual salary. To figure out how much you can afford, take into consideration your net monthly income, housing expenses, healthcare costs, monthly bills, other outstanding debt, the need to save for retirement and plan for a child's education among other items.

From a conventional mortgage lending perspective, your monthly housing expenses (mortgage principal and interest, real estate taxes, homeowner's insurance, additional costs) should be 30% or less of your gross monthly income. In addition, most mortgages require borrowers to have a debt-to-income ratio of 43% or less. This means you should be spending no more than 43% of your gross monthly income on longer-term debt payments.

For example, if you pay $2,000 a month for your mortgage and another $150 a month for an auto loan and $400 a month on other outstanding debts, your monthly debt payments are $2,550. ($2,000 + $150 + $400 = $2,550). If your gross monthly income is $6,000, then your debt-to-income ratio is 43%. ($2,550 is 43% of $6,000).

While the above numbers may allow the prospective homeowner to obtain a mortgage, you will likely need to play by another set of rules to pursue financial freedom in a timelier fashion.

Financial positioning factors to consider before purchasing a home:

- Be consumer debt free
- Have an Emergency Fund equal to six months of your monthly expenses. If you are in a household where only one spouse works, you are a single parent or a business owner, it would be ideal to have one year's worth of your monthly expenses set aside. If you are a business owner, we would also encourage you to have one year's worth of your business expenses in your company's Emergency Fund.

  A properly funded Emergency Fund helps protect you and your family against accidents, unforeseen events and could offer additional income assistance during tough economic conditions. This fund should remain set aside for emergencies not normal month-to-month cash flow expenditures. Please make sure these funds are readily available but earning the most they can earn. Look at your Emergency Fund as lifestyle insurance.
- Make a down payment of at least 20% to lower your payment and avoid Private Mortgage Insurance (PMI).
- Your monthly payment is 30% or less of your net monthly income.
- Obtain no more than a 15-year mortgage.
- Obtain an appraisal and full home inspection by qualified professionals prior to the purchase.

The recipe above is a formula to help minimize uncertainty and protect your quality of life and largest wealth building tool, your income.

Should you use a real estate agent?

Yes, in most cases. Find an experienced, knowledgeable, communicative and trustworthy real estate agent that can guide you. It will make the process of buying a home much easier, and it will likely save you time and money especially for a first-time home buyer.

A real estate agent can:

- Help you determine your housing needs
- Show you properties and neighborhoods in your price range
- Provide insight into neighborhoods and market activity
- Disclose positive and negative aspects of properties you're considering
- Prepare and present an offer to purchase
- Act as an intermediary in negotiations
- Recommend professionals whose services you may need such as lawyers, mortgage and title professionals, appraisers and home inspectors

If you enlist the services of an agent, find out how they are being compensated. A flat fee or a percentage based on the sales price arrangement is normal, and the seller typically pays the closing costs. Many states require the agent to disclose this information up front and in writing.

Choosing the right home

Before you begin looking at houses, decide in advance the features that you want in a home. Knowing what you want ahead of time will make the search much easier and less time consuming. Items to consider:

- Safety of the area
- Price of home and potential for appreciation
- Location and neighborhood
- Quality of construction, age, and condition of the property
- Style of home and lot size
- Size of the home in comparison to others in the neighborhood
- Number of bedrooms and bathrooms
- Property taxes and Insurance costs
- Quality of local schools
- Proximity to schools, work and lifestyle activities

Making the offer

Once you find a house, make an educated and reasonable offer. Most home sale offers and counteroffers are made through an intermediary, such as a real estate agent. Require all terms and conditions of the offer, no matter how small, be in writing to avoid future complications. Typically, an attorney or real estate agent will prepare an offer to purchase for you to sign. You may also want to include a nominal earnest money payment to the seller. If the seller accepts the offer to purchase, he or she will sign the contract, which will then become a binding agreement between you and the seller. For this reason, it is a good idea to have a real estate attorney review any offer to purchase before you sign.

The details

Once the seller has accepted your offer, you, your real estate agent and mortgage professional will complete the necessary procedures and documents to finalize the purchase. These include finalizing the mortgage loan, appraising the house and obtaining homeowners insurance. Typically, you would have made your offer contingent upon the satisfactory completion of a home inspection, so now is the time to get this done.

The closing

The closing may require some of the following entities to be present: the seller and/or the seller's attorney, your attorney, the closing agent (a real estate attorney or the representative of a title company or mortgage lender) and both your real estate agent and the seller's. Some closings can be conducted by mail or electronic signature.

During the closing process, you will receive and sign a variety of documents, including:

- Closing Disclosure: This lists the final terms of the loan you have selected. Your lender is required to send you the Closing Disclosure at least three business days before the actual closing meeting.
- Promissory note: This spells out the amount and repayment terms of your mortgage loan.
- Mortgage: This gives the lender a lien against the property.
- Deed: This transfers legal ownership of the property to you.

In addition, you will need to provide proof that you have the property insured. You will also be required to pay certain costs associated with obtaining the mortgage and closing the real estate transaction.

There is far more involved than most people think when buying a home. This decision will likely have a lasting impact on your quality of life and ability to build wealth. Give it the necessary time, care and attention to detail upfront to make life easier for you and your family in the future.

Best,



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Mortgage calculations performed at www.calculator.net
Some content provided by: Broadridge

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