FPA® FINANCIAL PLANNING ASSOCIATION

Financial Planning for a **Home of Your Own**



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Since 2000, the Financial Planning Association® (FPA®) has been the principal professional organization for CERTIFIED FINANCIAL PLANNER™ (CFP®) professionals who seek advancement in a growing, dynamic profession. FPA believes everyone can benefit from the advice of an experienced and qualified financial planner.

To search for a CFP® professional please visit **www.PlannerSearch.org** or call FPA at **800-322-4237**.

Buying a Home — Reaching a Dream

Owning a home is a cherished part of the American dream. Buying that home also may be the largest financial investment you will ever make. That's why it's so important to get financially ready to buy and take care of a home, and to feel confident that now is the right time for you to step into the shoes of homeowner.

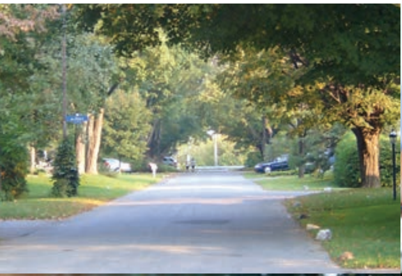
This brochure can help you get started on the path to homeownership by exploring some of the financial considerations involved in buying and owning a home. It draws on the expertise of thousands of members of the Financial Planning Association.

Getting Ready

One way to gauge if you are financially ready to buy a home is to ask yourself the following four questions.

1. Is my credit in good shape? Before lenders approve a home loan, they will analyze your ability to repay it. To make this determination, lenders will obtain your **credit report** from one or more credit reporting agencies. The credit report shows how much you owe, to whom, if you make your payments on time and how much credit you have applied for.

In addition, the credit report may contain a **credit score** (sometimes called a FICO® score), which is a number that the credit reporting agency calculates based on an assessment of your credit history and current credit situation. Think of the number as a snapshot of your credit risk at a particular point in time.



What does all this mean to you?
Financial planners note the following:

- If you have poor credit and a low credit score, lenders may evaluate you as a higher risk for not repaying the loan. As a result, they may charge you a higher interest rate or possibly turn down your loan application altogether.
- You can avoid surprises by getting a copy of your credit report from the three main credit reporting agencies before you apply for a home loan. If there are any mistakes on the reports, get them corrected immediately. The three agencies are: 1) Equifax, 800.685.1111, www.equifax.com; 2) Experian, 888.397.3742, www.experian.com; and 3) TransUnion, 800.916.8800, www.transunion.com. Or, go to www.annualcreditreport.com. By law, consumers are entitled to one free credit report from each agency every 12 months.
- If you have less than perfect credit, be prepared to explain to the lender why. If you have no credit accounts, show the lender your canceled checks and other documents to prove that you pay your rent, phone bills or utility bills on time. You also might decide to delay buying a house until you've improved your credit or established a credit history. Take the following four steps to improve your credit: 1) Pay your bills on time; 2) Reduce your debt by paying off your credit cards; 3) Only apply for the credit you really need; 4) Read all credit applications carefully.

2. Do I have a steady job history? A steady job gives lenders more confidence that you can repay a home loan. If you have been working continuously for two years or more, even if not in the same job, you are considered to have steady employment. Be prepared to explain to the lender if there are reasons why you have not been employed continuously, such as an illness or just finishing school or military service.

3. Can I afford to make the monthly mortgage payments? The answer to this question depends on how much you earn and how much other debt you have. As a general rule of thumb, a lender will want your monthly mortgage payment to total no more than 29 percent of your monthly gross income (that's your monthly income before taxes and other paycheck deductions are taken out). Add other long-term debt, such as car and student loans, and most experts say that the total should take no more than 36-41 percent of your monthly gross income. The U.S. Department of Housing and Urban Development (HUD) has a free calculator for determining how much home you can afford. Visit www.hud.gov/buying.

4. Have I saved for a down payment? In the past, down payments that equaled 20 percent of the purchase price were typical. Today, however, qualified borrowers who have good credit, but limited savings, can purchase homes with 5, 3, or even 0 percent down—the less you put down, the higher your mortgage payment. You also will need money for closing costs to cover items like appraisals, loan origination fees, processing fees and so on. In addition, in return for an interest rate below prevailing rates, you may be charged "points" by the lender. One point equals 1 percent of your loan, and that amount is due at the time of closing. Online calculators can help you estimate your closing costs. (Check out Freddie Mac's site at www.freddiemac.com.) Also know that you may be able to negotiate with the seller to pay certain closing costs.

If you can't answer "yes" to each of these four questions, don't get discouraged. Simply give yourself a little more time to get ready financially to buy your home. In addition, check into federal and local home buying programs that specialize in working with people with limited financial resources. Go online at www.hud.gov/buying, call your local office of housing and community development or contact your mayor's office for information.

Truth and Myth

Financial planners say that there are two common myths when it comes to buying a home:

1. It's always better to buy than rent. Buying a home can be a good investment, fixes the long-term costs of shelter and has certain tax advantages. But renting may make sense if:

- You only plan to live in the area for a short time and may not make back the costs of buying and selling a house.
- Coming up with a down payment and monthly house payments will jeopardize other financial necessities, such as your retirement fund.
- You can't afford regular maintenance and repairs, rising real estate taxes and insurance costs.
- Area home prices have risen excessively in the last few years, suggesting they may be due to stall or drop.
- You think that you can invest the money you would spend buying a house for a higher rate of return than what the home would earn due to appreciation.

2. A home is always a good investment. Many people think that home prices always go up and that real estate is always a great investment. It's true that home values can skyrocket, but they also can stagnate or even decline. Trying to guess what housing prices will do in the future is like trying to guess how stocks will perform. While a home can be an excellent investment, financial considerations alone should not drive your decision to buy.


Shopping for a Mortgage

A mortgage is a long-term loan—usually 15 to 30 years—that a homebuyer obtains from a bank, savings and loan, mortgage broker, online broker or even the property seller. The house and land on which the house sits serve as collateral for the loan. If the borrower doesn't make payments as agreed, the lender can take the home through foreclosure.

A monthly mortgage payment is sometimes called a PITI payment because it typically covers a portion of the following four costs:

1. Principal—the loan balance
2. Interest owed on that balance
3. Real estate taxes
4. Property insurance

In addition, some loans stipulate that the borrower must pay the cost of the mortgage insurance – a type of insurance that protects the lender if you default. This insurance will be required for Federal Housing Administration (FHA) or Veterans' Administration (VA) loans and most conventional loans with down payments of less than 20 percent. If required, several quotes from different institutions should be obtained.

Because a mortgage is such a large loan, it's important to shop for it carefully. Here are a few tips from financial planners:

- **Look for a mortgage that has no prepayment penalty.** That gives you the option to pay off your mortgage early if you wish.
- **Analyze whether a fixed-rate or adjustable rate mortgage is best for you.** With a **fixed-rate mortgage**, the interest rate on the loan stays the same for the term of the loan, which could be 15, 20 or 30 years. The advantage of a fixed-rate loan is the security of knowing that the interest rate will never change, which helps you fix your housing costs. In a recent survey, most Americans said that they prefer fixed-rate mortgages.

An **adjustable rate mortgage (ARM),** in contrast, has an interest rate that can vary during the life of the loan, with the possibility of both increases and decreases to the interest rate. An ARM frequently offers a lower initial interest rate than a fixed-rate mortgage; however, over time, the interest rate can rise, so it's important to know what the cap, or limit, is on the interest rate and determine if you could still afford the mortgage payment if the rate rose to the cap. In general, an ARM might make sense for someone who only plans to live in the house for a few years, is very confident their income will keep pace with inflation, or is willing to pay higher interest rates later in return for immediate use of cash saved early on.

Interest-only mortgages are another alternative that have become more popular recently. With this type of mortgage, you have the option of making only interest payments on your loan for a certain period of time, typically five to seven years. After this period, the loan converts to the original terms and the monthly payment will jump because you will now pay interest plus principal over a shortened period of time—for example, 20 to 23 years versus 30 years. As tempting as these lower initial payments may be, an interest-only mortgage can be risky. If you can't make the payments when they go up, you risk foreclosure or the prospect of trying to sell the house in a cooled-off housing market. In general, only consider an interest-only mortgage if you plan to stay in the house a short time (and are confident you will be able to sell the house for a profit when you move) or you are sure that your income will grow enough to manage the larger payments down the road.

- **Find out if you qualify for special mortgage programs.** For example, you might be able to take advantage of a loan through the FHA, VA, Rural Housing Service program of the U.S. Department of Agriculture, HUD home buying program, a local home buying program or first-time homebuyer programs in your area. To learn more about these programs, visit HUD's Web site at www.hud.gov/buying.
- **Seek pre-qualification or pre-approval before you start looking at houses.**
  Pre-qualification gives you an estimate of the amount you will be able to borrow. It makes sense to know this dollar amount so you can limit your house hunt to properties that are in your price range. You can go to a mortgage broker or lender to pre-qualify for a mortgage loan.
  Pre-approval is a more thorough process, but it results in a conditional approval that shows a seller that you are a qualified buyer who is well along in the mortgage process. This can strengthen your position to make an offer on a house, because the seller will know that your financing is in place.
- **Make sure you are comfortable with your estimated mortgage payments.** Just because you qualify for a large loan doesn't mean that you should spend that much. When you can comfortably afford your payments, you'll be better able to handle home maintenance costs and save for other goals, such as college and retirement.
- **Get objective advice on the mortgage that's right for you.** Be careful about taking advice from someone who has an interest in selling a house to you. Talk to several lenders, go online (try HUD's site at www.hud.gov/buying or Fannie Mae's site at www.homepath.com), or consult a financial planner.

Protect Yourself from Predatory Lenders

Every year, misinformed homebuyers, often first-time purchasers or seniors, become victims of predatory lending. Here are nine tips from HUD on being a smart consumer:

1. Before you buy a home, attend a homeownership education course offered by HUD-approved, nonprofit counseling agencies. To find a housing counselor near you, call HUD at 800.569.4287 or see HUD's list of housing counselors at www.hud.gov/buying.
2. Interview several real estate agents and ask for (and check) references before selecting one to help you buy or sell a home.
3. Get information about the prices of other homes in the neighborhood. Don't be fooled into paying too much.
4. Hire a properly qualified and licensed home inspector to carefully inspect the property before you are obligated to buy.
5. Shop for a lender and compare costs. Be suspicious if anyone tries to steer you to just one lender. Ask your local Better Business Bureau if complaints have been filed against the lender.
6. Do not let anyone persuade you to make a false statement on your loan application, such as overstating your income, the source of your down payment or failing to disclose your debts. Lying on a mortgage application is fraud and may result in criminal penalties.
7. Do not let anyone convince you to borrow more money than you can afford to repay.
8. Never sign a document containing blanks.
9. Do not sign anything that you don't understand. Also remember that you have three days after you sign the loan contract to change your mind.

The Best House for Your Money

When you buy a home, it's important to consider its resale potential, even if you have no foreseeable plans to move. Here are some tips:

- A single-family detached house typically is easier to resell than a condominium or townhome, although condos are popular in some major cities.
- Don't buy the biggest house on the block. A modest house in an upscale neighborhood will likely sell much better. Three bedrooms and two full baths seem to be standard.
- Conventional styles and standard interiors (for the region) sell better than unconventional.
- Look closely at the neighborhood and its zoning. Look for good schools, well-kept homes and yards, access to highways, commuter transportation, shopping, recreational opportunities and services.
- Determine how quickly houses have been selling in the neighborhood compared to the rest of the city.
- Check out the reputation of the company that built the house.
- Have a professional inspect the house to be certain there are no major defects before you decide to buy.
- Consult with your financial planner about the investment and tax aspects of buying the house.


I Bought a House. Now What?

Congratulations. You now own a piece of the American dream. Here are a few financial tips for being a homeowner:

- **Use your home to build good credit.** Make your mortgage payments on time every month, because late payments can stay on your credit report for up to seven years. If you're having financial difficulties, contact your mortgage lender at once. The lender may agree to modify your mortgage or allow a forbearance agreement, which is a repayment plan that lets you catch up on missed payments and avoid foreclosure. The lender also may point you to government-sponsored programs to assist you in keeping your home.
- **Maintain your home.** Take care of your investment. Handle minor repairs before they become major expenses, make sure you have adequate homeowners insurance and save money in an emergency fund to take care of unexpected expenses, such as a new furnace or roof repair.
- **Be careful about borrowing against the equity in your home.** Home equity loans are very popular, but remember, the loan is secured by your property. If you fail to keep up the payments, you could lose your home. Financial planners recommend that you carefully consider the following cautions:
  1. if interest rates rise significantly, it could cost you more to finance your outstanding loan;
  2. if housing prices slump, you could end up owing more than the equity left in the home;
  3. you could be tempted to borrow against your home to pay off your credit cards, only to turn around and rack up new credit card debt—this time, with your home at risk.

- **Know when—and if—to refinance.** Refinancing your mortgage to a loan with a lower interest rate can be advantageous in some situations, but there are costs involved, so it's important to run the numbers with the help of a financial planner. Generally, the longer you plan to live in the home after refinancing, the more time you have to recoup refinancing costs and begin to save real money. Also consider any prepayment penalties on your existing mortgage, the length of the new loan and whether that will mean that you will actually pay more in total interest even with a lower interest rate. In addition, evaluate what a lower interest rate will mean for your tax deduction.
- **Prepay your mortgage when it makes sense.** Making an extra principal payment ever so often or paying extra principal each month—even as little as $25 or $50—can save thousands of dollars in interest charges, and owning a home free and clear provides a great feeling of security. On the other hand, you may actually come out ahead financially by putting that extra money into a high-earning retirement account. Also, prepaying is beneficial if you have a low interest rate on the mortgage and are in a higher tax bracket, because you'll lose the advantage of tax deductions on your interest payments.

HOMEBUYING CHECKLIST

- ☐ Determine readiness for homeownership
- ☐ Compare advantages and disadvantages of buying and renting
- ☐ Take steps to get credit in shape
- ☐ Establish a steady job history
- ☐ Determine ability to make monthly mortgage payments
- ☐ Save for down payment, closing costs and home maintenance
- ☐ Evaluate fixed rate versus adjustable rate mortgages
- ☐ Guard against predatory lending practices
- ☐ Consider the home's resale potential
- ☐ Use home to build good credit
- ☐ Exercise caution with home equity loans
- ☐ Know when and if to refinance
- ☐ Prepay mortgage when it makes sense
- ☐ Get objective advice

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