Dollars & $ense

ARE YOU READY TO PURCHASE YOUR FIRST HOME?

If you are buying your first home, you should do a little homework before you start gathering paint chips and clipping furniture ads. Here's what you need to consider.

KNOW WHAT YOU CAN AFFORD

Most lenders use a two-part qualification ratio to determine how much money you can safely spend on living expenses and mortgage costs: 28/36. What this means is that lenders will generally allow you to spend up to 28 percent of your gross monthly income on housing expenses—principal, interest, homeowner's insurance and taxes. If the downpayment that you scrape together amounts to less than 20 percent of the purchase price, your 28-percent allowance also needs to include the cost of purchasing private mortgage insurance (PMI), which protects the lender in case you default.

In terms of the second part of the equation, 36 percent of your gross monthly income is the amount lenders will allow you for a mortgage plus monthly recurring debt, such as your car loans and credit card bills. Normally, only debts that will take more than 10 months to pay off will matter.

IDENTIFY YOUR COMFORT LEVEL

The 28/36 qualification ratio establishes the maximum amount you are eligible to be loaned, and lenders will happily lock you into as high a level of debt as you want, using these criteria. However, this number may not be within your comfort zone. Take a look at the past year's income and expenses. If you commit the maximum amount to a mortgage, will you have sufficient funds left over to meet expenses for hobbies and activities you enjoy? Are you willing to forego such activities to meet your mortgage commitment? And, after making your down payment, will you have a large enough savings buffer to enable you to sleep soundly at night? These are some of the questions you need to ask yourself.

MAKE SURE YOU'RE CREDIT HEALTHY

To qualify for a mortgage, you must have a clean credit record for at least two to three years. Even if you think your borrowing history is without blemish, take advantage of federal law and ask to inspect your credit reports; they could contain discrepancies. And remember, though you are entitled to request corrections, this process can be time consuming. To be safe, contact the credit agencies at least six months before you plan to apply for a mortgage, to save yourself the headache of possible closing delays.

GET YOURSELF PRE-APPROVED

Pre-approval means the lender has checked your credit and verified your income and other financial references. You'll get a document that says the lender will give you a mortgage up to a specific amount, as long as the home appraisal justifies the price. This may help you beat out a slightly higher bid from someone who does not have pre-approval.

WHAT YOU SHOULD PULL TOGETHER

To save yourself time further down the road, start pulling together the items you will need to apply for a mortgage. You'll be asked for income tax returns for the previous three years, current copies of paystubs, records of any past negative credit history that has since been paid off, and records of any supplemental income you may have. If you are self-employed, you will need all business records and tax returns for the past three years. Also, if you're going to be receiving money as a gift for the down payment from a friend or relative, have that person prepare a "gift letter" for you, confirming that the money is a gift, not a loan. This letter clarifies that you are not going further into debt and jeopardizing your ability to repay the lender's loan.

SHOP AROUND FOR YOUR MORTGAGE

All mortgages are not created equally. Doing a little competitive shopping definitely can save you money. Check newspaper ads and ask for referrals from friends and co-workers who have recently gone through the process. Ask each lender you're considering for a disclosure listing all loan terms. Be cautious of referrals that come from the real estate agent, especially if the agent receives a "referral fee" from the lender.

DON'T FORGET ABOUT THOSE OTHER COSTS

Even if you've decided to go with a no-points mortgage, out-of-pocket expenses to close on your new home can add up to a few thousand dollars. If you'll be making your purchase with an adjustable-rate mortgage, be sure you base your budget on what the interest rate will jump to in the second year. And remember those paint chips and furniture ads mentioned at the start of this article? You probably will spend

CalCPA Institute

360degrees of Financial Literacy
American Institute of CPAs

FEED THE PIG

© A joint project of CalCPA Institute and the American Institute of Certified Public Accountants
www.calcpa.org/FLC • (800) 922-5272 • These materials are intended for volunteer purposes only.

several thousand dollars in the first year just on appliances, furnishings and changes to the property—so be sure you have a few extra dollars to pay for items like these.

© A joint project of CalCPA Institute and the American Institute of Certified Public Accountants
www.calcpa.org/FLC • (800) 922-5272 • These materials are intended for volunteer purposes only.