

How Much Home Can You Afford?

When you are ready to begin looking at various houses to find your dream home you need to prepare all of the necessary materials to present to the lender. Your lender will tell you exactly what you can afford so that you do not spend time looking at "too much" home.

There are three key factors that you will need to consider when determining how much home you can afford. These are:

- **Down payment**
- **Ability to qualify for a mortgage**
- **Closing costs**



Down Payment Requirements:

Most loans today require a down payment of between 3.0% and 5.0% depending on the type and terms of the loan. If you are a first-time homebuyer, you may qualify for a first-time homebuyer program, talk to your lender for details. If you are able to come up with a 20-25% down payment you may be eligible to take advantage of special fast-track programs and possibly eliminate mortgage insurance.

It is often thought that bigger is better when it comes to down payments. In many cases this may be true. However, the arithmetic will differ from case to case. A bigger down payment means smaller monthly payments, and lower interest expense for as long as you remain with a mortgage. This can be an important factor for many people.

But if you can put your available funds to work for you, so that they can earn more than the interest rate on your loan, you could be dollars ahead with a smaller down payment. Also, a smaller down payment may allow you to keep your extra cash liquid and available for an emergency.

Qualifying for the Mortgage:

Most lenders require that your monthly payment ranges between 25-28% of your gross monthly income. Your mortgage payment to the lender includes four items -- the PITI. These items are discussed in detail on a following page entitled "Predicting your monthly payment -- the PITI." Remember, when you buy a home all interest is tax deductible so you will qualify for a major tax advantage that will effectively increase your take-home pay. Your total monthly PITI and all debts (from installments to revolving charge accounts) should range between 33-38% of your gross monthly income. This is a general rule of thumb, but other key factors specifically determine your ability to qualify for a home loan. These factors are:

Income: History of employment, stability of income, potential for future earnings, education, vocational training and background, and any secondary income such as bonuses, commissions, child support, etc.

Credit Report: History of debt repayment, total outstanding debt and total available credit. If you have concerns about your credit record consider contacting one of the major credit bureaus for a copy of your file: Equifax (800) 685-1111; TRW (800) 392-1122; and Trans Union (312) 408-1050.

Assets: Cash on hand, other liquid assets such as savings, checking, CDs, stocks, etc.

Property: The home you are buying must be appraised to determine that it has adequate value and is marketable to ensure it will secure the loan.

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Understanding Closing Costs

Closing Costs:



Don't forget to think ahead carefully. In addition to the down payment on your dream home, you will be required to pay fees for loan processing and other closing costs. These fees must be paid in cash at the time of the final settlement, unless you are able to include these in your financing. Typically, total closing costs will range between 2-5% of your mortgage loan.

Fees Associated With The Lender

Application Fee

Fee charged by lender to offset fixed costs related to mortgage loan processing such as appraisal, credit report, and underwriting.

Commitment Fee

This is often called an origination fee and is generally computed at 1% of the mortgage amount.

Discount Points

Each point is equal to 1% of the mortgage amount. Points are used by the lender to adjust the yield on the mortgage when it is sold to an investor. By paying more points, the borrower can obtain a lower mortgage interest rate.

Funding Fees

Normally applicable on VA loans only, equal to 1% of the loan amount. The fee is due at closing or may be added to the loan amount and financed.

Underwriting Fee

Usually included in the application fee. However, practices vary from lender to lender.

Miscellaneous Fee

FHA Funding Fee, Flood Certification Fee, VA Funding Fee



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Pre-paid Expenses

What is a “pre-paid” expense ?

This is a description that simply means **REAL ESTATE TAXES, INTEREST, AND HOMEOWNERS INSURANCE**. In order to purchase a home, a buyer must have sufficient cash available, in addition to his down payment and closing costs, to pay for approximately 12 months of homeowners insurance, 3 months of taxes and interest through the end of the month of closing.

It may also include:

Home Warranty Plans

While investing in a home, be it new or previously owned, it is always a good idea to have some type of warranty placed on it. One year premium is due in advance at time of closing.

Mortgage Insurance (PMI)

Insurance required by the lender when the down payment is less than 20%. In the case of loan default, this insurance reduces the lender's loss.



Fees Associated With The Title Company

Processing Fee

Fees charged by the escrow processor, either working for the escrow company, title company, or real estate company, for administrative escrow services performed from the point of contract through closing.

Recording Fees

Fees charged by state or municipal entities for entering the closing documents into the public record.

Survey Fee

Is usually required and is used by the lender to check for encroachments from within or from outside the subject property.

Title Insurance

Provides protection for lenders and homeowners against financial loss resulting from legal defects in the title.

Closing Fee

The fee charged by the closing agent who prepares the closing documents and closes the loan on behalf of the lender.

Miscellaneous Expenses

Termite inspection, Sewer/Lateral Line fee, pro-rated Water/Utilities