



## **Buying Your First Home**

Home ownership is the cornerstone of the American Dream. But before you start looking, there are a number of things you need to consider. First, you should determine what your needs are and whether owning your own home will meet those needs. Do you picture yourself mowing the lawn on Saturday, or leaving your urban condo for the beach? The best advice is to look at buying a home as a lifestyle investment, and only secondly as a financial investment.

Even if housing prices have recently fallen in many areas, buying a home can be a good financial investment over time. Making mortgage payments forces you to save, and after 15 to 30 years you will own a substantial asset that can be converted into cash to help fund retirement or a child's education. There are also tax benefits. Like many other investments, however, real estate prices can fluctuate considerably. If you aren't ready to settle down in one spot for a few years, you probably should defer buying a home until you are. If you are ready to take the plunge, you'll need to determine how much you can spend and where you want to live.

### **How Much Mortgage Can You Afford?**

Most mortgages today are resold in the secondary markets. The Federal National Mortgage Association (Fannie Mae) is a government-sponsored organization that purchases mortgages from lenders and sells them to investors. Mortgages that conform to Fannie Mae's standards may carry lower interest rates or smaller down payments. To qualify, the mortgage borrower needs to meet two ratio requirements that are industry standards.

The housing expense ratio compares basic monthly housing costs to the buyer's gross (before taxes and other deductions) monthly income. Basic costs include monthly mortgage, insurance, and property taxes. Income includes any steady cash flow, including salary, self-employment income, pensions, child support, or alimony payments. For a conventional loan, your monthly housing cost should not exceed 28% of your monthly gross income.

The total obligations to income ratio is the percentage of all income required to service your total monthly payments. Monthly payments on student loans, installment loans, and credit card balances older than 10 months are added to basic housing costs and then divided by gross income. Your total monthly debt payments, including basic housing costs, should not exceed 36%.

Many home buyers choose to arrange financing before shopping for a home and lenders may "prequalify" you for a certain amount. Prequalification helps you focus on homes you can afford. It also makes you a more attractive buyer and can help you negotiate a lower purchase price. Nothing is more disheartening for buyers or sellers than a deal that falls through due to a lack of financing.

In addition to qualifying for a mortgage, you will probably need a down payment. The 28% to 36% debt ratios assume a 10% down payment. In practice, down payment requirements vary from more than 20% to as low as 0% for some Veterans Administration (VA) loans. Down payments greater than 20% generally buy a better rate. Lowering the down payment increases leverage (the opportunity to make a profit using borrowed money) but also increases monthly payments.

## **Costs of Buying a Home**

Many home buyers are surprised (shocked might be a better word) to find that a down payment is not the only cash requirement. A home inspection can cost \$200 or more. Closing costs may include loan origination fees, up-front "points" (prepaid interest), application fees, appraisal fee, survey, title search and title insurance, first month's homeowner's insurance, recording fees, and attorney's fees. In many locales, transfer taxes are assessed. Finally, adjustments for heating oil or property taxes already paid by the sellers will be included in your final costs. All this will probably add up to be between 3% and 8% of your purchase price.

## **Ongoing Costs**

In addition to mortgage payments, there are other costs associated with home ownership. Utilities, heat, property taxes, repairs, insurance, services such as trash or snow removal, landscaping, assessments, and replacement of appliances are the major costs incurred. Make sure you understand how much you are willing and able to spend on such items. Condominiums may not have the same costs as a house, but they do have association fees. Older homes are often less expensive to buy, but repairs may be greater than those in a newer home. When looking for a home, be sure to check the actual expenses of the previous owners or expenses for a comparable home in the neighborhood.

## **Choosing a Neighborhood**

Before you start looking at homes, look at neighborhoods. Schools and other services play a large part in making a neighborhood attractive. Even if you don't have children, your future buyer may. Crime rates, taxes, transportation, and town services are other things to look at. Finally, learn the local zoning laws. A new pizza shop next door might alter your property's future value. On the other hand, you may want to run a business out of your home.

Look for a neighborhood where prices are increasing. As the prices of the better homes increase, values of the lesser homes may rise as well. If you find a less expensive home in a good neighborhood, make sure you factor in the cost of repairs or upgrades that such a house may need.

## **Finding a Broker**

If you are a first-time home buyer, you will probably want to work with a broker. Brokers know the market and can be a valuable source of information concerning the home buying process. Ask lots of questions, but remember that most brokers are working for the seller, and in the end, their primary obligation is to the seller and not to you. An alternative is a so-called buyer's broker. This individual does work for you, and therefore is paid by you. Seller's brokers are paid by the seller.

Brokerage commissions average 5% to 7% and are split between the listing broker and the broker that eventually sells the home. Don't be surprised if your broker is eager to sell you their own listing since they would then earn the entire commission.

Once you've determined a price range and location, you're ready to look at individual homes. Remember that much of a home's value is derived from the values of those surrounding it. Since the average residency in a house is seven years, consider the qualities that will be attractive to future buyers as well as those attractive to you.

Although it can be difficult, try to remember that you will probably want to sell this home someday. The more research you do today, the better your decision will look in the years to come.

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