Personal Finance: Another Perspective

The Home Decision 1 - The Process

Updated 2020-05-27

Objectives

Day 9. Understanding Mortgage Loans

Day 10. Home Decision 1

- A. Understand our leader's guidance and the principles of home buying and ownership
- B. Understand the home buying process

Day 11. Home Decision 2

- A. Understand options in the home buying decision
- B .Know how to compare different mortgage loans (different types of loans with different fees and points)
- C. Understand and create your Housing Plan

Home Decision 3 – Q&A

A. Answer questions relating to the Housing Decision

Your Personal Financial Plan (optional)

- Section XVIII: Your Home Decision Plan
  - What is your vision and goals for your housing plan? (use template (Education, Mission, Home Auto Template LT01-15)
    - Where do you currently live?
    - What expenses are you paying, including rent, mortgage, utilities, gas, repair and insurance?
  - What are your home plans and strategies?
    - This may include how often you will move, down payment strategy, negotiation strategies, strategies for warranties, etc.
  - What are your constraints and accountability?

Case Study

Hi Professor:

I took your class last semester. I'm about to graduate and start a job at ____ at the end of the summer in _________. My wife and I are excited to move on with life! We are starting to consider when we want to buy our first house. We know rates are low and will probably continue to be pretty low for the next little while. Also since we are living in Texas, buying a good size starter home at a low cost is very doable. Renting will probably be about as expensive as a mortgage will be each month. We want to have a good down payment however to avoid PMI and have a smaller mortgage. Do you recommend renting for a while to have a full 20% down payment or what is the best route do you think? Thanks for your thoughts and advice.

A. Understand our Leaders Guidance and the Principles of Home Ownership

- What are the benefits of home ownership?
  - It may be:
    - A good location for raising children, teaching them to work, good neighbors, etc.
    - A convenient place to minimize travel time
    - A place to reflect your personal tastes
    - An asset to allow you to grow equity
    - A place to enjoy your family and friends
    - A place to add value from your work and skills

Housing Decision (continued

- What are the risks in home ownership?
  - You buy a house you can’t afford
    - Your other financial goals are not attained
  - You buy a fixer-upper without the necessary skills
    - It stays a fixer upper
  - You buy the wrong type of house for your lifestyle
    - You must pay others to keep it up
  - You buy a house without the necessary inspections
    - You pay dearly for your mistakes
  - You are too far in debt and you lose your job
    - You lose the house and your self-respect

Housing Decision (continued)

- President Gordon B. Hinckley commented:
  - We have been counseled again and again concerning self-reliance, concerning debt, concerning thrift. When I was a young man, my father counseled me to build a modest home, sufficient for the needs of my family, and make it beautiful and attractive and pleasant and secure. He counseled me to pay off the mortgage as quickly as I could so that, come what may, there would be a roof over the heads of my wife and children. I was reared on that kind of doctrine. (Gordon B. Hinckley, "The Times in Which We Live," *Ensign*, Nov. 2001, 72.)

Housing Decision (continued)

- He further counseled:
  - I recognize that it may be necessary to borrow to get a home, of course. But let us buy a home that we can afford and thus ease the payments which will constantly hang over our heads without mercy or respite for as long as 30 years. … I urge you to be modest in your expenditures; discipline yourselves in your purchases to avoid debt to the extent possible. Pay off debt as quickly as you can. … That's all I have to say about it, but I wish to say it with all the emphasis of which I am capable" (Gordon B. Hinckley, "To the Boys and to the Men," *Ensign,* Nov. 1998, 51).

Housing Decision (continued)

- How much should we spend on housing?
  - From the Handbook for Families, it recommends:
    - Avoid spending more than 25 to 40 percent of your take-home pay for the total house payment, including insurance, taxes, and maintenance costs ("Preparing for Emergencies," *Ensign*, Dec. 1990, 59).

Principles (continued)

- What are the Principles of Home Ownership?
  - 1. Understand yourself, your vision, goals and budget
  - 2. Seek, receive and act on the Spirit’s guidance
  - 3. Understand the key areas and process of finding, funding, and buying a home
  - 4. Be wise in your housing spending
  - 5. Live below your means--fit your house to your budget, not your budget to your house
  - 6. Be a good steward over all your blessings and keep it up.

Principles (continued)

Finding Balance

Guiding Principles	Doctrines
• Understand yourself, your vision & goals	Identity
• Seek, receive and act on guidance	Obedience
• Understand housing basics and process	Agency
• Be wise in your spending	Stewardship
• Live below your means	Agency
• Be a good steward	Accountability

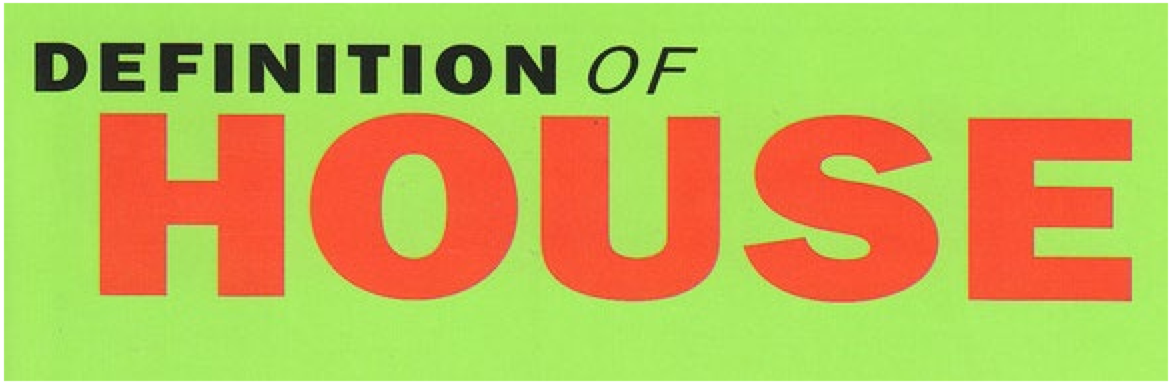
Principles (continued)

From obedience to consecration

I am a child of Heavenly Parents (identity), striving to have the companionship of the Spirit (obedience), learning about available housing options (accountability), so I can find the best housing option for my family (stewardship). This will allow us to enjoy a safe and secure home (agency) at an acceptable cost (stewardship), so we can accomplish my personal mission and achieve our individual and family vision and goals.

Questions

- Any questions about housing options and the principles of home ownership?



A. Understand the Home Buying Process

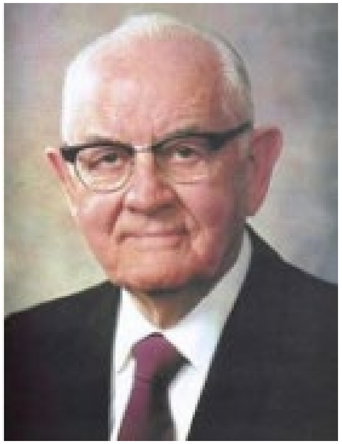
- Purchasing a house is a four-step process:
  - Step 1. Understand your limits
    - Know yourself, what you can afford and what you need now and in the future
  - Step 2. Find your home
    - Determine what you want, and go and find it
  - Step 3. Find, fund and service your loan
    - Know what lenders need, find the best loan, have everything ready, and get the best loan
  - Step 4. Enjoy home ownership
    - Realize you are a steward over all God has blessed you with. Take good care of your home

Step 1. Understand your Limits

- Understand yourself and your limits relates to 8 areas:
  - a. Know your budget and how much you can afford
  - b. Know your credit score and keep it high
  - c. Calculate your front and back-end bank ratios
  - d. Calculate your bank ratios for LDS
  - e. Choose your preferred loan type and term
  - f. Know what you need for a down payment and upfront costs
  - g. Have two years of copies of taxes
  - h. Get pre-approved

1.a. Know Your Budget (What Can You Afford?)

- Develop and live on a Budget
  - President Spencer W. Kimball said: "Every family should have a budget" (in Marvin J. Ashton, "*One for the Money*", Intellectual Reserve, 1992, inside cover).
  - Know your lifestyle
    - Make sure your budget is representative of your lifestyle
      - Take into account likely lifestyle changes, i.e., taxes, babies, new job, new city



Budgeting: The Old Way

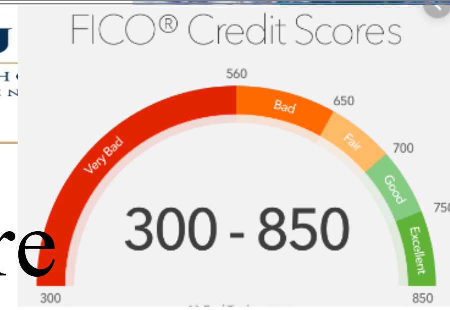
Income – Tithing – Expenses = Available for Savings

Personal Goals

Budgeting: The Better Way

Income – Pay the Lord – Pay Yourself – Expenses = Other Savings

Personal Goals



1b. Know Your Credit Score

- Know your Credit Report and Score
  - Review your credit history every year from all three agencies
    - Three major credit reporting agencies
      - Experian (www.experian.com), Equifax (www.equifax.com), and Transunion (www.tuc.com)
    - You can get a free copy of your credit report from each agency each year by going to:
      - www.annualcreditreport.com
    - Fill out the info and you can get a copy online
      - Make sure it is correct

Your Credit Score (continued)

- Get your Credit Score
  - After checking your credit report for errors, order a copy of your credit score. I recommend a FICO score. You can order it for free from www.discover.com/free-credit-score
- What determines your Credit Score or lending risk?
  - Payment History: What is your payment record?
  - Amounts Owed as % of Limit: How much do you owe as a percent of your available limit?
  - Length of Credit: How long have you had credit?
  - New Credit: Are you taking on more debt?
  - Types of Credit Use: Is it a healthy mix?

1c. Know your Affordability Ratios: Front-end and Back-end

- Know the rules for lenders—your affordability ratios
  - Take into account your savings and tithing when you calculate these ratios (Note: Mortgage Payments for Christians' (LT11) can help)
- Ratio 1: Housing Expenses or Front-end Ratio
  - This ratio calculates what percent of an your income is used to make mortgage payments.
  - Housing expenses should be less than 28% of your monthly gross income. The formula is:

$$\frac{\text{Monthly PITI*}}{\text{Monthly Gross Income}} < 28\%$$

- PITI = mortgage principle, mortgage interest, property taxes, and property insurance

Affordability Ratios (continued)

- Ratio 2: Debt Obligations or Back-end Ratio
  - This ratio calculates what percent of your income is used for housing expenses plus debt obligations.
  - It should not exceed 36% of your monthly gross income. The formula is:

$$\frac{\text{Monthly PITI* and other debt obligations}}{\text{Monthly Gross Income}} < 36\%$$

  - Debt obligations include mortgage payments, credit card, student loan, car, and other loan payments
  - *PITI = Principal, interest, property taxes, and property insurance

1d. Calculate Your Ratios for Christians'

- As members of the Church, we have other important obligations that we also pay, i.e., tithing and paying ourselves, i.e., saving
  - As such, should have smaller houses (at least less expensive), because we pay the Lord first and ourselves second.
- For a spreadsheet that takes into account the fact that we pay the Lord first and ourselves second within this front-end and back-end ratio framework, see:
  - Mortgage Payments for Christian Givers (LT11) can help

1e. Choose your Preferred Loan Type and Term

- Choose your preferred loan type.
  - The best type of loan takes into account your:
    - Goals, budget, income stream, down payment, and view on risk
  - There are a number of different types of mortgage loans available. These include:
    - Fixed Rate (FRMs) - RECOMMENDED
    - Variable or Adjustable Rate (ARMs)
    - Interest Only Options: Variable or Fixed Interest
  - There are also special loans (if you can get them)
    - FHA (best for students) or VA (if military)
    - (see Choosing a Mortgage Loan (LT35))

Mortgage Loan Options and Recommendations (LT35.2)
Personal Finance: Another Perspective

Objectives	Certainty	Pre-Payment	Fixed Rate FRM	Adjust. Rate ARM	Interest Only Option	Interest Only Period	Option ARM*	"X" first choice, "x" second choice Risks
I. Time Horizon: How long do you plan to be in the home?								
1. Does it exceed 10 years?	Very	No	X					No risk of rising payments as limited interest rate risk
	Uncertain	No		X				May enjoy lower initial costs if time horizon shorter
2. Is it less than 10 years?	Very	No		X	x	3-5 Yr		Perhaps lower initial costs for first few years
	Uncertain	No	X					No risk of rising payments if go fixed rate
II. Risk Tolerance: Are you willing to take the Interest Rate risk (it can be substantial)?								
3. Who takes the Interest Rate risk?								
Lender	Very	No	X					Interest rate risk is shifted to the lender
Borrower (you)	Very	No		X		3-5 Yr		Borrower takes interest rate risk
III. Cash Flow Preferences: What are your current cash flow concerns? (Are you within the 28% and 36% limits?)								
4. Do you need to minimize current payments?								
TH: Exceeds 10 years	Very	No		X	x	5-10 Yr		Higher rates, but costs increase after IO period
TH: Less than 10 years	Very	No		X	x	3-5 Yr		Higher rates, but costs increase after IO period
5. Does your income fluctuate dramatically?								
TH: Exceeds 10 years	Very	No		X	x	5-10 Yr		Higher rates, but costs increase after IO period
TH: Less than 10 years	Very	No		X	x	3-5 Yr		Higher rates, but costs increase after IO period
IV. Goals: What are your goals for this asset?								
6. Do you want/need a large house?								
TH: Exceeds 10 years	Very	No		X	x	5-10 Yr		Higher rates, but costs increase after IO period - very risky!
TH: Less than 10 years	Very	No		X	x	3-5 Yr		Higher rates, but costs increase after IO period - very risky!
7. Do you assume house is a long-term investment?								
TH: Exceeds 10 years	Very	No	X		x	5-10 Yr		Higher rates, but costs increase after IO period
TH: Less than 10 years	Very	No		X	x	3-5 Yr		Higher rates, but costs increase after IO period
8. Do you have other high rate debt you want to pay down quickly?								
TH: Exceeds 10 years	Very	No		X	x	5-10 Yr		Refinance with ARM with IOO and repay quickly
TH: Less than 10 years	Very	No			x	3-5 Yr		Refinance with ARM with IOO and repay quickly

Recommended Loan Term (continued)

- Choose your loan term
  - Generally, I recommend a 30 year fixed rate loan
    - However, I recommend you make additional payments on principal to pay off the loan sooner if possible after you have 3-6 months income in your emergency fund (see Home Loan Comparison with Prepayment (LT19) for help)

1f. Determine Down Payment and Upfront Costs

- Know what you will need for a down payment and upfront costs, and begin saving for it
- Down payments:
  - You will need a larger down payment to get into your home now versus two years ago
    - Begin saving for that now
      - Conventional loans – 20% recommended, but you can get in with 5%
      - FHA loans – 3.5%
      - VA loans – 0% down payment required
      - Once you realize how hard it is to save, it will help you not to spend too much

Up-front Costs (continued)

- Upfront costs include closing costs and points (1% of the loan value which we will discuss next class period)
  - Down payment (3-20 percent of the loan amount)
  - Closing costs including points (3-7 percent)
- Closing costs include:
  - Title insurance
  - Attorney's fee
  - Property survey
  - Recording fees
  - Lender's origination fee
  - Appraisal
  - Credit report
  - Termite inspection
  - Prepaids (property insurance & taxes, mortgage interest)
  - Points

Up-front Costs (continued)

- Know your impound/escrow/reserve accounts
  - These accounts are that portion of the monthly payments held by the lender or servicer to pay for:
    - Taxes
    - Hazard insurance
    - Mortgage insurance
    - Lease payments, and
    - Other items as they become due
- These are for payments for items above which are over and above your monthly mortgage payments of principle and interest. Plan for them!
  - These may or may not be required

Up-front Costs (continued)

- What are points?
  - One percent or one hundred basis points of the loan
  - This money is pre-paid interest, money paid to the mortgage broker (not the lender). It is deducted from the loan proceeds (you still must pay it back), and is essentially another fee for helping you arrange the loan (minimize points)
- Why do lenders charge points?
  - To recover costs associated with lending, to increase their profit, and provide for negotiating flexibility
- Do I have to pay points?
  - Origination points (likely), buy-down points (no)

1g. Have Copies of Two Years of Tax Returns

- Lenders want confirmation that you can pay back the loan. As such, they generally want to see two years of tax records
  - Have copies of your last two years of tax records, even though you were a student
- If you have a confirmed job letter with salary, that may also be helpful as well

1h. Get Pre-approved—Not Pre-qualified

- Get pre-approved for your loan by a number of lenders (with mortgage loans, you can have multiple loans requested within a 90 period and its counted as one loan request)

  - Pre-approved means that lenders have pulled your credit score, looked at your tax records and approved you for a specific amount of a loan
    - You can borrow up to this pre-approved amount without a problem
    - I recommend you check with multiple lenders
  - Remember however that you do not need to borrow that amount
    - I recommend you borrow less than that amount

Step 2. Find Your Home

- There is a five step process to finding your home
  - a. Determine what is important to you
  - b. Develop a plan and build your team
  - c. Once you are serious about a home, get a home inspection (you can make offers contingent on the home inspection results)
  - d. Determine any CCRs/fees for potential homes
  - e. Negotiate the home price

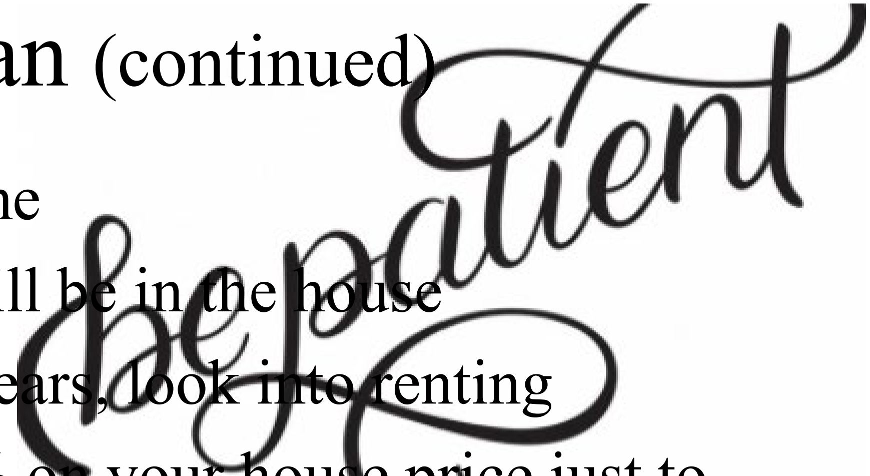
2a. Determine What is Important To You

- Determine what is important to you in a home and what you will and will not do without!
  - This may include:
    - Location
    - Home style and layout
    - Number of bedrooms, garages, fireplaces, etc.
    - Future plans, i.e., kids, work, schools, etc.
  - Realize that you will probably move within five to seven years (if you are like the average US family)

2b. Develop a Plan and Build Your Team

- Establish a buying Plan for finding your home
  - Once you know your limits, what you can afford, where you want to be, and what you want (your Plan):
    - Start driving around
    - Start looking in earnest
    - But keep to your Plan
  - Use Zillow.com or other resources to find reference home values in areas you may be interested in

Develop a Plan (continued)



- Be Patient and take your time
  - Estimate the time you will be in the house
    - If it is less than 3-5 years, look into renting
    - You must make 6-7% on your house price just to break even when you sell it (realtor fees are 6-7%)
  - You will be in the house for years—don't make the decision too quickly
    - It will likely be your largest financial commitment you will make for a long time
  - Often renting a luxury apartment for 6 months will give you time to search thoroughly

2c. Have a Home Inspection

- Once you have found the home you like, can afford, and is where you want to live, have a home inspection
  - This may alert you to potential problems with the home
    - Many of these problems should be fixed by the seller prior to purchase
  - Don’t buy someone’s problems

2d. Determine any CCRs, Fees and Other Costs

- Look to potential homes and potential costs
  - Look through all Covenants, Conditions and Restrictions (CCRs) for a potential home
    - These can be quite restrictive as to what you can and cannot do with your home
      - If you cannot live with the CCRs, don't buy there
    - There also may be lane or other monthly fees
  - For condos or town homes, determine the amount of the transfer/setup fees
  - Understand any other homeowners/association fees for potential homes and what they include

Fees and Other Costs (continued)

- Ask to see records of utility costs and other monthly expenses
  - Compare these to your current costs
  - Remember these costs will vary depending on the season
  - Make sure these costs are consistent with your budget

2e. Negotiate the Price of the Home

- Use the best available resources to negotiate a price for the home
  - Use wisdom and judgment in determining what you can and should pay for the home
    - Realize your best negotiating technique is walking away
  - This is a negotiation process—do not be afraid to haggle
    - Closing costs, things that need to be fixed from your home inspection report, and other things can all be part of the negotiated price
      - Most things are negotiable

Step 3. Find, Fund and Service the Loan

- Find, fund and service the loan—this is the final part of the process. It is a five-step process
  - a. Understand the lending process
  - b. Choose multiple lenders to compete for your business and get Loan Estimates from each of your lenders
  - c. Take the various loan offers from the lenders to calculate your lowest Effective Interest Rate
  - d. Negotiate with your best lender the best rate and get the loan funded
  - e. Try to pay off the loan early to reduce interest costs

3a. Understand the Lending Process

1. You've found a home that suites your lifestyle and budget, using resources such as the internet and a realtor

2. The realtor refers you to a mortgage broker

3. The mortgage broker pulls your credit, determines your needs and tries to find lenders among the competition to meet those needs

4. Each lender has unique programs and LEs. Lenders negotiate points, rates, prepayment penalties, fees, and other features of the loan

5. Brokers recommend the best loan to you after reviewing the features you agreed upon. You make the final decision after comparing various offers

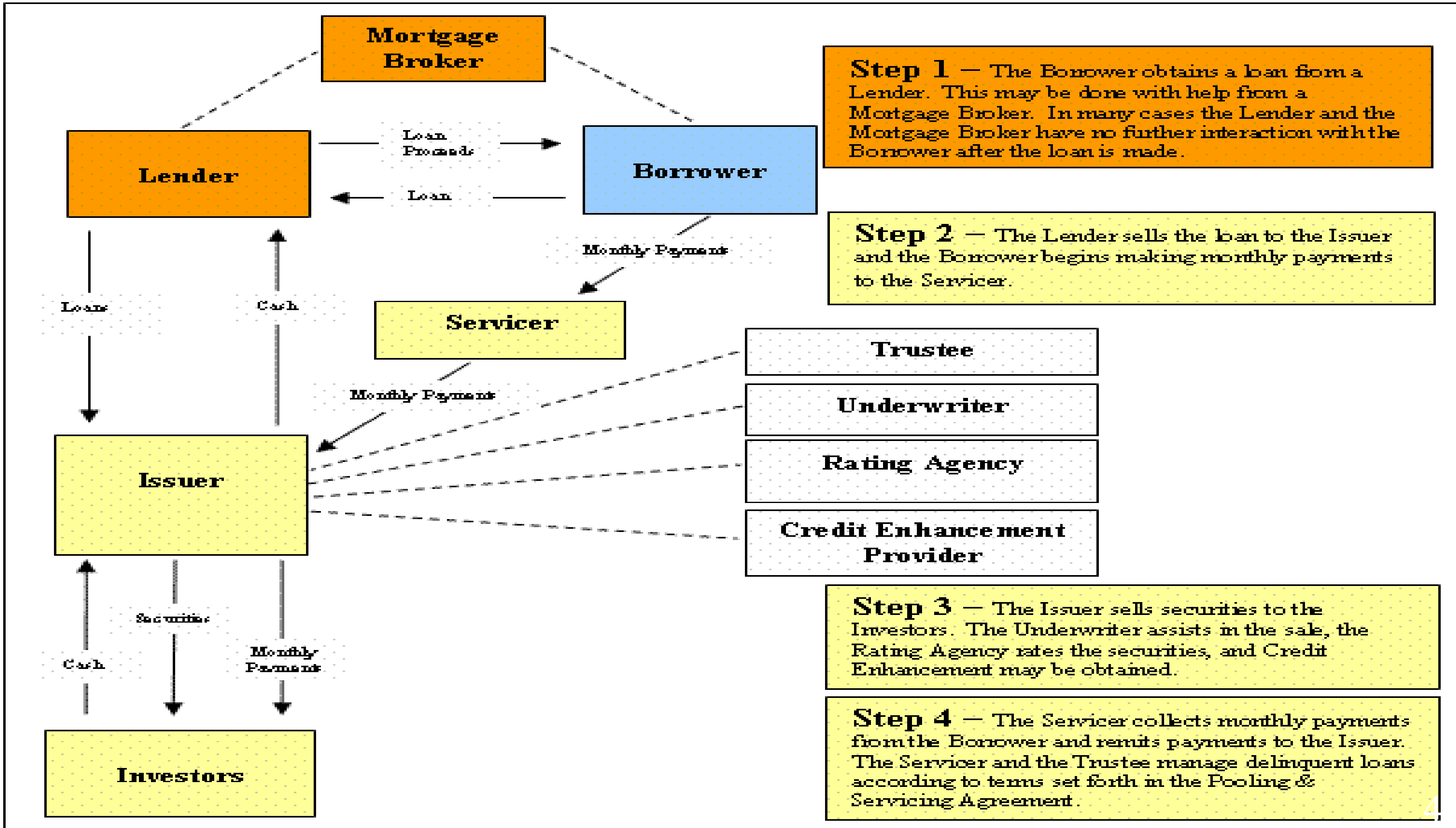
6. Chosen lender takes the loan package, structures the loan and conditions for any additional information they need to close the deal.

7. Broker, Title, Escrow, and Lender work to fill all loan conditions

8. Chosen lender sends out the documents to escrow for signing

9. Lender audits the documents, verifies all conditions are filled, and funds the loan! You are now a homeowner

The Lending Process (continued)



From http://upload.wikimedia.org/wikipedia/commons/0/08/Borrowing_Under_a_Securitization_Structure.gif on 7Oct08

3b. Choose Multiple Lenders and get LEs

- You will get a lower interest rate when lenders compete for your business
  - Work with multiple lenders
  - Talk with friends and others who have gone through the process for their favorite brokers
  - Hold brokers accountable for what they say
- Get Loan Estimates (LE) from each lender (not just a Summary)
  - These are the costs you will likely pay
  - Compare LEs from each lender
    - You do not need to have a signed contract to get a Loan Estimate

3c. Calculate your Effective Interest Rate

- Estimate how long you will be in the home
  - This is important as it helps determine over what period you can allocate points and other costs
- Calculate your effective interest rate for each loan
  - Your effective interest rate is the interest rate you will pay after all your points, costs, and fees are taken into account
- Get your best rate
  - Your lowest effective interest rate is the best indicator that you got a good rate on your loan

3d. Negotiate with Your Favorite Lender

- The key now is to find the lowest rate
  - Once you have multiple offers from multiple lenders, then you have bargaining power
- Determine your lowest rate, which includes points, fees, and the loan APR after evaluating each of the offers from the various lenders
  - You can take that offer if you want
  - Or, you can that offer to your favorite lender
    - Then ask them to beat it by 1/8 to 1/4 percent and you will go with them

3e. Pay off the loan early and save

- The key now is to service the loan consistently
  - Make sure payments are on time
  - Set up procedures to ensure you do not miss payments
  - Strive to pay off the loan early
    - Set a goal to pay it off after a certain number of years
      - This increases the money you can save for your personal and family goals
      - This brings freedom from worry when you own the home

Step 4. Enjoy Home Ownership

- Enjoy home ownership
  - Maintain it well
    - Take care of your purchase and it will take care of you
      - Generally it will take roughly 1-2% of the home’s value annually for upkeep.
      - Put this amount into your annual budget
      - A professional cleaning a few times a year can help retain a home’s value
  - Now keep the value of your home up!

Questions

- Any questions on the home buying process?

Review of Objectives

Day 10 (Home Decision 1)

- A. So you understand our leader’s guidance and the principles of home buying and ownership?
- B. Do you understand the home buying process?

Case Study #1

- Data
  - Bill and Brenda make $60,000 per year. They found the house they want for $225,000. They are looking at a 30-year fixed rate loan at 6.5%, and estimate property taxes and insurance costs at $200, a car loan of $270 and student loans of $50 per month. They pay tithes/offerings of 11%, save 15% in their company 401k (tax deferred and with a 5% match), and they estimate their marginal tax rate at 17%.
- Calculations
  - Calculate their front-end ratio and back-end debt to income (DTI) ratios for banks (28% and 36%, respectively). What is the amount most banks will lend? Using LT11, calculate the Saver's amounts.

Case Study #1 Answers

You do not need to do this by hand—the tool is sufficient

1. Bank Front-end DTI Ratio Calculations at 4.5%
   - Calculate Monthly income
     - Gross Income / 12 = Monthly Income = ?
     - $5,000
   - Multiply times 28%
     - $1,400
   - Subtract taxes (T) and insurance (I) for payment
     - \- $200 gives Max Mortgage Payment of $1,200
   - Calculate maximum amount bank will lend
     - Set 4.5% = I, PMT = 1,200, N=30, PV = ?
       - $236,833

Case Study #1 Answers (continued)

Using the tool to calculate this is all that is needed.

2. Bank Back-end DTI Ratio Calculations at 4.5%
   (PITI+Debt)/GI
   - Calculate Monthly Income (Gross Income/12)
     - $5,000 Multiply times 36% = $1,800
   - Subtract taxes (T) and insurance (I)
     - $1,800 – 200 = $1,600
   - Subtract Monthly debt payments
     - $1,600 - Car 270 - Student Loan - 50 = $1,280
   - Calculate amount based on adjustments
     - Set 4.5% = I, Pmt = 1280, N=30, PV = ?
       - $252,622

Case Study #1 Answers

1. Saver Front-end DTI Ratio Calculations at 4.5%
   - Calculate Monthly income
     - Monthly Income = $5,000 times 28% = $1,400
     - - $200 gives Max Mortgage Payment of $1,200
     - Adjustments
       - 11.0% *(1-.17% tax shield) = 9.1%
       - 15.0%*100%*(1-.17% tax shield) = 12.5%
       - Total adjustments = 21.6%
     - 5,000 * (1-.216) = $3,920 *.28 – 200 = $898
   - Calculate maximum amount bank will lend
     - Set 4.5% = I, Pmt = $898, N=30, PV = ?
       - $177,207

Case Study #1 Answers (continued)

2. Saver Back-end DTI Ratio Calculations at 4.5%
   - Monthly Income = $5,000
     - Adjustments
       - 11.0% *(1-.17% tax shield) = 9.1%
       - 15.0%*100%*(1-.17% tax shield) = 12.5%
       - Total adjustments = 21.6%
   - Subtract taxes & insurance, and loans
     - 5,000*(1-.216) = $3,920*.36 – 200 - 320 = $892
   - Calculate amount based on adjustments
     - Set 4.5% = I, Pmt = 892, N=30, PV = ?
       - $175,959

Case Study #1 Answers

Maximum Monthly Mortgage Payments for Christians' (LT11)
Includes Charitable Contributions and Savings

Directions: Fill in the green cells with your data. Be careful not to modify the blue cells

Loan Data and Closing Costs:	
Estimated Mortgage maturity (in years)	30
Estimated FIXED interest rate	4.50%
Estimated monthly real estate tax and insurance payments	200
Marginal Tax Rate	17.0%
Method 1: Housing or Front-end Debt to Income Ratio (LT11)	
Maximum Mortgage Payment Using the Ability to Pay and PITI Ratio	
a. Annual income	60,000
Calculated monthly income	5,000
b. Percentage of PITI (principal, interest, taxes and insurance) to monthly gross income that lenders will lend in the form of a mortgage loan	28%
Estimated Maximum monthly mortgage payment	1,400
c. Estimated monthly real estate tax and insurance payments	200
Maximum monthly mortgage payment using the 28% Rule	1,200
d. Maximum mortgage amount using the Front End Ratio	$236,833
With Adjustments for Christians Paying Tithes/Offerings and Paying Yourself:	
Tithes and Other Offerings (in percent)	11.0%
Effective cost of donations (after your tax shield)	9.1%
Payments to yourself, i.e. retirement savings, 401k, Roth IRA, IRAs,	15.0%
Percent of personal savings that is tax-deferred (IRA, 401k, SEP IR	100.0%
Effective cost of savings (after your tax shield)	12.5%
Total Additional Payments not usually included in this calculatio	21.6%
Maximum adjusted monthly mortgage payment using the 28% Rule	897.88
e. Christian adjusted maxc mortgage using Front-end DTI ratio	$177,207

Method 2: Debt or Back-end Debt to Income Ratio (LT11)	
Maximum Payment Using the Ability to Pay, PITI Plus Other Fixed Debt Expenses	
a. Monthly income	5,000
b. Percentage of PITI+current monthly fixed payments to your current gross income that lenders will lend in the form of a mortgage loan	36%
Total amount at 36% ratio	1,800
c. Estimated monthly real estate tax and insurance payments	200
d. Current nonmortgage debt payments on debt that will take over 12 months to pay off and other monthly legal obligations	
Auto loans, credit card debt you cannot pay off in 12 months	270
Student Loans, child support, alimony, or other long-term debt	50
Total long-term non-mortgage debt payments	320
e. Maximum payment using the Debt or Back-end DTI Ratio	1,280
f. Maximum payment using PITI plus Other Fixed Debt Payments R	$252,622
With Adjustments for Paying Tithes/Offerings and Paying Yourself:	
Tithes and Other Offerings (in percent)	11.0%
Effective cost of donations (after your tax shield)	9.1%
Payments to yourself, i.e. personal/retirement savings, 401k, IRAs, (	15.0%
Percent of personal savings that is tax-deferred (IRA, 401k, SEPs,	100.0%
Effective cost of savings (after your tax shield)	12.5%
Total Additional Payments not usually included in this calculatio	21.6%
Maximum adjusted monthly mortgage payment using the 36% Rule	891.56
e. Christian adjusted max. payment using Back-end DTI ratio	$175,959

Case Study #1 Answers (continued)

Applications:

- Since the bank will generally lend the lesser of the two ratios, they would likely be allowed to borrow $236,833.
- The Saver would likely adjust that amount downward toward roughly $180,000.
- We would recommend something between these two estimates

Conclusions (LT11):

Maximum Mortgage Amount using Method 1:	$236,833
Maximum Mortgage Amount using Method 2:	$252,622
Lower of the Two Methods, and Most likely to be used by the Bank	$236,833

Maximum Adjusted Mortgage Amount using Method 1:	$177,207
Maximum Adjusted Mortgage Amount using Method 2:	$175,959
Average of the Two Methods (for food for thought) for LDS	$176,583

Case Study #2

- Data
  - From Case #2, Trent and Jen will need to get exactly \$200,000 out of the loan. They have looked at Loan a for 6.0% and no points and fees, and Loan B is for 5.75% and \$1,500 in fees. They are assuming to include the cost of points and fees in the loan.
- Calculations
  - Assuming they go with Loan B, how much will they need to borrow above the \$200,000 so when they take out the 1 point and \$1,500 fees, they will have exactly the \$200,000 needed for the home?

Case Study #2 Answers

How much will Trent and Jen need to borrow above the $200,000 so when they take out the 1 point and $1,500 fees, they will have exactly the $200,000 needed for the home?

The formula for calculating the amount needed before fees and points is:

[Amount Needed + Fees] / ((100 - # points)/100)

- Trent and Jen need $200,000, they are paying 1 point and $1,500 in fees so the formula is:

$$\left[\frac{\$200{,}000 + \$1{,}500}{((100 - 1 \text{ point})/100)}\right] \text{ in fees } = ?$$

They will need: $203,535.35

As a check:

1% (1 point) of $203,535.35 =	$2,035.35
Fees:	1,500.00
Total Points and fees	$3,535.35

Note that they will need this amount regardless of their interest rate

Case Study #2 Answers

How much will Trent and Jen need to borrow above the $200,000 so when they take out the 1 point and $1,500 fees, they will have exactly the $200,000 needed for the home?

Home Loan Comparison (LT19): Loan 1
Personal Finance: Another Perspective

Amount Needed: After points and fees = 1, Before Points and Fees=2:						1
Loan Information:			**Amount Needed (after points & fees):**			$ 200,000
Loan Amount		$ 203,535.35	Total Periods		30	**Rates:**
Interest Rate (APR)		5.50%	Loan Payments:		30	**APR**
Years (1-30)		30	***Prepayment of Principal***			5.50%
Payments per year (12)		1	Number of Prepayments:		0	**Effective**
Annual Payments		$ 14,004.33	Total of Prepayments:		$ -	**Interest Rate**
Prepayment after # years?			Savings from Prepayments:		$ (0)	5.66%
		(blank = no early payoff)				
Received Before Fees		$ 203,535	Amount Received After Fees			$ 200,000
Points	1.00	2,035	Other Fees	1,500	Total Costs	3,535
Regular Pmts.	Extra Payments	Pts & Fees	Balloon Pmt	Total Paid	less Received	Interest Paid
420,130	-	3,535	-	423,665	203,535	220,130
Cost of loan without prepayment				Total Paid	less Received	Interest
420,130				423,665	203,535	220,130
				Interest Saved by Prepayment:		**(0)**

Case Study #3

- Data
  - Bill has taken a job that he expects to be at for 3-5 years until he goes back to graduate school. He and his wife are debating whether to rent or buy. She really wants to buy, and he is unsure. She has found a house in a nice neighborhood near your school that she thinks is perfect.
- Application
  - Are there any other tools or sources of information that may be helpful to them to help in this decision?

Case Study #3 Answers

Will live there 3-5 years until graduate school. Have found a nice house in a nice neighborhood. Any other tools to help in the decision making process?

There are two additional pieces of information that may be useful as they "study it out in their mind" before they make a final decision may be:

- 1. Talk with a realtor about the neighborhood. Find the average "days on the market" (or DOM) for the area. If houses are selling quickly <30-45 DOM, the market is currently strong. If the DOM>90-120, it is difficult to sell homes now and may be difficult in the future.
- 2. Talk with a realtor and get the data on the average annual appreciation of the houses in that neighborhood. If they have continued to appreciate over the last few years, there may be support for continued appreciation in the future. If not, they may be more difficult to sell in the future.

Teaching Tools

- Please note that I have prepared three teaching tools which may be helpful as you work on buying a home. They are:
  - Home Loan Comparison with Prepayment and Financing (LT19)
  - Maximum Monthly Payment for Christians' (LT11)
  - Debt Elimination Schedule with Accelerator (LT20)

For another good source of information, see

- www.mtgprofessor.com

Questions

- Do you have any questions on the home buying process?