15. The Housing Decision I: The Process

Introduction

Once you understand the principles for using wealth, have your priorities in order, decide what you want to accomplish in life, and learn to live on a budget, one of your next goals may be to own a house. I like how some have defined the word *house*, "A house is a hole in the middle of land that you pour money into."

How true that statement is. There are very different connotations of the word "home" and the word "house," as illustrated by the following story:

> A while back a house caught fire and burned down. A local journalist went to cover the story. Upon arriving at the site, the reporter found a little boy. The child was standing in the midst of ashes and ruins. The reporter asked the boy what his family would do without a home. "Oh, we still have a home, we just don't have a house to put it in" the child replied.[1]

It is important to remember the difference between a home and a house as you look for and eventually purchase a house. A house is what you live in while a home is what you bring to the house. The purpose of this chapter is to help you avoid some of the pitfalls of buying a house for the first time. For the remainder of this chapter, I will use the words "home" and "house" interchangeably.

Objectives

When you have completed this chapter, you should be able to do the following:

A. Understand our leaders guidance and the principles of home buying and ownership.
B. Understand the process of buying a home.

Understand our Leader's Guidance and the Principles of Home Buying and Ownership

Buying a home is not easy. The purchase of a home will likely be one of the largest financial commitments you will ever make. As such, you should not rush into this commitment. If you use wisdom and judgment in trying to decide what you want, what you can afford, and where you want to live, and if you will listen to and obey the promptings of the Holy Ghost, you will make correct decisions regarding your housing needs.

There are risks in home ownership—not just the risks of owning the home but the risks of owning the wrong home. What happens if you buy a house you can't afford? Your most

important financial goals will likely be downgraded to goals of minor importance because you will not have sufficient funds to meet them. Individuals who own a house they can't afford are referred to as being "house poor."

What if you buy a "fixer-upper," but you don't have the necessary skills or time to do the fixing up? Your new home will likely remain a fixer-upper.

What if you buy the wrong type of house for your lifestyle? For example, if you are a condo person in a family neighborhood, you will likely want to pay others to keep up the landscaping and other exterior elements.

Or what if you buy a house without obtaining the necessary inspections? You could pay dearly for the problems the previous owners left behind and should have fixed before your purchase.

Finally, what if you get too far in debt, and you lose your job? Quite simply, you could damage your credit score, lose your house, and lose your self-respect as well.

Principles of Home Ownership

Gordon B. Hinckley shared principles of home ownership when he shared what his father told him regarding a home:

> 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.[2]

The decision to buy a house, since it is one of the most expensive purchase you will make in your lifetime, should be done in wisdom and order. You should do significant research as to yourself, your budget, your needs, the market, the mortgage process, and how to get the best mortgage you can. It is important that you understand the key principles of home ownership. Following are five key principles that are important to the housing decision.

> **1. Understand yourself, your vision, goals and plans, and your current and future housing needs.** Understand yourself. What needs does your home fulfill? What are your family needs now and in the future? What is your vision and your goals? What are the things you want to accomplish in life? A good start is to determine your needs. What are your housing needs that you have? What different options do you have for those needs? Whatever you choose, make sure it is the right type of house and right time for your lifestyle and budget.
>
> **2. Seek, receive and act on the Spirit's guidance**. This includes seeking diligently through study and prayer, living worthy of the Spirit's guidance, and then acting on it

once it is received.

3. Understand the key areas and process of finding, buying, and funding a home. Know the process of how mortgages are marketed and sold, so you know how to get the best deal on your mortgage. You have received the best deal on your mortgage when you have the lowest Effective Interest Rate (EIR) calculation that includes all your points and fees (to be discussed later).

4. Be wise in your finances. Spend your money wisely and carefully. Be wise in your budget and in your spending. Make your house fit your budget, not your budget fit your house. Use the recommended 25-40% of take-home for housing expenses (which will be discussed later). Going beyond these limits will put significant financial burdens on you and your family. Get the necessary inspections (even if its new). Finance it wisely and try to pay it off before retirement or sooner.

5. Be a good steward over all your blessings. Don't just live in it—keep it up. Plan 1-2% of the cost per year for upkeep and maintenance on your home.

Based on this counsel, we can see that our challenge is to determine what a modest home is. The *Handbook for Families* 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."[3] That advice gives us a good start as we begin our study of home-buying.

Doctrines

As you work on the housing decision, finding balance among doctrines, principles and application is important in helping you make better decisions. We have shared some ideas for principles, although I am sure you can find others. Below are a few ideas for doctrines on which the principles are based. As you strive to increase your ability and effectiveness in the housing decision, I recommend you study and ponder the doctrines and principles supporting the housing decision.

Principles	Doctrines
Understand yourself, your vision, goals and plans	Identity
Seek, receive and act on the Spirit's guidance	Obedience
Be wise in your finances, make sure it is in your budget	Stewardship
Understand the key areas of making the home decision	Agency
Be a good steward over your blessings	Stewardship

From Obedience to Consecration

From the principles and doctrines, we can see that we are not just working on being wise with our housing decision, which is an application. Rather, from a higher perspective, or increased vision,

We are children of Heavenly Parents (identity), striving to live worthy of the Spirit (obedience), learning about available housing options (accountability), so we can find the best housing option for our family (stewardship). This will allow us to enjoy a safe and secure home (accountability) at an acceptable cost (stewardship), so we can accomplish our personal missions and achieve our individual and family vision and goals.

Understand the Process of Buying a Home

There is a process to buying a home, which, if followed, will help you make wise decisions and may help you reduce some of the problems people face when they do not understand this process. It is a four-step process:

- Understand your limits
- Find your home
- Find, fund, and service your loan, and
- Enjoy home ownership.

Step 1. Understand Your Limits

Understand yourself and your limits in the following areas:

1.a. Know your budget. The first part of understanding your limits is to check whether or not you have developed and are living on a budget. We have already talked about many important topics related to budgeting in **Chapter 3: Budgeting and Measuring Your Financial Health.** If you have questions about budgeting, please review that chapter.

1.b. Know your credit history and credit score and keep it high. If you don't have good credit or a satisfactory credit score, you may find that no one is willing to lend you money. Keep your credit score high.

We have already talked about many important topics concerning credit in **Chapter 6: Understanding Credit.** If you have questions concerning credit, please review Chapter 6. As we have discussed previously, your credit history can play an important role in your opportunity to buy a home. When you request credit, financial institutions will pull your credit history to determine how likely it is that you will pay back the loan. If you have made timely payments in the past, creditors assume it is likely you will continue to make payments in the future. Because your credit history can have a big impact on how much you pay for your loans and whether or not you get a loan in the first place, you need to periodically examine your credit reports from all three major reporting agencies. Make sure the reports are correct.

1.c. Know your affordability ratios. The third topic you should understand is mortgage lending. We have already talked about the different types of mortgage loans in **Chapter 7: Consumer and Mortgage Loans.** Review this chapter if you need to.

It is critical that you know your affordability ratios, or how much debt the bank thinks you can take on. There are two main ratios: the housing-expense ratio (or front-end ratio) and the debt-obligations ratio (or back-end ratio).

You should know how to calculate your housing-expense ratio, or front-end ratio. It is your monthly payment of principal, interest, property taxes, and insurance (PITI) divided by your monthly gross income. Banks have determined that if this ratio is 28 percent or less, there is much greater chance you will be able to pay back your loan.

The back-end ratio is your monthly payment of principal, interest, property taxes, and insurance (PITI) plus any other long-term debt (including any debt older than 12 months, i.e., car payments, student loans, alimony payments) divided by your monthly gross income. Banks have determined that if this ratio is 36 percent or less, it is an indicator that you have much more flexibility in your finances and are more likely to pay back your loan.

Know your affordability ratios before you get your loan. Don't use all the money the bank will lend, and don't buy the most expensive house on the block. Know how much you can afford.

1.d. Calculate your affordability ratios taking into account payment of tithes and offerings. Before you calculate affordability, take into account the amount you should be saving. Look at your budget realistically. I recommend you set aside 10 percent for tithing, plus an additional amount for other offerings. Set aside 10 to 20 percent more for paying yourself, for money you are saving for retirement and other goals. Since you pay the Lord first with tithes (10 percent of your increase) and offerings and since you pay yourself each month as well, you should really adjust these affordability ratios downward to take your donations and savings into account. I would encourage you not to borrow too much money for your home. To help you review your situation, please see Maximum Monthly Payment for Christian Savers (LT11). This spreadsheet takes the front- and back-end ratios, as well as the fact that you pay tithing and savings, into consideration when it calculates the amount a bank will likely lend you.

1.e. Choose your preferred loan type and term. 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):* I generally recommend this type of loan. The lender takes the interest rate risk, and you make constant payments throughout the life of the loan. This makes planning and budgeting easier.
>
> *Variable or adjustable rate* (ARMs): You take the interest-rate risk, so the lender may accept a lower rate of interest. However, there is the risk that interest rates will rise in the future.
>
> *Interest-only options, variable or fixed interest:* This is an option on a fixed or ARM loan. However, once the interest-only period is over, for example, 3 to 10 years, the loan

resets so the principal and interest is paid over the life of the loan, generally 30 years. There can be substantial payment shock when the loan resets. This is not like a minimum payment on a credit card.

There are also special loans, if you can qualify for them. They include Federal Housing Assistance loans for lower-income borrowers or Veterans Assistance loans, which are guaranteed by the U.S. Department of Veterans Affairs for those in the military.

Choose your loan term. Generally, I recommend a 30-year fixed-rate loan, which may give you flexibility in case financial concerns arise in the future. However, I recommend you make additional payments on principal to pay off the loan sooner if possible.

1.f. Determine down payment and up-front costs. Before you buy, remember that the down payment on a loan may be from 3 to 20 percent of the cost of the home, and the closing costs may be an additional 2 to 5 percent. Be aware that these costs are significant; given that these costs are paid up front, they must be planned for before you purchase the house.

Points are one percent of the loan value, or 100 basis points of the loan. Lenders charge points to recover costs associated with lending, to increase the effective interest rate they are receiving, to provide for negotiating flexibility in a market where interest rates fluctuate, and to adjust for differences in risk between loans. Points are deducted directly from the loan amount at closing. In other words, if you have a $200,000 loan with two points (2 * $2,000), you will only receive $196,000 at closing—the mortgage broker will keep $4,000. However, you will have to pay back the full $200,000.

Other up-front costs include title insurance, attorney fees, property survey fees, recording fees, lender's origination fees, appraisals, credit reports, termite/mold inspections, escrow payments, and the home inspection report.

Your impound account (or escrow, or reserve account) is the portion of your monthly loan payments that is held by the lender or servicer to pay for specific costs. These costs include property taxes, hazard insurance, mortgage insurance, and other items as they become due. These payments are made in addition to your monthly mortgage payments of principal and interest. An impound account may or may not be required for a loan, depending on your lender.

1.g. 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 for documentation. If you are a recent college graduate, you might share a confirmed job letter with salary.

1.h. Get pre-approved—not pre-qualified. Know that you should get pre-approved for a mortgage, not just pre-qualified. In addition, know your affordability ratios that the bank uses to determine credit worthiness. Pre-approved means the financial institution has done all the necessary analyses to qualify you for a loan, including checking your credit report and approving you for a specific amount. Pre-qualified, on the other hand, means that the financial institution

has essentially said that you will roughly qualify for some undetermined amount on a mortgage loan. Many times people have thought that they were pre-approved for a loan when they were only pre-qualified. When it comes time for these people to close on a house, they may discover they can't get all the money they need. Not only do they lose the house but they may lose their earnest money as well. (Earnest money is given by a buyer to a seller to show their good faith.) Should the deal fall through, the earnest money may be forfeited.

Step 2: Establish a Sound Plan and Find Your Home

Plan what you want, and then work your plan. There is a five-step process for finding your home.

2.a. Determine what is important to you. Determine what is important to you: how much of a commute are you willing to endure? How important is it that your house is close to schools? Do you need a yard for your kids? Do you want a flat lot or a lot on a hill? Write down which qualities you will and will not do without; articulate what you want regarding your desired location, type of home, future plans, and so on. Realize you will probably move within five to seven years if you are like the average US family.

2.b. Develop a plan and build your team. Once you know your limits, what you can afford, where you want to be, and what you want, you can then start developing your plan. How will you find your home? What resources will you use, including realtors, online resources, etc. In what areas will you look, in in what types of homes?

Be wise in your decisions, as you may be in the house you buy for a long time. Therefore, be patient and take your time in deciding which house to purchase.

Estimate the amount of time you will be in the house. If it is less than three to five years, consider renting. Remember, you will have to make at least seven percent on the selling price when you sell your house to break even from realtor's fees alone; you must also consider how much you paid for other up-front fees. Buying a house will likely be the largest financial commitment you will make for a long time, so be wise.

I often recommend that recent college graduates should generally plan to rent a nice apartment for at least 6 to 12 months before they buy a house. This gives them the time they need to search thoroughly, figure out what they want, decide on the area where they want to live, and determine which amenities they want in a house and location.

Do your homework—and footwork. Buying a house is not easy. It takes time, thought, and effort. Find a good realtor to help you. Realize that realtors work for the seller instead of for you, the buyer: as the seller pays the realtor's fees. It may be wise to hire a buyer's broker (or realtor), who works for you and gets paid by you as well. This buyer's realtor should be someone who knows the ins and outs of the neighborhoods you are interested in.

Use a team approach. Get others to help you in the process of buying a home. Remember, you can't, and shouldn't, do everything by yourself. Get a good appraiser who can help you make

sure you don't pay too much for a house. Get a good lawyer who can help you make sure you fill out the correct forms. Most importantly, get a good home inspector. The last thing you want to do is buy someone else's problems. Use multiple home inspections if necessary. Don't become emotionally attached to a potential house. The best thing you can do in many cases is to just walk away.

2.c. 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. While this is at your expense, it may alert you to potential problems with the home before you decide on the purchase. Many of these problems should be fixed by the seller prior to purchase at the seller's expense. Don't buy someone's problems.

2.d. Determine any CCRs, fees, and costs. With your home you like, look to potential costs. Look first through all Covenants, Conditions and Restrictions (CCRs) for your potential home. What additional costs are required. 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. Moreover, 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.

Finally, ask to see records of monthly utility costs and other monthly expenses. Compare these to your current costs for additional expenses. Remember that these costs will vary depending on the season so try to find the last few years of utility costs. Make sure these costs are consistent with your budget.

2.e. 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. Compare the cost of your potential home to those which may have sold recently. If you are working with a realtor, have them do a "comps" study of homes that have sold recently in the area.

This is a negotiation process—do not be afraid to haggle, and your best negotiating technique is walking away. Also realize that 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

Finding, funding, and servicing the loan is a five-step process.

3.a. Understand the lending process. This process utilizes the services of a number of different professionals, including realtors, lenders, title insurance professionals, and escrow professionals (see Chart 1).

The key players in this process are the realtors and mortgage brokers. Realtors, or real estate brokers, are individuals or companies who act as intermediaries between sellers and buyers of real estate. Unless stated otherwise, they represent the seller and the seller's interests and are paid by the seller. Generally, sellers pay a commission to the realtor for selling the property, which is split between the listing realtor (the realtor who listed the property), and the selling realtor (the realtor who brought the buyer of the property to the seller). The commission is generally a percentage of the value of the property and may range from five to seven percent or more.

Mortgage brokers are individuals or companies that arrange loans between the lenders (those who have money to lend for mortgage loans) and borrowers. Traditionally, banks and other lending institutions sold their own products. However, as the markets for mortgages became more competitive, the mortgage brokerage industry evolved and broadened beyond banks.

Mortgage brokers make money two ways: origination fees and discount points. Origination fees are the costs and profits on making the loan, while discount points are payments by the borrower to lower the loan interest rate.

3.b. Choose Multiple lenders and get Loan Estimates (LEs). To get the best deal in the lending process, the key is competition. You will get a lower interest rate on your loan when lenders compete for your business. Work with multiple lenders. Talk with friends and others who have gone through the process and ask for the names of their favorite brokers. Hold brokers accountable for what they say.

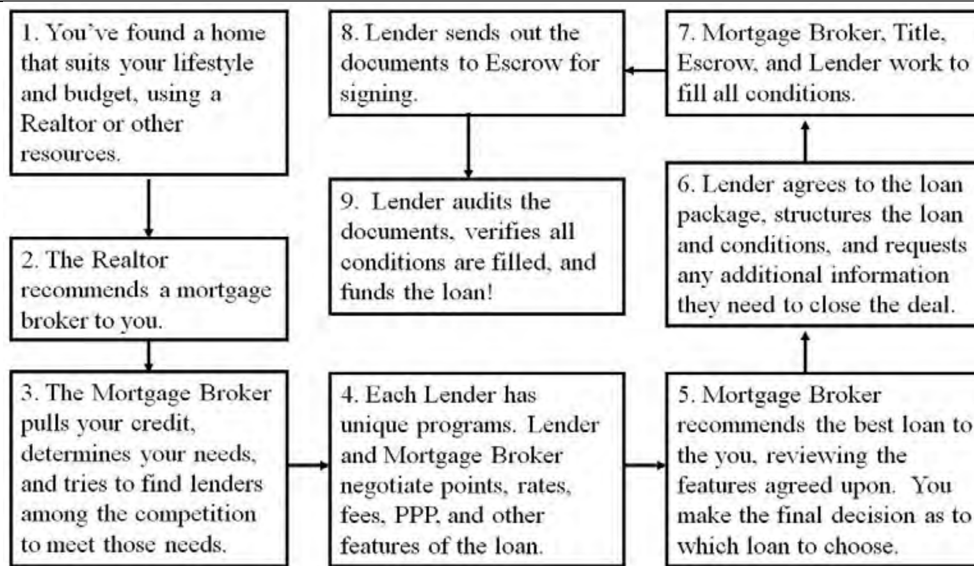
Get Loan Estimates (LEs) from each lender (and not just a Summary). A LE is an outline of the cost to be charged upon the closing of the loan. The LE also acts as protection for borrowers to keep lenders honest on what they charge. These are the estimated costs you will likely pay when the loan closes. Then compare LEs from each lender.

3.c. Calculate your Effective Interest Rate. Calculate your effective interest rate from each of your lenders. As inputs to this, 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. From your GFE, 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 and will be discussed in the next section.

The key is to get your best rate. Your lowest effective interest rate is the best indicator that you got a good rate on your loan.

3.d. Negotiate with your favorite lender. Once you have multiple offers from multiple lenders, you have bargaining power. Determine your lowest effective interest rate, which includes points, fees, and the loan APR after evaluating each of the offers from the various lenders. That is your beginning point. You can take that offer if you want.

Chart 1. The Lending Process



However, generally I recommend you take that offer to your favorite lender, and ask them to beat it by 1/8 to 1/4 percent and you will go with them. Remember, if they don't get your business they don't make any money.

In summary, mortgage brokers make money in two ways: origination fees and discount points. Origination fees are the costs and profits on making the loan. Discount points are payments by the borrower to lower the loan interest rate.

The objective in borrowing for a home is to minimize the interest rate you pay and the points and fees you pay (origination and discount points). How do you minimize these two areas? Following are a few ideas:

1. Talk with multiple mortgage brokers. Make this a competitive process. Remember that multiple institutions requesting your credit report and score within a specific period of time are only counted as a single request on your credit score. Get multiple bids.

2. Compare rates and points across different brokers from different companies. This will give you a general idea of rates and points, which can be very helpful.

3. Look at the minimum interest rate they will let you buy down to. Perhaps it is close to the lender's required rate. Once you have a feel for that rate, it may give you an indication of what the mortgage broker's back-end bonus would be.

4. Once you find the best rate and points from the multiple mortgage brokers you checked on, go to your favorite broker and agree to go with him or her if he or she can beat the best offer by 1/8 to ¼ percent.

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. We recommend you 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 once the loan is paid off. This also brings freedom from worry when you own the home instead of still needing to make payments.

Step 4: Enjoy Home Ownership

If you have completed the home-buying process well, you will enjoy the fruits of your labors for many years. Maintain your home well. If you take care of your purchase, it will take care of you. For example, having your home professionally cleaned a few times a year can help retain your home's value. For budgeting purposes, realize that maintaining your home will generally require roughly one percent of the home's value each year, so add that amount to your budget. This amount should be an included expense you will likely pay each year.

Summary

Buying a home is not easy. The purchase of a home will likely be the largest financial commitment you ever make. As such, you should not rush into this commitment. If you use wisdom and judgment in trying to decide what you want, what you can afford, and where you want to live, and if you will listen to and obey the promptings of the Holy Ghost, you will make correct decisions regarding your housing needs.

Understanding the key principles of home ownership are critical. These include:

- Understand yourself and your current and future housing needs.
- Seek, receive, and act on the Spirit's guidance.
- Understand the process of finding, buying, and funding a home.
- Be wise in your finances.
- Be a good steward over all your blessings.

There is a process to buying a home, which, if followed, will help you make wise decisions in buying a home. The process is the following.

- Understand your limits.
- Establish a plan and find your home.
- Negotiate your loan.
- Enjoy home ownership.

There is much to learn and remember when buying a home. Keep your goal of buying a home in the perspective of your overall goals and objectives. Develop a home buying strategy, and follow it when you are buying a home. Buying a home is an important goal—but it is not the only one.

In spite of the challenges associated with buying a home, having a home may bring many blessings and opportunities.

Assignments

Financial Plan Assignment

As you think about where you want to live, it is important to develop your own housing strategy. Include this as part of your PFP Education, Mission, Home and Auto Template (LT01-15).

Start first from where you are. What is your current housing strategy? Where do you currently live? What expenses and fees are you paying, including rent, mortgage, maintenance, utilities, gas, repair and insurance? How can you reduce your housing expenses?

Then work on your Housing Plan. This will be covered in the following chapter.

Learning Tools

The following Learning Tools may be helpful as you prepare your Personal Financial Plan:

Maximum Monthly Payment for Christian Savers (LT11)

This Excel spreadsheet will help you determine the maximum amounts that financial institutions will generally lend; the spreadsheet uses traditional front-end and back-end ratios. However, traditional banking ratios do not take into account the fact that Latter-day Saints pay tithes and other offerings and save a certain percentage of their earnings. This spreadsheet allows you to take these other factors into account and illustrates that you should be borrowing less for a home than those who do not pay tithes and offerings.

Home Loan Comparison with Prepayment and Financing (LT19)

This Excel spreadsheet helps you determine the effective interest rate for multiple home loans; it takes into account the loan amount, interest rate, compounding periods, points, and other fees. In addition, it also calculates the rate, assuming prepayment, after a certain number of years. The spreadsheet also helps you determine how much time and money you will save if you prepay a specific amount of principal each period over the life of your loan.

Debt Elimination Schedule with Accelerator (LT20)

This spreadsheet allows you to input your different debts and interest rates. It then prioritizes that debt based on interest rates and creates a repayment plan based on the minimum payments due each month. This repayment plan is consistent with Marvin J. Ashton's plan in the article "One for the Money." This spreadsheet also allows you to include an accelerator amount and an amount in addition to your normal monthly payments; you will be able to see how long it will take you to pay

off your debt.

Review Materials

Terminology Review

Annual Percentage Rate (APR). The APR is a rate that is generated from a precise calculation specified in Regulation Z. It only takes into account the fees going into the loan and does not take into account the time value of money.

Balloon Mortgages. These are mortgage loans whose interest and principal payment won't result in the loan being paid in full at the end of the term. The final payment, or balloon, can be significantly large. These loans are often used when the debtor expects to refinance the loan closer to maturity.

Buyer's Broker. This is a realtor that works specifically for the buyer and is paid by the buyer. The have a fiduciary responsibility to the buyer and not the seller which is different from the traditional buyer seller broker relationship.

Conventional Loans. These are loans that are neither insured nor guaranteed. They are below the maximum amount set by Fannie Mae and Freddy Mac of $417,000 in 2014 (single family). They require Private Mortgage Insurance (PMI) if the down payment is less than 20%.

Covenants, Conditions and Restrictions (CCRs). These are legal documents that can affect what you can do with any potential homes. These can be quite restrictive as to what you can and cannot do with your home including exterior, landscaping, and other requirements. If you cannot live with the CCRs, don't buy there.

Debt Obligations or Back-end Ratio. This housing affordability 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: Monthly PITI and other debt obligations/ 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

Discount Points: These are payments made by the lender to reduce the interest rate on the loan. They are somewhat similar to prepaid interest. You pay more upfront in points but you will pay less on interest costs in the future. Your challenge is to minimize your overall interest costs, i.e., your effective interest rate.

Down Payment. This is the amount that you pay on the house to reduce the cost of the loan. Generally, lenders like a significant down payment as that indicates that the borrower is not likely to walk away from the loan. Different loans require different down payment amounts, i.e Conventional loans – 20 % recommended (but you can get in with 5%), FHA loans – 3.5%, and VA loans – 0% down payment required.

Good Faith Estimates (GFE). This is an estimate from each lender (not just a Summary) of the likely costs you will likely pay as you complete the loan process. I recommend you get GFEs from each potential lender and compare them.

Home Inspection. This is a service, usually paid for by the buyer, to alert them to potential problems with the home. Many of these problems should be fixed by the seller

prior to purchase and so these problems need to be discovered and disclosed. Don't buy someone's problems.

Housing Expenses or Front-end Ratio. This is a housing affordability ratio that 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: monthly PITI*/monthly gross income <28%. PITI = mortgage principle, mortgage interest, property taxes, and property insurance.

Impound/escrow/reserve accounts. These accounts are that portion of a 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. These may or may not be required by your lender.

Housing Ratios for Christian Savers. As Christians, we have other important obligations that we also pay, i.e., tithing and paying ourselves, i.e., savings. 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: Maximum Monthly Mortgage Payments for Christian Savers Spreadsheet (from the website).

Loan term. This is the duration of the loan. It can be 10, 15, 20 or 30 years depending on your goals and your cash flow situation.

Origination fees: These are the costs and profits made by the mortgage broker for originating the loan.

PITI (Principle, interest, property taxes and insurance). This is the acronym for the separate parts of a typical mortgage.

Piggyback loans. These are two separate loans, one for 80% of the value of the home and one for 20%. The second loan has a higher interest rate due to its higher risk. The second loan is used to eliminate the need for PM Insurance. With a piggyback loan, PMI is not needed, but these are much harder to get now.

Points. Points are fees for a loan. 1 Point is 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). Lenders charge points to recover costs associated with lending, to increase their profit, and provide for negotiating flexibility. You will like have to pay origination points, but buy-down points (to reduce the interest rate on the loan) are purely optional.

Pre-approval. Pre-approval is the process whereby lenders have pull your credit score, looked at your tax records and approve you for a specific amount of a loan. 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). You can borrow up to this pre-approved amount without a problem. Remember however that you do not need to borrow that amount. I recommend you borrow less than that amount.

Pre-paids. These are the expenses put into escrow at closing, usually including real

estate taxes, insurance, and interest.
Prepayment. Prepayment is the process where you repay the loan early, either through paying off the loan or selling the house and then paying off the old loan.
Prepayment Penalties. These are penalties enforced by the lender for prepaying a loan too soon. Prepayment penalties have a stated period of time, i.e., 1, 2, or 3 years the prepayment penalty is in effect, a maximum pay down percentage (MPP), i.e., 6% of the principal per year, and a prepayment penalty if you sell it before, i.e., 6 months interest. With a soft prepayment you cannot within the stated period of time without penalty, refinance at all, sell the loan to family members, or pay down more than your MPP each year. The only way to get out of a soft prepayment penalty is to sell the property to an unrelated party. With a hard prepayment, you cannot within the stated period of time without penalty refinance at all, sell the loan to anyone, or pay down more than your MPP each year. There is no way to get out of a hard prepayment penalty before the defined period without paying the penalty.
Pre-qualified. Pre-qualified is a process where lenders estimate your credit based on information you tell them. I recommend you get pre-approved, not pre-qualified.
Private Mortgage Insurance (PMI). This is an insurance policy the borrower buys to protect the lender from non-payment of the loan. PMI policies are usually required if your down payment is less than 20% of the appraised value.
Realtor or Real Estate Broker. This is a person supposedly trained in the process of selling and buying real estate. You want a realtor that know the market in the area you are looking at. Remember that realtors are paid by the seller, so remember that in your associations. Sellers divide the sales commission (usually 6-8%) between the listing realtor and the buying realtor.
Title Insurance. This is an insurance policy that insures you against errors in the title search, guaranteeing your and your lenders financial interest in the property.
Total Costs Analysis. This is a form of loan analysis that does not take into account the time value of money, but is simple to calculate. To do this, calculate your total new costs and fees from the loan until it is paid off, your total current monthly principal and interest costs remaining without refinancing, your total refinance monthly principal and interest costs. If you will be paying equal or less overall, it likely does not make finance sense.
Underwriting. Underwriting is the process whereby the borrower fulfills the requirement of the lender and the lender funds the loan. It also includes the lender selling the loan and the loan being syndicated and sold to investors.
Upfront costs. These are cost due at the signing of the loan which include closing costs and points, down payment (3-20 percent of the loan amount), and other closing costs including points (3-7 percent).

Review Questions

1. We have been counseled to stay out of debt with the exception of what two things?
2. What are the four options in regards to the home decision?
3. According to the *Handbook for Families*, how much of our take-home pay should we

spend on our total house payment, including taxes, insurance, and maintenance costs?
4. In regard to a home mortgage, what are "points"? Why do lenders charge points?

Case Studies

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 Bill and Brenda's front-end ratio and back-end debt to income ratios for banks (28 percent and 36 percent, respectively) and for savers. What is the amount most banks will lend them (remember that most banks will lend to the lower of the two ratios)?

Case Study 1 Answers

1. Bank Front-End Ratio Calculations at 4.5%
   PITI / Gross Income
   Monthly Income ($60,000 / 12) $5,000
   $5,000 * 0.28% 1,400
   Real Estate Tax (T) and Insurance Payments (I) –200
   Maximum Monthly Mortgage Payment of Principal (P) and Interest (I) 1,200
   Set 4.5% = I, PMT = 1200, N = 30 * 12, PV
   Maximum Amount Bank Will Lend = $236,833

1. Saver Front-End Ratio Calculations at 4.5%
   Income ($60,000 / 12) $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 adjustments, percentages and insurance
   - 5,000 * (1-.216) = $3,920 *.28 – 200 = $898

   Calculate amount based on adjustments
   - Set 4.5% = I, Pmt = 1200, N=30, PV = ?
   - $177,207 Maximum Monthly Mortgage Payment

2. Bank Back-End Ratio Calculations at 4.5%
   (PITI + Debt Expenses) / Gross Income

Monthly Income	\$5,000
\$5,000 * 0.36%	1,800
Real Estate Tax and Insurance Payments (I)	200
Monthly Debt Payments: Car Payment	270
Student Loan	50
Maximum Monthly Principal and Interest	1,280
Set 4.5% = I, PMT = 1280, N = 30 * 12, PV	
Maximum Amount Bank Will Lend	\$252,622

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 projections

    Set 4.5% = I, Pmt = 892, N=30, PV = ?

    \$175,959

Maximum Monthly Mortgage Payments for LDS Borrowers (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 IF	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. LDS adjusted maximum mortgage using Front-end DTI ratio	\$177,207

Maximum Monthly Mortgage Payments for LDS Borrowers (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 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. LDS adjusted maximum payment using Back-end DTI ratio	\$175,959

Application

Since the bank will generally lend the lesser of the two ratios, they would likely be allowed \$236,855.

The saver would adjust his prices downward toward \$180,000.

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

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[1] All Things Cherished Blog, http://allthingscherished.blogspot.com/2008_05_04_archive.html
[2] "The Times in Which We Live," *Ensign*, Nov. 2001, 72
[3] "Preparing for Emergencies," *Ensign*, Dec. 1990, 59