

GREENPATH FINANCIAL WELLNESS SERIES

THE AMERICAN DREAM



"Empowering people to lead financially healthy lives."



TABLE OF CONTENTS

The American Dream	2
Cash Funds Required	2
Setting Financial Goals	3
Creating the Budget	4
Qualifying Ratios.....	5
Shopping for Your Home	6
Real Estate Agents	7
Negotiating the Deal.....	8
Types of Loans	8
Mortgage Specifics	9
Comparing Lenders.....	10
Applying for the Loan	11
Factors Used in Evaluating the Application	12
Closing Your Loan.....	12
Caring For and Enjoying Your Home	14



CHECK YOUR KNOWLEDGE

Look for this icon throughout the workbook for important information.

THE AMERICAN DREAM

For many people, owning a home is a major part of the American Dream. It is a symbol of financial success and stability. It is also a big responsibility—one that you will need to accept for many years to come. Buying a home is the largest purchase most people will ever make. So, where do you start?

Set goals and budget to save the money needed to achieve your *American Dream*.



CASH FUNDS REQUIRED

As a rule of thumb, people can typically afford to buy a home that costs 2½ times their annual income. However, your goal should be to get the smallest mortgage possible.

Let's take a look at the costs and expenses you can expect:

Down Payment

The down payment is the part of the purchase price that a buyer pays in cash. It is not included in the mortgage. There are programs that allow homeowners to buy a home with as little as 0-5% down.

Earnest Money Deposit

The earnest money deposit is used to demonstrate the buyer's serious intent to buy the home. The earnest money deposit is usually between 1-5% of the purchase price (though the amount can vary with local customs and conditions). It becomes part of the down payment, if the offer is accepted. Likewise, it is returned if the offer is rejected by the seller or it is forfeited if the buyer pulls out of the deal.

Closing Costs / Settlement Costs

Closing costs are customary costs above and beyond the sale price of the property that must be paid, to cover the transfer of ownership at closing. Closing costs vary by geographic location and are typically explained in detail to the borrower after submission of a loan application. Examples of closing costs include attorney fees, title insurance, appraisals, points, and property taxes.

Post-Purchase Reserve Funds

The lender might want to see that you have some savings to protect against potential cash flow problems, after purchase. Having a reserve, equal to two to three months' worth of housing expenses, can also give you peace of mind.

Other Costs/Expenses of Ownership

There are several other costs that first-time homebuyers initially overlook. Be sure to include the following, when buying a home:

- Homeowners insurance
- Property taxes
- Commuting costs
- Home maintenance / renovation fees
- Utilities

SETTING FINANCIAL GOALS

Assess your current financial situation, and establish goals to get you on the path to homeownership. Keep in mind that your financial goals should be SMART:

Specific

Measurable

Attainable

Realistic

Timely



A good SMART goal:

"I will set aside \$100 each week, for one year, in order to have a down payment on a new home."

Or


"I will pay \$25 more than the minimum payment on my credit card bill each month, in order to eliminate the debt within 6 months."

CREATING THE BUDGET

A balanced budget will allow you to achieve your financial goals. Be realistic with your housing budget. You don't have to take out a large loan, simply because you were approved for one. The amount you can borrow, and what you can afford to buy, will be based upon a number of factors, including how much you can pay up front and your qualifying ratios. We'll review these items in a later section.

After you make a written plan of where you want your money to be spent, track your expenses to see if your money is being spent according to your plan. As the saying goes, "If you don't watch your money, it will run away from you."

The easiest way to track your spending is to write down your purchases—even the tiny ones—in a notebook that you carry with you. If you're tech savvy, you can also use computer software or an application on your smartphone to aid in your tracking. Tracking your expenses for a few months will most likely be eye-opening, as most consumers tend to underestimate their expenses by approximately 25%.

 **Money Management System**

Expenses	Amount Budgeted Monthly	Track Your Actual Budget				Need to Adjust?	
		Week 1	Week 2	Week 3	Week 4	Actual Total	Over or Under
HOUSING							
First Mortgage / Rent	\$ 1,010.00	1,010.00				1,010.00	0.00
Second Mortgage	\$					0.00	0.00
Property Taxes	\$					0.00	0.00
Home/Rent Insurance	\$ 50.00		50.00			50.00	0.00
Home Owner Fees	\$					0.00	0.00
Other _____	\$					0.00	0.00
UTILITIES							
Gas	\$ 200.00	40.00	50.00	30.00		120.00	-80.00
Electric	\$ 115.00			140.00		140.00	25.00
Telephone Landline	\$ 30.00				30.00	30.00	0.00
Cell phones	\$ 84.00				84.00	84.00	0.00
Internet / Cable	\$ 30.00				30.00	30.00	0.00
Water / Sewage	\$ 15.00	20.00				20.00	5.00
Other _____	\$					0.00	0.00

Amount you *hope* to spend

Amount you *actually* spend

Amount by which your spending needs to decrease

How Much Can I Afford?

If you currently rent, or have a mortgage, you can use this amount to gauge how much you can afford as a new mortgage. While you may be able to get a large loan, make sure the monthly payments fit into your spending plan so you don't become "house-poor." Lenders will qualify you based on your gross (pre-tax) income, but you have to make the mortgage payment from your net (after-tax) income.



Qualifying Ratios

As part of the qualifying process, the lender will use ratio calculations, to determine whether you have adequate income to support the monthly mortgage payments. These calculations are often referred to as debt-to-income ratios. The ratios can vary depending on the type of mortgage you are applying for, and can vary from different lenders.

- **Housing Ratio (Front End Ratio)** – Calculated by dividing your potential monthly mortgage payment, property taxes and homeowners insurance by your gross monthly income.
- **Debt Ratio (Back End Ratio)** – Calculated by dividing all of your monthly debt obligations (potential mortgage payment *and* credit card debt, student loans, auto loans, etc.) by your gross monthly income.

Expected Housing Expenses	Remaining Debt Expenses	Monthly Income	Housing Ratio	Debt Ratio
\$800	\$300	\$3000	0.27	0.37

Examples:

1. *Housing Ratio- \$800 (Housing Expense) / \$3000 (Monthly Income) = .2666 or 27% Housing Ratio*
2. *Debt Ratio- \$1100 (Housing and Remaining Debt Expenses) / \$3000 income= .3666 or 37% Debt Ratio*

If your expected housing or debt ratio is higher than the desired ratios of the lender, you may need to increase your income, choose a less expensive house, or decrease your debt load to fall within the lender guidelines.



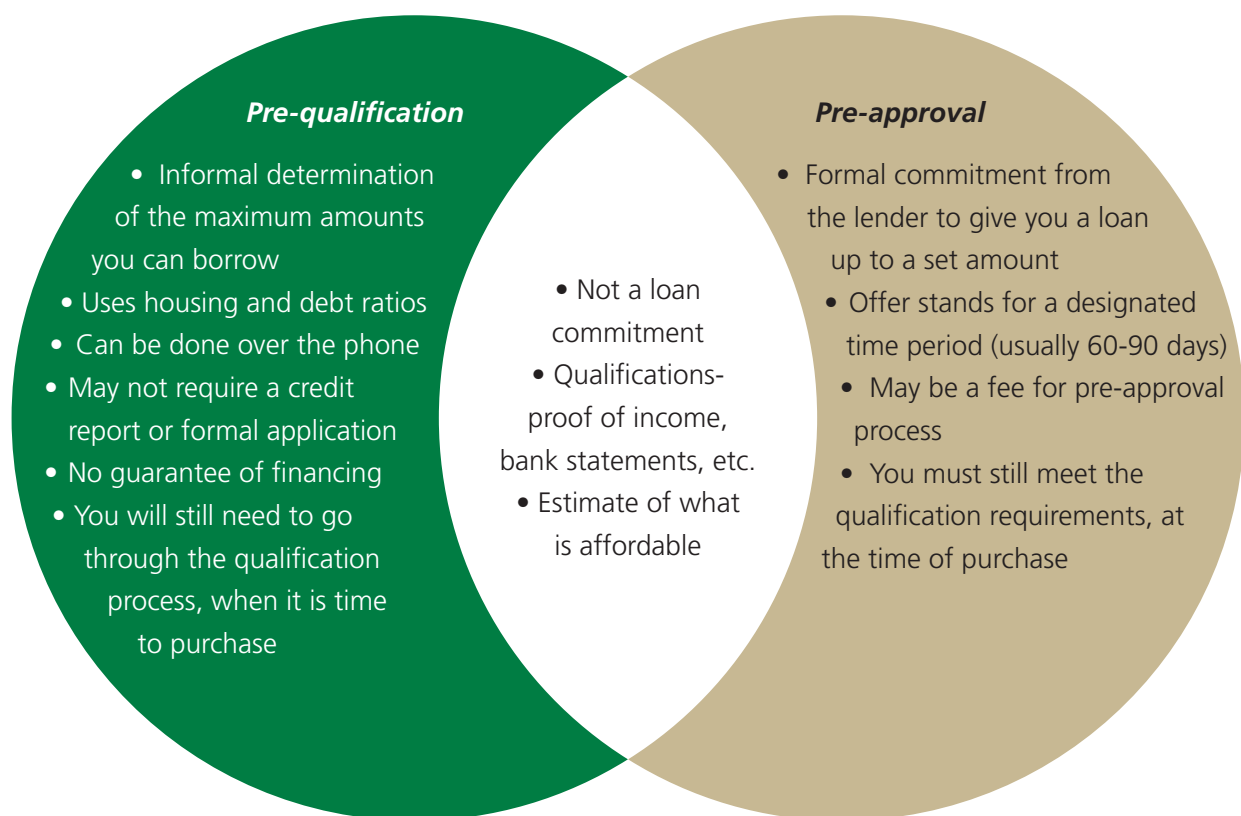
SHOPPING FOR YOUR HOME

Selecting the right house is not merely about your wish list. A big deciding factor may be the amount the lender is willing to loan you. It is important to understand how much you can realistically borrow, prior to falling in love with your dream home.

BEFORE YOU LOOK

Pre-qualification vs. Pre-approval

To get an idea of how much the lender is willing to loan, you may want to get pre-qualified or pre-approved for a mortgage. Although the terms sound similar, there are some key differences:



Factors to Consider

When it comes to buying a home, wants usually far outweigh needs. As a result, flexibility is required, when searching for a suitable house.

What are your top three needs for a home? (For example, *must be no more than 20 minutes from work*)

- 1.
- 2.
- 3.

Real Estate Agents

A real estate agent can be very helpful, in searching for houses and negotiating the purchase price of your new home. If an agent is representing the seller (known as a “seller’s agent”), it may be hard for them to advocate for your rights, as the buyer. Most people find more success with a “buyer’s agent,” who only focuses on the buyer’s interests.

Agent Qualifications

Start by asking family and friends if they can recommend a licensed real estate agent. You can also gather names from “for sale” signs, advertisements and open houses. Look for an agent who listens well, understands your needs and whose judgment you trust.

House Hunting Resources

In addition to your real estate agent, there are other ways to find houses for sale in the community you are interested in. They include:

- Newspaper ads
- Real Estate magazines
- Driving around
- Tax sales
- Foreclosures
- Internet



NEGOTIATING THE DEAL

Negotiating the deal means more than just setting a price for the new home. You may also be negotiating to keep some of the property currently in the home. Items like refrigerators, window shades, screens, and ceiling fans, are often up for negotiation. Be sure to put all negotiations in writing.

Here are some other issues to keep in mind, when negotiating the deal:

- **New Home Inspection**

Choose a home inspector carefully. After the offer is accepted, have them conduct their inspection before the closing. Make sure there is a contingency clause in the contract, in case the inspection reveals problems that need to be taken care of by the seller.

- **Selling Your Present House**

Make the purchase of the new home contingent, or dependent, on the sale of your current home. Otherwise, you could end up paying two mortgage payments – your existing mortgage and the mortgage for your new house.

- **Appraisal**

If the appraisal value comes in lower than the sale price, the difference between the two will need to be made up by either you or the seller. If neither party wishes to pay the difference, the sales agreement should be considered void.

- **Closing Costs**

Usually, both the buyer and seller have closing costs. How those costs are paid is occasionally negotiated between the buyer and seller.



With all these negotiations and clauses, this may be a good time to find a real estate attorney. They can help you negotiate the contract of sale and will represent you in the closing process, which we'll discuss later. Once you've signed the contract, it's time to get your financing in place.

TYPES OF LOANS

Mortgage products vary in their requirements for down payments, qualifying ratios, credit scores and cash reserves. To best understand these products, it is helpful to divide them into two broad categories: conventional loans and government-guaranteed or insured loans.

Conventional Loans

A conventional loan is a private sector loan that is not guaranteed or insured by the U.S. government.

Government Financed/Insured Loans

There are several mortgage products available through federal, state and local agencies.

- **Federal Housing Authority (FHA)** – offers government-backed mortgages through approved lenders. FHA mortgages let you borrow up to 95% of the price of the house.
- **Veteran’s Administration (VA)** – guarantees mortgages for veterans of the armed services, those currently in the armed services and spouses of veterans. VA guaranteed mortgage guidelines are similar to FHA guidelines, except a loan-to-value ratio of 100% is allowed for VA mortgages.
- **Rural Economic Community Development (RECD)** – administers several programs for low to moderate-income families who want to buy new or existing homes in rural areas.
- **State and Local Governments** – offer many homeowner programs for lower income and other underserved households. These programs offer local flexibility and have favorable underwriting and repayment terms.

MORTGAGE SPECIFICS



A mortgage is a type of installment loan that makes a house affordable, by spreading monthly payments over a 15- to 30-year period. Before you apply for a mortgage, you need to understand the characteristics of the various types of loan products available. Be sure to research the details of any mortgage product, to ensure that it will be affordable in the long-term and that it meets your needs.

Adjustable Rate Mortgage (ARM)

An adjustable rate mortgage (ARM) is generally a 15- to 30-year loan with an interest rate that fluctuates (adjusts) periodically, based on market conditions. The time between interest rate adjustments will vary, based on the details of the loan. The fluctuating interest rate can cause the total mortgage payment to increase or decrease. The interest rate on an ARM is often lower than that of the fixed-rate mortgage, because the borrower assumes the risk of the interest rate increasing. Many borrowers are caught off guard, when they don’t pay attention to details about mortgage payments and interest adjustment periods. You should be aware of how often your interest rate could change and the maximum limits of any potential adjustments.

Fixed Rate Mortgage

A fixed-rate mortgage has a fixed interest rate, a fixed principal payment and will be completely paid off over a specified number of years (e.g. 15 years or 30 years).

Hybrid / Convertible Mortgages

Convertible mortgages typically have a fixed interest rate for 3, 5 or 7 years. After a set time, the loan is converted to an adjustable rate mortgage for the remainder of the 15- to 30-year term. Like the ARM, this mortgage also provides lower interest rates in earlier years. However, the unpredictability of interest rates over time could result in a higher monthly payment, when the loan is converted to an ARM.

Escrow

Escrow is an account separate from the mortgage account. Deposit of funds occur for payment of certain obligations that apply to the mortgage, such as homeowners insurance and property taxes. Remember, your property taxes and/or homeowners insurance may increase or decrease, which could change your monthly payment.

Private Mortgage Insurance

Conventional and FHA loans generally require Private Mortgage Insurance (PMI), if the loan-to-value (LTV) ratio exceeds 80%. PMI is insurance written by a private company and it protects the lender against loss, if the borrower defaults on the mortgage.



COMPARING LENDERS

Comparison shopping is a good idea for any major purchase. Call or visit multiple lenders to see which one suits you best. When comparison shopping, keep a list of the company's name and basic information, as well as the type of mortgage, minimum down payment, interest rate and points. Keep in mind that interest rates fluctuate daily, when comparison shopping.

Here are some terms that you should be familiar with, in order to do your evaluation among lenders:

Down Payment

Down payment requirements vary by mortgage. Some lenders require a 5% down payment, while Fannie Mae and FHA both offer programs requiring a 3.5% down payment.

Discount Points

A discount point is equal to 1% of the loan amount. (On a \$70,000 loan, a point would be \$700.) For each discount point purchased, the mortgage interest rate decreases by approximately 0.125%. For example, if you were to buy 2 discount points on a mortgage with an interest rate of 8%, the discount points would decrease your interest rate to 7.75%. The more points required, the more cash is needed at closing, because discount points cannot be financed. Be aware of lenders that charge excessive points and rates and crunch the numbers ahead of time, to make sure it is in your best interest.

Annual Percentage Rates (APR)

The Annual Percentage Rate (APR) is the total yearly cost for the mortgage, stated as a percentage of the loan amount. The APR is a better source for comparison of mortgage costs than the interest rate alone. The APR is generally higher than the interest rate, because it also includes the cost of points, mortgage insurance, and other fees included in the loan.

APPLYING FOR THE LOAN

After your offer has been accepted, and you have identified your lender, your next step is to apply for a mortgage loan.

Bring the following items with you to complete the loan application:

- Pay stubs for the past 2-3 months
- W-2 forms for the past 2 years
- Information on long-term debts
- Recent bank statements
- Tax returns for the past 2 years
- Proof of any other income
- Address and description of the property you wish to buy



During the application process, the lender will order your credit report, as well as a professional appraisal of the property. Within three days of your application, the lender will provide you with a Loan Estimate with important details of the mortgage for which you have applied. Make sure this document reflects what you discussed with your lender. If something looks different from what you expected, ask why. Request multiple Loan Estimates, from different lenders, so you can compare and choose the loan that is right for you.

FACTORS USED IN EVALUATING THE APPLICATION

Lending institutions generally use four key factors, to determine a borrower's qualification for a mortgage loan:

- **Stability of Income**

Lenders want to know that your income is reliable. A long work history shows income stability. If you are self-employed, the lending institution will request previous income tax returns and financial statements for the business.

- **Adequacy of Income**

The lender's assessment of risk is measured by determining whether you have an adequate amount of stable income to support the mortgage payment and other financial obligations. Your monthly income should be high enough to cover a mortgage payment without causing a financial hardship.

- **Sufficient Money to Close**

Another key factor to lenders is the source and adequacy of your funds to close the mortgage. Keep in mind that you are prohibited from borrowing money to close on a mortgage without full disclosure of these intentions to the lender. If you are using gift funds from a family or relative, the lender may ask for documentation from the individual providing the gift.



- **Creditworthiness**

A detailed examination of your credit report will reveal the likelihood that you will repay the lender. The credit report is analyzed, to determine your pay habits and past patterns in meeting financial obligations. You will be asked to provide a statement explaining any derogatory information in your credit report.

CLOSING YOUR LOAN

If you ask most people what they remember about their closing experience, they'll probably say, "All the paperwork!" Closing will be the quickest part of the home buying process, but it will also result in the most documents.



The loan closing may occur at a lender's office, the escrow company, the title company, or at the attorney's office, depending on local custom. You will review the key documents and sign on the dotted line — several times! Be sure to get a copy of all the documents. The seller will then give you the title to the house, in the form of a signed deed. You'll pay the lender's agent closing costs and, in turn, he or she will provide you with a settlement statement of all the items for which you have paid. The deed and mortgage will then be recorded in the state Registry of Deeds, and you will be a homeowner!

Here is a list of some key documents you will receive, at closing:

- **The Loan Estimate** shows the real cost of the mortgage loan.
- **The Title** attests that there are no claims against the property that might jeopardize your ownership.
- **Title Insurance** guarantees the findings of the title search.
- **The Mortgage** is a legal document that describes your agreement with the lender and the amount of the loan.
- **Proof of Insurance** is often required by the lender, as evidence that their collateral is protected.
- **The Loan Note** spells out the terms of your mortgage loan and what happens if you default or pay late.
- **Certificate of Occupancy** attests that the house is safe and habitable.
- **Closing Disclosure** provides disclosures that will help you understand all of the costs of the transaction. It must be provided to consumers three business days prior to the closing.

CARING FOR AND ENJOYING YOUR HOME

Congratulations! You achieved the American Dream and have moved into your new home. Caring for your home after closing is the longest activity in the home-buying process. In fact, it could last a lifetime.

Here are some tips that will help you find success in maintaining your new home:

Consult With the Prior Owner

The best source of information regarding continuing maintenance of your new home is the previous owner. Go through each room with the seller, before you close on the loan, to become familiar with all aspects of the house.

Home Inspection Report

In some instances, you may not be able to consult with the prior owner. This is why holding on to your Home Inspection Report is important. The report may contain information on areas of concern or that need to be addressed to avoid future costly repairs.

Save for Home Maintenance

When you prepare your annual budget, estimate how much you will need to spend on home maintenance and repairs in the upcoming year. Divide that number by 12, and put away that amount of money each month, to save for the expected repairs. On average, you can expect to spend 1% of the home's value on maintenance, each year.

Homeowners Insurance

It is very important to keep hazard insurance complete and up-to-date. Flood insurance is also needed, if you are located in a federal designated flood plain area. You should make sure your hazard insurance policy contains an inflation rider that automatically increases the coverage, as the value of your home increases.

Good Neighbor Policy

A neighborhood is a wonderful place and you are a big part of it. The work that you put into being a good neighbor will help maintain the quality of the neighborhood. Maintain your house, yard and walks. And get involved – participate in neighborhood associations and groups. Most importantly, enjoy your new home.



36500 Corporate Drive
Farmington Hills, MI 48331
248-553-5400 fax: 248-553-8970
www.greenpath.org

