6-3: PURCHASE A HOME

UNIT 6 – ADULTING

WHAT WILL THE AMERICAN DREAM COST YOU?

- Buying a house is probably the most expensive investment you will ever make.
- Market value is the amount of which a house could be sold.

PROPERTY TAXES

- All home-owners pay property taxes, also called real estate taxes.

- The assessed value of the home is an amount used to determine the property taxes.

  Note: The assessed value may not be the same as the market value.

- Property taxes help pay for government services such as schools, libraries, and police.

MORTGAGES

- After making the required down payment, most people take out a loan to pay the balance on their new home. These loans are mortgages. Because interest rates differ, shopping for a mortgage is important.

- Most mortgage loans are paid over 15 to 30 years.

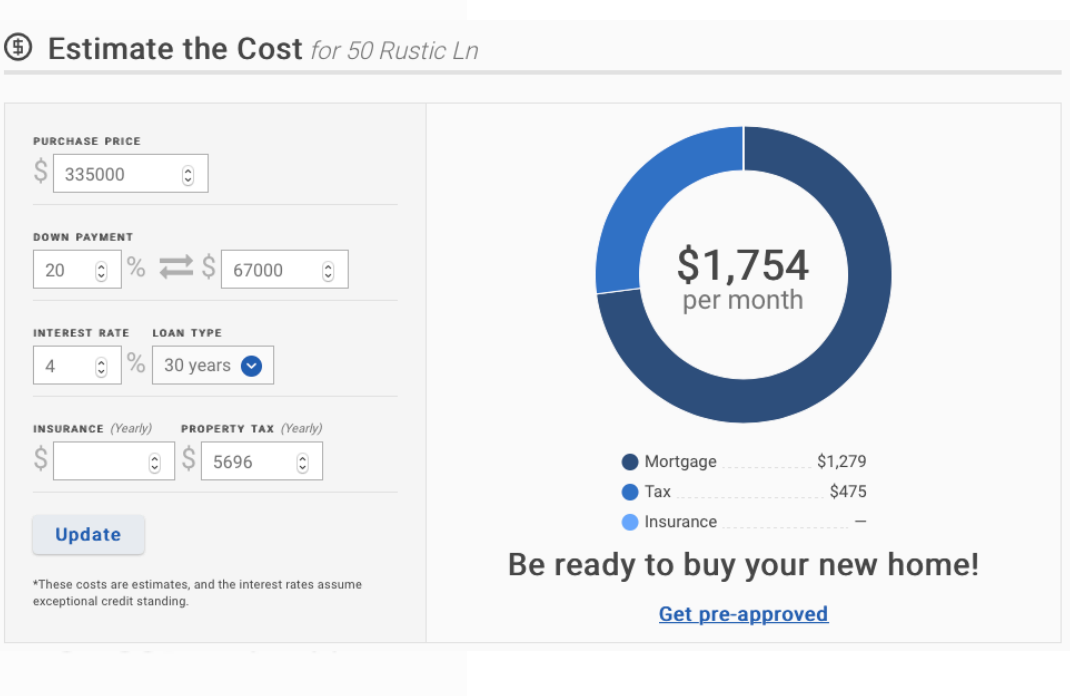
MORTGAGES

Common mortgage vocabulary:

- **Fixed rate mortgage**: a mortgage in which the monthly payment and annual percentage rate (APR) remain the same throughout the entire loan period.
- **Adjustable rate mortgage**: a mortgage in which the monthly payment and the APR may change, as specified in the signed agreement.
- **Foreclosure**: If the homeowner cannot pay the mortgage, the bank takes possession of it and sells it.
- **Homeowner's insurance**: Insurance that covers damage to the home due to fire and other natural disasters. It also covers the contents of the home in case of theft or vandalism.

MORTGAGES

https://www.coldwellbankerhomes.com/me/portland/50-rustic-ln/pid_24393118/



FRONT-END RATIO

- Banks use several factors to decide if they will lend money for a mortgage. One factor is called the front-end ratio. This helps them determine if someone will be able to afford their monthly payments.

- $\text{Front} - \text{End Ratio} = \frac{Monthly\ housing\ expenses}{Monthly\ gross\ income}$

- Banks often want the front-end ratio to be 28% or less before they lend the money.

EXAMPLE 1

Tom and Lori are considering buying a house and are researching the potential costs. Their adjusted gross income is $135,511. The monthly mortgage payment for the house they want would be $1,233. The annual property taxes would be $9,400, and the homeowner's insurance premium would cost them $876 per year. Will the bank lend them $190,000 to purchase the house?

$$\text{Front-End Ratio} = \frac{Monthly\ housing\ expenses}{Monthly\ gross\ income}$$

$$= \frac{2089.33}{Monthly\ gross\ income}$$

Monthly Housing Expenses:

- Mortgage payment: $1,233
- Property tax: $9,400 ÷ 12 = $783.33
- Insurance: $876 ÷ 12 = $73

❖ Total = 1,233 + 783.33 + 73
= $2089.33

EXAMPLE 1

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$$\text{Front-End Ratio} = \frac{Monthly\ housing\ expenses}{Monthly\ gross\ income}$$

$$= \frac{2089.33}{Monthly\ gross\ income}$$

$$= \frac{2{,}089.33}{11{,}292.58}$$

$$= 0.185 = 18.5\ \%$$

Yes!

Monthly Gross Income:

$135,511 ÷ 12 = $11,292.58

BACK-END RATIO

- Another factor that banks use to determine mortgage approval is called the back-end ratio.

- The back-end ratio takes into account someone's regular monthly debts, such as car loans, credit card bills, and student loans.

- $\text{Back} - \text{End Ratio} = \frac{Total\ monthly\ expenses}{Monthly\ gross\ income}$

- Banks generally want a back-end ratio to be less than 36% to approve a mortgage application.

EXAMPLE 2

Bill and Terry are considering buying a house and need to figure out what they can afford and what a bank will lend them. Their adjusted gross income is $166, 988. Their monthly mortgage payment for the house they want would be $1,544. Their annual property taxes would be $9,888, and their homeowner's insurance premium would cost them $1,007 per year. They have a $510 per month car loan and their average monthly credit card bill is $5,100. Would the bank lend them $210,000 to purchase their house?

$$\text{Back} - \text{End Ratio} = \frac{Total\ monthly\ expenses}{Monthly\ gross\ income}$$

$$= \frac{8{,}062}{Monthly\ gross\ income}$$

Monthly Expenses:

- Mortgage payment: $1,233
- Property taxes: $9,888 ÷ 12 = $824
- Insurance: $1,007 ÷ 12 = $84
- Car loan: $510
- Credit card bill: $5,100

❖ Total = $8,062

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Bill and Terry are considering buying a house and need to figure out what they can afford and what a bank will lend them. Their adjusted gross income is $166, 988. Their monthly mortgage payment for the house they want would be $1,544. Their annual property taxes would be $9,888, and their homeowner's insurance premium would cost them $1,007 per year. They have a $510 per month car loan and their average monthly credit card bill is $5,100. Would the bank lend them $210,000 to purchase their house?

$$\text{Back} - \text{End Ratio} = \frac{Total\ monthly\ expenses}{Monthly\ gross\ income}$$

$$= \frac{8{,}062}{Monthly\ gross\ income}$$

$$= \frac{8{,}062}{13{,}916} = 0.579 = 057.9\%$$

Monthly Income:

- $166,988 ÷ 12 = $13,916

No.

COSTS OF OWNING A HOME

- One of the biggest concerns for a prospective homeowner is the costs in both the immediate and the distant future. These costs are in two categories: recurring costs and non-recurring costs.
    - Recurring costs are the costs that occur on a regular basis. Examples: mortgage payments, insurance payments, property taxes.
    - Non-recurring costs are one-time costs. Examples: moving costs, closing costs

THE COSTS OF OWNING A HOME

- The closing is a meeting attended by the buyer, seller, their attorneys, and a representative of the lending institution. The official sale takes place at this meeting. The buyer is responsible for paying any closing costs (which differ from state to state).

CLOSING COST EXAMPLES

- Earnest Money Deposit (good faith deposit): money paid to the seller to show that the buyer is serious about buying the house
- Attorney Fees & Points (extra fees charged by the lending institution for the use of their money)
- Title: legal claim of property ownership
- Transfer Tax: a fee charged for the transfer of the title from the seller to the buyer.

CLOSING COST EXAMPLES

- Prepaid Interest: the amount of mortgage interest due to cover the time from the closing date to when the first mortgage payment is due.
  - *Example*: if you close on the 10th day of a 30-day month, you will need to prepay 20 days of interest at the closing.

- Rule of thumb: closing costs typically run between 2% and 7% of the purchase price.

EXAMPLE 3

Leah and Josh are buying a $600,000 home. They have been approved for a 7.25% APR mortgage. They made a 15% down payment and will be closing on September 6th. How much should they expect to pay in prepaid interest at the closing?

First, determine how much they borrowed.

Down Payment = $600,000 × 0.15= $90,000

So, loan amount = $600,000 – $90,000 = $510,000

EXAMPLE 3

Leah and Josh are buying a $600,000 home. They have been approved for a 7.25% APR mortgage. They made a 15% down payment and will be closing on September 6th. How much should they expect to pay in prepaid interest at the closing?

Their first mortgage payment will be due on October 1st. They will have to prepay interest from Sept 7th – Sept 30th (24 days).

To determine the *annual* interest, multiply the APR times the amount borrowed.

$$0.0725 \times \$510{,}000 = \$36{,}975$$

To determine the *daily* interest, divide the annual interest amount by 365.

$$\$36{,}975 \div 365 = \$101.30$$

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Leah and Josh are buying a $600,000 home. They have been approved for a 7.25% APR mortgage. They made a 15% down payment and will be closing on September 6th. How much should they expect to pay in prepaid interest at the closing?

Since they will have to prepay interest for 24 days, multiply the daily interest amount by 24.

$$\$101.30 \times 24 = \$2{,}431.20$$

EXAMPLE 4

What might Leah and Josh expect to pay in total at the closing?

- closing costs typically run between 2% and 7% of the purchase price.

Purchase price = $600,000

2% of purchase price = $600,000 × 0.02 = $12,000

7% of purchase price = $600,000 × 0.07 = $42,000

They can expect to pay between $12,000 and $42,000 at the closing.