Your Own Home

FDIC Financial Education Curriculum

Welcome

1. Agenda
2. Ground Rules
3. Introductions

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Objectives

- **If you are a pre-homebuyer:**
  - Explain the advantages and disadvantages of renting versus owning a home
  - Identify questions to ask to determine your readiness to buy a home
  - Identify the steps required to buy a home
  - Identify basic terms and required disclosures used in a mortgage transaction

Objectives

- **Pre-homebuyers:**
  - Describe the advantages and disadvantages of different mortgage options
  - Describe how interest rates affect the amount of house you can buy
  - Explain how taxes and insurance affect a monthly payment and the amount of house you can buy

Objectives

- **If you are a homeowner:**
  - Describe the advantages and disadvantages of borrowing against a home
  - Explain what to do if you are having trouble making payments
  - Describe different types of refinancing options
  - Explain the advantages and disadvantages of a reverse mortgage
  - Identify predatory lending practices and loan scams

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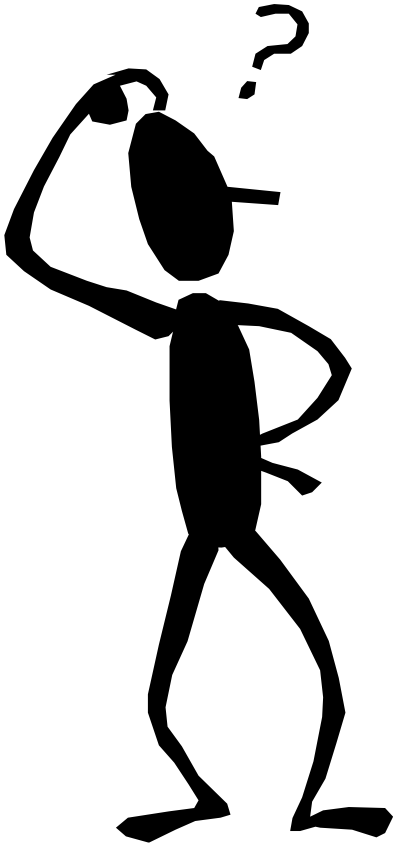
What Do You Know?



What do you know or want to learn about buying or owning a home?

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Renting a Home

- **Advantages:**
  - No property maintenance
  - Rental contract 1 year or less
  - No homeowner associated costs
- **Disadvantages:**
  - You are not the owner
  - Your rent might increase
  - You might not be able to renew your contract

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Owning a Home

- **Advantages:**
  - Building equity and borrowing against it
  - Good investment
  - Tax-deductible mortgage interest
  - Asset you can pass on to family members
- **Disadvantages:**
  - Property maintenance and upkeep
  - Not as easy to move as renting
  - Risk of losing your home

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Five Steps to Buying a Home

1. Determine your readiness to buy a house
2. Determine how much mortgage you can afford
3. Determine which mortgage option is best for you
4. Qualify for a loan
5. Go through settlement

Meet Patricia

- **Patricia…**
  - Is a medical technologist
  - Makes $49,200/year, or $4,100/month
  - Is currently living with her parents
  - Wants to know more about home ownership

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Step 1: Readiness to Buy A House

- **Do you have:**
  - A steady source of income?
  - Good credit history?
  - Ability to pay debts, mortgage, and other additional costs?
  - Plans to move within 2 to 3 years?
  - Money for a down payment and closing costs?

Down Payment and Other Expenses

- **Down payment:**
  - Typically 20% of the purchase price
  - Smaller down payment options may be available (e.g., 3% of purchase price)
- **Other expenses:**
  - Household emergencies, repairs, and other expenses
  - Private Mortgage Insurance (PMI)

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Mortgage Payments

- Include principal and interest
- May include PMI, property taxes, and homeowners insurance
- Should be no more than 28% of your income

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Other Questions to Ask Yourself

- Where do you want to live?
- What kind of neighborhood do you want?
- If you have children, what types of schools should be in the neighborhood?
- How much space do you need?

Activity 1: Is Patricia Ready to Buy a House?

Complete Activity 1 in the Participant Guide.

1. Read the scenario.
2. Answer the question.
3. Be prepared to explain your answer.

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Homebuyer Assistance Programs

- **For programs in your area, check with:**
  - Your lender, real estate agent, or local government about homebuyer assistance programs
  - A local Housing and Urban Development (HUD)-approved homeownership counseling agency

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Characteristics of Government Programs

- Low down payment requirements
- Flexible underwriting standards
- Longer payment terms
- Homeowner education requirement

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Fair Housing Act

- **Prohibits discrimination in housing-related transactions on the basis of:**
  - Race
  - Color
  - Religion
  - Sex
  - National origin
  - Family status
  - Handicap status

EQUAL HOUSING OPPORTUNITY

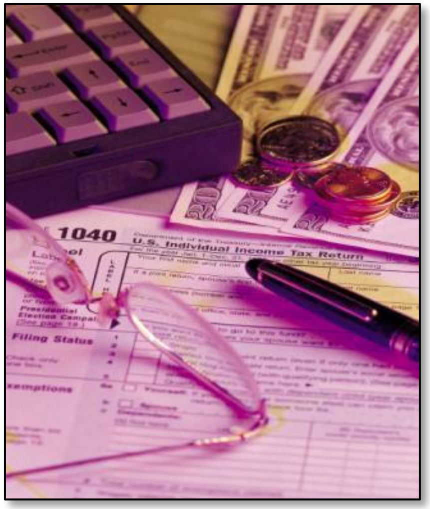
Activity 2: Does Patricia Have Enough Money for a Down Payment?

Complete Activity 2 in the Participant Guide.

1. Read the scenario.
2. Answer the question provided.
3. Be prepared to share your answer.

Mortgage Terms

- **PITI:**
  - **P**rincipal
  - **I**nterest
  - **T**axes
  - **I**nsurance
- **PMI**



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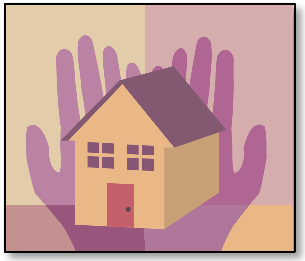
How Taxes and Insurance are Paid

- **Through escrow account**
  - The Real Estate Settlement Procedures Act (RESPA) limits amount required to be held in escrow account.
- **Separately**
  - You are responsible for periodic payments.



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Four Cs of Loan Decision Making

Four factors lenders use to qualify you for a loan:

- Capacity
- Capital
- Character
- Collateral

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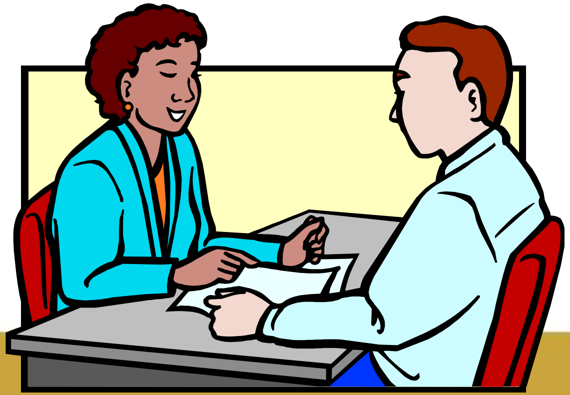
Step 2: Determine How Much Mortgage Can You Afford

- **Pre-qualification:**
  - Lets you know how much mortgage you can afford
- **Pre-approval**
  - Commitment from the lender to lend you money



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Patricia's Pre-Qualification

- **Pre-qualified for $165,000**
- **Rule of thumb estimate:**
  - 2 to 3 times their household income:

    $49,200 x 2 = $ 98,400
    $49,200 x 2.5 = $123,000
    $49,200 x 3 = $147,600
- **Consider what you can afford if you qualify for more!**

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Debt-to-Income (DTI) Ratios

- **Front-End Ratio:**
  - PITI or housing expenses should generally be less than 25–28% of your monthly gross income.
- **Back-End Ratio:**
  - Housing expenses + long-term debt should be less than 33–36% of your monthly gross income.

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Activity 3: How Much Mortgage Can Patricia Afford?

Complete Activity 3 in the Participant Guide.

1. Read the scenario.
2. Answer the questions.
3. Be prepared to share your answer.

Mortgage Terms

15-Year Mortgage	30-Year Mortgage
• Borrow less money because of larger monthly payments	• Borrow more money because of lower monthly payments
• Build equity faster	• Build equity more slowly
• Less interest to pay	• Can deduct more interest from income tax
• Lower interest rate	• Higher interest rate

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Mortgage Type

Fixed-Rate Mortgage	Adjustable-Rate Mortgage
• Interest rate cannot increase • Payments are predictable • Interest rates could go below your set rate	• Interest rate can increase or decrease • Rates may be low for only an initial period • Monthly payments may initially be lower than fixed-rate loans, but can increase significantly

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Step 3: Which Mortgage Option Is Best for You

- Fixed-rate mortgage
- Adjustable-rate mortgage (ARM)
- Interest-only mortgage
- Biweekly payment mortgage

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Interest-Only Mortgages

- Pay only the interest, not the principal, for a fixed term (e.g., 5 to 7 years)

- **After the fixed term, you can:**
  - Refinance
  - Pay the balance in a lump sum
  - Start monthly mortgage payments toward the principal

Benefits of Interest-Only Loans

- **A good choice if you:**
  - Do not plan to live in your home for more than the interest-only period
  - Have modest current income that will go up in the future
  - Are trying to resolve credit issues so that you can refinance into a lower fixed rate

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Pitfalls of Interest-Only Loans

- **Payments:**
  - May not cover all of the interest owed, prevents you from building equity
  - Can become unaffordable after the interest-only period
    - You may incur refinancing costs if you can no longer afford the payments.

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Biweekly Payment Mortgage

- A fixed-rate conventional mortgage with payment due every 2 weeks

- **Alternative: Add more money to your monthly payment**
  - Make sure your lender does not charge a prepayment penalty

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Shop, Compare, Negotiate

- Check newspapers and the Internet for terms and rates
- Negotiate your best price
- Let lenders compete for your business
- Get costs in writing
- Use the APR and GFE to compare all costs

Good Faith Estimate

- Settlement services cost estimate
- Given to you when you apply for the loan

- **Keep your GFE to compare with the final settlement costs**
- **Ask the lender questions about any changes**

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Mortgage Shopping Worksheet

- **Federal law requires the lender or broker to:**
  - Disclose estimates of how much the loan will cost and the APR (Truth in Lending Disclosure)
  - Give you an estimate of closing cost fees and the money required at closing (GFE)

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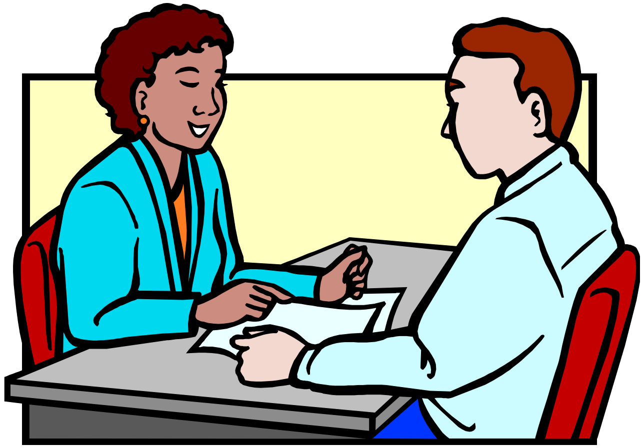
Step 4: Qualify For a Loan

- Obtain pre-qualification and pre-approval
- Include homeowner's association dues when calculating your housing expenses



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Activity 4: Does Patricia Qualify for a Loan?

Complete Activity 4 in the Participant Guide.

1. Read the scenario.
2. Answer the question provided.
3. Be prepared to share your answer.

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Debt-to-Income (DTI) Exceeds Recommended Ratios

- **You might still qualify for a loan if you:**
  - Have ability to pay more toward housing expenses
  - Show evidence of sustained, good credit history
  - Make larger down payment
  - Have cash reserves

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Step 5: Go Through Settlement

- **Settlement:**
  - Sign documents to finalize the sale of the house and any mortgage financing.
  - Right to review the settlement statement at least 1 day before closing.

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Having Trouble Making Payments?

- Contact your lender immediately
- Get help from a trained reputable housing counselor at no charge or for a small fee

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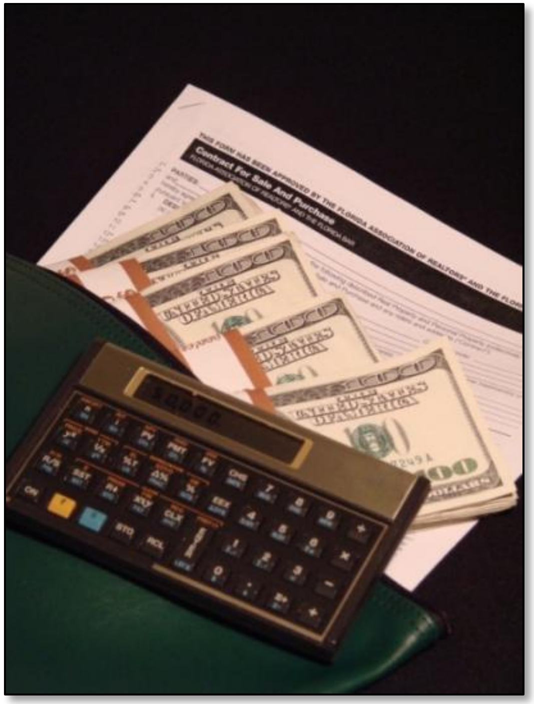
Tapping Into Your Home's Equity

- Home equity loans
- Home equity lines of credit (HELOC)
- Refinancing and cash-out refinancing
- Reverse mortgages



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Home Equity Loans

- One-time loan for a lump sum
- Typically at a fixed interest rate
- Equal monthly payments over a set period of time

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Home Equity Lines of Credit

- **Works like a credit card:**
  - Draw from the line of credit as needed
  - Repay the principal and available credit goes up again
- **Interest rates are typically variable**

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Advantages of Home Equity Options

- Flexibility to finance major expenses
- Lower interest rate than credit cards
- Tax-deductible interest

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Home Equity Options Risks

- **Home is collateral**
- **Housing values can decrease**
- **Rates/payment may increase**
- **Temptation to use the money for unwise investments or purchases**
  - Use caution and self-discipline

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Your Rights Under Federal Law

- **You have 3 business days after signing loan papers to cancel the deal without penalty.**
  - Must cancel the deal in writing
  - Lender must return any fees or finance charges you paid
  - Does not apply if you are buying a home or refinancing without borrowing additional money

Refinancing Options

- ***Refinancing:*** **pay off an existing home loan replace with a new loan.**
- ***Cash out refinance loan:*** **can borrow more money than owed on the loan to be replaced.**

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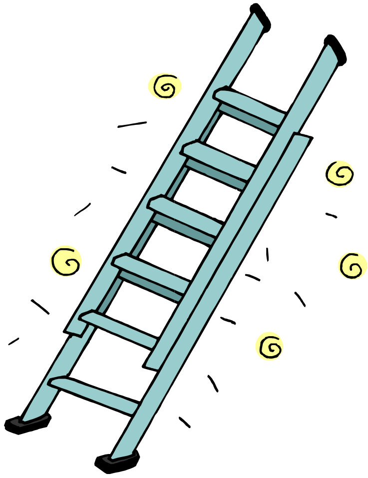
Cash-Out Refinancing Example

- **Current Mortgage: $100,000 at 9.95%**
- **Owe a total of $87,000**
- **Monthly payment: $873.88**
- **Want $20,000 for improvements**



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Cash-Out Refinance Example

Option 1:

- Refinance $107,000 ($87,000 + 20,000)
- Interest rate: 6.02%
- Monthly payment: $642.90 x 30 years
- Total = $231,442.40

Option 2:

- Refinance $87,000 at $522.73 x 30 years
- Home equity loan: $20,000 at 7.36% x 20 years
- Total = $226,440.75

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Reverse Mortgage

- **Borrowing against home equity to receive cash:**
  - In a lump sum
  - Through monthly payments
  - As a line of credit you can tap when needed
- **Homeowners must be at least 62 years old.**
- **At least one owner must live in the house most of the year.**
- **Home type must be eligible.**

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Reverse Mortgage Considerations

- **Must repay loan + interest when you sell, move, or die.**
  - Amount owed increases over time.
- **Continue to pay property taxes, insurance, and repair costs.**
- **Heir must repay the loan to keep the house.**
- **Up-front costs make the first years of the loan relatively expensive.**

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Predatory Lending Practices

Marketing tactics, collection practices, and loan terms that deceive and exploit borrowers

Department of Housing and Urban Development

- **Funds:**
  - Post-home ownership course
  - Housing counseling agencies
- **Contact HUD for a list of HUD-approved housing counseling agencies:**
  - 1-800-569-4287
  - www.hud.gov

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Summary

- What final questions do you have?
- What have you learned?
- How would you evaluate the training?

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Conclusion

- **You learned about:**
  - Renting versus owning your home
  - The steps required to buy a home
  - Questions to determine if you are ready to buy a home
  - The components of a mortgage
  - Different mortgage options for buying a home
  - Tapping into your home's equity
  - Pitfalls and dangers of unwise mortgage refinancing

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