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Cloverleaf Realty, Inc.'s **Home Buyers Handbook**

SECTION 1: Thinking About Buying a Home?

Buying a home can be one of the most rewarding experiences of a lifetime — and one of the most stressful. After all, a home mortgage loan is the largest contract most of us will ever sign. Add to that the unfamiliar terminology and the endless stacks of legal documents, and it's not surprising that many people are confused by the whole experience.

But buying a home doesn't need to be a headache. In fact, with a little preparation and the right attitude, it can even be fun.

Can You Afford a House?

Perhaps you know people who bought homes and now complain about being "house poor." That's because they underestimated what they needed for home payments, maintenance and other expenses. While some people don't mind making sacrifices to own a home, you don't have to be unpleasantly surprised later if you take the time now to figure out what you can *comfortably* afford. We've provided some formulas and worksheets in this chapter to help you.

In general, experts say you can afford a home that costs about 2 1/2 times your yearly income. Income can include salary, dividends, Social Security benefits, public assistance payments and alimony. To accurately estimate what you can afford with your income, you'll need to answer the following four questions:

- * How much can you afford to spend for monthly home loan payments?
- * How much money do you need each month to meet other obligations? (Consider utilities, home maintenance, medical bills, groceries, entertainment and all other expenses.)
- * How much cash have you saved for a **down payment*** and other costs? (You usually need a minimum of 3 percent of the total loan amount in cash. If you're a U.S. veteran, the **Veterans Administration (VA)** may offer you a loan with no down payment.)
- * How much will you need for home **closing costs**? (These are the costs involved in transferring ownership. Usually they should be no more than 2-4 percent of the total amount of your loan.)

[Pre-qualify for a Loan:](#)

Pre-qualifying is a process lenders use to give you a quick evaluation of your credit-worthiness and the maximum loan amount for which you are likely to qualify. In most cases, this is not approval, but rather it's a snapshot of your finances that gives you a ballpark figure to work with.



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You may decide to set aside more for expenses. Even before you have a specific house in mind, you can meet with a lender to find out how much you qualify for. You don't need to spend as much as a loan officer says you can afford, but it's a good way to determine the *maximum* amount you should spend. And remember, prequalifying with one lender does not obligate you to get your loan from that lender. *Don't sign any paperwork that would obligate you at this point.*

In the meantime, you can get an idea of what size loan you might qualify for by going through the worksheet on Page 6.

Before you fill out the Loan Qualification Worksheet on Page 6, learn these industry numbers:

28% / 36%

Lenders offering **conventional loans** (loans not backed by the government) don't want you to take out a loan you can't afford. Generally the lender won't allow you to spend more than 28 percent of your gross income on home loan payments. Also, they usually won't allow you to pay more than 36 percent of your gross monthly income toward all your long-term debts combined, including your home loan payment, car and student loans, credit card payments, day-care costs, child support and alimony. Lenders sometimes refer to these as "28/36 ratios." However, with the increasing use of automated underwriting, lenders are more willing to consider compensating factors in evaluating your loan, so these ratios are subject to some variation. Your lenders can assist you in more accurately determining the loan amount for which you may qualify.

29% / 41%

The federal government also guarantees certain loans made by private lenders. Uncle Sam wants to encourage home ownership, so the Federal Housing Administration (FHA) offers relaxed guidelines that let people with higher debt ratios and smaller down payments qualify for loans. With an **FHA loan** you can spend a higher percentage of your income on housing and still get a loan. Your home payment can be as high as 29 percent of your income, and your monthly debt payments (including your home payment) can be as high as 41 percent of your income.

Terms to Know:

Long-term debt: Anything you owe and are paying back on a schedule of six or more months. Long-term debt usually includes your mortgage loan payment, car and student loans, credit card payments, day-care costs, child support and alimony.

Gross income: Your total income before taxes are taken out. Besides wages, this can include income such as alimony, child support and public assistance.

PITI: Principal, interest, taxes and insurance _ all of which make up your monthly payment.



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Principal: The total amount you are borrowing to pay for a home. This is usually the purchase price minus the down payment.

Interest: A lender's charge for the loan.

Taxes: Property taxes usually are included in your monthly payment.

Insurance: You must purchase homeowner's insurance to protect your property against damage. The payment may be included in your monthly loan payment.

You may also have to pay for mortgage insurance, which protects the lender in case you **default**, or don't make your payments on your loan.

• **Step 1:** Estimate Your Maximum Home Payment

Gross Monthly Income \$2,500 _____

Multiply by

.28% (conventional loan) \$700 _____

or .29% (FHA loan) or \$725 _____

The number you came up with is your *maximum monthly home payment*.

• **Step 2:** Estimate Your Maximum Long-Term

Debt Payment Allowed by a Lender

(This is how large your monthly debt payments can be. This includes a house payment, credit card payments, car and student loans and other monthly debts. If you're applying for an FHA loan, add in monthly day-care costs, if you have any.)

Gross Monthly Income \$2,500 _____

Multiply by

.36% (conventional loan) \$900 _____

or .41% (FHA loan) or \$1,025 _____

This is the maximum total monthly debt payment a lender will allow, including housing.



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If your monthly debt payments are higher than 36 or 41 percent of your gross income (depending on whether you're applying for a conventional or an FHA loan), talk to loan officers about ways you can reduce your long-term debt. Or, you may choose to delay buying a home until you've paid off more of your debts.



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Monthly Payment Tables

for loans that fully pay off the debt over the loan term

Term of Loan: 30 years

AMOUNT FINANCED**	Interest Rate*							
	5%	5.5%	6%	6.5%	7%	7.5%	8%	8.5%
\$30,000	161.05	170.34	179.87	189.62	199.59	209.76	220.13	230.67
\$40,000	214.73	227.12	239.82	252.83	266.12	279.69	293.51	307.57
\$50,000	268.41	283.89	299.78	316.03	332.65	349.61	366.88	384.46
\$60,000	322.09	340.67	359.73	379.24	399.18	419.53	440.26	461.35
\$70,000	375.78	397.45	419.69	442.45	465.71	489.45	513.64	538.24
\$80,000	429.46	454.23	479.64	505.65	532.24	559.37	587.01	615.13
\$90,000	483.14	511.01	539.60	568.86	598.77	629.29	660.39	692.02
\$100,000	536.82	567.79	599.55	632.07	665.30	699.21	733.76	768.91
\$125,000	671.03	709.74	749.44	790.09	831.63	874.02	917.21	961.14
\$150,000	805.23	851.68	899.33	948.10	997.95	1,048.82	1,100.65	1,153.87
\$175,000	939.44	993.63	1,049.21	1,106.12	1,164.28	1,223.63	1,284.09	1,345.60

Term of Loan: 15 years

AMOUNT FINANCED**	Interest Rate*						
	5%	5.5%	6%	6.5%	7%	7.5%	8%
\$30,000	237.24	245.13	253.16	261.33	269.65	278.10	286.70
\$40,000	316.32	326.83	337.54	348.44	359.53	370.80	382.26
\$50,000	395.40	408.54	421.93	435.55	449.41	463.51	477.83
\$60,000	474.48	490.25	506.31	522.66	539.30	556.21	573.39
\$70,000	553.56	571.96	590.70	609.78	629.18	648.91	668.96
\$80,000	632.63	653.67	675.09	696.89	719.06	741.61	764.52
\$90,000	711.71	735.38	750.09	784.00	808.95	834.31	860.09
\$100,000	790.79	817.08	843.86	871.11	898.83	927.01	995.65
\$125,000	988.49	1,021.35	1,054.82	1,088.88	1,123.54	1,158.77	1,194.57
\$150,000	1,186.19	1,225.63	1,265.79	1,306.66	1,348.24	1,390.52	1,433.48
\$175,000	1,383.89	1,429.90	1,476.75	1,524.44	1,572.95	1,622.27	1,672.39

* Annual % rate, or APR, will be somewhat higher.

** Loan plus other costs to be paid monthly.

Figure Out What You Can Afford

Now that you know the amount a loan officer says you can afford to pay each month for a loan, double-check the figures. In other words, be skeptical. Use the worksheet below to figure out what you can *comfortably* afford to spend each month. This time, write down *all* your expenses



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(including the money you'd like to set aside for a retirement fund, travel or any other items you feel you can't do without).

Reality Check! Household Income/Expense Worksheet

Step 1: Your Monthly Income

Add the following:

Household income

After deductions _____

Interest and dividends _____

Other income _____

Total Monthly Income = _____

Step 2: Monthly Non-Housing Expenses

Add the following:

Food and supplies _____

Clothing _____

Medical bills, including

Insurance premiums _____

Life insurance _____

Disability insurance _____

Automobile expenses:

• Car loan _____

• Insurance _____

• Gas _____

• License _____

• Routine maintenance _____

• Parking _____

Education:

• Student loans _____

• Current classes _____

• Books _____

Travel _____

Recreation _____

Credit card payments _____

Child support you owe _____

Alimony you owe _____

Telephone bill _____

Dues, fees, subscriptions _____

Personal expenses _____



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Savings and investments _____ **Total Non-Housing Exp =** _____
Income taxes _____

Step 3: Monthly Housing Expenses

Estimate and add the following:

Mortgage loan payment _____
(Principal and Interest)

Property taxes _____
(Check with the county assessor for a rough estimate)

Mortgage insurance _____
(Estimate at 3 1/2 percent of the loan amount for roughly seven years. After you have 20 percent equity in your home, lenders must allow you to drop mortgage insurance.)

Homeowner's insurance _____
(Includes liability, flood, fire and any other)

Utilities _____
(Heat, Water, Electricity, as)

Garbage removal _____

Maintenance and repairs _____
(Usually 1 percent of the value of the home annually)

Other _____
(such as **assessments**, condominium association dues and any others)

Estimate of Total Monthly Housing Expenses = _____

Add the total in Step 2 to the total in Step 3 to arrive at your estimated expenses. Compare this to your income in Step 1. If your estimated expenses are higher than your income, you have some adjustments to make. You either need to lower your expenses or lower your expectations of what you can afford in a home.

How will you come up with a down payment?

You'll probably need at least \$2,000 to \$3,000 to cover the up-front costs, including the down payment. Here are some suggestions:

Save Now, Buy Later. Watch your spending habits. Don't take on any new long-term debt. Start putting as much money as you can in a savings account or another fund each month.

Gifts. If possible, ask a relative for a gift of money. Why? First, because loans are counted as long-term debt. The more long-term debt you have, the harder it is to qualify for a loan. Second, because lenders want you to sink some of your own money into the house so you're less likely to walk away from the investment. Lenders may question whether gifts for down payments are



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really loans in disguise, so anyone offering a money gift will have to sign a "gift letter" verifying that you won't have to pay it back.

Low-interest down payment loans. Check with lenders or the city where you want to buy a home. Some offer loans to first-time buyers to help them make down payments.

What do lenders want from you?

You may think you know what you can afford in a home, but will a lender agree? Lenders can seem like your best friends or your worst enemies when buying a home. They're your key to qualifying for a home loan, and you need to impress them with your responsibility. They *want* to give you a loan — that's how they earn their money — but they *have* to make sure you can pay it back, too!

Lenders usually want you to have at least two years of stable employment and a record of paying your bills on time. To check the financial data you give them, they will get your credit report from a credit bureau. It is well worth your time to get a copy of your credit report in advance to be sure it doesn't hold any unpleasant surprises. (To find out how to get your report, see Page 36.)

A credit reporting agency will give your credit report a **credit score**, which will help determine what kind of mortgage you qualify for. If you've paid your bills on time and don't owe a large amount of money, you will have a high credit score. If your credit record isn't perfect, you will get a lower credit score and may only qualify for a loan with a higher rate of interest than the best rate available.

Mortgages are also marked with a grade, such as "A," "B," "C" or "D." For example, the higher your credit score is, the higher the grade of "paper" you qualify for and the lower amount of interest you have to pay. An "A" paper mortgage loan is considered a **prime mortgage** and a grade of "B" or lower is called a **sub prime mortgage**. Ask your mortgage lender if they are offering you a prime or sub-prime loan. Some lenders may specialize in sub-prime lending and try to sell you their product even though you might qualify for a prime loan. If you believe you should qualify for a prime mortgage, be sure to comparison shop with a company that provides them.

If your finances haven't been stable, you often can take steps to rebuild your credit record and become a better credit risk. Call your bank or a non-profit consumer credit counseling agency to see if it offers a course on re-establishing credit. Or, go over your records with a mortgage lender for suggestions.

If you have a question or concern about a mortgage lender, contact the Minnesota Department of Commerce at 651-296-4026 or 1-800-657-3602.

Here are the key questions lenders will ask:



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Do You Have Stable Employment?

You must have a steady income and your current or future employer will have to confirm the amount of your income and verify that he or she expects to employ you long term.

Are You Self-Employed?

If you're self-employed — or paid on straight commission — you must verify that you've had a steady income for two to three years running. You must supply tax returns and profit/loss statements for these years.

Have You Ever Declared Bankruptcy?

* If you declared bankruptcy more than two years ago, you may still qualify for a home loan. But you will want to prove that you have since established good credit. To establish credit, use your credit cards and pay the bills on time. It is ironic, but true, that lenders would rather have you prove you can go into debt and pay it off on time, than see you pay for everything in cash.

What is Underwriting?

Ultimately, you're going to have to convince a lender that you're worthy of a loan. A lender may tell you that underwriters will make this decision. The loan officer and loan processor do most of the screening and qualifying by collecting information. The underwriter reviews the file, assesses the risks and gives a final stamp of approval. Lenders don't like bad risks, so they will carefully analyze your records to answer these questions:

*Will you be able to make your loan payments for the foreseeable future?

*Does the value of the home you want to buy justify the amount of money you want to borrow?

If the answer to both questions is yes, a lender is likely to approve your loan.

Gather These Records

Your lender needs about six weeks to collect, review and verify all of your financial records. All you can do is wait and perhaps answer a few more financial questions. You cannot close on a home until the underwriting process is complete and you are approved for a loan. Start collecting the following records for your loan application as soon as possible.

For the past 10 years

* All former addresses, including zip codes.



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For the past two years

- * Names and addresses of employers.
- * All sources of income (include recent pay stubs or copies of checks as proof of income).

Liabilities

Provide up-to-date information on payments you've made and what you still owe on the following:

- * Auto loans (include lenders' addresses, loan numbers and balances).
- * Credit cards (include account numbers and balances).
- * Installment loans (include addresses, account numbers and balances).
- * Alimony and child support payments you owe (include a copy of the divorce decree and any child care provider costs).

Assets

Provide information on any of the following resources you have:

- * Bank accounts (include bank address, account numbers and balances).
- * Automobiles (include years, makes and estimated values).
- * Stocks and bonds.
- * Furniture and personal property value estimate.
- * Market value of any real estate.
- * Other assets and their value (include cash value of whole life insurance).
- * Vested interest in a pension or other retirement plan.
- * Alimony and child support payments that you receive.

If you are self-employed

- * Corporate tax returns for the past two years if your business is incorporated.
- * Personal tax returns for the past two years.



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* Year-to-date profit and loss statement.

* Balance sheets for the year to date.

Other

* Driver's license (photocopy).

* Social Security number.