Your Own Home

FDIC Financial Education Curriculum
Welcome

1. Agenda
2. Ground Rules
3. Introductions
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
What Do You Know?

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

• Include principal and interest
• May include PMI, property taxes, and homeowners insurance
• Should be no more than 28% of your income
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.
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
Characteristics of Government Programs

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

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

• **PMI**
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.
Four Cs of Loan Decision Making

Four factors lenders use to qualify you for a loan:

- Capacity
- Capital
- Character
- Collateral
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
Patricia’s Pre-Qualification

• Pre-qualified for $165,000

• Rule of thumb estimate:
  • 2 to 3 times their household income:
    $49,200 \times 2 = \$98,400$
    $49,200 \times 2.5 = \$123,000$
    $49,200 \times 3 = \$147,600$

• Consider what you can afford if you qualify for more!
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.
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

<table>
<thead>
<tr>
<th>15-Year Mortgage</th>
<th>30-Year Mortgage</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Borrow less money because of larger monthly payments</td>
<td>• Borrow more money because of lower monthly payments</td>
</tr>
<tr>
<td>• Build equity faster</td>
<td>• Build equity more slowly</td>
</tr>
<tr>
<td>• Less interest to pay</td>
<td>• Can deduct more interest from income tax</td>
</tr>
<tr>
<td>• Lower interest rate</td>
<td>• Higher interest rate</td>
</tr>
</tbody>
</table>

FDIC Financial Education Curriculum
## Mortgage Type

<table>
<thead>
<tr>
<th>Fixed-Rate Mortgage</th>
<th>Adjustable-Rate Mortgage</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Interest rate cannot increase</td>
<td>• Interest rate can increase or decrease</td>
</tr>
<tr>
<td>• Payments are predictable</td>
<td>• Rates may be low for only an initial period</td>
</tr>
<tr>
<td>• Interest rates could go below your set rate</td>
<td>• Monthly payments may initially be lower than fixed-rate loans, but can increase significantly</td>
</tr>
</tbody>
</table>
Step 3: Which Mortgage Option Is Best for You

• Fixed-rate mortgage

• Adjustable-rate mortgage (ARM)

• Interest-only mortgage

• Biweekly payment mortgage
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
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.
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
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
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)
Step 4: Qualify For a Loan

• Obtain pre-qualification and pre-approval

• Include homeowner’s association dues when calculating your housing expenses
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.
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
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.
Having Trouble Making Payments?

• Contact your lender immediately

• Get help from a trained reputable housing counselor at no charge or for a small fee
Tapping Into Your Home’s Equity

• Home equity loans
• Home equity lines of credit (HELOC)
• Refinancing and cash-out refinancing
• Reverse mortgages
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
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**
Advantages of Home Equity Options

• Flexibility to finance major expenses
• Lower interest rate than credit cards
• Tax-deductible interest
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
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.
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**
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
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.
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.
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](http://www.hud.gov)
Summary

• What final questions do you have?

• What have you learned?

• How would you evaluate the training?
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