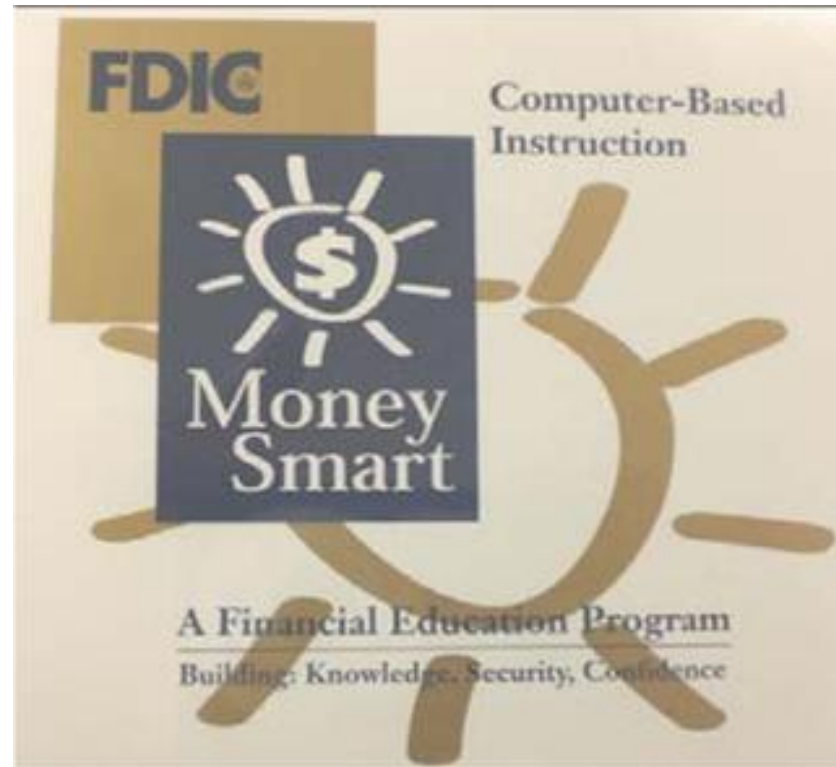


# A Roof Over Your Head

Dr. Debra Sherrill  
Central Piedmont Community College

# FDIC Money Smart Program



# Learning Outcomes

- ▶ Describe the benefits and pitfalls of renting versus owning a home.
- ▶ List the steps required to obtain a mortgage loan.
- ▶ Identify mortgage options

# Class Outline

- I. Introduction to financial terms
- II. To rent or to own?
- III. Steps involved with obtaining a mortgage loan.

# Part I

## Introduction to Financial Terms



# Mortgage Lending

- ▶ Mortgage lending is the process by which real estate is used as collateral for a loan.
- ▶ A mortgage is a legal document in which a one party pledges real estate as security for the payment of a debt.
- ▶ The mortgage is the “security instrument” by which the lender records its rights to the property.
- ▶ Upon satisfactory repayment, the lender will release its rights to the property, known as a satisfaction of mortgage.

# The Note

The written document that disclosed the terms of the debt and is the written promise to pay. This is the “signed IOU” that includes the following:

- ▶ The date
- ▶ The loan amount
- ▶ The interest rate and if it can change
- ▶ The amount of the payment
- ▶ The due date of the first payment and future payments
- ▶ The frequency of payments or balloon date
- ▶ The maturity date of the loan
- ▶ Where to send the payments
- ▶ A prepayment penalty (if applicable)
- ▶ Specific clauses

# Part II

## To Rent or to Own?



# Advantages to Renting

- ▶ Property maintenance is the responsibility of the landlord.
- ▶ Contract period may be from month-to-month or annually.
- ▶ Not responsible for real estate property taxes.
- ▶ Rental insurance is cheaper than homeowner's insurance.
- ▶ Can easily move to another location at the end of the lease.

# Renter's Insurance

- ▶ Protects your belongings if there is a fire or theft in the property being rented.
- ▶ Earthquake and/or flood insurance may also be available.
- ▶ The landlord's policy does NOT protect the renter.

# Disadvantages of Renting

- ▶ You are not the owner of the property and lease may contain restrictions.
- ▶ Rent may increase substantially.
- ▶ You may not be able to renew the rental contract, which requires you to find a new place to live.

# Advantages of Owning a Home

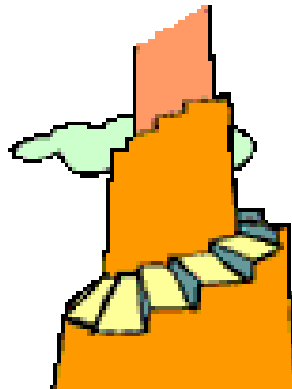
- ▶ You can build equity and this is an asset.
- ▶ Can borrow against the home.
- ▶ Over time, homes typically increase in value.
- ▶ Property may be rented to others.
- ▶ One loan is paid in full, the home is yours.
- ▶ Currently, real estate taxes and mortgage interest are tax deductible.
- ▶ The home can be willed to others upon your death.

# Disadvantages of Owning a Home

- ▶ Not easy to sell and re-locate to a new residence.
- ▶ Owner is responsible for all maintenance and repairs.
- ▶ Owner is responsible for:
  - Homeowners' insurance
  - Flood / Earthquake insurance
  - Real estate taxes
  - HOA dues
- ▶ You can lose your home and your investment.

# Part III

## Steps Involved with Obtaining a Mortgage Loan



# Step 1: Determine if you are ready

- ▶ Do I have a steady source of income?
- ▶ Is my employment steady?
- ▶ Is my income reliable?
- ▶ Do I have a satisfactory credit history?
- ▶ Do I have a good record of paying bills?
- ▶ Will I be able to pay all bills and other debts?
- ▶ Do I have the assets required for down payment, closing costs, and reserves.

# Homebuyer Assistance Programs

## Government Programs & Non profits

- ▶ These may help with down payment assistance and closing costs.
- ▶ May require home-buying and financial education courses.

# Four C's of Underwriting

- ▶ **Capacity:** Your present and future ability to repay the loan and meet all debt obligations.
- ▶ **Capital:** The value of your assets and net worth.
- ▶ **Character:** Your credit history and willingness to repay debt.
- ▶ **Collateral:** The property securing the loan.

# Step 2: Determine how much you can afford

- ▶ Pay stubs
- ▶ W2s (last two years)
- ▶ Tax returns (last two years)
- ▶ Asset and liability information
- ▶ Recent bank and asset statements
- ▶ Proof of any additional income: must show stability of receipt and continuance
- ▶ Disclosure of any additional liability not showing on credit report (such as child support, alimony, and separate maintenance)
- ▶ Housing and debt ratios

# Housing debt includes

- ▶ Principal & interest
- ▶ 1 / 12 of annual tax bill
- ▶ 1 / 12 of annual homeowner's insurance
- ▶ 1 / 12 of annual mortgage insurance, if applicable
- ▶ 12 of annual flood insurance, if applicable
  
- ▶ HOA dues (monthly amount due when applicable)
- ▶ Ground rent (monthly amount due when applicable)

# Consumer Debt

Consumer Debt = all monthly payments required for:

- ▶ Car loans
- ▶ lease payments
- ▶ personal loans
- ▶ student loans
- ▶ credit cards

**Warning: “Consumer debt” does not include all monthly obligations!**

# Housing Debt Ratio

- ▶ **Housing Debt Ratio =**

Housing debt

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Total gross monthly income

X 100 = %

**Your housing debt ratio should not exceed 30%.**

# Total Debt Ratio

▶ Debt Ratio =

Housing debt + consumer debt

$$\frac{\text{-----}}{\text{Total gross monthly income}} \times 100 = \%$$

**Your total debt ratio should not exceed 40%.**

# What other expenses may have to paid each month?

- ▶ Electric / gas bills
- ▶ Water / Sewer
- ▶ Telephone/ cell phone
- ▶ Cable / Satellite / Internet
- ▶ House maintenance
- ▶ Food & clothing
- ▶ Child care & school
- ▶ Gas, car insurance, tag renewal, taxes, & maintenance
- ▶ Medical & dental expenses
- ▶ Medical & life insurance
- ▶ Beauty & skin care
- ▶ Entertainment & restaurants

Housing Expenses

Personal Expenses

# Warning

**Loan approval does NOT**

**mean that you**

**can “safely”**

**afford the new credit!**



# Step # 3: Determine which Mortgage Option is Best for You

- ▶ Fixed rate 30 or 15 years term
- ▶ Adjustable rate mortgage (many choices)
- ▶ Balloon payment
- ▶ Bi-weekly payment plans
  
- ▶ FHA, VA, USDA, conventional
  
- ▶ Second mortgages

Share, compare, and negotiate!

# Amortization Options

## **Fixed rate:**

- Interest rate is fixed for the life of the loan.

## **Adjustable rate mortgage (ARM):**

- Interest rate can change during the life of the loan.

## **Balloon:**

- The entire balance will become due at a pre-specified time in the loan.

# VA Loans

- ▶ VA loans are **guaranteed** by the Department of Veterans Affairs (VA).
- ▶ They are part of the benefits provided to veterans under the Servicemen's Readjustment Act of 1944.
- ▶ To obtain a VA loan, borrowers must meet eligibility requirements and have a certificate of eligibility (COE) issued by the VA to show the amount of available entitlement.
- ▶ The amount of entitlement will be used to determine the maximum loan amount and possible down payment.

# VA Loans

- ▶ VA loans have specific qualifying requirements.
- ▶ Borrowers must fully document income and assets with a total debt ratio not to exceed 41%.
- ▶ VA also offers a streamline refinance program, which allows the borrower to refinance without re-qualifying.
- ▶ The property must meet VA specifications and Condos /PUD properties need VA approval.
- ▶ VA loans are assumable by another but new borrower must qualify.
- ▶ Borrowers must also meet residual requirements.

# FHA Loans

- ▶ Are insured through HUD (the Department of Housing and Urban Development).
- ▶ Congress created the Federal Housing Administration in 1934 and the program was designed to promote homeownership by allowing minimal down payments while insuring lenders against financial losses due to borrower default with required mortgage insured premiums.
- ▶ FHA loans have specific loan amounts based on county limits, which may be found on the website.
- ▶ FHA loans also have specific approval requirements for the property including condos and PUDs.

# FHA Loans

- ▶ FHA loans have more flexible underwriting guidelines than VA loans.
- ▶ Borrowers do not have to have eligibility or entitlements.
- ▶ FHA loans are assumable by another but the new borrower must qualify.
- ▶ FHA also offers a streamline refinancing program, which allows the borrower to refinance without re-qualifying.
- ▶ FHA also provides special programs such as those for first-time homebuyers.
- ▶ FHA loans require the borrower to pay mortgage insurance (MIP).

# USDA / Rural Housing

- ▶ USDA Rural Development programs are aimed to meet the needs of rural areas through loans, loan guarantees, and grants.
- ▶ Direct loans or guarantees may be available to public entities such as municipalities, counties, and special-purpose districts, as well as to non-profit corporations and tribal governments.
- ▶ Applications for loans are handled by USDA Rural Development field offices.
- ▶ Qualifying standards will include both the borrower and property requirements.

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# Conventional Loans

- ▶ Loans that are neither guaranteed nor insured through a government agency are typically known as conventional loans.
- ▶ Most conventional loans are purchased in the secondary market by Fannie Mae or Freddie Mac.
- ▶ A loan that meets Fannie Mae or Freddie Mac underwriting standards is referred to as a “conforming loan”.
- ▶ Both Fannie Mae and Freddie Mac have specific underwriting standards that must be met in order for the loan to be purchased.
- ▶ Lenders may utilize an automated underwriting system (AUS) such as Fannie Mae’s DU (“Desktop Underwriter” or Freddie Mac’s LP (“Loan Prospector”) as a tool to determine if the loan conforms to underwriting standards.

# Second Mortgages

Fixed second mortgage

Home equity line of credit (HELOC)

- ▶ Second mortgages tend to have higher interest rates and shorter terms than first mortgages.
- ▶ Lenders may even allow borrowers to combine a first and second mortgage for closing.

# Additional Items

- ▶ Bi-weekly payment programs typically require set-up plus monthly fees.

You can accomplish the same goal without fees by paying more to principal each month.

- ▶ Don't ever let hazard insurance lapse. Forced-placed policies only protect the lender and the premiums that you will pay are substantially higher with no owner coverage.
- ▶ Most mortgages have acceleration and alienation ("due on sale") clauses.

# Step # 4: Qualify for a Loan

- ▶ Credit history
- ▶ Credit score
- ▶ Employment stability and income
- ▶ Down payment / LTV
- ▶ Housing and debt ratios
- ▶ Asset requirements for down payment, closing costs, prepaid expenses, and reserves.
- ▶ Property requirements
- ▶ Citizenship

# Step# 5: Go Through Settlement

- ▶ Settlement agent reviews documents with the parties.
- ▶ All closing documents must be signed
- ▶ Appropriate funds provided to the settlement agent
- ▶ Required documents must be recorded.
- ▶ Settlement agent disburses funds accordingly.
- ▶ Ownership transfers on a purchase.

# Learning Outcomes

- ▶ Describe the benefits and pitfalls of renting versus owning a home.
- ▶ List the steps required to obtain a mortgage loan.
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# Renting

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- ▶ Rental insurance is cheaper than homeowners' insurance.
- ▶ Can easily move to another location at the end of the lease.
- ▶ You are not the owner of the property and lease may contain restrictions.
- ▶ Rent may increase substantially.
- ▶ You may not be able to renew the rental contract.

# Owning a Home

- ▶ This is an asset and it can appreciate in value.
- ▶ You can gain equity and borrow against the home.
- ▶ Property may be rented and once paid in full, home is yours.
- ▶ Real estate taxes and mortgage interest are tax deductible.
- ▶ The home can be willed to others upon your death.
- ▶ Not easy to sell and re-locate to a new residence.
- ▶ Owner is responsible for maintenance, repairs, insurances, and HOA.
- ▶ You can lose your home and your investment.

# Steps in obtaining a mortgage loan

1. Determine if you are ready to buy a house.
2. Determine how much you can afford.
3. Determine which mortgage option is best for you.
4. Qualify for a loan
5. Complete the settlement and closing.

# Mortgage Options

- ▶ Fixed rate 30 & 15 years
- ▶ Adjustable rate mortgage (many choices)
- ▶ Balloon payment
- ▶ Bi-weekly payment plans
  
- ▶ Conventional, FHA/VA/USDA
  
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