

Buying a Home 101

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We are currently witnessing a financial crisis that is primarily the result of bad home loan decisions on the part of both individuals and bankers. At a time when housing prices were increasing at a tremendous rate, banks could taste the profits associated with giving loans to families who did not understand the financial commitment they were signing their names to. To avoid falling into the same pattern, when thinking about buying a home it is imperative that you understand all of the terms of the loan and that you are sure that the loan payments fall within your budget.



CAN YOU AFFORD THIS HOUSE?

Tables 1 and 2 provide information on purchasing a \$200,000 home. It looks as though the best option, if you can afford the higher monthly payment, is the 15-year conventional loan. You pay the least amount of interest. The worst option is the 10/1 adjustable rate mortgage (ARM); even though your monthly payment is low, you will pay approximately \$300,000 in interest.

TERMS AND TIMELINES

Fixed Rate Loans (Conventional)

- **15 years**—paid in full in 15 years
- **30 years**—paid in full in 30 years

Adjustable Rate Loans

- **10/1**—Rate remains fixed for the first 10 years and then will readjust every year at the prevailing market rate for the remainder of the loan.
- **5/5**—Rate remains fixed for the first 5 years and then will readjust every 5 years at the prevailing market rate.
- **1**—Rate changes every year at the prevailing market rate.

Balloon Loans

- **5 year**—Interest rate remains fixed for 5 years and at the end of 5 years the loan must be paid in full or refinanced at prevailing rate.

INTEREST RATES

- **Adjustable Rate**—An interest rate that changes periodically in relation to an index. Payments may increase or decrease accordingly.
- **Fixed Rate**—Rate remains the same throughout the entire term of the loan.

continued

Table 1. Examples of different terms for conventional loans.

	Down Payment	Closing Costs ¹	Principal + Interest (5.5%)	Total Monthly Payment ²	Total Interest Paid
15 year	10%	\$24,500	\$1,471	\$1,736	\$84,735
	20%	\$44,500	\$1,307	\$1,532	\$75,320
30 year	10%	\$24,500	\$1,022	\$1,346	\$187,927
	20%	\$44,500	\$908	\$1,135	\$167,047

¹ Down payment, 1 year taxes, insurance, title fees, appraisal, application, fee, etc.

² Principal + interest + taxes + insurance + PMI.

Table 2. Examples of different terms for adjustable rate mortgages, 30 years.

	Down Payment	Closing Costs	Principal + Interest		Total Interest Paid
			During Fixed Term (5.5%)	After Fixed Term (4.5% - 6.5%)	
10/1	10%	\$24,500	\$1,045	\$930 - 1,117	\$293,069 - 340,138
5/3	10%	\$24,500	\$1,022	\$925 - 1,123	\$115,532 - 301,578

- **Annual Percentage Rate (APR)**—The cost of credit on a yearly basis, expressed as a percentage. Includes up-front costs paid to obtain the loan, and is, therefore, usually a higher amount than the interest rate stipulated in the mortgage note. Does not include title insurance, appraisal, and credit report.

OTHER CHARGES

- **Closing Costs**—Origination fee, application fee, discount points, attorney's fees, title insurance, land survey, house appraisal, and any items which must be prepaid, such as taxes and insurance escrow payments.
- **Hazard Insurance**—A contract between a purchaser and an insurer to compensate the insured for loss of property due to hazards (fire, hail damage, etc.) for a premium.
- **Insurance**—Home insurance purchased through a separate entity, based on the value of your home and the properties of the home that make it safe and secure.
- **Points**—The amount paid to maintain or to lower the interest rate charged. Each point is equal to 1 percent of the loan amount. You will **pay** for points at closing.

- **Private Mortgage Insurance (PMI)**—Insurance purchased by the borrower to insure the lender or the government against loss should you default. When you have accumulated 20 percent of your home's value as equity, your lender may waive PMI at your request.
- **Property Taxes**—An annual payment you make to your county based on a percentage of the value of your home. It will be, on average, about 1 percent of the value of your home. The value may change based on an appraiser's assessment.

You should expect to pay approximately **\$2,000** in closing costs **PLUS** taxes and insurance. Some banks will negotiate and offer deals on closing costs. Read the small print to see what they are including in closing costs. They cannot include your taxes and insurance, which you normally must pay for a full year up front.

RURAL HOUSING GOVERNMENT PROGRAMS

Single-Family Home Loan Program (Section 502)—A low-interest loan directly from the USDA Rural Development to a prospective homeowner who cannot afford regular mortgages but can afford to repay a low-interest loan on a "modest" home.

Self-Help Loan Program—Assists groups of six to eight families or individuals who want to build their own homes with professional supervision. The loan qualifications are the same as the regular direct single-family housing program. Participants must attend meetings and spend free time working on their new homes. All participants work on each other's houses, and the homes are all built at the same time.

Home Repair Loan and Grant Program (Section 504)—Available to lower income people who would rather stay in their present homes but can't afford the needed repairs. The government makes repair loans up to \$20,000 at 1 percent interest rate.

Rural Rental Program—Finances apartments for lower income people who may not otherwise be able to afford decent housing. Most tenants pay no more than one-third of their income for rent.

Kentucky Programs—Programs specific to Kentucky include:

- Farm Labor Housing Loan
- Housing Preservation Grants
- Guaranteed Single-Family Home Loan Program

For more information visit http://www.rurdev.usda.gov/ky/rural_housing.htm.