

Buying a home

Personal finance guide



Common home purchasing rules of thumb

Targets to Aim for:

A **down payment** of at least 20% of the home purchase price to avoid having to pay “Private Mortgage Insurance,” or PMI (PMI is a type of mortgage insurance that lenders require when homebuyers put down less than 20% of the home’s purchase price and will increase the cost of your monthly payments).

A **“back-end ratio”** below 36% (the highest ratio a borrower generally can have to still obtain a qualified mortgage). Your debt-to-income ratio = monthly debt payments divided by gross monthly income. This includes mortgage, credit card bills, loans, child support and other debt requiring regular payments.

A **“front-end ratio”** of 28% or less. This number is the sum of your housing expenses (monthly mortgage payment, real estate taxes, home insurances, etc.) divided by your gross income.

A **“loan-to-value ratio”** of 80% or less. This is your expected mortgage amount divided by the appraised property value. It is what lenders use to evaluate their risk prior to approving a mortgage.

A **credit score** of at least 680 or higher. and check your credit report for errors 12 months prior to applying for a loan to allow time for correcting any errors.

Many of these common rules of thumb help ensure that there is enough discretionary income to meet one’s other obligations and to assess the “risk” of a home purchase for both the potential homeowner and mortgage lender.

In addition, some things to keep in mind:

- ➔ The money you use for your **down payment** ≠ **your emergency savings** fund.
- ➔ Aim for staying in the home at least 5 years as a **general** rule of thumb to help recoup some of your purchasing costs and build up equity in the home.
- ➔ Home-buying costs include: inspection, title search, appraisal, survey and origination fees. These typically add up to 2-5% of the home’s sales price.
- ➔ Set aside 1% of the home’s value per year for **annual home maintenance**. If possible, set this aside in an account that is separate from your regular checking account and your emergency savings account.
- ➔ Build in additional initial costs including: furniture, new car, unexpected repairs, as well as ongoing new expenses including: potentially higher transportation costs, landscaping, and utilities.
- ➔ To be prudent, consider a home as an expense that needs to work within your current cash flow, rather than an investment or asset. Avoid stretching into a home that does not work within your present budget.
- ➔ Once you purchase your home, create a system for organizing your home improvement receipts and records for **keeping track of cost basis**.

Mortgage pre-approval checklist



- **Tax Returns:** Two most recent federal and state returns
- **Income Verification:** Copies of W-2 forms and two recent payroll stubs. If self-employed, a YTD profit and loss statement and two years of financial records. For real estate income, documentation of rental income, current market value of property if you need use of this income to qualify.
- **Proof of employment:** List of employers for the last two years (minimum).
- **Proof of residence:** List of where you have lived for the last two years (minimum).
- **Bank Statements:** Statements for every account whose assets you'll be using to qualify for the mortgage (from 60 days or later).
- **Brokerage/Retirement Accounts:** Statements (from 60 days or later).
- **Monthly debt payments:** List all monthly debt that will be used to calculate your debt-to-income ratio.
- Most recent **mortgage statement**, if applicable.
- **Rent:** Payments for the last year and contact information for landlords over last two years, if applicable.
- **Down Payment:** Sources of the money you plan to use, including gift letters if applicable.
- **Divorce:** Divorce Decree and any court orders for child support and alimony.
- **Purchase Agreement or Real Estate Contract:** Will need this for final underwriting and approval once you've made an offer on a house to show the agreed upon price. Later, this will also need to be accompanied by an appraisal.
- **Military:** If you served in the military, you may be eligible for a VA Home loan, which may offer a lower interest rate.

Important questions to consider

Tax

Will your mortgage exceed \$750,000?

If you purchased your home after December 15, 2017, you can only deduct interest on the first \$750,000 of the mortgage (\$375,000 if married filing separately).

Will property and state income taxes exceed \$10,000?

Note that you will not be able to deduct any amount over \$10,000 under the current federal tax code. Also note that the home mortgage interest deductions require that you itemize deductions on your tax return. Please consult your tax advisor on the best course of action for your specific circumstances.

Once you purchase the home, make sure you keep a record of home improvement costs.

These costs can be added to your cost basis and can impact your calculated taxable gains upon the sale of your home.

Estate planning

Should the home be owned by you, with a spouse/partner, or by a trust?

Will the home purchase require you to update your will and/or estate plan?

Insurance

Do you need to review your property and casualty insurance as a whole? Are the deductions and riders appropriate?

Consider bundling your home, auto, and if needed, umbrella policy together under one company, and review your coverages.

Are there any life insurance implications in light of your new assets/liabilities?

Home purchase worksheet

Down payment _____ or _____% down

Back-end ratio _____%

Front-End ratio _____%

Loan-to-value ratio _____%

Credit scores _____

Additions to expenses/budget:

Amount needed annually for home maintenance: \$ _____

Additional closing costs: \$ _____

One-time costs (e.g. furniture, repair, decoration): \$ _____

On going expenses to add to the budget:

Lawn/landscape _____

Transportation _____

Utilities _____

House cleaners _____

Security System _____

Other/misc. _____

For more information about managing your cash flow and budgeting, please contact us – we're here to help.

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