

Deciding to Buy Your First Home

Overview

Things to think about when deciding whether to buy a home.

- The pros and cons of home ownership
- Looking at your lifestyle
- Determining whether you can afford a home

Buying a home is more than a large purchase. It can be a significant milestone as well. To many people, buying a home means they're ready to lay down roots and plan for the future. And in many cases, it is a sound financial investment. But home ownership is not for everybody. Owning property can be expensive and time-consuming. Some people would rather use their money for other things, or simply don't want to be tied down to a home. Before making the decision to buy a home, it's a good idea to carefully examine your financial situation and your feelings about home ownership.

The pros and cons of home ownership

How can you tell whether you're ready to buy a home, and if you are, whether this is the right time for you? To help you decide, look at the advantages and disadvantages of home ownership and examine whether owning a home meshes with your lifestyle and your goals.

Advantages of owning a home

- *You save on taxes.* Property tax and the interest you pay on your mortgage are deductible from your income taxes.
- *You build equity.* Equity is the difference between your home's appraised value and the amount you owe on the mortgage. Your equity in a home is likely to increase over time as you pay off the principal and if your home's market value increases. You can tap into your home equity in a financial emergency.
- *Your monthly housing costs could remain more or less consistent over the years.* With a fixed-rate mortgage, your monthly payments will always be the same. Although property taxes may increase, you won't have to worry about a landlord raising the rent.
- *You will have more control over your environment.* As a homeowner, you are free to do what you want with your property as long as you don't violate local zoning laws or home association regulations. You can remodel, bring home a pet, and landscape your yard without asking a landlord for permission.

Drawbacks of home ownership

- *The initial cost is high.* Buying a home often requires a large amount of money up front, including the down payment, closing costs, and other fees.

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- *You are responsible for maintaining your property.* As a homeowner, you are the one who pays for repairs and keeps your property maintained. There is no landlord to repair a leaky roof or replace a defective furnace.
- *You may feel tied down by your home.* It's easier to pick up and move when you're a renter. If you or your partner are transferred, or if you simply want to live somewhere else, you'll either have to sell your house or find a tenant to rent it.
- *You assume financial risk.* While property values historically rise over time, there is always a risk that the value of your home will decrease. You can help protect yourself from this by researching your purchase thoroughly before signing off on the deal.
- *You're responsible for making mortgage payments.* Missing payments can ruin your credit and quickly escalate into serious financial problems.

Looking at your lifestyle

Next, take a critical look at your lifestyle. This is an important step in figuring out if this is really the right time to think about buying a home. Consider the following questions:

- *Are you secure in your job?* Do you foresee any career changes in the next few years that may cost you or your partner income? Are you both relatively certain that you will continue earning the same or higher salaries? If not, will you still be able to afford a monthly mortgage payment?
- *Do you expect to move within the next five years?* If you plan on moving because of military duty or job relocation, it may make sense to hold off on buying a new home. Generally it takes three to five years to build enough equity in your home to recoup the up-front costs of buying a new home, such as the down payment and closing costs.
- *Are you facing a big expense?* Are you planning to go back to college? To attend graduate school? If you are, it might make more sense to defer the costs and responsibilities of owning a home until you've completed your degree.
- *Will the money you spend on a home prevent you from doing things you love?* Are you a traveler who enjoys vacations to faraway places? Do you have expensive hobbies? Is it worth it to you to buy a home and give up these activities for a few years until you rebuild your cash reserves?
- *Will owning a home make you feel secure or will it make you feel tied down?* Your answer to this question will reveal whether you feel emotionally ready for home ownership.

Determining whether you can afford a home

For most people, a home is the largest purchase they will ever make. It's easy to become overextended financially and end up in debt or worse. Ideally, you will be able to comfortably afford the costs associated with home ownership.

- *How much can you afford to pay each month?* In addition to a mortgage, your monthly housing costs will include property taxes and homeowners insurance. If your down payment is less than 20 percent of the home's price, your lender will require you to buy private mortgage insurance as well. Depending on the type of mortgage you seek, a lender will allow you to spend 28 to 35 percent of your gross monthly income on housing costs.
- *How much long-term debt do you have?* Lenders also factor in the money you owe when looking at your mortgage application. Your long-term debt may include college loan payments, car payments, and credit card debt. A lender may limit long-term debt plus monthly housing costs to 36 to 45 percent of your gross monthly income.
- *Can you comfortably afford other costs of home ownership?* In addition to your monthly housing costs, be sure to factor in other expenses including maintenance, repairs, and furnishings. Condominium owners should factor in home association fees as well.
- *How much can you afford for a down payment?* Most lenders require a down payment of 5 to 20 percent of the home price. For low-down-payment loans, you will need 3 percent. (You must qualify for low-down-payment loans, and usually end up paying a higher interest rate and additional up-front fees such as the cost of private mortgage insurance.) Some lenders will approve a mortgage with no down payment to home buyers with excellent credit histories.
- *Can you afford the closing costs?* Buyers ordinarily need to pay certain costs and fees at the closing of a real estate purchase. Some are required by state and local laws while others are required by the institution that provides your financing. In general, closing costs can add an average of 3 to 5 percent of the price of the home to your total costs.

When you weigh the pros and cons of owning a home and think through its financial costs and its impact on your lifestyle, you will know whether home ownership is right for you.

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