



My Florida Home Book 1.1: Are You Ready to Be a Homeowner?¹

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Making the Decision to Be a Homeowner

It is very exciting to plan to own your home. Becoming a homeowner may give you a sense of prosperity.

For most people, buying or building a home is the largest financial investment they will ever make. So it requires solid and serious planning and preparation. If you prepare for and manage your homeownership well, you will enjoy the benefits of being a homeowner. However, if you buy a home before you are ready, your homeownership experience can be a negative one.

Are you truly ready to buy a home? To check if you are ready for homeownership, ask yourself the following questions:

Yes	No	
		Do you have steady income and stable employment?
		Do you expect to remain in the same location for at least a few years?
		Have you planned a new budget so you know how much you can afford to pay for a home?
		Are you currently on a budget and able to manage your money effectively?
		Do you have an established credit record? If so, is your credit record favorable?
		Do you consistently pay bills on time or even before the due date?
		Is your debt low enough that it will not limit your ability to qualify for a mortgage? If not, can you pay down your debt before you attempt to buy a house?
		Have you looked into all of the first-time homebuyer financial assistance programs available?

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If you can answer “yes” to all of these questions, you may be well on your way to owning your own home! If your answers are “no” for some questions or you are not sure about your answers, you may need to take more time to learn more about homeownership and to prepare yourself to be a successful homeowner. This curriculum will provide you with useful information to help you assess your current situation and, if necessary, improve your situation in order to purchase and maintain a home.

Owning a Home vs. Renting a Home

In the United States, homeownership is a goal that many people aim to achieve; it is part of the “American Dream.” Definitely, you can enjoy many benefits when you become a homeowner. However, homeownership is not necessarily the best choice for everyone. Sometimes, renting a home may be a better solution for some households depending on their situation.

To determine which housing option is right for you at this moment, you need to know the pros and cons of each one. Let's examine the advantages and disadvantages of renting, and then those of homeownership.

Advantages and Disadvantages of Renting a Home

About one third of American households live in rental housing units. For many of them, renting a housing unit might be an inevitable housing choice because of their limited resources. However, many people prefer to rent a home rather than owning one for reasons other than financial.

Here are some advantages of renting a home:

- **Affordability:** Compared to the cost of a homeownership, rental payments are cheaper in general. You also may be able to find a cheaper option on your next move.
- **Flexibility to move:** Most lease agreements are for one full calendar year. In other words, when your lease is over, you are free to leave. This is especially good when you are not satisfied with your current housing environment.

- **Freedom from maintenance and repairs:**

Your rental payments include maintenance service. As a renter, you usually do not need to worry about maintenance or home repairs.

- **In-home amenities:** Most rental homes offer built-in appliances and some rental homes are already furnished. So typically, you do not need to purchase those when you move in.

- **Community amenities:** Often, rental-housing communities provide various community amenities to attract future residents and to retain current renters.

- **Simpler and faster process:** Compared to a home purchase process, the leasing process is simpler and faster.

On the other hand, there are some disadvantages in renting a housing unit:

- **Not an investment:** Other than security deposits, once you pay your rental fees, they never come back to your pocket.
- **Less privacy:** Property owners or managers have keys to your home and they can enter your home when it is necessary. While rental property owners are required to give reasonable notice, they can enter without any prior notice in certain emergency situations.
- **Limited control over your home:** In general, renters are allowed to make many changes to their rental unit. You may not be able to paint walls with your favorite color, make any structural changes, or upgrade the heating and air conditioning systems to save money on your energy bill for example.
- **Promptness of maintenance service:** Although maintenance service is a benefit of renting a home, it also can be a headache when repairs are done on time.
- **Less stability of residency:** Rental homes have rules and regulations that the renter agrees to when signing the lease. Some are particular to the requirements of any given property owner or manager, while others are naturally enforceable under state Landlord-Tenant Law. If you break

the terms of the lease, the property owner could evict you even before your lease term expires.

Advantages and Disadvantages of Homeownership

The advantages and disadvantages of owning a home mirror those of renting: advantages of renting can be interpreted as disadvantages of homeownership, and disadvantages of renting can be considered advantages of owning a home.

Let's start with the potential disadvantages of owning your own home. Some aspects of homeownership can be unpleasant for some.

- **Less flexibility to move:** Compared to renting, it is not very easy to move from one home that you own to another. Shopping for a home requires more time and effort than finding a rental unit. In addition, selling your current home can be another problem.
- **Long-term financial commitment:** A homeowner must pay a mortgage over a long period (up to 30 years), and is responsible for property taxes, which tend to fluctuate. Plus, to protect the home structure and personal possessions from disaster and other threats, a homeowner will need to purchase proper homeowner's insurance.
- **Responsibility for home care and maintenance:** A homeowner is responsible for the care and maintenance of his/her own home. This requires time and money.
- **Possible decrease in property value:** One of the major reasons that people choose to own a home instead of renting one is to build a financial asset. However, the property value can either increase or decrease.

Of course, you can enjoy various benefits of being a homeowner that you would not have as a renter. These benefits are what most people expect from homeownership.

- **Building a financial asset:** Compared to rental payments that never come back to your pocket, you are, in a sense, paying yourself, building an asset as your property value increases.

- **Tax benefits:** Supported by government policies that encourage homeownership, mortgage interest and property taxes are usually tax deductible. There are other tax benefits for homeowners, depending on certain variables and current tax code.

- **Sense of security:** Homeownership contributes to a sense of security, especially in retirement years when income normally decreases or becomes more limited.

- **Sense of rootedness:** Settling down in a neighborhood for longer time gives you a sense of membership and rootedness in the community.

- **General well-being:** Many researchers have proven that homeownership positively influences both the physical and mental well-being of the residents because of the enhanced environmental quality and sense of stability.

- **Control of your property:** The home is yours. You have significantly more freedom to change the house and surroundings as you desire.

Right Choice for You

To buy or to rent, which would be the best choice for you? The answer depends on your current situation; it is your responsibility to make a fully informed and objective decision.

Think about any big changes that may happen in your life within a few years. Do you have any potential plans to move to another city for your work or school? Then you may want to consider an affordable rental home so that you have more flexibility. If you choose to buy, will you have time to take care of your home and perform regular maintenance routines?

Most importantly, seriously review your financial situation. Although buying a home may be one way of building your assets, homeownership also requires a large financial investment initially that you're committed to for a long time, plus whatever maintenance costs you incur over the years.

Your current financial situation is very important. You also have to be reasonably sure of your future financial stability to pay off your mortgage and other costs associated with homeownership. Do you have a stable income source for at least the next five to seven years? Do you expect to make any other major purchases (a new car, a trip, surgery) in the next few years?

In the next section—How Much Can You Afford?—you will learn how to examine your own financial readiness for homeownership in detail.

How Much Can You Afford?

Wise management of your credit helps you achieve many of your goals. Now, it is time to use your credit toward your home purchase. Your credit will influence your mortgage approval and your interest rate. Thus, it is important to know your credit situation prior to meeting with lenders. Knowing where you stand can also be helpful in determining how much home you can afford since it affects how much you can borrow.

The credit score is a standardized rating system of a person's credit condition in comparison to that of others. The information used to compute your FICO score (credit score computed by Fair Issac and Company) is provided in your credit report. One of the most popular and reliable sources for obtaining your current credit report is <http://www.annualcreditreport.com>. You can also pay to receive your score from this website or from <http://www.myFICO.com>. Once you obtain your score, you might want to compare your score with corresponding current mortgage interest rates; both <http://www.bankrate.com> and <http://www.myFICO.com> would have this information.

The higher your credit score, the lower your interest rate can be. Table 1.1 shows interest rates and mortgage payment amounts by credit scores for a \$100,000 30-year fixed rate mortgage in Florida.

The monthly payments in Table 1.1 are calculated based on a total mortgage amount, interest rate, and the total number of mortgage payments a person would make on a 30-year loan. The total payment is the amount that a person has to pay throughout his/her mortgage period. In this case, the amounts in the last column were calculated by multiplying “monthly payment” by 360 (360 months over 30 years).

To understand how much one's credit score can influence his/her total payment, let's compare a total amount of mortgage payments that a person with a credit score of 770 will eventually pay over 30 years and a total mortgage amount that a person with a credit score of 550 will pay. A person with a credit score 770 will pay a total of \$204,120 over a 30 year term, while a person with a credit score of 550 will pay \$306,720 during the same length of time. Considering the initial mortgage was \$100,000, the person with a credit score of 770 pays a total of \$104,120 in mortgage interest. However, a person with a credit score of 550 pays \$206,000 in interest, which is \$102,600 more than the other person's accrued interest. This is why we emphasize the importance of credit management. It saves you money!

Do you know your current credit score? If not, find it out now! There are some Internet sources where you can get your credit report free of charge including www.annualcreditreport.com. However, you will have to pay to receive the score itself. Note that the score is based on information contained in your report. You can pay to receive your score as well. If your credit score does not look good enough, then start to manage it.

1. Stay current on all of your debt. If you are not current, contact your lenders or those issuing bills to discuss repayment.
2. Pay down any outstanding debt. The more you owe for other debt (car payments, credit cards, loans, etc.), the less you can afford to borrow on your mortgage.
3. Do not apply for other credit during this time. Mortgage lenders can be concerned by seeing too much activity, especially for first-time homebuyers.

Table 1.1. Example of Credit Score, Interest Rate, and Mortgage Payment

Credit Score	Interest Rate ^A	Monthly Payment ^B	Total Payment ^C
760–850	5.489%	\$567	\$204,120
700–759	5.711%	\$581	\$209,160
660–699	5.995%	\$599	\$215,640
620–659	6.804%	\$652	\$234,720
580–619	9.080%	\$810	\$291,600
500–579	9.649%	\$852	\$306,720
	^A Rate as of April 14, 2008, from http://www.myFICO.com	^B Monthly mortgage payment for a \$100,000 30-year fixed rate mortgage in Florida	^C (Total payment) = (Monthly payment) x 360 (months)

4. Work with a credit counselor or Extension Educator to plan your budget and debt repayment. This can help you communicate with a potential lender about your situation.

Lastly, one issue that often arises with homeownership is the desire to fill every room in the home with furniture. This tends to be a popular use of consumer credit when purchasing a home. It is critical to avoid this trap. Taking on too much consumer debt too soon can leave a family with no resources for emergencies or other unforeseen expenses that come with homeownership, such as furnace maintenance.

Your Debt and Homeownership

Mortgage lenders use a debt-to-income ratio, which is the percentage of your income that pays debt, to either approve or reject your mortgage application. For example, if a household's gross monthly income is \$4,000, and the total combined monthly housing expense and other debt payments is \$2,000, the debt-to-income ratio of the household is 50%. Monthly debt includes:

- Total mortgage payment: Principal, Interest, Taxes, and Insurance (PITI)
- Any other loans (car, student, etc.)
- Credit card payments
- Child support
- Alimony

In addition to these, some lenders may be concerned about mortgage applicants having

substantial access to open lines of credit like credit cards, since some homebuyers will purchase household items on credit once they obtain a mortgage. Thus, you should take caution in opening additional credit lines or increasing your current credit limit when you are applying for a mortgage, as these actions may lower your credit score and affect your mortgage approval.

If your debt ratio is over 41%, you will have difficulty in getting your mortgage application approved. In addition, your total mortgage payment (PITI) should not exceed 25–29% of your gross income. Any more than that not only looks like a risky investment to a lender, but it is certainly a risk for you and your financial stability.

Housing Affordability Calculation

Calculation Example: Mr. Smith

Here is a calculation example to figure out the maximum monthly debt that a person (Mr. Smith) may have in order to qualify for a mortgage approval. After the example, you will have a chance to calculate your own. Remember that the lower your debt is, the better your chance is to get mortgage approval. Thus, it is important to keep your debt lower than the allowable maximum amount and as low as you can in general.

To show the calculation process, let's assume the following:

- Mr. Smith's gross annual income: \$36,000

- Mr. Smith's monthly debt other than PITI: \$300
- Mr. Smith's FICO score: 710
- Mr. Smith is applying for a 30-year mortgage.

First, calculate Mr. Smith's gross monthly income (GMI) by dividing his annual gross income by 12.

- (a) Gross annual income = \$36,000
 (b) Gross monthly income (GMI) = Gross annual income (a) \div 12 = \$36,000 \div 12 = \$3,000

Then, calculate Mr. Smith's maximum allowable amounts of his combined debt and his monthly PITI (total mortgage payment) by multiplying his GMI (b) by 0.41 (41%) and 0.29 (29%), respectively.

- (c) Maximum allowable total monthly debt = Gross monthly income (b) \times 0.41 = \$3,000 \times 0.41 = \$1,230
 (d) Maximum allowable monthly PITI = Gross monthly income (b) \times 0.29 = \$3,000 \times 0.29 = \$870

Calculate Mr. Smith's maximum allowable monthly debt other than PITI by subtracting his maximum allowable monthly PITI (c) from his maximum allowable monthly combined debt (d).

- (e) Maximum allowable monthly debt other than PITI = Maximum allowable total monthly debt (c) - Maximum allowable monthly PITI (d) = \$1,230 - \$870 = \$360

Compare the total amount of Mr. Smith's actual monthly debt with his maximum allowable monthly debt other than PITI from your earlier calculation (e). His actual debt other than PITI is \$300 while his maximum allowable debt other than PITI from our calculation was \$360. Thus, it is okay for him to apply for a mortgage. If a person's actual debt exceeds what the calculation allows, the person needs to work to reduce current debt to within the allowable amount before applying for a mortgage.

From the previous calculation for Mr. Smith's maximum allowable monthly debt, you can also calculate the maximum amount that he can reasonably spend for his mortgage payments (PITI). Usually, people pay about 10% of their PITI as

property taxes and homeowner's insurance. So let us assume here that the rest—principal and interest payments (PI)—is 90% of the total PITI.

You can calculate the maximum amount that Mr. Smith can pay for his PI by multiplying his maximum allowable monthly PITI (line d. from previous calculation) by 0.90.

- (f) Maximum allowable monthly PI = Maximum allowable monthly PITI (d) \times 0.90 = \$870 \times 0.90 = \$783

To estimate the total mortgage amount, you will need to use the following Present Value and Mortgage Payments Chart (Table 1.2) using the appropriate multiplier based on your interest rate and the number of years to repay the mortgage. Since you may not know your interest rate yet, select an interest rate from the first column and then the desired length of your mortgage period from the top line to determine the multiplier. For example, if the interest rate is 7% and you are applying for a 30-year mortgage, then the multiplier will be 150.31.

- (g) Mr. Smith's Present Value of Mortgage Payment multiplier = \$166.79

Multiply Mr. Smith's maximum allowable monthly PI (f) by his multiplier \$166.79 to calculate his estimated mortgage amount.

- (h) Estimated mortgage amount = Maximum allowable monthly PI (f) \times Present Value of Mortgage Payment multiplier (g) = \$783 \times \$166.79 = \$130,596.57

Now calculate how much Mr. Smith can afford to borrow—this will determine the maximum home price he can afford. Let us assume that he makes a 10% down payment of the total home price and the remaining 90% will be his total mortgage. It means that:

$$\text{Home Price} \times 0.90 = \text{Mortgage amount}$$

So, to calculate the home price that Mr. Smith can afford, divide mortgage amount (g) by 0.90.

- (i) Home price Mr. Smith can afford = Estimated mortgage amount (h) \div 0.90 = \$130,596.57 \div 0.90 = \$145,107.30

Table 1.2. Present Values of Mortgage Payments Chart

Interest Rate	15-year Mortgage	20-year Mortgage	30-year Mortgage
5%	126.46	151.53	186.28
6%	118.50	139.58	166.79
7%	111.26	128.98	150.31
8%	104.64	119.55	136.28
9%	98.59	111.15	124.28
10%	93.06	103.62	113.95

Calculate Your Own

Now calculate your own. First, calculate your actual monthly debt. Use the following checklist to calculate your current monthly debt. Be sure to include any monthly payments not listed in the checklist that you will need to make beyond one year from now.

	Monthly Payment
Car loan	\$
Student loan	\$
Other loan 1.	\$
2.	\$
Credit card payment	\$
Furniture	\$
Child Support	\$
Alimony	\$
Doctors/Hospital	\$
Other	
1.	\$
2.	\$
3.	\$
4.	\$
Total Debt (Other than PITI)	\$

Now start the calculations for the home price you can afford:

- (a) Gross annual income = \$_____
- (b) Gross monthly income (GMI) = Gross annual income (a) ÷ 12 = \$_____ ÷ 12 = \$_____
- (c) Maximum allowable total monthly debt = Gross monthly income (b) x 0.41 = \$_____ x 0.41 = \$_____
- (d) Maximum allowable monthly PITI = Gross monthly income (b) x 0.29 = \$_____ x 0.29 = \$_____

(e) Maximum allowable monthly debt other than PITI = Maximum allowable total monthly debt

(c) - Maximum allowable monthly PITI (d) = \$_____ - \$_____ = \$_____

Compare your actual monthly debt other than PITI to your maximum allowable monthly debt other than PITI from calculation (e). Is your actual debt less than the allowable debt?

(f) Maximum allowable monthly PI = Maximum allowable monthly PITI (d) x 0.90 = \$_____ x 0.90 = \$_____

Using your FICO score and Table 1.1, find out your interest rate. Then using Table 1.2, get your present value of mortgage payment multiplier.

(g) Present Value of Mortgage Payment multiplier = \$_____

Now calculate your estimated mortgage amount:

(h) Estimated mortgage amount = Maximum allowable monthly PI (f) x Present Value of Mortgage Payment multiplier (g) = \$_____ x \$_____ = \$_____

If you assume that you make a 10% down payment towards the total home price, the remaining 90% will be your mortgage. Therefore, the home price that you can afford is:

(i) Home price you can afford = Estimated mortgage amount (h) ÷ 0.90 = \$_____ ÷ 0.90 = \$_____

Impact of Monthly Debt on Housing Affordability

Table 1.3 compares a person whose monthly debt other than PITI averages about \$100 with a person carrying \$300 monthly debt other than PITI to show you just how much just a \$200 difference in monthly

debt can influence housing affordability. In both cases, we shall assume the following:

- Annual income: \$20,000
- Maximum debt-to-income ratio other than PITI: 41%
- Monthly debt besides PITI in dollar amount: \$100 for Person 1, \$300 for Person 2
- Principal and interest (PI) make up 90% of the total PITI
- 30-year mortgage with 6% interest rate
- Present Value of Mortgage Payments multiplier (From Table 1.2): 166.79
- Down payment: 10% of home price

Table 1.3. Comparison of Housing Affordability with Different Amounts of Debt

	Person 1	Person 2
a. Gross annual income	\$ 20,000.00	\$ 20,000.00
b. Gross monthly income (= a/12)	\$ 1,666.67	\$ 1,666.67
c. Maximum allowable combined debt amount (= bx0.41)	\$ 683.33	\$ 683.33
d. Debt other than PITI	\$ 100.00	\$ 300.00
e. Maximum allowable monthly PITI (= c-d)	\$ 583.33	\$ 383.33
f. Maximum allowable PI (= ex0.90)	\$ 525.00	\$ 345.00
g. Present Value of Mortgage Payments multiplier	166.79	166.79
h. Estimated mortgage amount (= f xg)	\$ 87,564.75	\$ 57,542.55
i. Affordable home price (= h /0.90)	\$ 97,294.17	\$ 63,936.17

As you can see, a \$200 difference in monthly debt can make a significant difference in the price of the home you can afford. So, find ways to reduce your monthly debt. If you already have one or more long-term loans, such as a car loan or student loans, and/or have credit card debt, work to pay off those debts as quickly as possible. Pay more than the minimum monthly payment and avoid using credit cards.