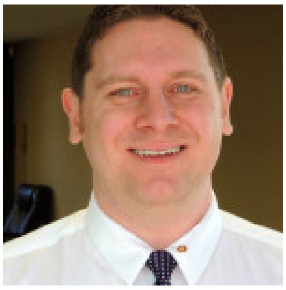
Money Matters: Buying a piece of the American Dream

By Nic Abelow

For many people, buying their first home represents the biggest financial commitment they'll make. Before making such an important decision, you should consider a variety of factors, starting with whether home ownership is right for you.



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When considering this question, it may help to view the ownership decision as a lifestyle choice first, and a financial decision second. While over time buying a home can potentially be a good way to build equity, history has shown that like many other investments real estate prices can fluctuate considerably. If you aren't ready to settle down in one spot for a few years, you may want to defer buying a home until you are. But if you are ready to take the plunge, you'll need to determine how much you can afford to spend.

How much house can you afford?

Most people, especially first-time buyers, must take out a mortgage to buy a home. To qualify for a mortgage, the borrower generally needs to meet two industry standard ratio requirements: the housing expense ratio and the total debt ratio.

· The housing expense ratio compares basic monthly housing costs to the buyer’s gross monthly income (before taxes and other deductions). Basic costs include mortgage payments, insurance and property taxes. Income includes any steady cash flow, including salary, child support or alimony payments. For a conventional loan, your monthly housing cost generally should not exceed 28 percent of your monthly gross income.

· The total debt ratio is the percentage of income required to service all of your monthly debt payments. Monthly payments on student loans, installment loans and credit card balances, for instance, are added to basic housing costs and then divided by gross income. Your total monthly debt payments, including basic housing costs, generally should not exceed 36 percent.

In addition to qualifying for a mortgage, you will likely need a down payment. Down payment requirements generally vary from a minimum of 3 percent to 20 percent or more depending on individual factors. Down payments greater than 20 percent generally exempt you from buying private mortgage insurance and may help you secure a lower interest rate. Mortgages available to some military veterans and active duty military personnel through the Veterans Administration (VA) may require no down payment.

Closing costs

Closing costs vary considerably, but typically add between 2 percent and 7 percent to your purchase price. Such costs can include, but are not limited to, a home inspection, loan origination fees, upfront “points” (prepaid interest), application fees, an appraisal fee, title search and title insurance, homeowner’s insurance, recording fees and attorney’s fees.

Operating costs

In addition to mortgage payments, there are other costs associated with home ownership. Home association fees, utilities, heat, property taxes, repairs, insurance, services such as trash or snow removal, landscaping and replacement of appliances are some of the more common costs incurred. Check the actual expenses of the previous owners and make sure you know how much you are willing and able to spend on such items.

Once you’ve determined a price range and location, you’re ready to look at individual homes. Remember that much of a home’s value is derived from the values of those surrounding it. In addition to “comparables,” consider the neighborhood, schools and other qualities that may be attractive to future buyers as well as those attractive to you. The more research you do today, the better your decision will look in the years to come.

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