- *I WANT TO BUILD UP EQUITY QUICKLY.* Consider a loan amortized over fifteen or twenty years, or take out a thirty-year mortgage and make voluntary prepayments. These are also good choices if you value paying less interest over the life of the loan and building up the equity you have in the home. This can positively impact your financial net worth and your credit worthiness.
- *I WANT TO MINIMIZE RISK.* A thirty-year fixed-rate loan with a 20 percent down payment is probably your safest option in the United States. You move in with equity already in the property, and your interest rate is locked in for the life of the loan, no matter how high interest rates may climb after you move in. (If you live in Canada, we advise you to discuss your loan options with your mortgage specialist to minimize risk.)

Remember, as a first-time home buyer, we urge you to consider all your options carefully, including government-sponsored first-time buyer programs. We think you'll enjoy the benefits these programs offer and thank yourself for years to come.

Creative Financing

The evolving consumer lending landscape at times makes conventional financing somewhat more difficult, expensive, or perhaps altogether unavailable. So, as an option, we'd like to introduce a set of time-tested financing strategies that may be available to you regardless of unfavorable economic circumstances, whether general or personal.

Creative financing incorporates a set of strategies that can help you buy a property with less of your own money used as a down payment and may even lower your monthly payment. A common creative financing scenario involves a seller with a specific situation that may work to your advantage such as a high equity position in the seller's home and a need to sell. The situation presents a unique opportunity in which you and your real estate agent construct a creative transaction that meets the seller's goals and still works for you.

The following four examples represent common ways to execute creative financing. First, a seller may offer owner financing. In this case, the seller actually holds the mortgage for you while you make payments. A second situation involves your assumption of the seller's mortgage. In this scenario, the seller's mortgage lender allows you, the buyer, to take responsibility for the seller's mortgage. A third situation is called a wrap finance, where the owner offers you a new loan while keeping and paying down the original loan (the new loan "wraps" the seller's original loan). The fourth concept is a lease option in which you lease the property from the seller until you have the equity or cash to buy it. If you're challenged to find financing through conventional means, you might consider ways you can employ creative financing to help you achieve your home purchase.

While owner financing is widely available, please note that not all mortgages are assumable and many mortgages have a "due on sale" clause that will involve the lender's notification and approval for one to be assumed or wrapped. Be aware that some areas don't permit lease options or their variations: deed-for-contract and lease purchase. We recommend you ask your agent to connect you with a reputable real estate attorney if you choose one of those creative-financing options.

Figure 3.11 illustrates how the numbers might work in a scenario where you, the buyer, attempt to take ownership of a $100,000 property through creative financing. You'll note that conventional financing (column 1) is included as a point of reference for these creative variations.

In all four of the ownership scenarios (columns 1-4), it is important you understand that a private second loan can also come from the seller. Just know that secondary liens in general carry less favorable terms for the buyer—it's about collateral. First liens are generally secured against the property and first in line if the deal goes sour and the property must be liquidated to pay back the loan. Secondary lenders account for this in the terms they offer. The main thing to recognize is the many financing options you have when buying a home. Sometimes you just need to look in less obvious places to find them.

Canadian agent Sylvie Begin of Ottawa, Ontario, did just that. Her clients were second- and third-year medical students who had rented a place for several years, one they absolutely loved. "At the time, they earned a modest student salary and really couldn't qualify for a conventional mortgage," Sylvie recalls. "They were about to start their medical careers and knew they'd be making much more money in a few years, so future income really wasn't a concern."

Sylvie's clients wanted to stop wasting money on rent, so creative financing made perfect sense. And the seller, who was the clients' landlord at the time, was happy to work with them. After agreeing on a price with the seller, Sylvie negotiated a lease option purchase in which her clients would pay a few hundred dollars extra each month in addition to rent. The seller/landlord held the extra money, and it accumulated as an

Basic Creative Financing for Property Acquisitions

{1} **CONVENTIONAL FINANCE** Owner Owes $0 to $100,000+	{2} **OWNER FINANCE** Owner Balance: $0 to $20,000	{3} **ASSUMABLE FINANCE** Owner Balance: $80,000	{4} **WRAP FINANCE** Owner Balance: $80,000
• $80,000 Conventional Loan • $20,000 Down Payment • One Monthly Payment	• $80,000 Loan from Owner • $20,000 Down Payment • One Monthly Payment	• $80,000 Assumed from Owner • $20,000 Down Payment • One Monthly Payment	• $90,000 New Loan from Owner • Owner Continues to Pay Original Loan • $10,000 Down • One Monthly Payment
or	*or*	*or*	*or*
• $80,000 Conventional Loan • $10,000 Conventional Second • $10,000 Down Payment • Two Monthly Payments	• $80,000 Loan from Owner • $10,000 Private Second • $10,000 Down Payment • Two Monthly Payments	• $80,000 Assumed from Owner • $10,000 Private Second • $10,000 Down Payment • Two Monthly Payments	• $95,000 New Loan from Owner • Owner Continues to Pay Original Loan • $5,000 Down Payment • One Monthly Payment
or	*or*	*or*	
• $80,000 Conventional Loan • $15,000 Private Second • $5,000 Down Payment • Two Monthly Payments	• $95,000 Loan from Owner • $5,000 Down Payment • One Monthly Payment	• $90,000 Assumed from Owner • $15,000 Private Second • $5,000 Down Payment • Two Monthly Payments	

OR If you can't utilize one of these *Creative Financing* opportunities for *Ownership* of the property, you may be able to *Lease Option* the property until you're able to take ownership.

{5}
LEASE OPTION

- Lease the property while you accumulate enough savings to buy it from the owner.
- Option to buy at end of the contract.

Figure 3.11

eventual down payment. Sylvie adds, "The key for my clients was to agree on a price with the seller, especially in a scenario where the real estate market might be flat or depreciating in a year or two."

Both parties agreed on the amount of a nonrefundable deposit check, which guaranteed the buyers an option—an exclusive right to purchase the property at the agreed-upon price in a predetermined time period. The parties also agreed on the option expiration date. Every piece was negotiated, including the portion of the rent that went toward the down payment.

They closed about eighteen months later and the home was theirs. "It was a win-win deal for both my clients and the seller," Sylvie notes. "All elements were agreed upon in advance, and the tenants, my clients, always had the ability to opt out at any time by giving up a nonrefundable deposit and any extra payments made toward the property."

The Suitcase Principle

Imagine you're packing to go on vacation. You get out your suitcase and start filling it with T-shirts and shorts, your toothbrush and swimsuit, and a nice outfit in case you go out for a formal dinner. You pack everything you know you'll need to make your vacation as fun as possible. However, you probably won't pack the suitcase so tight you have to sit on it to get it closed. You know that once you get to Boise or Bali, you'll probably find something you want to bring home. So, you leave room for the unknown.

The suitcase principle applies just as well to mortgages. When you get your preapproval letter, make sure the monthly payment is an amount you feel comfortable paying each month. Lenders are careful, but they make qualification decisions based on averages and formulas. They won't understand the nuances of your lifestyle and spending patterns quite as well as you do. So, leave a little room in your suitcase for the unexpected—for all the new opportunities your home will give you to spend money, from furnishing the guest bedroom to landscaping the lawn. "You don't want to be so strapped that you can't go out and buy a flat of flowers," says Mary Anne Collins, an agent in California. "You want to be able to afford the things that make a house a home. If you max out what a loan originator says you can afford, you might not be able to do that."

As a general rule, we recommend spending no more than a third of your gross monthly income on your first home payment. Historically, banks used a ratio called 28/36 to decide how much buyers could borrow. An approved housing payment couldn't be more than 28 percent of the buyer's gross monthly income, and his or her total debt load, including car payments, student loans, and credit card payments, couldn't be more than 36 percent. (In Canada lenders apply similar formulas to determine how much a buyer can afford. The Gross Debt Service ratio, or GDS, is not to exceed 32 percent of the buyer's gross monthly income, and the Total Debt Service ratio, or TDS, is not to exceed 40 percent of the buyer's total debt load.) As home prices

YOUR LENDER DECIDES WHAT YOU CAN BORROW BUT YOU DECIDE WHAT YOU CAN AFFORD

Olivia and Alex each earn $4,000 a month.
Traditionally, their maximum housing payments would be 28 percent of their incomes, or $1,120.

However, their financial profiles are really very different, leading them to very different decisions about how much they can afford.

OLIVIA HAS $15,000 IN STUDENT LOANS, JUST BOUGHT A NEW CAR, AND HAS SEVERAL CREDIT CARDS WITH BALANCES.

Car payment	$350
Student loans	$150
Credit card minimum	+ $150
Monthly nonhousing debt	$650
Maximum total debt payment (36 percent of $4,000)	$1,440
	– $650
Safe housing payment	$790

ALEX'S STUDENT LOANS ARE PAID OFF, HE HAS LITTLE CREDIT CARD DEBT, AND HIS CAR IS AN ECONOMY MODEL.

Car payment	$200
Credit card minimum	+ $50
Monthly nonhousing debt	$250
Maximum total debt payment (36 percent of $4,000)	$1,440
	– $250
Safe housing payment	$1,190

Figure 3.12

have risen, some lenders have responded by stretching these ratios to as high as 50 percent. No matter how expensive your market, though, we urge you to think carefully before stretching your personal budget quite so much.

Deciding how much you can afford should involve some attention to how your financial profile will change in the coming years. If you expect to incur a bunch of new costs—for example, if you plan to start a family—it might be smart to scale back. On the other hand, if you're about to get a big promotion, make your final car payment, or send a child from private day care into public kindergarten, you may be able to afford a little more. In the long run, your own peace of mind and financial security will matter most.

Finding the right mortgage takes a little work, but you'll find that the effort is well worth it. Chosen wisely, your home mortgage can be one of your best financial assets. It's what enables you to fulfill the dream of home ownership. It helps ensure your financial security through building equity and net worth. As your equity grows, it will be a valuable source of credit worthiness and financial stability.

Notes to Take Home

- Follow these six steps to financing your home:
    1. Choose a loan officer.
    2. Make a loan application and get preapproved.
    3. Determine what you want to pay and select a loan option.
    4. Submit to the lender an accepted purchase offer contract.
    5. Get an appraisal and title commitment.
    6. Obtain funding at closing.

- You don't need to save up a lot of money for the down payment. A conventional mortgage can require as little as a 5 percent down payment, and there are even some first-time buyer programs that require even less.

- Having the right loan officer (or mortgage specialist) working for you assures that all the details will be handled in an accurate and timely manner and that you will receive sound financial advice.

- Remember, lenders determine what you can borrow, but only you can decide what you can afford.

- Understanding the three basic parts of a mortgage loan—down payment, interest rate, and terms—will help you choose the best one for you.

- Visit YourFirstHomeBook.com for worksheets and other helpful resources.

Mary's First Home

The first fourteen years of my life seemed idyllic. My family lived in a wonderful home in Greeley, Colorado. I was the middle child of five. Then one day our lives changed dramatically. My father was injured in a major automobile accident and unable to work, and we had to sell our home and move into a rental. It was a sad day when we packed up and left the home we loved.

Having been through such an ordeal, you can imagine how my father felt when, at the age of twenty-nine, I purchased a home for the enormous sum of $52,000—a lot of money back in 1975. Still somewhat distressed, he told me I was making the biggest mistake of my life.

At the time my husband and I lived in an apartment two blocks from a California beach after spending a year traveling around the country in a mobile home. My son was one year old, and I was pregnant with my daughter. I was determined that my kids would have a home with a yard where they could play barefoot in the grass. We found exactly what we had in mind: a two-story home close to the beach with a park and elementary school nearby. It had a huge backyard just as I had imagined.

We had no savings, but we purchased the home using my husband's Veteran Administration benefits. We still had to sell one of our cars to make the down payment. I didn't care because having that home far outweighed any inconvenience. I had a bike outfitted so I could carry both my babies to the grocery store and travel around the neighborhood.

I was so thrilled to move into our first home that even as pregnant as I was, I went to work knocking out the wall between the dining room and living room, redoing the fireplace, wallpapering the bedrooms, painting the upstairs, and landscaping. My daughter came two weeks later. I loved bringing her home from the hospital to the room I had decorated for her.

Even today, that first home means more to me than anything I've purchased since. It was our children's first home, where we put down roots for the first time and really felt secure. My husband built a gazebo in the backyard and I made even more improvements, putting up shutters and planting two magnolia trees in the front lawn.

I remember one of the real estate agents we interviewed when we began our search told me that the mature thing would be to go home and save some money, and then we'd talk. Thank goodness we didn't listen. We sold that California house for $76,000 a year after we bought it and used the profit to finance our dream: a home on a Colorado mountaintop.

I think having a home means more to me and my siblings because we know what it feels like to lose a home we loved. Today, every one of us owns a beautiful home. And although it took awhile, my parents were finally able to buy another home, which they eventually owned free and clear.

Mary Tennant is President of Keller Williams Realty International.