Charting your Course

BUYING YOUR FIRST HOME

Supplementary Reading Materials
Retirement/Life Challenge Ltd.
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INTRODUCTION

Home Ownership may seem like an alternative to renting, but before you make the decision to purchase a home, gather as much information as possible so you can make a choice that you will be happy with. Owning a home may be just what you are looking for or there may be aspects of ownership that do not suit your financial situation, your personality, or your lifestyle. The first section of this handout is provided to help you assess your financial situation and make a realistic decision about home ownership. The second section includes information related to the process involved in the purchase.

As you read through the information and work through the exercises in the first section, you may be better able to evaluate and answer the following questions:

*Can I afford to be a homeowner?

*Am I really suited to home ownership?

CAN I AFFORD TO BE A HOMEOWNER?

To help you determine the amount of money you have available to invest in the housing market, work through the budget and net worth statements provided. As a homeowner, regardless of the type of dwelling you choose, you will have to make the following financial commitments: a down-payment, costs involved with the actual purchase, monthly mortgage and tax payments, insurance, and maintenance costs.

A **down-payment** is the portion of the price of the house that you assume prior to arranging a mortgage. You can decide on the amount you would like to use as a down-payment, but it must be at lease 5% of the purchase price of the house in order to qualify for a mortgage.

Examine your net worth statement to determine the maximum amount you are able to put into a down-payment. The assets you put toward your down-payment will remain assets, they will just be put to a different use. Although you would like to make as large a down-payment as you can afford, resist the temptation to transfer all of your assets to your down-payment. You still need to reserve a reasonable amount of money to cover unexpected expenses.

The **mortgage** is the amount of the purchase price remaining after the down-payment. Canadian Mortgage and Housing Corporation (CMHC)) recommends using the following formula to determine the portion of your monthly income which can be applied to housing expenses and/or emergencies:

	Example:	**Your Figures:**
Your gross monthly income	$2,500	____________
Your spouse's gross monthly income	$1,400	____________
Other income (monthly)	$250	____________
TOTAL	$4,150	____________
Multiply the total by 30% to determine your monthly payment ceiling.	$1,245	____________

In addition to your mortgage payment, the total includes utilities, property taxes, and condominium or town house fees if that is the type of dwelling you choose.

If you have other debts such as car loans or credit card payments, the total amount of all monthly payments should not exceed 40% of your gross monthly income.

Additional costs attached to the purchase of your home may include legal fees, a professional inspection, and an appraisal of the home.

Alberta Corporate and Consumer Affairs has developed a list of expenses you may be faced with when purchasing a home (see the following page). Although you will not be able to provide an exact cost for many of the items until you actually make your purchase, this will give you an idea of the kind of expenses that may occur.

COSTS ASSOCIATED WITH CLOSING THE DEAL

Application Fee: Some lenders charge a fee when you apply for a mortgage loan. It may include the cost of the appraisal.

Appraisal: The lender usually requires an appraisal of the property to find out the market value.

Survey: The lender may require a survey of the house and lot to determine the precise boundaries.

Mortgage Insurance: You may have to buy mortgage insurance if your mortgage is worth more than 75% of the property value. This insurance protects the lender if you fail to make your payments.

Taxes: Your monthly payment may include taxes. If not, money should be set aside each month to pay the taxes when they are due.

Adjustments: You may have to partially reimburse the prevouS owner for certain perpaid expenses (such as taxes).

Fire Insurance: You may be required to buy fire insurance equal to the value of the home (not including the lot).

Legal Fees and Disbursements: Legal fees vary. Ask your lawyer for details.

Lawyer: Your lawyer will undertake a Land Titles search for the record of ownership. The Certificate of Title, which shows whether the owner has the right to sell the property to you, must be searched and transferred to you. Other searches may also be needed.

Lender's Lawyer: The lenders lawyer will prepare the mortgage document to be registered against the title at the Land Titles Office.

TOTAL $_______________

You may also want to take into account other optional expenses:

Housing Inspection	_____________
Appliances	_____________
Decorating	_____________
Repairs	_____________
Utility Hookups	_____________
Total Additional Expenses	_____________

Insurance costs will increase when you become a homeowner since your insurance will not cover your home and property as well as your belongings. The cost of insurance varies with the type of dwelling being insured and the value of the home, lot and furnishings. You will need to make sure that your insurance coverage begins at the time you take possession of your new home.

Many financial institutions also require you to have **mortgage insurance** to protect them if you fail to make your payments. You may want to have **life insurance** to cover the cost of your mortgage payments if you should die. THis will ensure that your survivors will not have to worry about maintaining a mortgage and will be able to remain in their home. This type of insurance may also be available from the lender at a better rate than you may be able to obtain on a private basis.

Maintenance and upkeep are regular expenses that homeowners face. Depending on the state of your house at the time of purchase, this expense can vary. Looking after your house and yard will not only provide satisfaction, but will also help to ensure that your home maintains its market value. In order to carry out the various tasks involved in looking after your home, you may need to purchase tools and equipment that you did not need as a renter (i.e. lawn mower, lawn rake, garbage pails, etc.).

After determining the costs that may be incurred by owning your own home, look back to the budget form you filled out. Will the money you are presently spending on housing costs cover the new costs? Will your financial situation remain stable over the next few years? Will you have to make a significant change in your lifestyle in order to accommodate the new expenses, and is that a change you are willing to make?

In addition to evaluation your financial ability to purchase and maintain a home, you will also need to look at your lifestyle and personality.

AM I REALLY SUITED TO HOME OWNERSHIP?

* Do you have the time, energy and interest needed to maintain a home? As a renter, your landlord was available to make repairs and changes as needed. As a homeowner, it will be your responsibility. Will this new responsibility be a pleasure or a burden.

* Will you take pride and satisfaction in being able to maintain and develop your home and property?

* You may gain the benefit of stability, but are your willing to lose the mobility you enjoyed as a renter?

After reading the information and doing the exercise in section one, are you still interested in home ownership? If you are, you can proceed to the actual process of choosing and purchasing a home.

CHOOSING THE RIGHT HOME

Take plenty of time to make your decision. You are probably planning to spend several years in the home that you choose, so make changes that may occur in your family situation. WHat kind of home will accommodate your present need as well as future needs/changes? Take the following steps to help you make the right choice.

FIND A PRICE RANGE

Knowing what your price range is before you begin your search for a home can save you time and possibly disappointment. CMHC) has set out the following formula to help you determine your price range.

Example:

Your gross annual salary	$30,000
Your spouse's gross annual salary	$22,000
Other income	$6,000
TOTAL	$58,000
Multiply the total by 2.5 to find out the approximate price you can afford.	**$145.000**

Many financial institutions offer a **pre-arranged mortgage** where they will tell you in advance the amount they will be prepared to grant you based on your income, the down-payment you can make and any other debts you currently have.

TYPE OF DWELLING

Before you contact a real estate agent or make arrangements to look at available homes, decide what kind of dwelling will best meet your needs and your budget.

There are several types of dwelling to choose from. Some of the possibilities include condominiums, co-operative housing, town houses, and single family detached housing. Your choice should be based on your circumstances, your family needs, your tastes and the amount of money you are willing and able to spend. Following are descriptions of several types of dwellings.

Condominiums: The word condominium refers to a specific form of shared legal ownership. Condominiums may be detached, semi-detached, row-houses, duplexes, or apartments. Whatever the style, a specific unit is owned by the individual and the rest of the property, including the land, walkways, parking areas, and lobbies, are owned in common with other owners.

Cooperatives: Cooperative housing provides an alternative to renting and individual ownership. Co-operatives are a form of housing in which the members jointly own and manage the complex they live in. Housing co-operatives are associations of individuals who have come together to provide themselves with quality, affordable housing. They include accommodations for single family housing, duplexes, town houses, apartments, and mobile homes. They can accommodate families, couples, and singles from all age groups and backgrounds. The co-operative obtains the mortgage financing necessary to develop the housing project. Individual members pay a deposit and then make monthly housing payments which cover the cost of financing, maintenance and administration fees.

Town Houses: A town house is a row-housing type of unit that is connected by common walls. They are more like houses than apartments, since they have an 2nd story and basement.

Single Family Detached House: Single family dwellings offer a great deal of flexibility of style. Bungalows, split level houses, and two-story houses each come with their own advantages and disadvantages.

Bungalow:
*Attractive exterior
*Easily adaptable to unusual design and style
*Heating costs more per square foot then split level and two story houses
*Bedrooms on the same level as living area

Two Story House:
*Plumbing and heating are usually less expensive
*Uses the land space well
*Bedrooms can be away from the living area
*Noise from upstairs may affect main floor living

Split Level House:
*Makes better use of space than a bungalow, but does not use the land as well as a two-story house
*Design has more total steps.

ADVANTAGES AND DISADVANTAGES

Because of the similarity of the dwelling, condominiums and town houses have several advantages and disadvantages in common.

Advantages:
*Financing is readily available.
*Both types of housing offer protection from rent increases
*A wide range of prices, locations, types of structure, size, and features are available to meet your needs and preference.
*There is a benefit of home ownership in terms of participation in the real estate market, but prices are generally lower than for a comparable single dwelling.
*You have individual ownership of living units with the security of tenancy.
*Pride in home ownership

Disadvantages:
*Real estate appreciation is generally not as high as for a single family dwelling.
*It may be difficult to accurately assess the quality of construction.
*Loss of freedom may be experienced

through restrictions contained in the rules and by-laws.
*There will be monthly fees to pay in addition to your mortgage payment and these amy increase periodically.
*You may be paying for maintenance and use of facilities that you will not be using.
*Sharing common walls and grounds with neighbors may present problems.

Co-operatives are a different type of housing because the investment you make into the co-operative is returned to you when you leave, so you are not able to realize an increase in your investment. Co-op housing has its own distinct advantages and disadvantages.

Advantages:
*As a co-owner, you have a say in the management and operations of the co-operative community.
*As owners, there is a community pride which results in a responsible attitude toward maintenance of both home and grounds.
*You have the opportunity to set up other communal services such as day care, food stores, and recreational facilities.
*As an owner, you are part of the group making decisions about the management of the co-op.
*If you live up to the obligations and standards set by the group, you can feel reasonably secure that you will not have to move except by choice.
*Your rent is lower than another rental property of similar value.
*Your initial investment is low.
*You can choose to live in an accommodation and atmosphere that is suited to your lifestyle.

Disadvantages:
*Co-op rules are often more restrictive and comprehensive then those for condominiums and townhouses.
*There is no return on your initial investment in the co-op.
*In the co-op, you remain a tenant, whereas in a condominium or town-house, you own the unit you live in.
*The requirement to actively participate in the management and maintenance of the co-op may be something you do not enjoy.
*The selection of co-operatives available may not be suitable to your lifestyle and there may be a substantial waiting list for a co-op that would be desirable.

Single Family Detached House: Single family dwellings offer both freedom and responsibility. Different types of detached housing styles were described earlier, so the following shows general advantages and disadvantages to a single detached house:

Advantages:
*More privacy than with other types of housing.
*Larger lot with more yard
*Greater freedom in development of your home or property
*Real estate appreciation is generally higher than other kinds of housing.
*Pride in home ownership
*Security and stability
*Financing is readily available.

Disadvantages:
*You are responsible for the maintenance and upkeep of your property.
*You may be forced to spend more time and energy on maintenance of both your house and yard than you are prepared or willing to.
* You may be less mobile in a house than in some other form of accommodation.
*Single detached housing is generally more expensive than other forms of housing.
*Your expenses may result in having to reduce your expenses in another area.

LOCATION AND NEIGHBORHOOD

When you buy a house, you also buy into the neighborhood. Check around to see what surroundings suit your needs. You may want to consider the following issues as you make your choice as to the general kind of neighborhood you are interested in:

Transportation: Will public transportation be needed to get to and from work? If public transportation is not available will you be forced to buy a second car?

Local Taxes: The property tax you pay makes up a significant part of your monthly costs. How does the level of taxation in one neighborhood compare with another?

Schooling: If you have children attending school, you may want to be near an adequate school system.

Recreation and community activities: Would you prefer a neighborhood where there are good parks and recreational facilities?

Price: Housing costs in certain neighborhoods are more expensive than in others. Decide what kind of neighborhood you can afford to live in.

Standards for Property: Neighborhoods have their own standard of what is acceptable in terms of the upkeep of their homes and property. In what kind of neighborhood will you feel most comfortable?

Zoning: Will by-laws protect your property values? Will they permit you to pursue special interests or a line of work from your home?

BEGINNING THE SEARCH

Once you have decided on the type or home you are interested in and the kind of neighborhood that's right for you. Take your time and look at a variety of homes. Get a feel for the market values so that you can make an informed decision as to the offer you will make. You can contact a real estate agent to assist you in making your choice, or you can begin doing your own search.

A real estate agent will:

*Evaluate your housing needs and desires and your financial situation
*Find houses suitable to you
*Arrange for you to see housing
*Assist with the steps to make an offer.

Real estate agents work for a commission which is percentage of the sale price of the home. The commission is paid by the seller, not the buyer.

Inspections

Once you have found one or more homes that you feel will suit your needs, you can evaluate them using the following check list:

*Is the space sufficient? Will a change in family size cause your space requirements to change in the next few years? How many people can the home comfortably accommodate?
*Will the house or yard require more maintenance and skill then you are capable of?
*Do the kitchen and bathrooms meet your needs? Both are costly conveniently located?
*Is the water of good quality and is the pressure adequate? Do the taps drip? Do fixtures drain easily?
*Is the floor plan logical?
*How convenient is the kitchen?
*Is the heating system efficient? Are there registers in every room?
*What have the utility bills been over the past year or two?
*Do the windows and doors open and close easily?
*Are their visible cracks in the walls, ceilings or basement?

*Is the whole house insulated? What kind of insulation was used?
*Are the floors even? Do they squeak?
*Are there cracks in the foundation?
*Is the drainage around the house adequate?
*Are the outside walls in reasonable shape. Is the mortar between the bricks deteriorating or the paint peeling?
*Is storage adequate?
*Are there aspects of the house or neighborhood that might make resale difficult?
- size
- no basement or garage
- poor location

*What kind of property taxes will you have to pay?

Location

*Does the neighborhood look like people care about their homes and yards?
*Will you require a lawn service to keep up with the neighbors yards?
*Is the location convenient to work, school, shopping?
*Can you live with the zoning regulations?
*Are prices rising or falling in the neighborhood?
*Are there environmental considerations such as noisy or busy traffic route, sources of pollution?

Drive or walk around the neighborhood to familiarize yourself with it. Alberta Corporate and Consumer Affairs offers a checklist for inspecting a home. It provides a list of 250 items to check with symbols attached to each indicating the severity of the problem and a range of costs if repairs are needed.

After you have narrowed down your choices to one particular home, you may consider having the house checked by a professional home inspector It could be worth the cost to hire a professional to check the home for you, particularly if it is a resale home. A few hundred dollars spent now could save you thousands of dollars of repairs and renovations in the future.

An inspector has the knowledge to check for problems you may not be aware of. They also take an objective view of the house in contrast to your subjective view.

To choose a qualified inspector:

*Ask friend, colleagues, or neighbors for recommen-dations.
*Contact the Better Business Bureau for suggestions
*Is the inspector or the company licensed to do inspections?
*Do they have liability insurance?
*How long have they been in business?

OFFER TO PURCHASE

If everything checks out and you have decided that this is the house for you, you are ready to make an Offer To Purchase. An “Offer To Purchase” becomes legally binding the moment it is accepted so you would be wise to involve your lawyer before you present the offer. Don’t assume that this is the job of the real estate agent.

An Offer To Purchase is a written contract which stipulates that a seller agrees to sell a property and the buyer agrees to purchase it an agreed price. When it is accepted, the offer binds both parties to the terms and conditions set out in the document. Show the Offer To Purchase to your lawyer before you sign it. There are several points that should be clearly laid out in the offer:

*the full name of both the buyer and the seller
*a legal description of the property location
*financial information, including the price offered the amount of the deposit, and mortgage loan details, if known
*list of all extras to be included in the purchase price (appliances, drapes)
*list of any repair work to be done prior to

the possession date
*the date and time the offer expires
*the date when you assume responsibility for expenses such as tax, insurance
*the date the house legally becomes yours
*the deadline for paying for the house, transferring the title, and signing sale documents
*any conditions that might affect the sale

CONDITIONS ON THE OFFER TO PURCHASE

You may add conditions to your offer to purchase which make the sale "subject to" the fulfillment of these conditions. This will allow you the opportunity to back out of the sale if these conditions are not met. Examples of conditions would be: approval of the offer by your lawyer, approval of financing at a suitable interest and payment rate, inspection of the home by a qualified inspector or third party. Make these conditions very specific since they may be used in an argument about whether or not an offer can be withdrawn. If you do add conditions to your offer, keeping the time limits short will make the seller more ready to accept the offer.

LAWYERS

Choose a lawyer who is experienced in real estate work by asking friends, neighbors or the local bar association. The bar association can also tell you what the going rates are for real estate work although individual lawyers are not bound by this rate. The financial institution arranging your mortgage may require you to use a lawyer approved by them.

Your lawyer will advise you about legal procedures related to:

*Offer To Purchase
*Transfer of Title - your lawyer will check to make sure that you have clear title to the property (no unsettled claims on the property). Documents attached to the deed will describe the property. Your lawyer may ask you to have a survey done to make sure the boundaries of the property are as described.
*Mortgage document - Your lawyer will record the mortgage loan.

ARRANGE FINANCING

Most people will require some type of financing when they buy a house. A mortgage is an arrangement with a financial institution which sets out terms and conditions for paying back the debt owed on a house. There are a variety of mortgages available as well as the methods of repayment. Once you know how large a mortgage you will need, you are ready to decide on the terms and conditions of the mortgage.

Conventional Mortgage Loan: With a conventional mortgage, you will not be able to borrow more than 75% of the appraised value of the property. You will have to make a down payment of at least 25% of the property value.

High-Ratio Mortgage Loan: With this type of mortgage, you may borrow more than 75 percent of the property value so your down-payment will not need to be as great. Your financial institution will require you to pay for mortgage insurance with this type of mortgage. This type of mortgage insurance protects only the lender, not the borrower.

Second Mortgage: A second mortgage is provided at a higher interest rate to provide the borrower with additional financing if their first mortgage does not meet their total financial requirements.

Open and Closed Mortgages: An open mortgage will allow you to make additional payments on the principal, or pay off the mortgage completely, without notice or penalty. With a closed mortgage, additional payments may be confined to a certain amount and to certain times during the year. Some financial institutions may not allow you to make additional payments at all. Rates are usually lower for a closed mortgage.

AMORTIZATION PERIOD:

The amortization period is the length of time taken to pay off the debt. A mortgage loan is usually amortized for between 5 to 25 years. The longer the amortization period, the lower your monthly payments will be, but the more your will pay overall.

INTEREST RATES:

Fixed Rate: A "fixed" interest rate will remain the same throughout the term of the loan. This is generally the most popular form of mortgage financing, because it offers the security of knowing exactly how much your monthly payment will be so that you can budget for it. If you will have difficulty making higher mortgage payments if rates go up, you may feel more comfortable with a fixed rate with payments locked in for a 5 year term. You may pay more if rates go down, but you will have the security of knowing what your monthly payments will be over a long period of time.

Variable Rate: A variable interest rate will fluctuate up and down with the prime interest rate set by the Bank of Canada. If you are willing to keep close track of the interest rates, a variable rate may save you money, particularly if the rates go down. The interest rates are lower as you assume more risk. You may be able to start with a variable interest rate and lock the rate in when rates begin to climb or when you think they are as low as they will go. Find out what options for change are available to you before you make your decision.

Convertible Rate: A mortgage that can be converted from a variable rate to a fixed rate mortgage when the interest rates go down.

Reduction Option Loan: A new type of fixed rate which allows home buyers to convert their mortgage to a lower rate without having to pay the usual costs of refinancing.

REDUCING YOUR OVERALL PAYMENT

*By negotiation weekly or bi-weekly payments, you can manage to pay off the principal more quickly. For example, if your monthly payments is $648.60 per month you will pay $7,783.20 annually. To arrive at a weekly payment, divide $648.60 by 4 for a weekly payment of $162.15 or $8,431.80 annually. Over the course of the year, you will make an extra payment of $648.60 directly to the principal.

*Try to make extra lump sum payments to your mortgage during the year. This is easier to do with and open mortgage, but may be possible at certain times of the year with a closed mortgage.

*Negotiate the shortest amortization that you can afford. When your mortgage comes up for renewal, you may be in a better financial position and can reduce you amortization period even further.

RESOURCES

Alberta Consumer and Corporate Affairs. TIPS: Shopping for the Best Mortgage, Buying a House, Buying a Condominium, Inspecting a House.

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