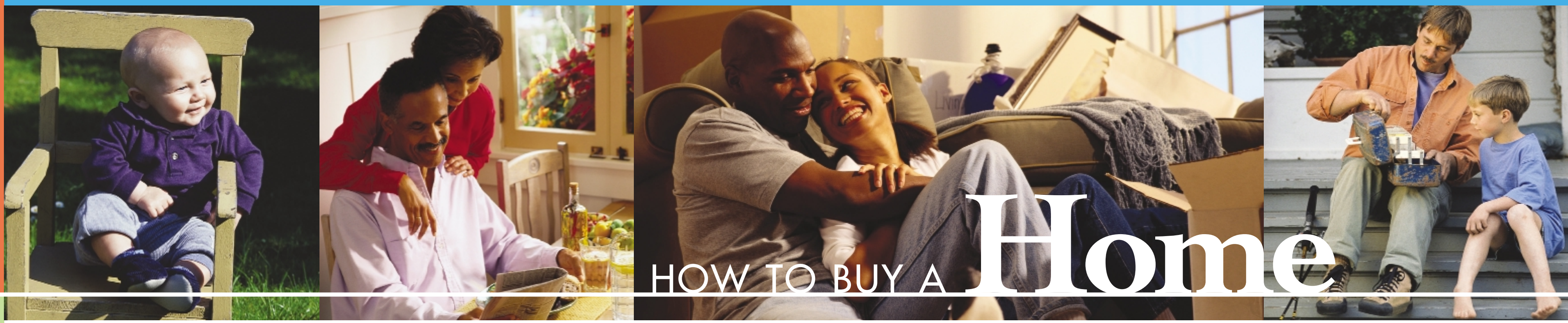


HOW TO BUY A Home

WITH A LOW DOWN PAYMENT

A consumer's guide to owning a home with less than three percent down.

3% or less

If you're dreaming of buying a home, congratulations. You're in good company! About two-thirds of the nation's households own their own home.

This brochure describes how families can get into their own homes with little cash up front. It explains mortgage insurance and how it works, and looks at the two options — private mortgage insurance and government mortgage insurance.

WHY BUY A HOME?

Homeownership remains one of the highest goals for many people because of its many benefits. Along with owning a home comes a sense of security and belonging that cannot be found elsewhere. For many, homeownership represents personal and financial success.

There is much personal satisfaction in living in a home that you own. A home is a valued investment that can have many financial advantages and tax benefits. The interest you pay on a home loan and the real estate taxes you pay on your home are among the few major federal tax deductions. Owning a home is the primary way most people build wealth.

Homeownership is also good for our communities, because families who own their homes are more involved in their communities and participate in local events.

The rewards of homeownership include:

- Personal satisfaction
- Sense of community
- Tax savings
- Stability for you and your family
- Investment in the future

OBSTACLES TO HOMEOWNERSHIP

Still, for many Americans, owning a home continues to remain just slightly out of reach. For more and more families, saving the money for a down payment is the biggest obstacle to homeownership. Many people mistakenly believe that you have to come up with a down payment equal to 20 percent of the price of a home.

Traditionally, lenders have required that home buyers be able to make a down payment of at least 20 percent of a home's purchase price to get a home loan or mortgage. Mortgage lenders, however, will grant home loans to qualifying home buyers with a down payment of as little as 3 to 5 percent of the purchase price if the mortgage is insured.

In fact, home loans with down payments of less than 20 percent are becoming increasingly popular. They are called "low down payment mortgages."

This is good news for the millions of home buyers who are finding it difficult to save a large down payment, especially for their first house.

MANY PEOPLE MISTAKENLY BELIEVE THAT YOU HAVE TO COME UP WITH A DOWN PAYMENT EQUAL TO 20 PERCENT OF THE PRICE OF THE HOME.

WHAT MAKES A LOW DOWN PAYMENT POSSIBLE

Simply put, mortgage insurance protects the mortgage lender against financial loss if a homeowner stops making mortgage payments. Lenders usually require insurance on low down payment loans for protection in case the homeowner fails to make his or her payments. When a homeowner does not make mortgage payments, a default occurs and the home goes into foreclosure. Both the homeowner and the mortgage insurer lose in a foreclosure. The homeowner loses the house and all the money he put into it. The mortgage insurer has to pay the lender's claim on the defaulted loan.

For this reason, it is crucial that the family buying the home can really afford it — not only when they buy it, but throughout the time period of the loan.

Although the cost of mortgage insurance is paid by the home buyer, or borrower, the mortgage insurer works directly with the lender. Mortgage insurance is available to commercial banks, mortgage bankers and savings & loans, all of which offer mortgage loans to home buyers.

Remember that mortgage insurance is not the same as credit life insurance, also called mortgage life insurance. This type of policy repays an outstanding mortgage balance if the person who took out the insurance policy dies.

THE SECONDARY MARKET

The lender's decision to use mortgage insurance is driven by the requirements of investors in the mortgage market. Because of the losses that could occur, major investors require mortgage insurance on all loans made with low down payments.

The three primary investors in home loans are the Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac) and Government National Mortgage Association (Ginnie Mae). By purchasing and selling residential mortgages, Fannie Mae and Freddie Mac help keep money available for homes across the country.

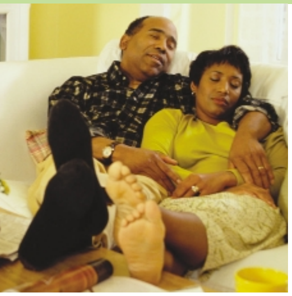
Unlike Fannie Mae and Freddie Mac, Ginnie Mae does not actually buy the mortgages. It adds the guarantee of the full faith and credit of the U.S. government to mortgage securities issued by private lenders.

THE TWO CHOICES: GOVERNMENT INSURANCE AND PRIVATE INSURANCE

Now that we have explained how mortgage insurance works and why it is necessary, let's look at the basic kinds of mortgage insurance. Low down payment mortgages can be insured in two ways — through the government or through the private sector.

Mortgages backed by the government are insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA) or the U.S. Department of Agriculture's Rural Housing Service (USDA-RHS).

The minimum effective down payment FHA requires is less than 3 percent. For single-family homes, there is a limit on the loan amount that varies according to geographic area.



EARLY ON IN THE HOME-BUYING PROCESS, IT IS A GOOD IDEA TO MEET WITH SEVERAL LENDERS TO COMPARE THE TYPES OF MORTGAGES THEY OFFER AND SHOP FOR THE BEST PRICE AND TERMS.

Although anyone can apply for FHA insurance, the other two government mortgage guarantee programs are much more targeted. The VA program is limited to qualified, eligible veterans and reservists. The USDA Rural Housing Service insures loans for the construction and purchase of homes in rural communities. These programs are very specialized, so contact your lender for details.

Obtaining conventional financing is the alternative to obtaining a home loan backed by the government. Conventional mortgages are all home loans not guaranteed by the government, including those guaranteed by private mortgage insurers.

Although both government and private insurance are based on the concept of allowing families to get into homes with less cash down, there are many differences between the two. Often the lender or loan originator will play an important role in suggesting and deciding which insurance is selected.

Private mortgage insurance is available on a wide variety of low down payment home loans and there is no pre-set limit on the loan amount. Although differences such as these may affect whether the lender prefers to work with government or conventional mortgages, your lender will discuss with you which one would be better for your situation.

With the wide variety of loans available, home buyers have the freedom to choose the type of loan that best suits their needs. Early on in the home-buying process, it is a good idea to meet with several lenders to compare the types of mortgages they offer and shop for the best price and terms. Best of all, working with a mortgage insurer can be very easy — whether your loan is insured by the FHA or a private mortgage insurer — because your lender handles all of the arrangements.

By making lending money to home buyers safer, mortgage insurance helps more families get into homes of their own.

QUALIFYING FOR A LOW DOWN PAYMENT LOAN

Qualifying for a low down payment loan is much like applying for a regular loan.

To be considered for a low down payment loan, you generally need to have:

- Sufficient income to support the monthly mortgage payment.
- Enough cash to cover the down payment.
- Sufficient cash to cover normal closing costs and related expenses (explained below).
- A good credit background that indicates your payment history or "willingness to pay."
- Sufficient appraisal value, which shows the house is at least equal to the purchase price.
- In some instances, a cash reserve equal to two monthly mortgage payments.

Closing costs, or settlement costs, are paid when the home buyer and seller meet to exchange the necessary papers for the house to be legally transferred. On average, closing costs run 2 to 3 percent of the house price. This percentage may vary, depending on where you live.

Closing costs include the loan origination fee (if not already paid), points, prepaid homeowner's insurance, appraisal fee, lawyer's fee, recording fee, title search and insurance, tax adjustments, agent commissions, mortgage insurance (if you are putting less than 20 percent down) and other expenses. Your lender will give you a more exact estimate of your closing costs. You can eliminate the need to pay a year's mortgage insurance premium at closing by choosing a monthly premium program.

Points are finance charges that are calculated by the lender at closing. Each point equals 1 percent of the loan amount. For example, two points on a $100,000 loan equal $2,000. Lenders may charge one, two or three points in up-front costs in addition to the down payment. The more points you pay, the lower your interest rate will be. In some cases, you may be able to finance the points.

SO HOW MUCH OF A MORTGAGE CAN YOU AFFORD?

There are two basic formulas commonly used by lenders to determine how much of a mortgage you can reasonably afford. These formulas are called qualifying ratios because they estimate the amount of money you should spend on mortgage payments in relation to your income and other expenses.

It is important to remember that the following ratios may vary from lender to lender and each application is handled on an individual basis, so the guidelines are just that — guidelines. There are many affordable housing programs, both government and conventional, that have more lenient requirements for low- and moderate-income families. Many of these programs involve financial counseling to help potential home buyers learn about the financial responsibilities of owning a home.

Generally speaking, to qualify for conventional loans, housing expenses should not exceed 26 to 28 percent of your gross monthly income. For FHA loans, the ratio is 29 percent of gross monthly income. Monthly housing costs include the mortgage principal, interest, taxes and insurance — often abbreviated PITI. For example, if your annual income is $30,000, your

IT IS IMPORTANT THAT YOU SELECT A HOME THAT WILL MEET YOUR FAMILY'S NEEDS AND KEEP YOU HAPPY FOR YEARS TO COME.

gross monthly income is $2,500, and $2,500 x 28 percent = $700. So you would probably qualify for a conventional home loan that requires monthly payments of $700.

Any expenses that extend 11 or more months into the future, such as a car loan, are termed long-term debt. Total monthly costs, including PITI and all other long-term debt, should equal no more than 33 to 36 percent of your gross monthly income for conventional loans. Using the same example, $2,500 x 36 percent = $900. So the total of your monthly housing expenses plus any long-term debts each month cannot exceed $900. For FHA loans, the ratio is 41 percent.

Maximum allowable monthly housing expense:
26–28 percent of gross monthly income — conventional
29 percent of gross monthly income — FHA

Maximum allowable monthly housing expense and long-term debt:
33–36 percent of gross monthly income — conventional
41 percent of gross monthly income — FHA

One way to determine how much to spend for housing is to compare your monthly income with monthly long-term obligations and expenses. Use the worksheet, "Evaluating Financial Resources," to determine how much money you can spend on housing. Be sure to include only income you can definitely count on.

When budgeting to buy a home, it is important to allow enough money for additional expenses such as maintenance and insurance costs. If you are purchasing an existing home, gather information such as utility cost averages and maintenance costs from previous owners or tenants to help you better prepare for homeownership.

Homeowner's insurance or property insurance is another cost you will have to consider. The lending institution holding the mortgage will require insurance in an amount sufficient to cover the loan. To protect the full value of your investment, however, you might want to consider purchasing insurance that provides the full replacement cost if the home is destroyed. Some insurance provides only a fixed dollar amount, which may be insufficient to rebuild a badly damaged house.

WHAT KIND OF PROPERTY CAN YOU BUY WITH A LOW DOWN PAYMENT LOAN?

There are a few restrictions on the type of home you may buy with a low down payment loan. In addition, low down payment loans may be used with a wide variety of mortgages.

Besides price range, there are many other factors to consider when purchasing a home. It's in your best interest to take care in selecting a home that will have lasting value as well as provide shelter. Be sure the neighborhood and house meet the needs of your family. If you have children, you may want to know if there are other children in the neighborhood and what schools or playgrounds are nearby. Also consider the

availability of public transportation and how far family members will have to commute to work or school.

Check the condition of the plumbing, heating and electrical systems and whether they are up to regulatory codes. The best and easiest way to do this is through a home inspection from a certified inspector.

If you are like most people, a home is the single largest purchase you will ever make. It is important that you select a home that will meet your family's needs and keep you happy for years to come. And most important, you must be able to afford to remain in that home for as long as you please.

YOUR INITIAL MEETING WITH A LENDER

The loan approval process generally begins with an initial meeting at which the prospective home buyer and the lender discuss the potential loan. You will need to bring information to verify your income and long-term debts.

Often people prefer to meet with the lender before house hunting to determine in advance what price range they can realistically afford and the mortgage amount for which they can qualify. This step is called prequalification and can save you much time and trouble by assuring you are looking in the appropriate price range.

For your first meeting with the lender, you should bring:

- A purchase contract for the house, if you have one.
- Your bank account numbers and the address of your bank branch, along with checking and savings account statements for the past two to three months.
- Pay stubs, W2 withholding forms, tax returns for two years, or other proof of employment and income verification.
- Divorce settlement papers, if applicable.
- Credit card bills for the past few billing periods, or canceled checks for rent or utility bill payments, to show payment history and amount of revolving debt.
- Information on other consumer debt, such as car loans, furniture loans, student loans and retail/credit cards.
- Balance sheets and tax returns, if you are self-employed.
- Any gift letters, if you are using a gift from a parent, relative or organization to help cover the down payment and/or closing costs. This letter simply states that the money is in fact a gift and will not have to be repaid.

Having these items on hand when you visit the lender will help speed up the application process. Usually, you will need to pay an application fee and appraisal fee when you submit the mortgage application. This is done only after you have negotiated successfully on a home and the seller has accepted your offer. Generally, there is no fee for prequalification.

After the initial meeting with the lender, you should have a general idea if you qualify for the size and type of loan you want. The lender should let you know if you qualify for the loan in 30 to 60 days. If you are denied a home loan, the lender must explain the reasons. If this happens, the lender usually will discuss any options with you.

MORE AND MORE BORROWERS ARE TAKING ADVANTAGE OF LOW DOWN PAYMENT MORTGAGES AND BECOMING HOMEOWNERS WITH LESS THAN 3 PERCENT DOWN.

TWO KEY FACTORS IN QUALIFYING FOR A HOME LOAN

In attempting to approve home buyers for the type and amount of mortgage they want, lenders basically look at two key factors: the borrower's ability and willingness to repay the loan. Ability to repay the mortgage is verified by your current employment and total income. Generally speaking, lenders prefer for you to have been employed at the same place for at least two years, or at least to have been in the same line of work for a few years.

The borrower's willingness to repay is determined by examining how the property will be used. For instance, will you be living there or just renting it out? Willingness also is closely related to how you have fulfilled previous financial commitments, thus the emphasis on the credit report or rent and utility bills.

It is important to remember that there are no rules carved in stone. Each applicant is handled on a case-by-case basis. So even if you come up a little short in one area, perhaps one of your stronger points will make up for the weak one. Everyone involved in real estate is in the business of selling homes, in one way or another. Therefore, if the loan makes sense, lenders and insurers will do their best to see that you qualify.

By its very nature, mortgage insurance is an aid to affordability, because it allows families to buy homes with less cash on hand. The industry plays a central role in helping low- and moderate-income families become homeowners.

More and more borrowers are taking advantage of low down payment mortgages and becoming homeowners with less than 3 percent down. For more information on how you can take advantage of the benefits of a low down payment home loan with mortgage insurance, contact your local lender or real estate agent. For general information on purchasing a home, contact the county extension office of the U.S. Department of Agriculture, listed in the government pages of your telephone book.

PAYMENT TABLE

MONTHLY PAYMENT FOR EACH $1,000 BORROWED

Interest rate	15 years	20 years	30 years
4.0%	$7.40	$6.06	$4.77
4.5%	$7.65	$6.33	$5.07
5.0%	$7.91	$6.60	$5.37
5.5%	$8.17	$6.88	$5.68
6.0%	$8.44	$7.16	$6.00
6.5%	$8.71	$7.46	$6.32
7.0%	$8.99	$7.75	$6.65
7.5%	$9.27	$8.06	$6.99
8.0%	$9.56	$8.36	$7.34
8.5%	$9.85	$8.68	$7.69
9.0%	$10.14	$9.00	$8.05
9.5%	$10.44	$9.32	$8.41
10.0%	$10.75	$9.65	$8.78

Note: Chart represents principal and interest only.

This table helps you calculate your monthly housing costs, not including taxes and insurance. For example, assume you have a 30-year mortgage and the interest rate is 8 percent. The chart shows that the monthly payment amount per $1,000 is $7.34. If you want to borrow $75,000, you can estimate the payment by multiplying *75 x $7.34*, which equals $550.50 per month. As you can see, the lower the interest rate, the easier it is to afford a home.

EVALUATING YOUR FINANCIAL RESOURCES



STEP 1: DETERMINE NET MONTHLY INCOME

GROSS MONTHLY INCOME

Gross base pay (all wages and salaries other than overtime)	$________
Net profit (from business)	$________
Interest and dividends	$________
Other income	$________
Total gross income (add)	=$______ +$______

DEDUCTIONS

Income tax (federal, state and local)	$________
Social Security/retirement	$________
Insurance (life, health and property)	$________
Other	$________
Total deductions (add)	=$______ +$______
1 Total take-home pay **Subtract deductions from income**	**=$______ +$______**

STEP 2: FIGURE LONG-TERM MONTHLY OBLIGATIONS (MORE THAN 11 MONTHS)

Installment payments (car, furniture)	$________
Other debt	$________
Total long-term debt (add)	=$______ +$______
2 Subtract long-term debt from total take-home pay. Bring forward the number from Step 1.	+$______

This worksheet was reprinted with permission from the Small Homes Council/Building Research Council, University of Illinois at Urbana.

STEP 3: MONTHLY NONHOUSING EXPENSES

Food, beverages (home and work)	$________
Transportation/auto expenses	$________
Education	$________
Medical/dental care	$________
Clothing and grooming	$________
Insurance (life and health)	$________
Child care	$________
Gifts and charity	$________
Entertainment and recreation	$________
Savings	$________
Other	$________
Total monthly nonhousing expenses (add)	=$______ +$______
3 Subtract nonhousing expenses from total of Step 2	**= $________**

STEP 4: ESTIMATE MONTHLY HOUSING EXPENSES

Proposed mortgage payment	$________
Allowance for property taxes	$________
Allowance for utilities (heat, water, phone, electricity)	$________
Allowance for maintenance, furnishings	$________
Allowance for insurance	$________
4 Total monthly housing expenses (add)	**= $________**

STEP 5: COMPARE

Compare estimated monthly housing expenses (Step 4) with income available (Step 3). If income available from Step 3 does not equal or exceed monthly housing expenses, then you must re-evaluate your budget and resources.

Total from Step 3 ≥ Total from Step 4

FOR MORE INFORMATION, CONTACT:

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727 15th Street N.W., 12th Floor
Washington, D.C. 20005
202-393-5566
www.privatemi.com

DEPARTMENT OF VETERANS AFFAIRS
1-800-827-1000
www.va.gov
for eligible veterans

OFFICE OF INSURED SINGLE FAMILY HOUSING PROGRAMS & PROCEDURES BRANCH
451 7th Street S.W., Room 9276
Washington, D.C. 20410
202-708-2676
www.hud.gov
for FHA information

USDA RURAL HOUSING SERVICE
www.usda.gov
Contact your local/county office listed in the government pages of your telephone book.

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