

GETTING STARTED

Introduction:

Building a home can be a stressful experience. Understanding the process will help to minimize the stress. The following information will give you a general outline of the building process and help you in determining the house you can afford.

Financing:

Most people don't pay cash for a home and will need a mortgage. Your credit rating, income and cash will determine how much you can borrow.

Credit:

Your credit rating is based on your debt and how timely you have made payments on that debt. Lenders use a rating system that creates a number called a FICO score. Your FICO score determines your credit risk. A FICO score of 700 + will allow you to borrow at the most competitive interest rate.

Income:

In qualifying for a loan, all continuing sources of income that you receive during the year are classified as your annual income. A lender uses your annual income and credit rating to determine how much you can borrow. This determination is made by allocating a percentage of your gross income to cover your principle and interest (P&I) taxes and insurance (T&I) = PITI, and another percentage to cover other debt such as credit cards and car payments. Historically, this percentage has been 36 percent, 28 percent for PITI mortgage debt and 8 percent for other debt. With a FICO score of 720 and higher, most lenders will go as high as 45 percent in combined debt.

Cash:

This is the money that you will need for the down payment, settlement and interest on the construction loan.

Cash Required:

For new construction, you will need enough cash for a down payment of 20 percent of the lot and house cost, settlement and construction loan interest. If you own your lot, the equity in the lot is the same as cash and you may not have to put up any cash.

How Much To Borrow:

You need to determine the monthly payment that meets your comfort level. Before making this decision, consider the following:

1. Building a home may be the largest and potentially, the best financial investment you can make. No other investment provides you a place to live and when sold, allows you keep up to **\$500,000** in untaxed profit.
2. Your tax refund from interest and real estate taxes should be taken into consideration in setting your mortgage payment objective. By increasing your tax deductions, the refund you would get in a lump sum at the end of the year can be added to your take home pay and applied to your monthly mortgage payment. **IE:** The monthly principal and interest payment on a **\$300,000.00** mortgage for **30** years at **4.5%** would be **\$1,520.00**. In a **25%** tax bracket, the first years refund would be **\$3,350.00** or **\$279.00** a month. After applying the **\$279.00** refund to the **\$1,520.00** payment, your adjusted net payment would be **\$1,240.00**.
3. Unless you intend to sell in 5 years or less, you should take out a 30 year fixed rate loan. A shorter term loan locks you into a larger monthly payment. You can reduce the repayment time of a 30 year loan by making additional payments each month against the principal. You can start out making small additional principal payments and increase them as your financial situation improves.

The monthly Principal and Interest payment for a 15 year mortgage at 4.5% on \$300,000.00 is \$2,295.00

The monthly Principal and Interest payment for a 30 year mortgage at 4.5% on \$300,000.00 is \$1,520.00

This is a difference of \$ 775.00

4. With a fixed rate loan, as your income increases, your mortgage payment will become a smaller percentage of your take home pay.

Income Tax Bracket:

Your tax bracket is the percentage of your total income that is taxed by the federal government. To find your tax bracket, take your latest 1040 and divide line 43 into line 63 to arrive at a percentage. This percentage is the portion of your mortgage interest and property taxes that will be refunded. **IE:** If your mortgage interest and property taxes are **\$15,000.00** and you are in a **25%** tax bracket, you would get a **\$3,750.00** tax refund.

