

## The First-Time Home Purchase

*Life's biggest purchase can be made much easier if a planner is involved.*

By Howard W. Wolosky

It's what you don't know that will hurt you." This saying can turn out to be true when going deeply into debt to make a purchase for maybe \$200,000 or more. Thus it comes as no surprise that a professional's knowledge and expertise can prove invaluable to a first-time homebuyer, who doesn't know all of the necessary considerations, pitfalls to avoid, and available options. Here is the role that practitioners play.

### Beginning the Process

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Timothy Sullivan, principal with Tobin & Collins in Hackensack, N.J., advises reviewing credit reports before applying for financing so any blemishes can be cleared up. William Cox, a sole practitioner in Paducah, Ky., initially treats assisting a client on the purchase of a home as he treats any other financial planning engagement. He has the client fill out a questionnaire about assets, income, and expenses.

Dianne Goodman, president of Comprehensive Small Business Solutions, PC, in Albuquerque, N.M., provides comprehensive services to her home buying clients. In some instances, she helps them find and evaluate the property. In addition to asking the client to check their credit report, she finds it extremely valuable for them to closely check out the house. It goes beyond an independent inspection. She has them get a CLUE (short for Comprehensive Loss Underwriting Exchange) report from Atlanta-based ChoicePoint. The report contains a detailed history of all insurance information on the property, including claims made and paid off by insurance companies. Goodman points out ChoicePoint compiles other types of information such as medical, auto insurance, credit ratings, and employment histories. Individuals may request reports on themselves annually at no cost, according to Goodman.

Cynthia Menker, a financial planner with Contour Financial in Orland Park, Ill., often begins with a detailed look at exactly what the potential homebuyer can afford, using a formula approach. "One is a 28-percent rule where your principal and interest payment, property taxes, and insurance total should equal no more than 28 percent of your gross income. There is also a 36-percent rule, where you add to those expenses car payments, student loans, etc., and that should not total more than 36 percent."

Sullivan has a rule of thumb that the mortgage shouldn't be more than two and one-half times the buyer's current annual income, as that is the most that banks will allow to be borrowed. However, he then looks at other factors, such as real estate taxes, cost of homeowner's insurance, etc., and expenses over a six-month period, running scenarios with different mortgages and taking into consideration the tax benefits. In evaluating if an existing client can afford the home that they desire, Goodman factors in her knowledge of the client, specifically their levels of discipline.

## Not Stretching Too Thin

In looking at the price to be paid for a home, Cox sometimes asks, "Do you want to tie yourself down to a house, and pretty much not do other things?"

Joel Kosovsky, a member of Horizon Financial Advisors and the affiliated accounting firm of Kosovsky, Pratesi & Company, based in Farmington, Conn., like the other practitioners, looks at how much the prospective homeowners are going to save on taxes, and comes up with an amount that they should then spend. He takes into consideration the current funding of retirement plans because he doesn't want them to miss out on 10 to 15 years of retirement funding. Likewise, if they have kids, he makes sure they are providing for education funding.

Menker points out that she advises clients not to put too much down. "Clients tend to forget that in addition to the down payment, they should have enough cash for moving, decorations, etc. You really need to have 10 to 15 percent of the purchase price of a home. You might need a new roof." Kosovsky also pays attention to the down payment. If he thinks it will be too little, he will advise buying a house at a lesser price so they won't end up being house poor. To make the down payment, Sullivan points out that first-time homebuyers can take \$10,000 from an IRA without paying a penalty.

Menker does recommend to clients, if possible, to put 20 percent down to avoid PMI (private mortgage insurance). Sullivan explains the cost of PMI is roughly .5 percent of the mortgage. Its purpose is to protect the bank so if there is a default, it will get its money back.

According to Sullivan, some mortgage companies allow the PMI to be discontinued if the value of the house goes up and an appraisal is done either by an independent appraiser or by the mortgage company. It's usually possible to do so a couple of years after the purchase, and might result in a rebate to the homeowner in addition to the removal of the PMI payments, points out Sullivan. He also suggests that in order to afford a home, first-time homeowners should consider purchasing a two-family home.

## Mortgage Advice

Cox evaluates the different mortgage options to see which fits what the client is trying to do. Typically he recommends a standard fixed rate mortgage, especially now as he likes to lock in the lower rates. He normally advises taking the longest possible term, telling the client, "You can prepay it if you want to do so."

Goodman also advises to pay the mortgage off early if possible. But she also points out if there is credit card and other debt, it is usually better to pay that off first. But after the credit card debt is gone, the focus can turn to the mortgage.

Menker is also a big believer in fixed rate mortgages. She finds adjustable rate mortgages appropriate if the owner is staying in the house for five years, otherwise she sees it as taking too much of a risk. Kosovsky's advice on mortgages is normally based on the client's cash flow, and he finds first-time buyers are usually squeezed for cash, so he tries to lock in the rate in a variable mortgage for at least five years. Like the others, he prefers a fixed rate mortgage unless the homeowner is moving in three to five years.

Whether points should be bought is based on how long the homeowner will be staying in the house, according to Cox. If it's long-term, he points out that it's basically better to buy points.

Sometimes to assist in finding the best rate, Sullivan recommends using mortgage brokers. He indicates they charge a small application fee, and they are paid by the lending institution with the application fee often refunded on closing.

Sullivan does caution about too much shopping around for rates, pointing out if there are lots of requests for credit reports that can work negatively. He also suggests that self-employed individuals might have difficulty getting mortgages that they want if the years under review don't show sufficient income.

Goodman has a number of articles on her Web site at [www.dgoodmancpa.com](http://www.dgoodmancpa.com) that offer tips to homebuyers, especially on financing. She advises not only to shop lenders to see if you are getting the best deal, but, when you decide, get a "good faith estimate" upfront from the lender. She explains it lists all of the lender charges and includes the loan amount, origination fee and/or points, interest rate, and any other fees. It can then be compared to the document prepared at the signing of the loan. She also advises paying attention to make sure there are no prepayment penalties or hidden charges in the fine print of the loan.

## **Best Ownership Status**

Rather than using the usual joint tenancy with survivorship, the title to the home might be in only one spouse's name. One reason for that, Cox suggests, is for estate planning purposes, as it allows an equalization of the estates of the spouses. In such a situation, Menker has seen the house in one spouse's name and the couple's investments titled in the other.

Professionals often title the home in the nonworking spouse's names because they worry about being sued, reports Sullivan. Cox remembers that a few years ago, in his area a lot of doctors put the house in the name of their spouse and the divorce rate then went up. Kosovsky indicates some professionals, especially those who have been married a short time, put the title in the other spouse's name, but in return that spouse gives the professional a quit claim deed for one-half of the property to be kept in a safe deposit box. A tenancy in common is often used if a couple isn't married, observes Sullivan, or if they are planning to get married in the future, suggests Kosovsky.

Where there are second and third marriages, it often depends on whose assets are used for the down payment on the home, and who is going to make the mortgage payments, opines Kosovsky. He also observes it is common if there are two homes, usually a primary residence and a vacation home, that one is in each of the spouse's names.

## **Protecting the Investment**

For young homeowners with children and because of the prevalence of two-wage earner couples, Cox believes life insurance on both parties is needed to cover the mortgage. He leans towards term policies. Menker advises looking at increasing the disability insurance coverage, especially if it isn't costly, such as where a spouse is covered by a group policy. Kosovsky looks at group policies, but, when needed, advises buying an individual policy.

The need for homeowner's insurance is obvious. But even there you can help. Sullivan cautions homeowner's insurance should always cover replacement value plus contents. Goodman cautions

checking that the homeowner's insurance policy for replacement value isn't enough. What is the scope of the coverage? Is there coverage of computers or for damage caused by septic tank back-up? Also, when applying for insurance, she advises when there is an inspection performed by the prospective insurer, make sure the resulting report properly reflects the property's characteristics so there is no dispute if a claim is made.

## Providing Financial Comfort

As a practitioner you can play a very important role. According to Kosovsky, first-time homebuyers tend to overextend themselves. A little financial analysis can insure that doesn't happen and also ensure the clients other financial planning goals aren't ignored.

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