CHAPTER 6

Helping Your Clients Succeed as Homeowners

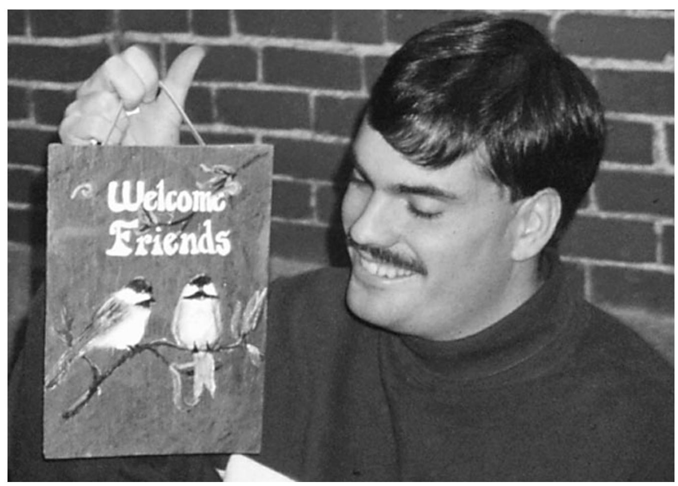
Overview

Well before the excitement fades, new homeowners need to understand that their responsibilities — which include making the monthly mortgage payments and maintaining their newly purchased home — have just begun. Part of your role as a housing educator and counselor is to prepare your clients for taking on these responsibilities and achieving successful homeownership. In this chapter we emphasize the need to maintain the house, make and follow a budget, and get immediate help if they have trouble making their mortgage payments. We also look at the financial benefits of homeownership, including substantial tax breaks.

Settling in

Meeting the neighbors

A housewarming party is a great way for your clients to celebrate with friends, family, and others who helped along the way, as well as to meet their new neighbors. As they settle in and become familiar with every inch of their new house, remind them to take time to meet their neighbors. Not only can neighbors be a great source of practical information, getting involved in the community is personally rewarding and fun. Moreover, because neighbors tend to look out for one another and keep an eye on each other's houses, getting to know people in the neighborhood is also a way to help protect their investment.



Getting to know the house

If your clients have always lived in rental units, with family members, or in agency-run housing, homeownership will bring with it many new responsibilities. They need to learn about the major systems of their house to do routine maintenance and handle emergencies. If they need assistance, they may want to designate one person from their planning team to supervise in this area.

A good way to stay organized is to set up a file of important information about the house. This file might include warranties, owner's manuals, and other documents obtained from the previous owner, as well as any notes taken during the house tour with the seller. This file can also be used to track repairs, routine maintenance, and home improvements.

Safety tips

The following safety tips may be particularly useful to new homeowners.

Personal safety

Even if your clients do not need full-time assistance, they should have a plan for receiving quick assistance in the event of an emergency. Following are some strategies you might suggest to your clients:

- Keep handy the telephone number of a friend or family member who is accessible at all times.
- Ask a neighbor or friend to check in by telephone or in person at mealtimes or at other designated times during the day.
- Purchase an inexpensive electronic device that automatically calls the police, fire department, hospital, or ambulance at the push of a button (a valuable aid in the event your client can't get to a telephone).
- Have a backup caregiver in case your regular service provider is unable to come on a given day.

Emergency numbers

Suggest that your clients post a list of emergency telephone numbers, including the nearest hospital, police station, and fire station, by each telephone. In many areas, 911 is an all-purpose emergency number that connects to the police, fire department, and ambulance. They may also want to post the names and telephone numbers of neighbors, family, friends, or others who can be called in an emergency.

Theft prevention

Recommend that your clients replace all the door locks with new deadbolt locks and have new keys made. There is no way of knowing how many sets of keys there may be to the old locks and who has them. Following are some more tips you may want to pass along:

- Lock windows and doors when you are not at home.
- Alert a neighbor if you plan to be away for a few days or more.
- Install a timer so that inside and outside lights come on automatically at dusk.
- Ask a neighbor to collect your mail, or have the post office hold it until your return.
- Discontinue newspaper deliveries while you are away.

Fire safety

You can help your clients avoid possible disaster by urging them to eliminate fire hazards and install smoke detectors and fire extinguishers.

Smoke detectors. One should be installed outside each bedroom door and in or near the living room. They should be checked at move-in, and retested at least twice a year. Many homeowners do this in the spring and fall when they reset their clocks for daylight savings time.

Fire extinguishers. Every house should have at least one fire extinguisher that is easily accessible from the kitchen and the main living area. In a bigger house, additional extinguishers might be placed in the garage, in the basement, and on each floor.

Fire-prevention inspection. In many communities, fire departments provide free home inspections to point out possible fire hazards such as frayed electrical cords, an overloaded electrical system, flammable materials stored too close to a heat source, or clutter in the basement or attic. Or they may provide videos and written materials to help homeowners do their own inspection.

Fire drills and evacuation plan. Advise your clients to devise an evacuation plan and make sure all members of the household know the safest and fastest way to get out of the house in the event of a fire. If anyone would need physical assistance to get out of the house, the local fire department (and the neighbors) should be aware of this. The evacuation plan should identify a location outside the house where all members of the household will gather while waiting for the fire department to arrive. Periodic fire drills with family members (especially children) and service providers help ensure that everyone knows what to do in case of a fire.

Carbon monoxide detectors. Carbon monoxide (CO) is a colorless, odorless, deadly gas. Because today's energy-efficient, airtight home designs may trap CO-polluted air inside the house, the U.S. Consumer Product Safety Commission recommends installing at least one CO detector near the bedrooms. A second detector located near the home's heating source adds an extra measure of safety.

Storing valuables. All of a homeowner's important papers, including the deed to the house, should be stored in a safe place such as a fireproof box or a rented bank safe-deposit box.

Insurance coverage

Homeowner's insurance

Insurance coverage is essential to protecting a homeowner's investment, and at least minimal coverage is required by the lender. Advise your clients to make sure their homeowner's policy remains up-to-date and provides sufficient coverage. A good way to ensure they always have sufficient coverage is to request an inflation rider, which automatically increases the amount of coverage as the value of the house increases. Your clients also should check with their agent to determine whether standard coverage is sufficient to cover the replacement cost of their personal belongings.

Flood insurance

This is required by lenders if the home is in a federally designated flood area. Even if it is not required, your clients should consider purchasing coverage if they live in a flood-prone area.

Mortgage life insurance

This type of insurance pays the balance of the mortgage if the policyholder dies or, in some cases, becomes disabled. Mortgage life insurance can be expensive and may not make sense for a single homeowner with no dependents.

If your clients have questions regarding their insurance coverage, they can access the Consumer Insurance Guide on the Internet (www.insure.com). This is an independent site that does not sell insurance and is neither owned nor operated by an insurance company.

Defining roles for in-home caregivers

As new homeowners, your clients are likely to have much more responsibility and decision-making power than they had in their previous living situations. They should take this opportunity to define the roles of each of the people assisting them and to spell out how they will work together as a team. It may be useful to schedule one or more meetings of any paid and unpaid aides to ensure that all issues are resolved. Issues that may need to be addressed are scheduling, boundaries, and privacy. The following tips should help ensure that the transition goes smoothly.

Schedules

Arranging for assistance when and where it is needed can be a difficult chore. Your clients may find it helpful to choose one person to help coordinate the schedule for all of the people who assist them.

Boundaries

Now that they have their own place, your clients likely will have more opportunities for privacy than they had previously. Nevertheless, they may find that getting the assistance they need while maintaining their private space is a challenge. If they want to establish boundaries within their home, they need to clearly communicate their expectations to everyone who will be coming into their home on a regular basis. Suggest that your clients answer the following questions as they consider what ground rules will work for them:

Do you want the people who assist you to —

- enter your home without knocking?
- answer your telephone?
- answer the door?
- make coffee without asking?
- clean your house?
- help themselves to food from your refrigerator?
- schedule appointments for you?
- use your shower?
- come into your bedroom without knocking?
- have meetings at your house?
- smoke in your home?
- have their own set of house keys?
- bring their pets or children to your house?

Making monthly mortgage payments

You cannot overemphasize to your clients the importance of making their mortgage payments on time each month. Buying a home is the biggest investment most people ever make, and no one wants to jeopardize it. Making late payments may result in late charges and damage to your clients' credit rating. Failing to make payments will set in motion even more serious consequences — the lender's action to foreclose and sell the home.

Your clients can guarantee that this will never happen by always making their payments on time. If a problem arises that could keep them from making their payments, they need to immediately discuss their situation with the lender. They may be able to work together so that the borrowers can keep their house and get back on the right track.

Understanding the loan terms

At the closing, your clients signed both a mortgage note (a legal IOU to the lender) and the mortgage or deed of trust (the legal document that secures the note and gives the lender a claim against the property if your clients default on the note's terms).

Payment terms

Make sure your clients know —

- when their monthly mortgage payments are due (normally the first day of the month) and
- where to send them.

Lenders usually either provide a payment book to help borrowers keep track of their payments or send monthly billing statements. Borrowers are responsible for sending in their payment at the beginning of each month and may be charged a late fee if the payment is received after the 15th of the month. Remind your clients that the payment must be received by the date indicated on the mortgage note. Mailing a check on the due date does not satisfy this requirement.

Automatic deductions. Making late payments results in a bad payment record and could hurt your clients' chances of getting an extension of time on a payment in the event of a real emergency. As we discussed earlier, if your clients are worried about making payments on time, one option is to have the mortgage payment automatically deducted from their bank account each month.

Biweekly payment schedule. Borrowers who get paid every two weeks or receive benefit checks twice a month may find it convenient to split their mortgage payment and pay on a biweekly schedule. They should check with the lender to make sure this is acceptable.

Extra payments. All borrowers should understand the positive consequence of paying extra money toward the mortgage (provided this does not result in prepayment penalties). Especially in the early years of the mortgage, most of each monthly payment goes to pay the interest on the loan. Any additional amount is applied directly against the principal. Most borrowers are surprised to learn that even a small additional contribution, made regularly, can significantly shorten the life of the loan.

The Power of Extra Payments

By including a little extra amount with each monthly mortgage payment, borrowers can save a substantial amount of interest over the term of the loan. For example, borrowers who consistently pay an extra $50 per month can typically pay off a 30-year loan in 25 years. If your clients are in a position to make extra payments regularly, they should ask the lender to calculate the reduction in loan term and resulting savings in interest.

ARM terms

If your clients have an adjustable-rate mortgage (ARM), the amount of their mortgage payments may change over time. Be sure they understand how frequently the interest rate and payments may change and how the new rate is calculated. Whenever the interest rate or monthly payment changes, they should check carefully to see that the lender has accurately calculated the new payment based on the correct index as of the correct date. If they have any questions about the calculation, they should contact the lender immediately and ask for an explanation. If they are still not satisfied, they should contact the federal regulating agency.

Federal regulators have found that lenders often make mistakes in calculating the new monthly payments on ARMs. Because such a mistake could cost your clients hundreds or even thousands of dollars over the life of the loan, advise them to be vigilant.

Other terms

If your clients decide to sell their house, can they pay off their loan without being charged a prepayment penalty? Would the buyer be allowed to assume (take over) the existing mortgage? Their mortgage documents should provide the answer to both of these questions.

Servicing issues

Servicing a loan involves collecting and processing the borrowers' mortgage payments and handling the escrow account (including paying the borrowers' property taxes and insurance premiums when due).

Transfer of servicing

Many lenders routinely transfer the responsibility for servicing the loans they originate to another lender or servicer. This is a common practice, and the only drawback for borrowers is that instead of dealing with bank personnel at the local branch where they applied for the loan, they send their payments to another company that may be in a different state. A transfer of servicing does not affect the terms of the mortgage.

If a transfer of servicing occurs, your clients should receive two letters: one from the original lender and one from the new servicer. Advise your clients never to send their mortgage payment to a third party unless their current servicer notifies them that their mortgage servicing has been transferred. If in doubt, they should contact their original lender to verify the transfer.

Escrow adjustments

If your clients' monthly mortgage payment includes escrows for homeowner's insurance and property taxes, this portion of the payment may change if the insurance premium or property tax rates change. The servicer calculates the increase in the monthly escrow and informs borrowers of the adjusted mortgage payment.

Your clients should receive an annual escrow statement from their servicer. Advise them to check the accuracy of the calculations and to contact the servicer immediately if they don't understand an item on the analysis.

Servicing problems

If your clients believe that they have been improperly charged a penalty or late fee or if they have other problems or questions relating to the servicing of their loan, they should contact their servicer in writing. Lenders are required to provide written acknowledgment within 20 business days of receiving a written inquiry from a borrower. Within 60 business days, the servicer must either correct the account or determine that it is accurate. The servicer must send the borrower a written notice of the action taken and why.

Cancellation of mortgage insurance

If your clients have a conventional loan (that is, a loan other than an FHA or VA loan) and they made less than a 20 percent down payment, they are probably paying mortgage insurance, or MI. This type of insurance protects the lender (not the borrower) in the event the borrower defaults on the mortgage. Under the terms of the Homeowners Protection Act of 1998, borrowers with a good payment record have the right to request that MI be canceled when they have paid off 20 percent of the original mortgage balance. For some mortgages, lenders are required to automatically cancel MI when the borrower has 22 percent equity in the property. Servicers must inform borrowers about their right to MI cancellation each year.

Even if they are not required to do so, lenders may agree to cancel MI on the request of borrowers who have achieved 20 percent equity in the property. Advise your clients to be aware of this and to ask at the appropriate time.

Avoiding foreclosure

A homeowner's most important financial obligation is the monthly mortgage payment. If borrowers fall behind on their monthly mortgage payments, the lender has the legal right to foreclose on the loan and then sell the property to pay off the loan. Your clients risk losing their home, all the money they have invested in it (including the down payment, closing costs, and all the monthly payments), and their good credit rating. Any legal fees related to the foreclosure may be added to the amount owed. Worse yet, if the value of the property has dropped, the foreclosure sale may not bring a high enough price to cover what is owed on the mortgage. If the lender obtains a deficiency judgment, your clients could wind up owing the lender money even after they have lost their home!

Planning ahead

The best way to avoid foreclosure is to plan ahead. If your clients have established an escrow account for long-term maintenance and repairs, they should be prepared when unexpected repairs are needed. Also advise your clients to make a budget and stick to it, as described later in this chapter. If they want to make an improvement or purchase an expensive item for their home, recommend that they set aside whatever they can afford each month until they have saved enough to pay for the item they want without going into debt.

What to do if financial problems hit

If your clients start having problems making their monthly mortgage payments, they are in a serious predicament. Even one missed payment can be difficult to make up. If borrowers find themselves in this situation, they need to get help right away. You can help by them consider all possible resources by asking questions such as these:

- Is there a relative you might be able to borrow from?
- Can you cut back, at least temporarily, on other expenses?
- Can you work overtime or get a second part-time job?
- Is there a nonprofit or government agency you can turn to for help?

Warn your clients against the temptation to catch up on a missed mortgage payment by taking out a short-term loan from a loan company or by taking a cash advance on a credit card. The interest rate on consumer credit is very high and will only lead to more serious financial trouble.

Contacting the servicer

Many people have a tendency to hide from their creditors when they encounter financial problems. But this is exactly the wrong thing to do. If they put off doing anything in hopes that their financial situation will soon improve, they risk losing their home. Instead, they should call their loan servicer immediately to explain why they are unable to make their mortgage payment. They should get the name of the person they talk with and write a follow-up letter that will be placed in their loan file.

The follow-up letter to the lender should include the following information:

- borrower's name,
- mortgage loan number,
- property address,
- borrower's daytime and evening telephone numbers, and
- a brief explanation of why they are unable to make the mortgage payment.

Servicers are generally willing to work with borrowers provided they believe they are acting in good faith (that is, they sincerely want to make their monthly mortgage payments and keep their home) and it appears the problem can be resolved. The servicer is more apt to be sympathetic if your clients' payment history is good and they contact the servicer right away, rather than waiting for the servicer to initiate action.

Advise your clients not to avoid telephone calls from their servicer if they are behind in making payments. They should also not make repayment promises they know they won't be able to keep.

Working with a credit counselor

If the lender thinks there is a good chance that your clients can bring their payments up to date, they may suggest a credit counselor. The counselor may either work for the lender or for an independent credit counseling agency. As a home-buyer educator/ counselor, your agency or a nonprofit housing assistance agency also may be able to help. Credit counselors are trained to give advice and help homeowners who are having trouble paying their bills manage their money better. They can help your clients develop a realistic household budget and set up a repayment plan that will allow them to get back on track with their mortgage payments.

To locate a housing counseling agency in your community, call 1-800-388-2227.
Or contact Fannie Mae's Consumer Resource Center at 1-800-7FANNIE (1-800-732-6643).

Alternatives to foreclosure

Depending on your clients' situation and the type of mortgage they have, the lender might offer some type of temporary or permanent assistance. If your clients have an FHA or VA mortgage, the loan servicer must follow the foreclosure policies set by HUD or VA, respectively. If your clients' loan has been purchased by Fannie Mae, the servicer may discuss various options, depending on whether the borrowers can afford to keep the home. To find out if a loan is owned by Fannie Mae, you may contact the Consumer Resource Center at 1-800-7FANNIE (1-800-732-6643) and provide your clients' property address. We can check to see whether that property is in our database.

If borrowers can afford to keep their home

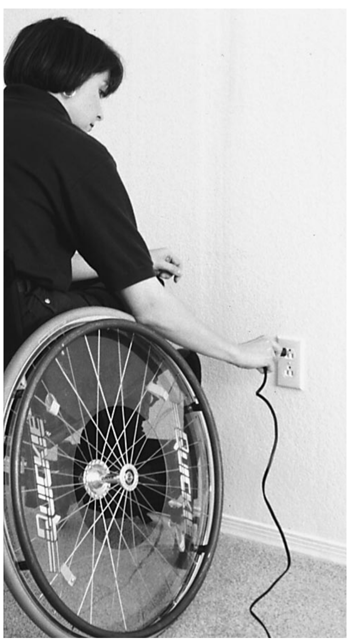
Sometimes borrowers experience a temporary reduction in income or financial hardship, such as an illness. When this happens, they may temporarily be unable to afford their mortgage payments. Once the situation improves, however, they are able to resume their scheduled mortgage payments. By working cooperatively with the lender, your clients may be able to catch up on their mortgage obligations and salvage their credit record.

If the borrower is experiencing a temporary financial setback, the servicer may suggest one of the following options:

Repayment plan. The servicer arranges for the borrower to make an additional payment each month (in addition to the regular mortgage payment) until the loan becomes current.

Forbearance. This is a formal written agreement under which a lender agrees to reduce or suspend a borrower's monthly payments for a specific period of time. After the agreed-upon period, the borrowers resume their regular payments and pay an additional amount each month to make up for the missed payments.

Loan modification. In extreme cases, the lender may be willing to change the terms of a borrower's mortgage (for example, by lowering the interest rate, changing an adjustable-rate mortgage to a fixed rate, or increasing the repayment period) in order to reduce the borrower's monthly payments and prevent foreclosure.



If borrowers cannot afford to keep their home

When borrowers experience financial hardships from which they cannot recover, the following options may be available to help avoid foreclosure:

Loan assumption. This is a method of transferring ownership of a home to a new buyer who agrees to take responsibility for the existing mortgage. Not all mortgages are assumable, so this option must first be discussed with the servicer.

Preforeclosure sale. The servicer (and the investor, such as Fannie Mae, if any) allows the property to be sold and agrees to accept the proceeds of the sale in satisfaction of the mortgage loan even though the sale may yield less than the amount owed on the mortgage.

Deed in lieu of foreclosure. Under this option, the borrower voluntarily gives the property deed to the servicer in satisfaction of the mortgage loan. Generally, this is a last alternative to foreclosure.

Beware of dishonest "buyers"

Unfortunately, some individuals and companies try to take advantage of homeowners who are having financial difficulties. Many homeowners have been cheated by individuals who say they can help but actually cause the homeowner to lose everything. These "distressed homeowner" programs may look enticing to people who can no longer make their monthly mortgage payments. Advise your clients that if they believe the only way out of their financial difficulty is to sell the house, they should talk with and seek advice from their lender, credit counselor, planning team, or a real estate attorney before signing any form or sales agreement.

Getting help

As always, remind your clients to ask the members of their planning team for advice or help if they run into problems or have questions. For more information or for assistance with any homeownership issue, they may call Fannie Mae at 1-800-7FANNIE (or 1-800-732-6643).

Maintaining the home

Often, only after settling in does reality hit the new homeowner. Unless they have bought into a condominium or cooperative, homeowners must take responsibility for many chores they may have taken for granted as tenants — for example, mowing the lawn, raking leaves, shoveling snow, and cleaning gutters. Gone are the days of phoning the landlord or building maintenance staff to report a leak or faulty outlet. Make sure your clients are prepared to deal with this new reality.

Here are some suggestions that may help ease the transition.

Preventive maintenance

In many cases, preventive maintenance can actually extend the life of things and avoid the need for expensive repairs. For this reason, your clients would be wise to create a seasonal checklist and mark the calendar at the beginning of each year to highlight upcoming chores. Once they have established a routine, these chores won't take long and are well worth the trouble.

We have provided a Seasonal Home Maintenance Schedule (see Worksheet 6) to help your clients get started. It can be tailored to reflect each home's individual systems and unique needs. Reviewing the home inspection report they received before they bought the house may also remind them of specific areas needing attention.

Energy conservation measures

Many new homeowners are shocked to discover the high cost of utilities. When they see their first heating or air-conditioning bills, they may be eager to find ways to conserve energy. Many low-cost ways to improve the energy efficiency of a home don't require specialized skills. Your clients should ask the following questions:

- Does the house need more or better insulation?
- Are storm windows installed in each window?

- Is weather stripping or caulking needed?
- Is the attic properly ventilated?
- Is the room temperature regulated by a timed (programmable) thermostat?

The local utility company or state conservation agency may provide energy-saving tips specific to your geographic area. Most electric companies will do a free home inspection to help homeowners find ways to reduce their consumption of electricity. Free weatherization services may be available to low-income homeowners. Your clients might also investigate federal tax rebates and utility company incentives, including low-interest loans, for installing energy-efficient heating and cooling systems.

Of course, conserving energy is not a one-time effort. Homeowners must continue to monitor their use of utilities and carry out maintenance projects aimed at cutting energy bills each year.

The U.S. Department of Energy and the Environmental Protection Agency jointly sponsor the Home Energy Saver, a Web-based tool to help homeowners identify the best ways to save energy in their homes and find the resources to accomplish the energy-saving measures. The Web site is located at http://hes.lbl.gov.

Do-it-yourself repairs

Doing routine maintenance and making small repairs before they turn into big projects can save both money and aggravation. Moreover, many basic home repairs don't require expensive tools or a lot of experience. Encourage your clients to ask their planning group, social service providers, family members, friends, and neighbors for hands-on help or advice with small projects such as painting the exterior woodwork, building a deck, or installing an air conditioner.

Homeowners should have at least the following basic tools to get started:

- hammer and an assortment of nails,
- straight-blade and Phillips (or combination) screwdrivers,
- slip-joint pliers,
- handsaw,
- wall scraper,
- tape measure,
- flashlight,
- plunger (one that works for both sinks and toilets), and
- a stepladder.

Basic home repair courses are offered by many community colleges and cooperative extension service offices, as well as by local hardware stores and building suppliers. Public libraries and local bookstores may have basic home maintenance books or videos on maintenance and repairs. And if your clients have access to the Internet, dozens of Web sites are devoted to home maintenance and repair topics.

Home improvements and accessibility modifications

If your clients' new home requires accessibility modifications or other major repairs, you may be able to provide guidance as they gather funds for the project and hire a contractor. If the improvements are not urgent, you might advise them to consider postponing any major renovations for a year or so to make sure they can comfortably afford their mortgage payments and routine maintenance expenses.

When your clients need to hire an expert, the following tips may help them get the project done right for a fair price.

Hiring a qualified contractor

An architect or contractor who is otherwise qualified and comes highly recommended may have had little or no experience with accessibility design and renovation. Your clients should attempt to locate a person who has expertise in this area and who is willing to be flexible and creative when it comes to ensuring that their home is tailored to their specific needs.

Requesting referrals. To find a qualified contractor, your clients should look for companies that work in their area and have a reputation for high-quality work. They may receive more personalized service and a better price from an individual than from a big company. They might ask for referrals from local human services agencies, independent living centers, or rehabilitation facilities. Or they might ask for recommendations from people who have made similar modifications to their homes and have received good service.

For information on accessibility and design issues, your clients also can contact the Center for Universal Design at North Carolina State University (1-800-647-6777).

Checking references. Advise your clients to get names and telephone numbers of a contractor's previous customers and call them to find out if they were satisfied with the contractor's work. If a contractor comes to their door trying to sell his or her services, your client should be suspicious. Reliable contractors do not usually operate this way.

Obtaining a written contract. Ideally, homeowners should get written estimates from at least three contractors who are qualified to complete the required work. The more precise the specifications the homeowners provide, the more realistic the bids will be. Advise your clients to compare the estimates, including the details of how and when the work will be completed, to determine which contractor is offering the best price.

Make sure your clients find out whether the quoted price is an estimate or a firm bid. A bid is an offer from the contractor specifying that the work will be completed for the stated cost. With an estimate, the contractor has the right to charge more for the work, depending on how long it takes or how complex the job becomes. Often, especially with older houses, contractors will not give a firm bid because it's impossible to know until they start the work what they'll find and how hard it will be to fix.

Get a written contract. For major construction projects, your clients should insist on a written contract from the contractor. The contract should specify exactly what work is to be performed, start and completion dates, and a schedule of payments. Recommend that your clients always withhold part of the payment until the entire job is completed to their satisfaction.

Financing major repairs and home improvements

No matter how well your clients plan and budget, at some point they may be faced with costly emergency repairs they can't afford. Following are some suggestions:

Public or private repair programs. There may be a state or local government program or a nonprofit agency in your area that will help pay for needed repairs. Many communities also have volunteer organizations and community housing programs that provide assistance with repairs.

Warranties and insurance coverage. Remind your clients to check whether the item needing repair (for example, the heating system or washing machine) is covered by a warranty. Some repairs (such as those necessitated by water damage) may be covered by your clients' homeowner's insurance policy. For condominium owners, damage to common areas may be covered by the association's insurance policy.

Home improvement and personal loans. Home improvement loans may be a source of funds, especially for homeowners who have little or no equity in the property. Personal loans from a bank or credit union may be another option. Or your clients may find a contractor who will provide financing. Fannie Mae offers HomeStyle® second mortgages that provide funds to repair, remodel, or enlarge a home. Another possibility is the FHA Title I Home Improvement Loan.

Home equity loans. Home equity loans enable homeowners to borrow against the equity they have built up in the home. They may either borrow a fixed amount that is repayable in equal monthly installments or a line of credit that allows the homeowner to borrow money as it is needed. An advantage of home equity loans is that the interest paid may be deductible. A disadvantage is that the borrowers are putting their house up as collateral, which means they risk losing their home in the event they are unable to repay the loan.

Be sure your clients understand the terms of the loan and how it is to be repaid. Advise them to shop around for the lowest interest rate, just as they did for their mortgage. They also need to know whether the loan is repayable in monthly installments or whether they must repay it all at once.

Household budgeting

As new homeowners, your clients may feel the need to buy many things — perhaps a new lawn mower, an air conditioner, or some new furniture. Recommend that they wait a few months, if possible, until they are confident that they can handle their new mortgage payments. Although mortgage payments should be their top financial priority, they also can't afford to get behind on their utility bills or their car payments. This leads us to the important subject of prioritizing expenses and managing a household budget.

Creating a budget

Most people would like to spend less and save more, but they just don't know where to start. For many of us, creating a budget is like starting a diet — well, there's always tomorrow. Encourage your clients not to delay but to take that first step today!

A budget doesn't have to be complicated. It's simply a picture of the money flowing in (income) and the money flowing out (expenses) of the household. The goal is to ensure that money is flowing in faster than it's flowing out. The process of developing a budget will help your clients set goals and priorities as well as keep track of how they spend their money. A budget will also help them identify poor spending habits before they cause problems. The budget worksheet that your clients completed in Chapter 1 is a good basis from which to develop a budget.

The basic steps to developing and managing a budget are the following: (1) determine the household's total net income; (2) determine the household's total monthly expenses; (3) compare monthly expenses with monthly income; (4) analyze where to cut back; and (5) set goals.

Step 1: Determining total net income

For budget purposes, your clients need to know the total amount of money they receive each month. This includes their benefits, take-home or net pay (that is, after deductions for taxes, medical insurance, and so on), and any other regular income they receive. Have them review and update the income figures in their budget worksheet.

To calculate monthly income:

- If paid weekly, multiply take-home pay by 52 and divide by 12.
- If paid every other week, multiply take-home pay by two.

Annual bonuses, gifts, income tax refunds, occasional overtime, and other infrequent sources of income should not be included. Your clients should focus on what they receive on a regular basis each month.

Step 2: Determining total monthly expenses

Have your clients review and update the "proposed" expense figures in their budget worksheet.

Housing costs. These figures should reflect your clients' actual mortgage payments (including property taxes and property insurance) and their average monthly utility costs (gas, electricity, water and sewage, trash collection, cable television, and telephone) and homeowner's association or condo fees, if applicable. Any annual, semi-annual, and quarterly expenses should be broken down into a monthly figure. For example, if a car insurance premium of $150 comes due twice a year, they should set aside $25 each month to meet this expense.

Using a Budget Calendar

Advise your clients to use a calendar to note the due date of all their monthly expenses (mortgage, utilities, car payments, etc.). They should pay particular attention to expenses that come due quarterly or annually, such as property taxes, property insurance, and car insurance and registration. A budget calendar will help ensure that your clients have set aside enough money to cover all of these expenses and are not caught unprepared.

Home maintenance allowance. Homeowners need to budget for regular home maintenance and emergency repairs. Some financial advisers suggest saving 1 percent of the purchase price of the house for annual maintenance and repairs. This means that if your clients paid $80,000 for their house, they should set aside $800 per year (or $65 per month). This amount should be adjusted as appropriate for each individual situation. Your clients' maintenance costs may be higher if they have an older house with the original plumbing, wiring, furnace, and roof.

If your clients have a commitment from an agency to provide a certain amount to help cover their home maintenance costs, they should take this into consideration in figuring their own allowance.

Other monthly debt payments. For budget purposes, your clients don't need to include any expenses (such as income taxes and health insurance) that are deducted from their paycheck. They should, however, include all other regular debt payments such as credit cards and car loans.

Credit card debt. If your clients have credit card debt, they should pay it off as quickly as possible. Because credit card companies usually require only a minimum payment each month, many consumers are tempted to pay only this minimum

The High Cost of Credit Card Debt

Suppose Joe owes $500 on his credit card, which has an interest rate of 18 percent. If he charges no new purchases and makes the minimum payment of $15 each month, it will take him 47 months (or almost four years) to pay off the $500 and he will have paid $198 in interest!

Now suppose that Joe had decided he could afford to make monthly payments of $35. He would have finished paying off the debt in 17 months (about 1-1/2 years), and he would have paid only $67 in interest — quite a savings!

amount. This is a serious mistake because it may take years to pay off even a small credit card balance at this rate.

Because the interest rate on credit cards is so high, your clients should have a definite plan for paying off this debt as quickly as possible. You might suggest the following strategies:

- Compare the terms of multiple cards, including the annual percentage rate (APR), finance charge, annual fee (if any), credit limit, grace period (the number of days after the due date before a penalty is charged), and minimum monthly payment. Combine existing credit card debt under the card that offers the lowest APR.
- Use only one or two credit cards consistently, and pay for all new purchases when they are billed each month.
- Close out all unused credit card accounts by contacting the bank that issued the cards. (Simply cutting up the plastic will not remove the account from the card holder's credit report.)
- Resist the temptation to sign up for "preapproved" credit card offers. Shred these offers and throw them away!

Debit Cards

These look like credit cards, but funds are immediately deducted from the user's checking account. Remind your clients to record each use of their debit card in their checkbook, just as if they had written a check. Otherwise, they may overdraw their checking account and incur expensive bank charges.

Cash purchases. Most people find it hard to keep track of their cash expenditures. They have a record of payments made by check and credit card, but they often have no idea how much they and their family members spend for entertainment or miscellaneous cash expenditures. Suggest that your clients begin by "guess-timating" these expenses, then verify their accuracy by tracking their out-of-pocket expenditures for a two-month period. They may be surprised at how those little impulse purchases add up!

Automated Teller Machines (ATMs)

By making it so easy to withdraw cash, ATMs are some people's worst enemy. Some people find that cash "eats a hole in their pocket." If they have it, they spend it. In addition, many banks charge fees for the use of ATMs or allow only two or three withdrawals a month before imposing a fee. In some cases, ATM users are charged twice — by their own bank and by the bank operating the ATM machine.

Emergency reserve fund. No homeowner can afford to be without a serious savings plan. Everyone needs a safety net to fall back on. Many financial advisers suggest saving 5 percent of take-home pay in a separate account that is set aside only for a real emergency. The goal should be to build up a reserve equal to three to six months' worth of expenses. Most people find if they simply save whatever is left at the end of each pay period, they wind up with no savings at all. Establishing an emergency reserve fund should be a high priority. Failure to put aside money for an emergency can mean losing their home in the event of a temporary financial setback.

Step 3: Comparing expenses with income

If your clients' net income covers their monthly expenses, skip to step five, setting goals. If their expenses exceed their net income, they're in trouble! They can't keep this up for long before they will face a real financial crisis. If their finances look fine on paper but they admit that they often run out of money before the end of each pay period, that's also a sign of trouble.

If the "buy now, pay later" way of life has left your clients with a mounting pile of bills, they could be headed for real trouble. If they're in over their head, they need to get help. Suggest that they contact Fannie Mae's HomePath Hotline at 1-800-7FANNIE (1-800-732-6643) to find a free consumer credit counseling agency in their community. Or check Fannie Mae's consumer Web site at http://www.homepath.com.

Step 4: Deciding where to cut back

What advice can you give your clients who need to cut back on their spending?

First, have them categorize their monthly expenses as either fixed or discretionary expenses. Fixed expenses, such as the mortgage payment, utilities, and insurance premiums, are obligations that cannot be changed. Discretionary expenses are those over which they have control, such as entertainment, eating out, and clothing.

Second, have them categorize their discretionary expenses as either needs or wants. Food and clothing are necessary expenses, but the amount spent on these items is partly discretionary. For example, your clients might be able to decrease their food budget by taking a lunch to work rather than always eating out. Or they might decide they don't really need another new pair of shoes.

Third, have them prioritize their "wants." You can help your clients decide how much they can really afford to pay for items in this last list. Suggest ways to save on entertainment expenses (such as getting books out of the local public library rather than buying them, renting a movie rather than going to the movie theater, and going to free concerts and events). This will help them create a realistic spending (and savings!) plan that will allow them to live within their budget.

Step 5: Setting goals

If your clients have enough income to cover all their expenses (and they have home maintenance and emergency funds and are paying down their credit card debt at a reasonable rate), congratulate them! They can now begin to establish some short-term goals (perhaps a home improvement project, a new stereo, a car, or a vacation) and long-term goals (such as saving for retirement). Help them decide how much they would need to save each month to achieve one or more of their goals, and suggest they put this money aside in a separate bank account.

Keep in mind, however, that recipients of disability benefits may be limited as to the amount they can save without jeopardizing their benefits or eligibility for Medicaid.

Living within one's budget

Creating a budget can help put your clients on the road to greater financial security. But they won't reach their goal unless they actually use their budget on a daily basis. A budget is not something that can be created and then put aside and forgotten. Encourage your clients to look at their budget at least once a month (perhaps when they pay their bills) to see how they are doing. If they continue to spend more than they're bringing in, they need to keep looking for ways to cut back. They can't afford to give up!

The following budget tips may prove helpful to your clients:

- Be a wise grocery shopper. Try not to go food shopping when you're hungry. Always use a grocery list so you only buy items you need. Compare prices of similar products and of the same product in different size packages. Use coupons to reduce your grocery bill but only to buy items you need. Remember to compare prices.
- Plan ahead for major purchases rather than making impulsive decisions. Whenever you charge anything, look carefully at the financing terms. Often the retailers that offer the easiest terms (such as no payments due for three months) charge the highest rates. Shop around and compare. Try to save up for things you need, rather than charging them. You'll pay less, and while you are saving, you may decide that you'd rather use the money for something else.
- Most people find that credit cards create a temptation to spend money they don't have. Establish the habit of using checks to make purchases and pay bills, rather than using a credit card. Store-issued credit cards usually have higher interest rates than bank-issued cards (such as Visa or MasterCard).
- Sign up for your gas and electric companies' "budget" or "average payment" plan. The company determines an estimated cost per year based on your past consumption, then divides this figure by 12. You pay this amount monthly, no matter how much gas or electricity you actually use. Once a year, the utility adjusts the monthly payment up or down to reflect actual usage. Paying a set amount each month helps with budgeting because it spreads the high cost of winter heating throughout the year.

Financial benefits of homeownership

Along with the increased responsibilities that come with homeownership, remind your clients that there are also many financial benefits of owning their own home.

Tax benefits

For many years, the federal government has promoted homeownership by providing homeowners with significant tax benefits that are not available to renters. A quick rundown of these benefits follow. To take advantage of these deductions, taxpayers must use IRS Form 1040 rather than Form 1040EZ.

Interest deduction

The interest paid on a home mortgage is deductible, which can save homeowners a lot of money, especially in the early years of a mortgage when most of a borrower's monthly mortgage payment is interest.

Example: Suppose your clients are paying 8 percent interest on an $80,000 fixed-rate mortgage payable over 30 years. The monthly payments (principal and interest only) are $587.02, or $7,044 per year. In the first year of the loan, your clients will pay $6,375.86 in interest and only $668.26 in principal. The entire interest amount is a deductible expense.

The interest paid on a second mortgage is also deductible. Moreover, in the first year, home buyers can deduct any points that they (or the seller) paid to the lender in the process of obtaining the mortgage.

Property tax deduction

Property taxes paid to local jurisdictions are deductible, and some states also allow deductions for these taxes. Your clients may also qualify for local property tax rebates offered to low- and moderate-income or first-time homeowners.

Depreciation of rental income

Homeowners who rent out part of their home must pay taxes on the rental income. However, they can first deduct the cost of repairs, operating expenses (including utilities, insurance, and advertising for tenants), and an annual depreciation allowance.

Capital gains exclusion

Generally, when people sell something for more than they paid for it, they must pay a capital gains tax. Again, homeowners receive preferential treatment in this regard. Homeowners who sell a property in which they have lived for at least two of the past five years are not taxed on up to $250,000 of profit (or $500,000 for a husband and wife who file a joint income tax return).

For tax purposes, it's important to keep accurate and complete records of the cost of any home improvements. Although these expenditures are not deductible, they increase the home's "basis," which in turn determines the amount of the gain for tax purposes. Even the closing costs paid by the borrower can increase the home's basis, so advise your clients to keep the HUD-1 Settlement Statement in a safe place with their other important papers.

Using homeowner's equity

Owning a home is an investment. As borrowers pay down their mortgage, they build up equity (their ownership interest) in their home. In addition, if the market value of the house increases, their equity increases. Your clients can quickly calculate their equity as follows:

Current value of house – Mortgage balance = Equity.

Homeowners can take advantage of this equity buildup in a number of ways.

Second mortgages

One way to take advantage of the equity buildup in a home is to take out a second mortgage. This is a loan for a specified amount targeted for a specific purpose (such as a major home improvement project) that is repayable over a fixed period. It differs from a personal loan in that the property serves as security for the loan. The interest rate on such a loan is normally higher than for a first mortgage but less than for an unsecured (personal) loan.

Home equity loans

Another way to take advantage of the equity in a home is to take out a home equity loan. Because the debt is secured by the home, all or part of the interest is deductible, regardless of how the money is spent. As discussed previously, homeowners may either borrow a fixed amount that is repayable in equal monthly installments or establish a line of credit that allows them to borrow funds as they are needed. An advantage of home equity loans is that the interest may be deductible. However, borrowers should be certain that they understand and will be able to meet the repayment terms. Because their house is the collateral for the loan, they risk losing their home in the event they are unable to repay the loan.

Refinancing

If interest rates are falling, your clients may be able to significantly reduce their monthly mortgage payment by refinancing their mortgage at a lower interest rate. By obtaining a mortgage that is greater than the outstanding balance of their existing mortgage, they also can cash in on their homeowner's equity ownership without selling the house. Even if the new loan is with the same lender, refinancing usually involves going through closing (and paying closing costs) all over again. A prepayment penalty on the mortgage could result in a significant additional expense, so advise your clients to check their mortgage documents before proceeding with refinancing. They also should shop around for the best terms, just as they did for their original mortgage — again comparing closing costs as well as the annual percentage rate.

A salable asset

Your clients can turn their housing investment into cash by selling it. Because most people don't remain in the first home they buy for the rest of their lives, it is prudent to consider the resale value of a home from the outset, especially if they plan costly renovations.

Post-purchase checklist

Have your clients use this checklist to ensure that they are on the right track to successful homeownership:

______Move in.

______Organize a housewarming party!

______Meet the neighbors.

______Become familiar with the house.

______Establish a maintenance schedule and set aside funds for maintenance and routine repairs.

______Take safety precautions.

______Define the roles of people who provide assistance.

______Establish schedules of caregivers.

______Set boundaries; make a list of house rules.

______Establish a household budget and take appropriate measures if you are over-spending.

______Establish an emergency fund.

______Make your mortgage payments on time and get help immediately if you run into problems.

______Enjoy the tax and other financial benefits of homeownership!

Summary

Once they have purchased a home, it is essential that your clients protect their investment by developing a sound financial management plan that includes setting aside funds for routine maintenance and emergency repairs. If they ever find that they are unable to keep up with their monthly payments, they should contact the loan servicer immediately to discuss the situation and try to work out a solution. If they cooperate with the lender, they may be able to avoid foreclosure and the loss of their home. As they pay down their mortgage over time and the market value of their home increases, they will have the satisfaction of knowing they are building up substantial equity for the future. We are confident that your clients will enjoy the many benefits and rewards of homeownership.