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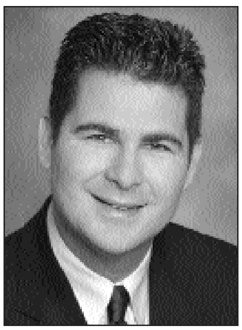
Tips for Financing a New Home Purchase



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Looking for a home can be quite a trying experience. Supply is not keeping up with demand, which means prices are high and plenty of competition. Know how big a mortgage you would qualify for before you start looking for a new house. Otherwise, you may find the right house, but not the right price.

Once you have found your new house, how do you finance it? Whether you use cash, your investments, your retirement savings, or a loan, you will need to plan for the down payment, a first and possibly second trust deed mortgage.

Down payments can be quite costly, depending upon the purchase price of the house. If you don't pay at least 20 percent down, you will need to purchase private mortgage insurance, known as PMI. PMI protects the lender from immediate decreases in property value until you build equity in your house. PMI is not tax deductible, but does increase your monthly mortgage payment.

What are your options to pay the down payment? If you have the cash needed, then use it. If you have investments, such as stocks, bonds, and mutual funds, examine your overall portfolio position. Sell investments at gains if you have taken losses previously during the year, or sell securities with losses if you previously sold investments at gains. This will allow you to optimize your tax planning, and reduce your tax liability at the end of the year. If all of your investments are in retirement plans, then you may need to take a distribution or a loan. A "first time" home-buyer is allowed to take a one-time distribution of up to $10,000 from his/her IRA without early withdrawal penalties, but it will be subject to income tax. This exemption allows you, if married, to take out $20,000 to use toward your down payment. In addition, you may be able to take a loan from your 401(k) plan or other pension plan. Discuss the restrictions on loans from your plan with your plan administrator. If you take a loan from your 401(k) plan or another pension plan, you will have to pay it back over a normal amortization period (30 years) with interest, but at least you will be paying interest to yourself. Keep in mind one option might not work alone, so you may need to use a combination to put 20 percent down.

If you can't pay 20 percent down, pay as much as you can and then apply for a second mortgage for the remaining amount. This is known as a second trust deed loan and is similar in nature to a first trust deed. However, interest rates are normally higher on a second trust deed loan. You will also need to qualify for the loan amount.

The remaining 80 percent of the price will be financed through a first trust deed loan. You will need to apply and qualify for this loan. There are many different options with a first trust deed loan. Consider how long you plan to live in your new house. Is it a starter home that you will live in for 5 years, or your dream home that you will live in for 40 years? It will help you determine the period you want at a fixed rate. There are loans that have variable rates changing constantly; there are those with fixed rates, and interest only loans. Fixed rate loans range from 1 year to 30 years fixed. The shorter the period is fixed, the lower the interest rate will be. However, it is always best to fix your interest rate for more time than you think you will live there. For example, if you think you will live in your house for five years, you may want to consider a 7-year fixed rate mortgage, which will become adjustable in the 8th year.

Be aware of lender fees and closing costs when purchasing a house. Consider getting several quotes, because each lender has different costs. Fees are not tax deductible, but points are and they can help reduce the interest rate.

In March, inflation surged at an annualized rate of 6.2%, which means rates for mortgages will begin to rise. Higher rates mean housing prices will slowly cool down. If you are planning to buy a new house, you may want to weigh the difference in housing prices against the potential increase in mortgage rates. You may be better off resisting the urge to pay top dollar now, and wait to see if inflation continues to rise this year. As a rule of thumb, if you only plan on living in the house for a short period of time, you are better off paying less for the home and a higher interest rate.

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