

## Budgeting for Home Ownership

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Perhaps you are just beginning to think about buying a home sometime in the future. Or maybe you have already found a home you would like to buy. Whether you hope to buy a home soon, or not for a number of years, it is very important to look at your personal or family financial situation. If you do not have and use a written spending plan (a budget) and keep records of your spending and saving, now is the time to begin!

The budgeting and record keeping habit will help you decide whether you are ready for the costs and responsibilities of homeownership. Too often, people think only about saving enough money to *get into* a house. They forget that the expenses of home ownership can be greater than the costs of renting—and that they also need to be able to manage their money well in order to *stay in* the house.

This publication will help you estimate and then prepare to meet three different kinds of homeownership costs:

**One-Time Costs**—including down payment, closing costs and other essential items such as moving fees, utilities deposits and start-up charges;

**Regular Mortgage Payments and Household Operating Costs**—including utilities, cleaning supplies and services, plus periodic expenses for homeowners insurance and property taxes (the last two may be part of the mortgage payment); and

**Future Occasional Housing Costs**—such as preventive maintenance, repairs, new

furnishings, replacement of major appliances, home improvements.

When you begin shopping for a mortgage loan, being able to show your budget and records for each type of homeownership cost above will demonstrate to the lender that you and your family know how to manage money—that you are good credit risks.

### UNDERSTANDING THE CREDIT REPORTING SYSTEM

Could your credit record contain some information that would make a lender hesitate about approving a mortgage loan? You need to find out exactly what is in your credit record.

The credit reporting system in this country involves an enormous network of local businesses (credit bureaus) that keep electronic records of the credit history of millions of consumers. These companies are connected by a nationwide computer system that cooperates to permit any lender to request information about the credit record of any borrower.

The purpose of this credit reporting

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system is to help businesses decide whether or not to grant credit to you. The credit bureau does not make the decision; it simply shares the information in your record. The lender studies that information, which shows how promptly you have paid your debts. The lender also considers your income (ability to repay), the length of time you've lived in one place, and how long you've held your present job. In the case of a home purchase, the lender would have the extra security of being able to foreclose on the house if you failed to keep up with loan payments.

Ask the nearest credit bureau for a copy of your credit report so that you know what it says. If you find errors, you can ask for corrections. If you've had credit problems in the past, you can learn how to reduce the risk of future problems and improve your credit record through good budgeting and record keeping. Check the yellow pages for the credit bureau(s) in your area, and ask if they have your records. Or call any of the three national corporations to locate your record: Equifax (800-6855-1111); TRW (800-682-7654); and TransUnion (see local yellow pages). If you have been denied credit recently, you will be given a copy of your report without charge. Otherwise there might be a small fee. Knowing what is in your report before you apply for a loan is a good investment.

### GETTING STARTED

Financial counselors suggest that you take a good look at your *current financial situation* before you prepare a budget to guide your future spending. Ask yourself the following questions, and fill in your answers on the work sheet at the bottom of this page.

*How much income does your household receive?*

- Make a complete list of **gross income** (total income) from all sources for the past year. (Mortgage lenders will ask to see your gross income figures.)
- Figure the **average monthly gross income** you received last year by dividing the above total by 12.
- Make a list of your monthly deductions and withholdings.
- Subtract the deductions/withholdings from your gross income to show your **average monthly net income**. This is the usual amount of money you have available for debt payments, family living expenses and savings.

## WORK SHEET: YOUR CURRENT FINANCIAL SITUATION

### 1. How much income does your household receive?

- a. Annual Gross Income \_\_\_\_\_
- b. Average Monthly Gross Income ( $1a \div 12$ ) \_\_\_\_\_
- c. Average Monthly Deductions \_\_\_\_\_
- d. Average Monthly Net Income  $1b - 1c$  \_\_\_\_\_

### 2. What is your credit situation today?

- a. Total long-term debt owed (debt load) \_\_\_\_\_
- b. Total due each month for debt repayment \_\_\_\_\_
- c. Percent of average monthly gross income required for debt repayment ( $2b \div 1b$ ) \_\_\_\_\_

### 3. How are you using household income?

- Uses of income (use monthly averages)
- \_\_\_\_\_
- a. Monthly debt payments \_\_\_\_\_
  - b. Family living expenses  
EXCEPT housing \_\_\_\_\_
  - c. Current housing expenses \_\_\_\_\_
  - d. Savings and investments \_\_\_\_\_
  - e. Total uses of income ( $3a + b + c + d$ ) \_\_\_\_\_
  - f. Monthly net income less total uses of income  
( $1d - 3e$ ) \_\_\_\_\_
- (If anything is left, add it to your savings!)

### 4. How much money have you set aside for savings and investments?

- a. Current cash value of assets \_\_\_\_\_
- b. Current money owed \_\_\_\_\_
- c. Current Net Worth ( $4a - 4b$ ) \_\_\_\_\_

*What is your credit situation?*

- Make a complete list of all your long-term debt (loans and charges that will take a year or more to repay).
- Figure the total amount of money you owe and note when each loan will be paid in full.
- Figure the total amount due each month for debt repayment.
- Figure the percentage of your average monthly gross

income that is required for your monthly debt payments.

- As recommended earlier, study your credit report from the credit bureau that keeps your record. Check it for accuracy, and be prepared to discuss it with the lender if you apply for a mortgage loan.

*How have you used your household income this past year?*

- Make as accurate a list as possible of the average amount of money you use in a month for each category:
  - debt payments for previous purchases
  - new family living expenses, *except* housing
  - housing expenses (rent, utilities, cleaning supplies and services, furnishings and equipment, insurance)
  - savings and investments
- Figure your average monthly total for all of the above.
- Compare your average monthly net income with your average monthly total for debt payments, family living expenses and savings. Do they balance? Being able to

plan and control your use of cash and credit today will help you control your spending and meet future housing expenses.

*How much money have you been able to save and invest?*

- List the current value of all your savings, investments and other assets (things you own and could sell, such as jewelry, furniture, a boat).
- Compare the value of all your assets above with the total amount of debt you owe. This is called your *net worth*. It will be used later in planning for your down payment and other one-time costs.
- Find out how much you actually need for a down payment under some of today's special lending programs. If you don't have enough money at this time, you may be able to increase your savings (and perhaps your income) and buy the home you want in the future.

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## MAKING A BUDGET AND KEEPING RECORDS & MAKING ADJUSTMENTS\*

Because you are developing a budget, or spending plan, for the specific purpose of getting into and staying in your own home, it's a good idea to keep your estimated housing costs separate from other family living expenses. That will make it easier to see what kinds of adjustments you need to make. You can make your own work sheets, or use a printed form or computer system that is personalized for you or your family.

If you take the time to carry out each of the following steps, you will discover the size of mortgage and monthly housing expenses you could afford today—and then plan for the future. Use the work sheet on page 5.

### Steps 1-4: Making a Budget

#### 1. *Spell out your financial goals.*

- Look at your *net worth*, and think about how much of your assets you would be willing to use in order to buy a home. If you do not yet have enough money for a down payment and other one-time costs, you will want to increase your savings (and your income, if possible) to help reach that goal.
- If your debt load is too large, your first goal will be to spend less, use less credit, and pay off some of your debts.

#### 2. *Estimate your gross and net income for the coming year.*

- Look at last year's income and think about possible changes in the coming year. Include only income that you are confident will be available. Also look down the road and think about how stable your income will be for many years of mortgage payments and other housing expenses.

#### 3. *Analyze your current financial situation.*

- Look at your credit situation. Think about each debt and the amount of payments due each month. Ask yourself what changes you *must* make or want to make in the coming year.
- Look at last year's average expenses. Think about each item, and ask yourself what changes you *must* make, and others that you want to make.
- Look at your savings and investments. Think about how much you can set aside each month to increase them.

#### 4. *Make a plan for the use of net income in the coming year.*

- a. Spell out your planned monthly payments for all long-term debt obligations. (Your lender will calculate the percentage of debt payments in comparison with your gross income, to see if it falls within specific guidelines.) Subtract the amount needed for debt payments from your estimated net income.

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\*If you feel that you need more detailed information on budgeting, ask for a copy of North Carolina Cooperative Extension Service publication HE-345, Making a Budget, and Making It Work!

**WORK SHEET: MAKING A BUDGET and  
MAKING IT WORK!**

**1. Set Financial Goals**

**2. Estimate Next Year's Gross and Net Income**

- a. Average Monthly Gross Income \_\_\_\_\_
- b. Average Monthly Deductions/Withholding \_\_\_\_\_
- c. Average Monthly Net Income \_\_\_\_\_

**3. Analyze Current Financial Situation**

(previous worksheet) and consider the ways in which your estimates for the coming year will be similar or different from last year

**4. Make a Plan for Using Your Net Income**

- Average Monthly Net Income (2c) \_\_\_\_\_
- a. Monthly Debt Repayment \_\_\_\_\_  
Balance Left \_\_\_\_\_
- b. Estimated Monthly Family Living Purchases  
EXCEPT housing expenses \_\_\_\_\_  
Balance Left \_\_\_\_\_
- c. Estimated Monthly HOUSING expenses \_\_\_\_\_  
Balance Left \_\_\_\_\_
- d. Average Monthly Savings & Investments \_\_\_\_\_  
Balance Left, if any \_\_\_\_\_

**5. Keep a Record of Your Expenses**

**6. Compare Budget and Expense Records and Make Adjustments**

- b. Write down your monthly estimates for all family living expenses *except* housing, and figure the total. Subtract this estimated non-housing expenses total from the amount left at the end of 4a.
- c. Estimate each of the average monthly housing expenses for a house in the price range you are consider-

ing, and figure the total. A lender or realtor can help you estimate mortgage payments (principal and interest), taxes, and insurance. They may be able to help you estimate utilities, although these will depend on the specific house and the way you would use it. You also need to estimate the average monthly cost of caring for a house (the operating costs), plus an additional estimated amount to be set aside each month for future maintenance, furnishings, equipment, and repairs. (The recommended range is from 3 to 5% of the house's value.)

- d. Compare your estimated housing expenses in 4c with the estimated income available at the end of 4b. Is money still available for savings and investments? If the income available is not equal to or greater than estimated expenses, it's time to re-evaluate your situation. Will you cut back on other spending, look at less expensive housing, or wait and save a while longer?

Prepare an actual budget for the coming year that will guide your spending and help you reach your goals. Use a pencil so that you can revise your budget whenever necessary. Remember: a budget is a flexible tool to help you reach your goals.

**Steps 5-6: Keeping Records and Making Adjustments**

If you develop a good budget, but do not keep a record of your expenses, you're wasting your time. If the budget you've developed above shows that you do have enough income to pay both the operating costs and future occasional costs for a home of your own, you're ready to begin looking at houses in your price range. Be sure to study the housing market itself to determine whether current interest rates and local housing costs are acceptable. Keep good financial records while you wait, and practice planning your purchases, controlling credit use, and increasing your savings.

*5. Keep track of all expenses.*

- For each pay period, use a chart and jot down how you actually used your money. Choose a specific area in your house to be your "office" and work out a bill paying and record keeping system for convenient, frequent use. Many companies today allow only a short time before their bills are due, and they may not arrive until after the first of the month. Paying your bills only once a month may not be often enough to

keep your credit record “clean.” Each time you pay your bills, enter the amount in your records. Keep labelled receipts and cancelled checks to help you remember to enter other expenses in your records.

6. *Get in the habit near the end of each month of comparing your spending plan with your expense records from 5 above.*

- Do not expect your plan and your expenses to be exactly the same, but ask yourself why they are different. If you need to revise your budget for future months, do so! If you need to be more careful about spending and use of credit, try to think of ways to remind yourself to stop and think before you spend money for things that aren't in your plan and would delay your reaching your goal of home ownership.

## **ACCEPTING LIMITATIONS AND MAKING DECISIONS YOU CAN AFFORD**

The decision to buy a house—with its commitment to repay the mortgage loan and meet the other costs of owning a home—is very serious. It is important to remember that there is no such thing as the perfect house. There is more than one house that you and your family could find satisfying. In order to get and keep a home of your own, take the time to estimate the costs and choose a home you can afford.

The forms provided in this publication ask you to gather much of the information that a lender will want to know. However, these forms are designed for your personal use—to help you understand your current financial situation and to begin planning and keeping track of personal and family expenses. The lender you choose will provide specialized forms for you to complete when you actually apply for a mortgage loan. You should have no trouble completing those forms and demonstrating your credit-worthiness if you and your family take steps now to make budgeting and record keeping a habit.

## **References**

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### **You may be interested in other North Carolina Cooperative Extension Service publications:**

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|---|--|
| Should You Buy or Rent? HE-426                                  | Selecting Home Buying Professionals HE-434 |
| Selecting Your House HE-427                                     | Negotiating for Your House HE-435          |
| Choosing to Rent HE-428   | Inspecting a House HE-436                  |
| Selecting the Location for Your House HE-429                    | Choosing the Best Mortgage HE-437          |
| How Does the Space in Your House Rate? HE-430                   | House Purchase Contracts HE-438            |
| Environmental Considerations in Real Estate Transactions HE-431 | Furnishing Your First Home HE-439          |
| Budgeting for Home Ownership HE-432                             | Preventive Home Maintenance Guide HE-440   |
| Financial Aspects of Home Ownership HE-433                      | Homeowner's and Renter's Insurance HE-444  |

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