

How Much Should You Put as Your Down Payment?

Question: I have been renting the same townhouse for the last six years. My landlord now wants to sell the property and he has asked if I want to buy it. He is offering to sell it to me for \$220,000, which I think is a great deal. I have a good salary, good credit and a good savings account. My question is this: How much cash should I use as a down payment and how much of a loan should I apply for? Some people tell me I should put at least 20 percent down to eliminate Private Mortgage Insurance (MI). Others have said I should keep my cash and take the largest loan possible to get the tax deduction. Is there a rule of thumb that I should follow when it comes to a down payment?

Answer: First, congratulations on purchasing your townhouse. Over the long run, your investment of ownership in your dwelling is likely to be very profitable. Remember at the end of the journey, a homeowner pays off his mortgage and owns a house. A renter has zip.

Now, let's get to your question. Although many experts will say it's wise for income earning folks to have a large mortgage because of the low rates and tax deduction, it's not right for everyone. Here are some things to think about:

- **Private Mortgage Insurance (PMI).** PMI is a monthly fee that the borrower pays if the first trust loan exceeds 80 percent of the purchase price. Since a lower down payment results in a statistically higher risk to the lender, PMI insures a portion of the loan to reduce the risk to the lender. Thanks to creative lenders, however, a borrower can still put as little as no money down and avoid PMI by taking out two loans. Ask your loan officer about loan packages with no PMI, sometimes called "piggy-back" financing.
- **Monthly payment "comfort level".** This is a very important issue. If you have good credit and income, most lenders will qualify you for a larger loan amount than you would want. The first thing you should do is assess your personal spending and saving habits and try to come up with the maximum mortgage payment that would fit into your budget.
- **Taxes.** Understand the benefits of mortgage interest and real estate tax deduction. Since you will own the home, you will be able to deduct all the interest and taxes you pay on the home. Consult a tax expert on these issues, but it's important to get an idea of how much of a tax break you will receive if you own the home. This will help you decide your mortgage amount.
- **Opportunity costs.** Analyze the "opportunity cost" of a large down payment. In other words, if you put down 20 percent, or \$44,000, what are you giving up? Is the \$44,000 earning a good rate of return? Do you have to sell securities and pay capital gains taxes to liquidate the money? Get an idea of how much it will cost you to put down \$44,000.
- **Other debts.** Take into consideration other debt you may have. For example, if you are carrying substantial credit card debt, it would probably be better to pay the cards off instead of putting down a large down payment.

Hopefully this is a start in the right direction when determining how what mortgage balance you should carry. But as I said, congratulations on purchasing a home. It's a great way to ring in the new year.