

**WHY NOT BORROW TO
BUY A HOME?**

**A GUIDE FOR FUTURE
HOMEOWNERS**

(A Public Education Brochure)

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- How large a loan can you get?
- How will the type of housing loan you get determine how big a house you can afford?
- Which housing loan is best for your budget?

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When you finish reading this guide, you will have the answers to these questions and several more. It is important that you know this information so you will be prepared for questions a lender will ask when you apply for a housing loan. It is also important to know this information so you can get an idea about how expensive a home you can afford before you go shopping.

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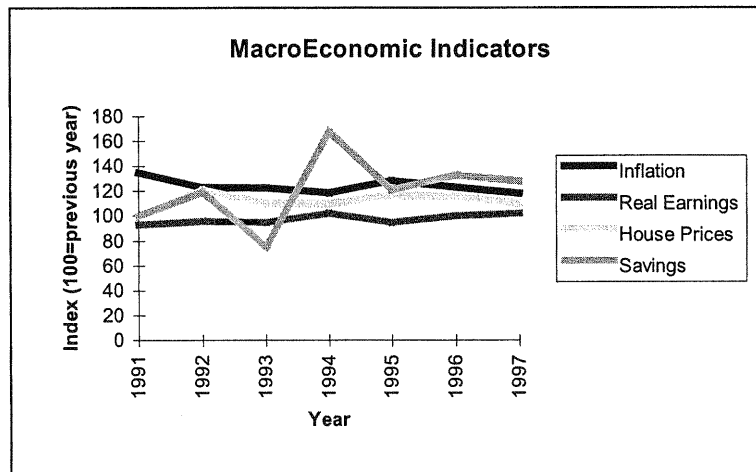
HOUSING FINANCE IN HUNGARY

Access to housing opportunities has fundamentally changed in Hungary since 1989. Before, housing was allocated by the state through control of supply and demand, leading to an inequitable distribution of resources. Families could not always choose where to live nor in what type of dwelling.

Recent developments in the housing sector have caused more people to access to home ownership either through privatization of existing dwellings or purchase of new or existing housing, leading to greater personal savings through equity in housing. Today, about 90 percent of all Hungarians own their own home. With lower interest rates and expansion of the capital markets in Hungary more households can access finance for the purchase of a house.

Demand for Housing Is Related to Current Income and Money Savings

Macroeconomic indicators for Hungary show a steady increase in real income growth over the past several years. As Chart 1 shows, real income growth has risen in recent years leading to greater consumption of goods and services. Household saving rates has also risen over the same period at a rate faster than income growth. With greater purchasing power families have more disposable income to attribute to housing investment.



On the whole, housing prices have risen, although not as fast as inflation, so that at present real estate is a relatively attractive investment, especially for a longer term.

For the prospective home buyer these macroeconomic developments have led to increased flow of capital to banks to finance housing.

There has never been a more favorable time to invest in home purchase—prices of new or existing homes are relatively low; inflation rates and, in turn, interest rates are falling; and household savings rates are increasing.

Given these favorable macroeconomic indicators, the risks for families associated with financing house purchase are lower than in previous years. With increases in liquidity banks have additional motivation to lend more money. By accessing housing loan, families can realize home ownership earlier than if they waited to save enough money to purchase a house outright.

The lending process, however, involves choices both for the consumer and the lender.

WHAT YOU CAN AFFORD

As you know, when you want to purchase a house but the amount of your savings are not sufficient you can complement your own resources with taking out a housing loan. You may also know that most families in Hungary can afford to borrow between one to almost two times their annual net income, depending on the type of loan, length of term, and whether the loan is subsidized. Following this rule, a family with a combined income of 2,000,000 HUF per year should be able to borrow up to almost 4,000,000 HUF for an existing house—about the typical price.

What is a Housing Loan?

A housing loan in Hungary today is usually secured by a mortgage, that requires you to pledge the house or other property as the lender's security for repayment of your loan. The lender holds the title to your property until you have paid back your loan plus interest on the loan. If you do not repay your housing loan, the lender has the right to repossess your house. Using your home as security enables you to get a loan at a lower interest rate than you would pay if you wanted an unsecured loan.

Principal and Interest

All housing loans have two features in common. The first feature is the housing loan *principal*, which is the amount you borrow. The second feature is the housing loan interest, which is the money you pay for use of the money you borrow. How much interest you pay over the life of the loan depends upon many factors, including the type of housing loan, the amount of the loan, and the terms of the loan (interest rate and length of the loan).



Amortization

You will repay your housing loan gradually through periodic payments that will decrease the principal of your loan and pay down the interest charged on the loan.

Affordability

There are four factors you should know about before you decide upon a property to purchase and you *choose* to finance the purchase with a housing loan. These are:

1. The size of your down payment
2. The amount of your housing loan
3. Your housing loan interest rate
4. Repayment terms of the housing loan

All four factors will influence affordability for you. Therefore it is important to pay attention to all four factors without excluding any one.

In addition, you might want to take into consideration the availability of housing subsidies when determining affordability. There are housing subsidy programs available—like interest subsidies, down payment grants, contract savings premiums, and guarantees—that you might want to use to supplement your purchase.

Size of Your Down Payment

The larger the down payment the smaller will be the amount you will need to borrow, and therefore the smaller your housing loan payments will be.

Lenders view housing loans with larger down payments as more secure since you have more of your money invested in the property. However, by depleting your entire savings to make a larger down payment you overextend your personal finances since there are other costs (moving costs, lender fees, costs associated with repairs and purchase of new appliances) associated with home purchase.

How Much Money Should You Save for a Down Payment?

You may have more money than you know. However, you should carefully work through an exercise to calculate the money you have at your disposal to make a down payment. The worksheet below will help you to calculate the amount money available for your down payment.

After you have calculated the amount of money you are willing to initially invest in your purchase, you can proceed to calculate the amount of money you need to borrow to make your home purchase.

Down Payment Calculation Work Sheet

Assets Available for Down Payment		Upcoming New Home Expenses	
Savings account		Moving expenses	
Checking account		New home repairs	
Cash value of life insurance		Home decorating	
Proceeds of sale of home, if applicable		Major appliance purchases	
Gift from relative(s)		Estimated closing costs at settlement (usually 3-6% of your loan amount)	
Other assets that can be sold to obtain funds		Other major purchases in next six months unrelated to new home (car, etc.)	
A. Total liquid assets available	\$	B. Cash needs for next six months in new home	\$
A-B = Total down payment available: \$			

Guidelines to Determine the Amount to Borrow

Your monthly housing loan payments will depend to a great extent on the amount you borrow—your principal. Lenders will use your current income and amount of debt as a guide to determine how much money they will lend to you. One guideline a lender will use to determine the amount of money to lend to you is the size of your monthly payment in relation to your monthly income. Usually lenders will not lend to you if your monthly housing loan payment will exceed between 25 and 33 percent of monthly income, taking into consideration other factors such as the amount of your debt, length of housing loan, the total price of the house, collateral used to secure the loan, etc. The following chart shows different levels of income and maximum allowable monthly loan payment using a 30 percent housing loan to income ratio.

Note that the numbers in this chart are for information, and do not coincide with any monthly payment calculated by any bank. Additionally, only interest on the principal has been included taken into consideration for calculating loan amounts that can be borrowed. No other fees, like servicing fee, have been considered. You can use this chart in different ways. If you feel comfortable spending a third of your income, start by looking up the row with your household net monthly income (in the first column) to see how large a loan you can afford. If you would like to spend less than that, choose a monthly repayment that you are comfortable with from column 2.



Net Monthly Income	Monthly Payment (30% of your net monthly income)	Loan Amount That Can Be Borrowed	Loan Amount That Can Be Borrowed
		Loan period 10 years Interest rate: 24%	Loan period 15 years Interest rate: 24%
70000	21000	930000	1010000
80000	24000	1060000	1150000
90000	27000	1190000	1300000
100000	30000	1325000	1440000
125000	37500	1655000	1800000
150000	45000	1990000	2160000
200000	60000	2650000	2880000
250000	75000	3315000	3600000
300000	90000	4000000	4320000
350000	105000	4640000	5040000
400000	120000	5300000	5760000

OBTAINING A HOUSING LOAN

The type of housing loan you choose will be influenced by the following:

1. How much money will you need to borrow?
2. For how long would you like to incur debt for housing?
3. What will be the financial burden you undertake by borrowing various types of loans (with respect to both the amount of the loan and variation over time)?

There are basically two types of conventional housing loans available in Hungary. These are:

- Variable Rate Annuity Loan
- Deferred Payment Housing Loan "(DPM)"

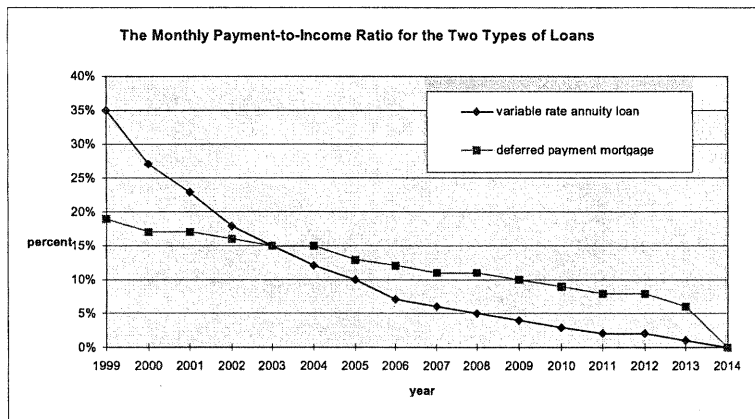
The two types of housing loans are distinguished by the way the interest rate is applied to calculate monthly payments.

The Variable Interest Rate Housing Loan is used most commonly. The amount of its payment fluctuates according to the current market interest rate. Banks usually calculate the payment once or twice a year. Under current conditions, most banks in Hungary will offer variable rate housing loans with maximum payment-to-income ratio set at 33 percent. In addition, most banking institutions that offer this type of housing loan require a loan-to-house value (price) ratio to not exceed 60 percent (varying from 50 to 70 percent depending on the lending institution and other terms of the loan).



If you are confident your income will increase over time, then you should consider a deferred payment housing loan (DPM).

The design of this type of housing loan is based on the idea of postponing some of the repayments in the early years of the loan to the later years, when your nominal or current income is expected to be higher. The interest rate you must pay for this type of housing loan is set lower than the existing market interest rate and the difference between the initial payment (based on the lower “payment rate” of interest) and the payment due at the market interest rate is deferred. Periodically, your monthly payment will increase gradually (in nominal terms) so that the loan is fully amortized over the repayment period. Currently, the maximum payment-to-income ratio is 25 percent for a DPM—lower than the one for a variable rate housing loan. In addition, by using a DPM type of housing loan you will be able to qualify for a larger housing loan since your initial monthly housing loan payments will be lower than those associated with a variable interest rate loan.



The main difference between the two housing loans described above is that in the case of VRM the financial burden is much heavier at the beginning of the loan period while in the case of the DPM the cost is more evenly distributed across the life of the loan.

The difference between the two loan types is depicted by the chart above. The chart demonstrates how the share of the borrower’s income that is spent on the loan each month changes over the course of the loan period. (The following conditions have been used in the chart: a total family monthly income of Ft 150,000; an inflation rate of 12 percent; an interest rate of 23 percent; a payment rate of 10 percent for the DPM loan; and a loan amount of Ft 2,467,000.)



Soon, other types of housing loans will become available at select lending institutions. One new type of loan will apply a fixed interest rate over the term of the loan (5 years). It is expected that the interest rate for this type of loan will be set at between 15 and 16 percent. A fixed rate loan means that the borrower can be certain that monthly payments will remain constant throughout the term of the loan, so that the borrower will not be subject to unexpected increases in the repayment but at the same time will not be able to take advantage of decreases in the interest rate over the term of the loan. The other new product is a "mortgage loan" that applies a variable interest rate over the term of the loan but does not use your income to determine the amount of money you may borrow. Instead, the "mortgage loan" relies on the value of your collateral to determine the amount of money a bank will lend to you. Usually, a bank that issues this type of loan requires that you have collateral of at least 3 times the amount of the loan.

When you take out a loan you have to consider carefully the length of your loan repayment period. This can vary. You should take into consideration that the longer the repayment period the less you have to pay each month and the more total interest you will have to pay on the principal amount of borrowed money. Today, banks in Hungary offer various repayment periods such as 5, 10, 15, or even 25 years. The length of your repayment period will also be influenced by your income or ability to meet the payment to income ratio set by banks.

Another important consideration when choosing a housing loan is the amount of equity you wish to retain in your house. The larger the down payment the more equity you retain in your house over the term of your loan. Moreover, the shorter the repayment period, the faster you build equity in your house. Equity can be an important consideration, especially if you plan to use your house as collateral for another loan.

WHY WAIT?

A loan can help you and your family buy a house now instead of waiting until you have saved the total cost of the house in cash. Nevertheless, you will want to consider your options carefully.

The decision to purchase a house is an important one for most families since it involves a commitment to not only maintain a house but also to engage in a contractual relationship with a financial institution for a longer period. This decision should be carefully weighed against the alternatives. Before having their own house many people live with their parents or other relatives, often in overcrowded circumstances trying to save as much money as they can. But for some families, there is another alternative, which is to rent existing housing.

The economic role of rental housing is based on three simple facts. First, occupancy of rental housing is separate from ownership. This saves the cost of marketing the property and transferring ownership every time residency changes. Second, renters rely on current cash flow, not past accumulation of money. (Ownership requires accumulation of savings.) Third, rental housing requires minimal management and maintenance activity by the renter.

Rental housing caters to people who are mobile, either economically, or geographically. An individual's position in the life cycle plays an important role in the decision to own or rent. Young adults who are not ready to marry but are economically and socially independent of their parents can rent freeing them of longer-term financial commitment.

In addition, renters whose economic circumstances change can adjust their housing accommodations to suit their needs. Finally, and very importantly for Hungary, families who change their geographic location, usually for reasons of employment, can more easily find rental housing.

For these reasons, rental housing is a viable option for many individuals and families in Hungary especially in a country that is still undergoing transition to a market-based economy. Of course, most families will eventually want to own their own home if they can afford it: there are many good reasons to purchase housing and build equity as a homeowner.

If you do decide that now is a good time to buy a home, remember that a housing loan can help you take that step. Before deciding on a lender, you will want to shop for the best terms for you. Before you decide on a specific property to purchase, use this guide to determine whether the price of the property fits within your resources and the terms offered by lenders. There are a number of financial institutions that offer housing loans. The following table lists the financial institutions that offer housing loans in Hungary. You may want to contact several of these institutions to inquire about their rates and terms before deciding where to apply for a housing loan.