



Learning at Your Fingertips

# Buying Your First Home



In this module:

- Overview
- Getting Finances In Order
- Shopping For A Home
- Making An Offer
- Finalizing The Deal



## Overview

For many people, it's the biggest financial transaction they'll ever make. That's why doing it right the first time is so important. Sometimes, buying a house can feel like a dizzying set of rules and regulations. Luckily, armed with the right knowledge and know-how, you can start realizing your homeowner dreams — the fast, easy, way.



# Getting Finances in Order

**1. Strengthen your credit.** The higher your FICO score, which ranges from 300 to 850, the better interest rate you'll qualify for. The difference between a 4.5% interest mortgage and a 5% interest mortgage can mean *tens of thousands of dollars* over the life of the loan. Get a free copy of your credit report so you can see what the lenders see on your credit history.



## Getting Finances in Order

Pay off credit cards and resolve any credit disputes or delinquencies. In general, scores between 650-700 will get the average rate. A higher score it will get a great .25% reduction, but a score below that will cause a significant increase in your interest rates.





## Getting Finances in Order

**2. Get pre-approved to get the actual amount you can pay.** Apply to several lenders within a two week period so that the inquiries do not damage your credit report. Do this *before* contacting a real estate agent so you have a firm idea of what you can afford, and you don't accidentally fall in love with a [house] that you cannot afford.



## Getting Finances in Order

- Sellers *love* buyers who get pre-approved. Pre-approved buyers are almost always given the green light by lenders, meaning there's less risk for the deal to get scuttled in the end.



## Getting Finances in Order

- Don't accidentally get pre-qualified instead of pre-approved. There's a difference. Pre-approval means that the lender is usually prepared to give you a loan after seeing your financial vitals. Pre-qualified only means that the lender is *estimating* what you could borrow. It doesn't mean you'll get a loan.





## Getting Finances in Order

**3. Shop for your mortgage.** Wait — why would I shop for a mortgage before deciding on a house? Isn't that totally backward? Not necessarily. Shopping for a mortgage before you decide on a house can be beneficial for one overriding reason:



## Getting Finances in Order

- You'll know exactly how much you can borrow *before* you buy your home. Too many people fall in love with a home that they — well — can't afford. They struggle finding a mortgage that covers the cost of the home. Finding a mortgage first and a home second is decidedly less sexy, but it's twice as smart. You'll immediately be able to tell whether a home is in your price range or out of it.



## Getting Finances in Order

- Think about the sort of down-payment you'll be able to afford. This should be part of your mortgage calculations, although you don't need to know for sure when shopping for a mortgage. Have a general idea in mind. More on this later in the article.



## Getting Finances in Order

**4. Find out what ratios lenders are using to determine if you qualify for a loan. "28 and 36" is a commonly used ratio. It means that 28% of your gross income (before you pay taxes) must cover your intended housing expenses (including principal and interest on the mortgage, as well as real estate taxes and insurance).**



## Getting Finances in Order

Monthly payments on your outstanding debts, when combined with your housing expenses, must not exceed 36% of your gross income. Find each percentage for your monthly gross income (28% and 36% of \$3750 = \$1050 and \$1350, respectively). Your monthly payments on outstanding debts cannot exceed the difference between the (\$300) or else you will not be approved.





## Getting Finances in Order

**5. If you qualify, check out first-time buyers' programs.** These often have much lower down payment requirements. These are offered by various states and local governments. You may also be able to access up to \$10,000 from your 401(k) or Roth IRA without penalty. Ask your broker or employer's human resources department for specifics regarding borrowing against those assets.



# Shopping For A Home

## **1. Find a good real estate agent to represent you in the search and negotiation process.**

The real estate agent should be: amiable, open, interested, relaxed, confident, and qualified. Learn the agent's rates, methods, experience, and training. Look for a realtor who lives local, works full time, closes at least several properties per year, and has a reputation for being busy.



# Shopping For A Home

**2. Sign up for an MLS alert service to search on properties in your area.** A Multiple Listing Service will give you a feeling for what is on the market in your price range. Your agent can do this for you.



## Shopping For A Home

**3. Start looking for houses within your range.** Most lenders suggest that you pay no more than 38% of your monthly income towards your mortgage and debts combined. This means, on any given month, no more than 38% of your paycheck goes to paying back loans. You should use an online Home Affordability Calculator to find your own sweet spot.



# Shopping For A Home

**4. Start to think about what you're really looking for in a home.** You probably already have a vague idea, but the angel's in the details. There are a couple things in particular that you and your family should give good thought to:





# Shopping For A Home

- What will you and your family need in several years? Maybe you're just a couple right now, but are there are plans for kids in the future? A home that snugly fit two people could be torturous for three or four.



# Shopping For A Home

- What tradeoffs are you willing to make? In other words, what are your priorities? Although we like to believe that buying a house can be straightforward, it's often a complex ordeal in which we're forced to compromise.



## Shopping For A Home

- Do you expect your income to increase over the next couple years? If your income has increased by 3% for several years in a row and you hold a secure job in a safe industry, you can probably rest assured that buying an expensive but still reasonable mortgage is possible. Many homebuyers buy relatively expensive and then grow into their mortgage after a year or two.



## Shopping For A Home

**5. Define the area you'd like to live in.** Scout out what's available in the vicinity. Look at prices, home design, proximity to shopping, schools and other amenities. Read the town paper, if there is one, and chat with the locals. Look beyond the home to the neighborhood and the condition of nearby homes to make sure you aren't buying the only gem in sight.



## Shopping For A Home

**6. Visit a few open houses to gauge what's on the market and see firsthand what you want.** Pay attention to overall layout, number of bedrooms and bathrooms, kitchen amenities, and storage. Visit properties you're seriously interested in at various times of the day to check traffic and congestion, available parking, noise levels and general activities.





# Shopping For A Home

**7. Look at comparable houses in the neighborhood.** If you are unsure about the price, have the home appraised by a local appraiser, who also looks at comparables. When appraising a home, appraisers will look for comparables or "comps," homes in the area which have similar features, size, etc. If your home is more expensive than the comps, or the appraiser has to find comps in a different subdivision or more than  $\frac{1}{2}$  mile (0.8 km) away, beware!



## Shopping For A Home

Never buy the most expensive house in the neighborhood. Your bank may balk at financing the home, and you probably won't see your home appreciate in value very much. If you can, buy the least expensive home in a neighborhood — as homes around you sell for more money than you paid, your home's value increases.



# Making An Offer

**1. If possible, tailor your bid to the seller's circumstances.** This is not easy, and often impossible, but it doesn't hurt to try when making one of the biggest purchases in your life. Here are some things to keep in mind as you think about your offer:



## Making An Offer

- What is the seller's financial prospects? Are they in desperate need of money or are they sitting on a pile of cash? Cash-strapped sellers will be more likely to take an offer that undercuts their asking price.



## Making An Offer

- How long has the home been on the market? Homes that have been on the market for longer periods of time can usually be bid down.
- Have they already bought another house? If the sellers aren't currently living in the house they're trying to sell, it may be easier to bid less than you otherwise might.



## Making An Offer

**2. Look at comparables when you make your bid.** What did other homes in the neighborhood start off as ("asking price"), and what did they sell at? If homes in the area routinely sold for 5% *below* asking price, think about making an offer that's anywhere from 8% to 10% lower than the asking price.





## Making An Offer

**3. Calculate your expected housing expenses.** Estimate the annual real estate taxes and insurance costs in your area and add that to the average price of the home you're trying to buy. Also add how much you can expect to pay in closing costs. (These take in various charges that generally run between 3 to 6 percent of the money you're borrowing.)



## Making An Offer

Credit unions often offer lower closing costs to their members.) Put the total into a mortgage calculator (you can find them online or make your own in a spreadsheet. If the figure is above 28% of your gross income (or whatever the lower percentage used by lenders in your situation) then you will have a hard time getting a mortgage.



## Making An Offer

**4. If you absolutely fall in love with a home, be prepared to make an offer that's above the asking price.** Economics of supply and demand will sometimes force your hand. If many people are competing for few homes, be prepared to lead with your highest possible offer.



## Making An Offer

Some homebuyers don't believe that you should lead with your highest offer, but you could easily find yourself being outbid and never get the chance to bid on your house. If you want to give yourself the best shot on a home that you really, really like, lead with a high bid.



## Making An Offer

**5. Talk to your realtor when you're ready to formally present your offer.** Although the guidelines for submitting offers may differ from state to state, this is usually how it goes: You submit your offer to your realtor, who then forwards it to the seller's representative. The seller then decides to accept, reject, or make a counteroffer.



## Making An Offer

- Include earnest money with your offer. Once you sign an offer, you are officially in escrow, which means you are committed to buy the house or lose your deposit, unless you do not get final mortgage approval or something came up during your inspection contingency time that you cannot accept.





## Finalizing The Deal

**1. Determine how much of a down payment you'll need to offer up front.** A down payment establishes equity, or ownership, in a home. That's also money that you don't have to pay interest on. The more of a down payment you're able to make on your home, the less money you'll ultimately pay on your home.



## Finalizing The Deal

- You will be expected to put down 10-20% of the *appraised value* of a home. *Note that the appraised value may be higher or lower than the selling price of the house.* If you have \$30,000 saved for a down payment, for example, you can use it as a down payment for a home between \$300k (10% down payment) or \$150k (20% down payment).



## Finalizing The Deal

- Putting less down often, but not always, requires you to pay private mortgage insurance (PMI), which increases your monthly housing cost but is tax deductible.



## Finalizing The Deal

- If you can't afford a 10%-20% down payment on your home, but have good credit and steady income, a mortgage broker may assist you with a combination or FHA mortgage. In that, you're taking out a first mortgage up to 80% of the value of the home, and a second mortgage for the remaining amount.



## Finalizing The Deal

- While the rate on the second mortgage will be slightly higher, the interest on it is tax-deductible and combined payments should still be lower than a first mortgage with PMI. If you're buying new, consider the Nehemiah Program to get assistance with your down-payment.



## Finalizing The Deal

**2. Make sure final acceptance is predicated on a suitable home inspection.** Request the following surveys and reports: inspection, pests, dry rot, radon, hazardous materials, landslides, flood plains, earthquake faults and crime statistics. (You will generally have 7-10 days to complete inspections — be sure that your agent explains this fully to you when signing the purchase and sales contract.)





## Finalizing The Deal

- A home inspection costs between \$150 and \$500, depending on the area, but it can prevent a \$100,000 mistake. This is especially true with older homes, as you want to avoid financial landmines such as lead-paint, asbestos insulation and mold.



## Finalizing The Deal

- If you use the inspection results to negotiate down the price of your purchase, do not refer to the inspection or bids for work in your contract. The lending institution may request to see a copy of your inspection, which will supersede their appraiser's evaluation.



## Finalizing The Deal

**3. Have a home energy audit completed on the house and ensure that the contract is contingent on the outcome.** Getting a home energy audit is an essential part of the home buying experience. Not knowing what it really costs to heat and cool a home is a potential financial disaster waiting to happen.



## Finalizing The Deal

Home buyers make "guesstimates" when figuring out a new home budget. These estimates can be significantly incorrect and place families into dire financial circumstances.



## Finalizing The Deal

**4. Close escrow.** This is usually conducted in an escrow office and involves signing documents related to the property and your mortgage arrangements. The packet of papers includes the deed, proving you now own the house, and the title, which shows that no one else has any claim to it or lien against it.



## Finalizing The Deal

If any issues remain, money may be set aside in escrow until they are resolved, which acts as an incentive for the seller to quickly remedy any problem areas in order to receive all that is owed.





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## Summary

Purchasing a home is usually considered a good investment. According to real estate experts, the housing market is currently favorable to buyers, with prices and interest rates remaining low. It is usually the biggest investment you will make. Don't be intimidated, and follow the right steps.

