You Can Buy a Home - The keys to Homeownership

The keys to homeownership

Buying a home is one of the most important purchases you'll ever make. Owning your own home helps you build wealth, save on taxes and become your own landlord. But you need to be prepared for the costs of homeownership—in time, effort and money.

The cost of owning a home includes more than your monthly mortgage payment. You must pay for property taxes, insurance, maintenance costs and emergency repairs.

Insurance and an emergency savings account are vital to homeownership. Homeowner's insurance covers damage to your house, your possessions and your liability to other people who are injured on your property.

Getting ready

Buying a home is a big step. It takes time. Start by organizing your finances:

- **Save**. Put money in a savings account each month for a downpayment. You can make a downpayment of 3% to 20% or more if you wish. Aim to make the largest possible downpayment. If your downpayment is less than 20%, lenders require that you pay extra for private mortgage insurance (PMI).
- **Housing counseling**. Enroll in a certified counseling program that helps buyers get ready for home ownership. To find a local program go to the HUD website on Buying a Home and click on "Housing Counselor," or call 800-569-4287.
- **Credit history**. You'll get a lower interest rate on your mortgage if you have good credit. The best way to have a good credit record is to pay your bills on time. Get *free* copies of your credit report at the Annual Credit Report website or call 877-322-8228. If you find a mistake, follow the directions in the report for disputing errors.
- **Budget**. Track your spending. Can you trim expenses and have more money to save for a home?
- **Income and assets**. Add up your income (wages, child support, benefits, etc.) and assets (money in checking, savings and retirement accounts).
- **Debt**. How much do you owe? List all your monthly bills, rent, insurance premiums, payments due on car loans and credit cards, etc.

What size loan can you qualify for?

Very few buyers can pay cash for a home. Instead, most homebuyers apply for a mortgage.

Many things influence the type and amount of mortgage you will be approved for, including the credit history, debts and income of all applicants, the downpayment, your savings and the type of loan you choose, such as fixed rate or adjustable rate.

The kind of property you choose to buy, such as a single family home, duplex, condominium or cooperative unit, also figures in the kind of loan you'll get.
In general, the smaller the amount you owe, the higher the mortgage you'll qualify for. Pay off any debts you can before you apply.

The higher your downpayment, the less you have to borrow. The downpayment is usually expressed as a percentage of the lower of sales price or appraised value. Don't pledge all your cash—you'll need money for closing and moving costs. To find downpayment assistance programs visit Local Homebuying Programs.

When you apply for a mortgage, lenders compare your income to your housing costs and other debts to see how much you can afford to spend each month on mortgage payments and other housing costs. This percentage also helps them determine how much money you can borrow to buy a house. All debts, including housing costs, should total no more than 36% of income.

Who's who in real estate

Real estate agents. Buyer's agents represent the homebuyer in the sale. Seller's agents may work with buyers, but they are responsible for the seller's best interest. Typically, the seller, not the buyer, pays agent fees.

Mortgage brokers match homebuyers with lenders. Broker fees are negotiable—ask for a breakdown of how your broker is compensated and question all charges so that you don't pay more than you need to.

Mortgage banks and online lenders. You can meet directly with banks and other mortgage lenders or visit them on the Internet. National online lenders also arrange mortgages.

Appraisers. These professionals determine the current value of the house you want to buy. Appraisers are usually hired by your mortgage lender, but you pay the appraisal fee of $300-$500.

Home inspectors. Hire an inspector to learn if there are any major problems with the house you want. When you sign a contract for a home, ask for a home inspection contingency—then you can walk away if the inspection finds problems you don't want to fix. To find an inspector, ask your buyer's agent for a recommendation or contact The International Association of Certified Home Inspectors, 877-FIND-INS or The American Society of Home Inspectors, 800-743-2744.

Get the right home

Check out the neighborhood. If possible, walk around to get a feel for the community. Check out the schools, shops and crime statistics with the local police or town newspaper, or online at the Homefair website.

Check environmental hazards. Order an environmental hazards report to rule out toxic contaminants or natural hazards like floods or forest fires.

Flooding. The federal government offers flood insurance. Do you need it? Check your flood risk at FloodSmart.

Mortgages

The most common mortgages last for 15 or 30 years. Several types of mortgages are available:

Fixed rate mortgages carry the same interest rate during the life of the loan. Your basic mortgage payment is always the same. (If your lender collects monthly property tax and insurance payments for you, your fixed payment may vary from year to year.) Fifteen-year mortgages have much higher monthly payments.

Variable rate mortgages often allow you to qualify for a smaller payment and lower introductory rate, but your monthly payment can increase if interest rates rise. Learn how high the rate can go, how often the rate may change and be sure you can afford a higher payment.

Federal Housing Administration (FHA) loans. If you have damaged credit, FHA loans are easier to qualify for and usually have lower downpayment requirements. To find out more, visit the FHA web page.

Unfair and inappropriate loans

Watch out for loans that contain unfair or deceptive (predatory) terms, such as pre-payment penalties (hefty fees for paying the loan off early). Be cautious about "interest only" loans or any mortgage that starts out with low payments but jumps to unaffordable levels. Zero-down loans don't require a downpayment and you may lose money when you sell.

Qualifying for a mortgage

Get pre-approved. Lenders "pre-approve" you for a loan only after a thorough review of your credit history and income. Pre-qualified is not the same as pre-approved. Pre-qualification is only a general estimate of the loan amount you might qualify for.

Contact a few lenders to compare rates, fees and points (an optional charge to get a lower rate). A point is 1% of the loan amount.

To prepare to meet with lenders or mortgage brokers:

- Copy your most recent tax returns, pay stubs, and bank account statements.

- Know your credit score—a number that measures the quality of your credit history. You can buy your score at Myfico, Experian, Equifax or Transunion.
- Don't apply for other loans (auto, credit card) near the time you apply for a mortgage as it might lower your credit score.
- If rates are heading up, consider paying extra to lock-in (guarantee) your interest rate.

If you apply with several different lenders, do it within 60 days to maintain a good credit score and help you get the lowest interest rate.

Participation in first-time homebuyer programs can reduce your interest rate, limit fees or help with a downpayment. Check with a housing counselor, or with your city, county and state government to learn about affordable housing programs.

Private mortgage insurance (PMI). If you put down less than 20%, lenders require you to pay PMI. To avoid PMI, you sometimes can take a second "piggyback" mortgage to use as a downpayment. PMI premiums and the interest on most piggyback loans are tax deductible, along with your mortgage interest.

Appraisals. Lenders hire appraisers to estimate the home's value. You're entitled to a copy of the appraisal before closing.

Truth in Lending statement. Within three days of submitting your application, the lender is required to give you this statement containing information on the annual percentage rate, the finance charge, the amount financed, and the total payments required. This document will also provide information about prepayment penalties (if any), whether the loan is assumable, the payment schedule of the loan, and any late payment charges.

Good faith estimate. Also within three days of submitting your application, the lender must give you a "good faith estimate of settlement costs" (GFE). Expect closing costs of 3%-6% of the mortgage. This standardized form is intended as a tool to comparison shop for a mortgage. It should include the interest rate, amount to be borrowed, taxes, and insurance, plus the type and length of loan. Focus on the summary section which will also list how much the interest rate could increase and when, and how long the estimate is good for. Final costs may be several hundred dollars more than the GFE shows. Ask for an explanation of all fees and shop around.

Title insurance. Lenders require that you pay this charge to ensure that the property is free of forged titles, liens and errors. Consider buying owner's title coverage to protect you from title problems that were not found during the title search and to cover any legal fees needed to defend your title.

Making an offer

If you offer to buy a house and the seller accepts, you've got a deal—and it's binding.

Contingencies. Make sure your offer gives you a way out by including a home inspection or financing contingency. If you find a serious structural problem or can't get a mortgage, you'll be able to walk away.

Earnest money. Most sellers want you to make an earnest money deposit. When the seller accepts your offer, your deposit is held by a third party—an escrow or title company—until closing.

Negotiations. Be prepared to make a counter-offer if the seller rejects your first bid. Know your limits and stick to them.

At your closing

The final step in the home purchase is closing (settlement). Your sales contract sets the closing date, typically 30-90 days for existing homes. Before closing, take a final walk through to check the home's condition.

A day or so before closing, your lender will give you a HUD-1 settlement statement listing all closing costs. Review all costs and payments carefully and call your lender if you have questions.

Go to closing with a certified check in the amount called for on your HUD-1 form, a photo ID and extra personal checks. You'll be asked to sign many papers. Review each document carefully before you sign—mistakes can be costly. If necessary, ask someone you trust to go with you to the closing.

At closing, you'll pay a pro-rated portion of the property taxes and utilities such as electric, gas or fuel oil. The lender may also require you to pay for homeowner's insurance and interest from the date of closing until your first mortgage payment is due.

When all the papers are signed, you'll get the keys to your new home