

The Keys to Home Buying



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Getting Started

Buying a house is the largest purchase that most people will ever make. It is a major milestone and a big responsibility, but with the right tools, you can achieve this goal!

Before making such a large purchase, it is important to know why you want to buy a house. List at least three reasons in the space below.



Why I Want to Buy a Home



How Much Home Can You Afford?

Your Budget

The biggest factor in determining how much you can afford to spend on a house is your budget. Financial experts suggest that you spend no more than 35% of your gross income on housing costs.

To find your magic number, take your salary and multiply it by .35.



Monthly Salary: \$ _____ x .35 = \$ _____

Remember, housing costs includes more than just your mortgage payment. There are other expenses that you must consider when determining how much you can afford to pay monthly for your home.

Some other things to include in that 35% are:

- Homeowner's Insurance
- PMI (Private Mortgage Insurance)
- Property Taxes
- Home Maintenance/Emergency Repairs
- Utilities
- Furniture
- Home Owner's Association and/or Condo Fees

Cash Funds Required

You may be able to afford a monthly mortgage payment, but in order to purchase a house, there are other expenses that you'll have to pay before you set foot into your new home.

Earnest Money Deposit

When you're ready to make an offer on a home, the seller will want to know you're serious. This is where earnest money comes into play. The deposit (which is usually between 1-5% of the purchase price) will become a part of the down payment if the seller accepts. If the seller rejects your offer, your deposit will be returned. Be careful, if you pull back your offer, you may forfeit the money.

Down Payment

The down payment is the part of the purchase price that you'll pay in cash. Depending upon the loan type, you could put down as little as 0-5%.

Closing Costs

On top of the price of the mortgage, you'll also be required to pay closing costs. The price of closing costs will vary based on where you're buying your house. Some typical things included in closing costs are title insurance, attorney fees, and appraisals; Your mortgage lender will be able to explain exactly what your total will include.

Post-Purchase Reserve Funds

Some lenders will want to know that you have two or three months' worth of housing expenses saved, in case of financial emergencies. Remember, it's always good to have an emergency fund, even when not required by your mortgage lender.

Debt-To-Income Ratio

When determining the amount you'll be approved for, lenders will look at your DTI, or debt-to-income ratio. This number can indicate to lenders that you have enough income to cover your current debts plus a house payment or that you're over-extended, and adding a home might not be a good idea at this time.

To calculate your DTI, divide all your monthly obligations by your gross monthly income. For example, if your monthly income is \$3,000.00 and your monthly debt expenses are \$600, your DTI would be 20%.

To find your monthly debts, add up the minimum payment for each debt that you have.



Monthly Debts: \$ _____ ÷ Monthly Salary: \$ _____ = _____ %

Remember, if you're borrowing with your spouse or another person, be sure to include their income and debts into the calculation as well.

Pre-Qualification vs. Pre-Approval

Before you begin your home search, it is wise to see how much you'll be approved for by a mortgage lender. In order to do this, you'll want to get a pre-qualification or pre-approval. Though similar in name, these aren't the same thing.

Pre-Qualification

- Informal determination of the amount you can borrow
- May not require a review of your credit report
- No guarantee of financing
- When it's time to purchase, you'll need to go through the formal application process
- You can get pre-qualified more quickly, sometimes even over the phone

Pre-Approval

- Formal commitment from a mortgage lender, to give you a loan up to a certain amount
- Requires proof of income and review of credit report
- Will last for a set amount of time (typically 60-90 days)
- Can take up to 30 days to get a pre-approval

Both options are good, depending upon your needs. Since pre-approvals take longer to finalize, a pre-qualification may be the best option if you're ready to begin looking for homes and want to know the price range that will fit your budget.

In either case, when you're serious about buying a home, avoid making major purchases, taking out new lines of credit, or switching employers until you're in your new home. If you must do one of these things, be sure to let your lender know as soon as possible.

Shopping For Your Home

Now that it's time to go house hunting, you want to keep in mind the things that you want and need in your new home. You're making a big purchase and you will likely be living in the home for years to come, so choosing wisely is important. However, it is equally important to be flexible. Remember, needs are things such as "good school district for children," or "accessible to public transportation." Wants are more so things that are nice to have, but not decision making factors. Things like "must have a fireplace," or "kitchen with granite counter tops" are wants.



In the space below, write down the things you need and the things you want in your home.

NEEDS

WANTS

Once you've identified your wants and needs, begin searching for your home. A real estate agent will assist you with the house search, but there are other resources available to you. Real estate websites, newspapers and real estate magazines will also be good ways to find potential homes. You could also drive around in neighborhoods where you would like to live and look for For-Sale signs.

Negotiating The Deal

You've found the home you want and put in an offer. What's next? Now is the time to negotiate the deal. Aside from just negotiating the price, you'll also want to be clear on property inside of the house -- are the washer & dryer staying, or will the seller be taking them? Questions like these are all answered during the negotiation process.

Home Inspection

Inspections are important, because they could find things that you will want to be fixed before closing on your home. They will inspect the home's plumbing, electrical, heating systems and much more.

Selling Your Present House

If you already own a home, consider making your purchase contingent upon the sale of your current home. You don't want to end up with two mortgages.

Appraisal

The appraisal ensures that you're not paying more for the home than what it is worth. Your mortgage lender will not finance a loan for an amount higher than the value of the house. If the difference is small enough, you may elect to pay it out of pocket, or even ask the seller to pay for it.

Closing Costs

Most times, both the seller and buyer have closing costs that range in price based on location. The seller can choose to pay a portion of the buyer's closing costs, depending upon the loan type.

Choosing The Right Mortgage Type

Just like houses, mortgages are not one-size-fits-all. You'll have to choose the best options for you.

Loan Types

Conventional

Conventional loans are private loans that are not insured by the government.

- Stricter guidelines for credit score and DTI
- Minimum 5% Down Payment
- Typically, fixed rates for 15 or 30-year loans
- Seller can cover up to 3% of closing costs

FHA (Federal Housing Authority)

- Minimum 3.5% Down Payment
- Requires Private Mortgage Insurance (PMI)
- Seller can cover up to 6% of closing costs

VA (Veteran's Administration)

- Only for military servicemen, veterans, and their spouses
- Requires NO Down Payment
- Buyers must pay closing costs

Mortgage Types

Fixed Rate Mortgage

Fixed rate mortgages will have a permanent interest rate for the life of the loan. The rate on your home will not change unless you refinance your loan.

Adjustable Rate Mortgage (ARM)

The rates in an adjustable rate mortgage will change periodically based on market conditions, which will cause a rise or fall in your payment. Loan documents will specify how often the rate can change.

Convertible Mortgages

For a set amount of time (between 3 to 10 years) your rate will be fixed. After that set time passes, the mortgage will convert to an adjustable rate.

Other Items Included In Mortgage Payment

Escrow

Each month, when you make your mortgage payment, a portion of the funds will go to escrow. Those funds will be used to pay your Homeowner's Insurance, PMI, and property taxes.

Private Mortgage Insurance (PMI)

To protect the lender against a loss, you may be required to have PMI. When the loan amount exceeds 80% of the home's value, you will need to get PMI for your mortgage. With conventional loans, you can remove PMI once the loan-to-value ratio is lower. For FHA loans, PMI will remain for the life of the loan, unless you refinance.

Approval Criteria

Every lender has different criteria when deciding to approve borrowers for loans. In general, the factors below are used to determine if you're qualified for a loan.

Stability of Income

A steady work history shows lenders that you're stable and that you should be able to keep up with mortgage payments.

Adequacy of Income

Lenders will look at the amount of money you make to determine a suitable mortgage amount. They will want to know that paying a mortgage will not cause you financial hardship.

Sufficient Money For Closing

You will be required to show financial statements to prove that you have enough money to pay for the closing of the house. You are not allowed to borrow money to pay for your down payment or closing costs without notifying the lender. If you will receive monetary gifts from family or friends, disclose that information to the lender as well.

Creditworthiness

Lenders will also examine your credit report to determine the likelihood that you will repay the mortgage. If there is any negative information on your credit report, the lender will likely ask for clarification to decide if you're still a good fit for the loan.

Improving Your Financial Health

You may find that you're not quite ready to purchase a home, and that's OK! In the meantime, make sure that you're making smart financial decisions, so that when the time comes you're prepared.

Debt Consolidation & Refinance

It could be beneficial to consolidate debt that you have. You may find that you can lower your rates and monthly payments by consolidating your debts. Also, consider refinancing loans (like auto and student) to a lower interest rate or payment amount. You could put the money you save into a down payment fund, or towards paying off other debts. Speak to a FedChoice Financial Service Advisor to determine how FedChoice could save you money by consolidating and refinancing your loans.

Improving Credit Score

Work on paying off any delinquent loans or collection items on your credit report. If you're not already making your payments on time, begin making your payments in a timely manner. Use a tool like FedChoice BillPay to schedule automatic payments.

Saving Money

Open a special savings account that's dedicated to your home fund. Create a budget to determine where you can cut out unnecessary expenses, and save that money instead.

Work With A Financial Counselor

FedChoice offers free financial counseling, through our partner GreenPath. They can assist with budgeting, credit and more! Learn more about GreenPath at [fedchoice.org/greenpath](https://www.fedchoice.org/greenpath).

Your Home Buying Team

During the process of purchasing a home, there's a special team of people you'll need by your side. Be mindful when choosing your team, as they could affect the amount of money you'll pay for your new home, as well as the ease of the entire process.

Mortgage Lender

Your mortgage lender will let you know the different loan types you're qualified for, and the amount that you'll be able to borrow. Having a pre-approval from a mortgage lender lets sellers know that you're serious about making a purchase. During the loan application process, the lender will look at your credit score, employment history, and debt information before approving you for a loan. So, be sure to bring information such as:

- Pay stubs for the past 2-3 months
- Tax returns for the past 2 years
- Recent bank statements
- Proof of any additional income
- Information on any long-term debts



Real Estate Agent

A real estate agent can be very helpful when searching for houses and negotiating the purchase price. If the agent is representing the seller, it can be hard for them to advocate for your rights as a buyer. You may find more success with a “**buyer's agent**,” a type of real estate agent that only focuses on your interests as the home buyer.

Finding a Qualified Agent

Finding a qualified real estate agent that you can work with is very important. You'll want an agent who understands your needs and whose judgment you can trust. Start your search by asking family and friends for recommendations of agents they've worked with. You could also find agents by looking at “for sale” signs, advertisements, and open houses.

Home Inspector

After you make an offer on a home, you will want an inspection done before closing. The inspection may reveal problems that need to be taken care of by the seller, so be sure your contract includes a contingency clause. The home inspector will also provide you with a **Home Inspection Report** that may contain information on areas of concern that need to be addressed to avoid future costly repairs.



Homeowner's Insurance

It is very important (and required by your lender) to have up-to-date homeowner's insurance. Be sure to have basic hazard insurance, and depending upon your home, you may need to have special insurances such as flood or mobile home insurance.