Buying Your First Home

Buying Your First Home

Table of Contents

Introduction

Buying your first home can be both exciting and stressful. This may be the biggest purchase you will ever make. Learning about buying a home before you start your search should help the experience go more smoothly. This booklet can help you get started by introducing you to important steps in the home-buying process. It includes checklists and links to tools to help you prioritize your needs, determine how much you can afford to pay and find a mortgage that is right for you.

1. Deciding to Buy a Home

Along with building equity, owning a home represents stability, security and freedom—you can paint the walls any color you want and you never have to worry about the landlord hiking the rent or selling the building. Owning a home may also limit your freedom as a service member. If you must relocate at a moment's notice, you might have to sell your home at a loss.

The following questions will help you decide whether the time is right to buy a home.

Questions to Ask Yourself

1. **Is it less expensive to rent or to buy?**
   When calculating whether it makes more financial sense to rent a home or to pay a mortgage, be sure to factor in property taxes, insurance, maintenance, utilities, homeowners association fees, if applicable and other expenses associated with owning a home.

2. **What is my price range?**
   The top amount you can spend on a home is based on your income, monthly expenses, your down payment and the interest rate on your mortgage.

3. **Will I be able to pay my mortgage and other bills and still save money each month?**
   Experts say you shouldn't spend more than 28% to 31% of your gross monthly income on your home.

4. **Do I have a clean credit record?**
   Your credit rating will affect the terms of your mortgage. If you have a high credit score, you may qualify for a better interest rate and a lower monthly payment. Federal law entitles everyone to a free credit report once a year. Order a copy from Annual Credit Report.com. Your free report will not include your score but you can check for errors. If you find mistakes, clear them up as soon as possible by writing to the credit reporting company. Include copies of any documents that support your position. Identify each item in your report that you dispute; state the facts and the reasons you dispute the information, and ask that it be removed or corrected.

5. **Do I have enough cash for a down payment?**
   Depending on the type of loan for which you qualify, you may need a percentage of the selling price of the home for a down payment. Aim to put down 20% if possible. If you find a lender who is willing to accept a down payment of less than 20%, the lender will likely require you to purchase private mortgage insurance (PMI). PMI protects the lender in case the homebuyer fails to pay.

6. **Can I afford the closing costs?**

   Depending on where you live, expenses related to closing average around $4,000. You may need to have that cash on hand when you finalize the home loan and the property transfer. However, you can try to negotiate that figure down or ask the seller to pick up all or a portion of the costs. Another option is to take out a Veterans Administration loan, which limits closing costs. Or fold the closing costs into your mortgage. You will pay more in the long run in the form of interest, but at least you won't need the money up front.

7. **Will I have enough money to cover the unexpected expenses that come with home ownership?**

   Roofs leak, appliances break, you may want to remodel, etc. The costs add up, so be sure you can absorb them each month. Try to set aside money to cover emergencies and unforeseen expenses.

Questions Service Members Should Ask

1. **How long will I stay in the home?**

   On average, it takes three to five years to recover the upfront costs of buying a home. Plan to keep your home for at least that long before selling.

2. **How strong is the housing market in my area?**

   If you plan to sell your home the next time you have a permanent change of station, you will either break even, make a profit, or lose money. Check listings to see how long homes have been on the market. A healthy market is one where homes sell quickly. Moving is challenging enough without the added worry of selling your property at a loss—or continuing to pay its mortgage if it doesn't sell.

3. **How do I feel about being a landlord?**

   If your plan is to rent out your home while you are at another duty station or on a long deployment, check that the rental market in your area is strong. Research rents for comparable properties or ask a real estate professional to help you. Will the going rates for rentals cover your mortgage and other expenses? Are you prepared to be an absentee landlord?

2. Getting Pre-approved for a Loan

After weighing the pros and cons of buying a home, if you decide you are ready to take the plunge, a good next step is to get pre-approved for a mortgage. Unless you have the funds to pay cash for your home, you will need to take out a loan.

A lender will approve you for a certain loan amount after verifying your income, debt and credit history. A pre-approval is stronger than a loan pre-qualification, which is a quick calculation based on your reported income, assets and debts. Having a pre-approval letter in hand when you're ready to put an offer on a home shows sellers that you're a credible buyer and will allow you to act fast when you find a property you want to buy.

A pre-approval is not a guarantee that you'll get a loan, but it will speed up the loan approval process. You might even seek conditional approval for a loan. Conditional approval is granted by the loan underwriter. It virtually guarantees you the loan as long as your finances don't change and the home meets the lender's standards.

Types of Home Loans

Fixed rate and adjustable rate mortgages are the two most common types of home loans. Your loan may be backed by the federal government as a Department of Veterans Affairs (VA) loan or a Federal Housing Administration (FHA) loan. The chart below describes the advantages and disadvantages of different home loans.

Common Home Loans		
Type of Mortgage	Pros	Cons
Fixed-rate mortgage	No surprises. The interest rate stays the same over the entire term, usually 15, 20 or 30 years.	If interest rates fall, you could be stuck paying a higher rate.
Adjustable-rate (ARM) or variable-rate mortgage	Usually offers a lower initial rate of interest than fixed-rate loans and can help you qualify for more home.	After an initial period, rates may fluctuate over the life of the loan, depending on the market and the individual loan caps
Federal Housing Administration (FHA) loan	Allows buyers who may not qualify for a home loan to obtain one. Low down payment.	The size of your loan may be limited.
VA loan	Guaranteed loans for eligible veterans, active duty personnel and surviving spouses. Offers competitive rates, low or no down payments.	The size of your loan may be limited.

Source: www.USA.gov

3. Finding a Lender

Shop around for a lender who offers you the best annual percentage rate (APR) and mortgage terms such as discount points, origination fees, underwriting fees and document preparation fees. Also, compare the Good Faith Estimates of fees due at closing, which lenders must provide when you apply for a loan. These will help you determine who can offer you the best deal.

You can seek a home loan from a thrift institution, a commercial bank, a mortgage company or a credit union. Another option is to use a mortgage broker, who will find a lender for you. Before working with a broker, be sure to ask about fees that are separate from the lender's fee.

Ask each lender or broker about the same type of loan so that you can compare the costs and terms that each offers.

Questions to Ask

Ask friends, family and neighbors to recommend lenders or mortgage brokers. When you talk with prospective lenders, ask:

1. What are the interest rates for fixed and adjustable loans and for 15-, 20- and 30-year mortgages?
2. How will the rate and loan payment vary when the interest rate goes up or down with an adjustable rate mortgage?
3. What is the loan's annual percentage rate (APR)? The APR includes the interest rate, points, broker fees and other charges.
4. What can I expect to pay in points? Points are fees that you pay. These are usually tied to the interest rate—the higher the rate, the lower the points. Make sure you find out the dollar amount of points.
5. What can I expect to pay in fees? You'll pay some of these fees when you apply for the loan and others when you close the loan.
6. If my down payment will be less than 20%, what can I expect to pay for private mortgage insurance? How will the PMI affect my monthly payment?

Print copies of this Mortgage Shopping Worksheet from the Federal Trade Commission to keep track of these and other questions as you shop for the best mortgage.

Getting the Best Deal

Choosing a mortgage can be like buying a car—it's possible to negotiate a better deal than the one advertised or first offered to you. Typically, there are overages built into mortgages, which the loan officer or broker will keep as compensation. This allows wiggle room to reduce some of the costs associated with the loan. Ask the loan officer to reduce the points, fees or the interest rate.

When you are satisfied with the terms of the loan, you may want to lock it in. This is a written guarantee from the lender that the terms you negotiated will be available to you for a fixed period of time. The downside of a lock-in is that if the rates go down when you're ready to buy, you'll be locked in to the higher rate. There may be a fee for the lock-in, though it may be refundable when you close on the loan.

4. Choosing a Real Estate Agent

Typically, there are two real estate agents involved with a property sale: one who represents the seller and one who represents the buyer. They work on commission, splitting a percentage of the home's purchase price. As the buyer, you do not pay your real estate agent directly.

While it's possible to buy a home without a real estate agent, the process is likely to go more smoothly if you work with one. A real estate agent is versed in state and local laws affecting property sales and will guide you through the experience, from visiting properties for sale, to closing on a new home and each step in between.

You might start your search for a real estate agent by asking for recommendations from friends, family, co-workers and neighbors. You'll be spending a lot of time with your agent—make sure they are professional, pleasant and experienced.

Here are some things to keep in mind while searching for a real estate agent.

- **Consider hiring a Realtor.** A real estate agent must have fulfilled certain requirements to be licensed in your state. A Realtor has furthered their education to become a member of the National Association of Realtors. Realtors must adhere to a strict code of ethics. They also have access to Multiple Listing Services (MLS), where members share their property listings.

- **Avoid "dual agencies"**—real estate firms that represent both the buyer and the seller. An agent who attempts to act on behalf of both the buyer and the seller may not be able to avoid a conflict of interest.

- **Look for an agent who handles homes in your price range.** Some agents only work on deals involving very high-range homes; others may focus mostly on fixer-uppers. You want your agent to understand what you're looking for and to have experience with your market. Ask the agent how many homes they have sold in the past year and how many in the neighborhoods that you're interested in.

- **Find out if the agent will recommend other professionals** for the home inspection, moving, insurance, legal representation and other services. That can make things easier for you, but remember you should still shop around for the best prices and services.

- **Ask for references** and check them before settling on an agent. It is important to find a good fit. If you are not satisfied with your agent, it is appropriate to find a new one.

5. Searching for a Home

While you search for a lender you can also think about where you want to live and what features you would like in your home. Are you looking for a place in the country? The suburbs? The city? Are good schools and neighborhood amenities important to you? Do you crave a big yard?

Use the chart below to track the features you must have and those that aren't essential, but would be nice to have in a home. Fill in numbers where appropriate and checkmarks for the rest. Use the blank rows to include additional features not listed here.

WISH LIST		
Feature	**Must Have**	**Would Like to Have**
Square footage		
Number of bedrooms		
Number of bathrooms		
Eat-in kitchen		
Formal dining room		
Family room		
Office		
Separate laundry room		
Fireplace		
Central air		
Garage		
Basement		
Porch		
Deck		
Size yard		
Swimming pool		

Questions to Ask

You will likely look at a lot of houses before you find one that meets your needs and your budget. Each place you check out will help you narrow down what you want (and don't want) in a home. In addition to the features you've already identified as must-haves and want-to-haves, ask yourself the following questions as you walk through houses.

1. Will this house grow with us into the future?
2. Is the house structurally sound?
3. Are there any major repairs? If so, will the seller take care of repairs or will I have to?
4. Are the mechanical systems and appliances in good working order?
5. Will this home be equally comfortable in summer and in winter?
6. Will our furniture fit in this house?
7. Is there enough storage space?
8. Is the water pressure adequate?

It is easy to become so distracted and overwhelmed while house hunting that you forget entirely to check the closets or to take note of how close the nearest neighbors are. Consider printing the checklist on the next pages to use when you visit homes. It will keep you on track while touring homes and later, when reviewing your options, help you recall details of each property you visited.

Property Checklist			
Address of Property	Good	Average	Poor
Square footage			
Number of bedrooms			
Number of baths			
Floor plan			
Closet space			
Condition of basement			
Fireplace			
Lawn/yard			
Fence			
Patio or deck			
Garage			
Energy efficiency			
Screens/storm windows			
Roof age and condition			
Gutters and downspouts			
The Neighborhood	Good	Average	Poor
Condition of neighboring properties			
Traffic/noise level			
Safety/security			
Parking			
Zoning regulations			
Neighborhood restrictions/covenants			
Fire protection			
Snow removal			
Garbage service			
Schools	Good	Average	Poor
Age/condition			
Reputation			
Quality of teachers			
Achievement test scores			
Curriculum			
Class size			

Convenience to	Good	Average	Poor
Supermarket			
Schools			
Work			
Child care			
Public transportation			
Hospitals			
Parks/recreation			
Church/synagogue			
Airport			
Highways			
Notes:			

Source: www.hud.gov/

6. Making an Offer

When you find a home that you want to buy, you will give the seller a written offer along with a deposit to show the seller that you are serious. The offer is essentially a contract that spells out the price you are willing to pay as well as any terms and conditions.

It is common to make the offer contingent on the buyer receiving a home loan and the home passing an inspection. You might also ask the seller for a home warranty, to contribute to closing costs and to make certain repairs. If the housing market is weak, your offer may be significantly below the asking price. In a strong market where you are competing with other buyers, be prepared to offer full price or even over the asking price for the home.

The seller may reject your offer or make a counter offer. When you reach an agreement, you are ready for the next step.

7. Understanding the Home Inspection

Before you close on the house, make sure there are no major repairs or hidden concerns like pest infestations. A home inspector will check out the structure and systems and supply you with a written report of the findings.

You can find a home inspector through friends or neighbors who have been through the home-buying process. You can also find one through the American Society of Home Inspectors. Your real estate agent may recommend one as well, but keep in mind that it's in your agent's best interest to have the sale go through with as few glitches as possible. Make sure the person you hire is thorough. Ask to see a typical report. Depending on the inspector, these can range from a hand-written report to a PowerPoint presentation.

If possible, attend the home inspection. You can ask questions and learn more about the home that you may soon be living in. The home inspector will look for safety concerns or areas that need to be repaired. You can expect the inspector to look at:

- The structure, including the foundation and the framing
- The exterior of the home, including walkways, the driveway, steps, siding, windows and doors as well as porches, decks and balconies
- The roof, including flashing, shingles, gutters, downspouts, skylights and chimneys
- Plumbing, including water heating equipment, water supply and drainage systems
- Electrical systems
- Heating and vent system, flues and chimneys
- Air conditioning
- The interior of the home, looking for leaks, insect damage, rot, construction defects and other issues
- Ventilation and insulation to make sure it's adequate and appropriate for the climate
- Fireplaces to make sure they're installed properly and in good working order

If the inspection reveals problems, you can negotiate a lower price with the seller or ask the seller to pay for the repairs. You also have the option of backing out of the sale, assuming your offer included that contingency.

8. Closing on the Home

The closing is when the legal transfer of the property takes place. All parties involved in the sale will meet to finalize the documents, including the home loan. You will also settle the fees and exchange money for the keys to your new home.

Before the closing, you should have the opportunity to do a final walk through the property to make sure that everything is in good condition and to check whether agreed upon repairs have been made.

Be prepared to sign a lot of documents at the closing. Take all of the time you need to understand what you are signing. These documents will include:

- The HUD-1 settlement statement detailing all of the costs related to the home sale, including lender's fees, escrows, insurance premiums, government recording charges, the survey, a termite inspection, title insurance, homeowners association/condo dues and the title company's fees.
- Final Truth in Lending Act statement outlining the cost of the loan and annual percentage rate.
- Mortgage note stating the buyer's promise to repay the loan.
- Mortgage or deed of trust securing the mortgage note.

Earlier in the process you probably received the Good Faith Estimate and preliminary titles and HUD statements, so there shouldn't be any surprises at the closing, either with the closing costs or the property itself. However, sometimes glitches do happen. A problem with the property title may surface or a change to your financial circumstances may have shown up on a final credit report. Be sure to read the documents carefully and ask questions if anything needs clarification.

When all of the papers are signed and initialed and the keys to your new home are in your pocket, take a moment to congratulate yourself. You are now officially a homeowner.

9. Glossary of Terms

Annual percentage rate (APR). The cost of a loan or other financing expressed as an annual rate. The APR includes the interest rate, points, broker fees and certain other credit charges a borrower is required to pay.

Closing costs. The upfront fees charged in connection with a mortgage loan transaction. Money paid by a buyer (and/or seller or other third party, if applicable) to effect the closing of a mortgage loan, generally including, but not limited to a loan origination fee, title examination and insurance, survey, attorney's fee and prepaid items, such as escrow deposits for taxes and insurance.

Conventional mortgage. A mortgage loan that is not insured or guaranteed by the federal government or one of its agencies, such as the Federal Housing Administration (FHA), the U.S. Department of Veterans Affairs (VA), or the Rural Housing Service (RHS).

Escrow. An item of value, money or documents deposited with a third party to be delivered upon the fulfillment of a condition. For example, the deposit by a borrower with the lender of funds to pay taxes and insurance premiums when they become due, or the deposit of funds or documents with an attorney or escrow agent to be disbursed upon the closing of a sale of real estate.

Escrow account. An account that a mortgage servicer establishes on behalf of a borrower to pay taxes, insurance premiums or other charges when they are due; sometimes referred to as an "impound" or "reserve" account.

Fixed-rate mortgage. A mortgage with an interest rate that does not change during the entire term of the loan.

Interest. The cost you pay to borrow money. It is the payment you make to a lender for the money it has lent to you. Interest is usually expressed as a percentage of the amount borrowed.

Interest accrual rate. The percentage rate at which interest accumulates or increases on a mortgage loan.

Loan origination fees. Fees paid to your mortgage lender or broker for processing the mortgage application. This fee is usually in the form of points, where one point equals one percent of the mortgage amount.

Lock-in rate. A written agreement guaranteeing a specific mortgage interest rate for a certain amount of time.

Mortgage. A loan using your home as collateral. In some states the term mortgage is also used to describe the document you sign (to grant the lender a lien on your home). It also may be used to indicate the amount of money you borrow, with interest, to purchase your house. The amount of your mortgage often is the purchase price of the home minus your down payment.

Point. One percent of the amount of the mortgage loan. For example, if a loan is made for $50,000, one point equals $500.

Private mortgage insurance. Insurance for conventional mortgage loans that protects the lender from loss in the event of default by the borrower.