How to Buy a home

1. Start financial preparation

Buying a house is a major commitment. Before you begin shopping for properties or comparing mortgage options, you need to make sure you're ready to be a homeowner.

If you have not done so already, start saving for your down payment (usually between 3.5% - 20% of the purchase price) plus save additional money for your closing costs (usually another 2%- 4% of the purchase price) far in advance of buying. And keep in mind that buying a home takes into account factors that are specific to your current situation, so remember to take other's homebuying experiences with a grain of salt.

A good place to begin is by calculating your debt-to income (DTI) ratio. Look at your current debts and income and consider how much money you can reasonably afford to spend each month on a mortgage payment. *We will go into more detail later*.

Homeownership also comes with several costs that you do not need to have while you are renting. When you own a home, you will need to pay property taxes and maintain some form of homeowners insurance. Factor these expenses into your household budget when you decide how much house you can afford.

Below is a review of some of the major expenses related to a home purchase and how much you might want to save for them. Other key definitions are outlined for your information as well.

Down Payment

Your down payment is a large, one-time payment toward the purchase of a home. A down payment is typically required because it mitigates the loss, the bank might suffer in the event that a borrower defaults on their mortgage.

Many potential home buyers believe that they need a 20% down payment to buy a home but this is not usually necessary. Also, a down payment of that size is not likely to be realistic for many first-time home buyers.

Fortunately, there are many options for buyers who cannot afford a 20% down payment. For example, you may be able to get a conventional loan for as little as 5% down (confirm with your lender). FHA loans have a minimum down payment of 3.5%. VA loans and USDA loans even allow eligible and qualified borrowers to put 0% down.

There are advantages, however, to making a larger down payment. For one, it typically means you will have more home loan options. It also usually means you will have a smaller monthly payment and a lower interest rate. Plus, if you put at least 20% down on a conventional loan, you will no longer need to pay for private mortgage insurance (PMI).

Closing Costs

You will also need to save money to cover closing costs, which are the fees you pay to get the loan. There are many variables that go into determining how much closing costs will be, but it is usually advisable to prepare for 2% – 4% of the total home value. This means that if you are buying a home worth $200,000, you might end up paying $4,000 – $8,000 in closing costs. *The amount you save for closing costs is an addition to the money you set aside for your down payment. The amount added together will be the combined total amount of money you should set aside to buy a home.*

The specific closing costs will depend on your loan type and other variables in the transaction. Almost all homeowners will pay for things like appraisal fees, title & escrow fees, and lender fees. If you take out a government-backed loan, you will typically need to pay an insurance premium or funding fee upfront. Once you begin your loan process after you have an accepted offer on a home, your lender will give you a document called a *Loan Estimate* which will give you an estimated breakdown that is specific to the home you are under contract to purchase. Then, closer toward the end of the loan process, your lender will provide a *Closing Disclosure*, which lists each of the closing costs more accurately so you will know how much you will need to pay at closing. Look over your Closing Disclosure carefully before you close to know what to expect and to catch any errors.

Other Costs Based on Loan Type

Your loan type might require a specialized inspection as well. For example, you often must get a pest inspection if you have a VA loan. Most lenders or real estate agents will schedule this inspection on your behalf and pass the cost along to you at closing.

These expenses might seem minor when held up against the other costs associated with buying a home, but they can add up, so be sure to budget wisely.

Review your credit profile ahead of time and see what you can do to raise your score (which can get you a better interest rate- especially if above 720). Request a copy of your soft credit report, start paying off credit card bills to balances below 30% of the limit if possible, and resolve any discrepancies or errors. Make all payments on time and do not add any new lines of credit.

Income And Employment Status

Your lender will need to see a work history (usually about 2 years) to make sure your income source is stable, reliable, and consistent.

Preparing your income is all about pulling the right documentation together to show steady employment. If you are on payroll, you will likely just need to provide recent pay stubs for one month and last two years of W-2s. If self-employed, you will need to submit your tax returns for two years and other documents the lender requests. It may be possible to use a bank statement program for self-employment with a larger down payment which can be discussed with your lender.

Debt-To-Income Ratio

Debt-to-income ratio (DTI) is what mortgage lenders use to evaluate your loan application. Your DTI helps your lender see how much of your monthly income goes to debt so they can evaluate the amount of mortgage debt you can take on and let you know how much of a monthly payment the bank will determine you can afford.

DTI is calculated by dividing your monthly debt by your gross monthly income. For example, if your monthly debts (credit card minimum payments, loan payments, etc.) total $2,000 per month and your gross monthly income is $6,000, your DTI is $2,000/$6,000, or 33%. Your lender will use the debts shown on your credit report to calculate your DTI.

It is wise to review your DTI before you apply for a loan. In most cases, you will need a DTI of 50% or less to qualify for a mortgage, although this number varies based on your loan type and other factors.

Credit Health

Your credit score plays a huge role in what loans and interest rates you qualify for. Your credit score tells lenders how risky you are to lend money to.

Taking steps to improve your credit score and reduce your debt can pay off big as you prepare to get a mortgage. Better numbers mean better loan options with lower interest rates.

Your credit score is based on the following information:

- Your payment history
- The amount of money you owe
- The length of your credit history
- Types of credit you've used
- Your pursuit of new credit

Most lenders require a credit score of at least 620 to qualify for the majority of loans. A score above 720 will generally get you the very best loan terms.

Keep in mind that you should also avoid taking out any additional loans (large or small) until after the home purchase is finalized as that will affect your credit score.

2. Get to know your market within your desired budget

Once you are pre-approved by your loan officer that works for a lender you will have an idea of your monthly payment and purchase price range you want to buy in. You can now start looking at homes with your realtor. Narrow down your must-have list in terms of home type, features, and location as well as features you are flexible with. If you decide to buy in a new home community, you must bring your realtor on your first visit so they can represent you in the transaction and negotiate on your behalf.

A great real estate agent can guide you through every step and connect you with other professionals like inspectors, contractors, and mortgage brokers/ lenders if needed.

At this point, you will also want to be aware of your spending and its impact on your credit report. Do not take out any large loans because they could lower your credit score and affect your debt-to-income ratio – a calculation that lenders use to determine how much you qualify to borrow. Any major changes related to your income or employment might also change your ability to get financing.

4-5 months before buying:

- Set aside money for down payment AND closing costs.
- Define your wants and needs.
- Hire a real estate agent and loan officer.
- Keep track of spending and credit use.

3. Get pre-approved and start searching

Choose a lender or mortgage broker to guide you through the financing process. Get pre-approved by your chosen lender so when it comes time to make an offer, sellers will know you are serious. To get pre-approved, you will need two months of recent bank statements reflecting the total funds to purchase your home, one-month recent pay stubs, and two years of W2's and/or tax returns. Most pre-approval letters are good for 60 to 90 days. Below are some of the loan options that a lender will help you to consider.

Conventional Loans

Conventional loans, sometimes called conforming loans, are loans that are backed by Fannie Mae or Freddie Mac. The majority of mortgages in the U.S. are conventional loans. Conventional loans are always a popular option for homebuyers, and you can get one with as little as 5% down.

FHA Loans

Backed by the Federal Housing Administration, FHA loans are less of a risk for lenders because the government insures them if you stop making payments. As a result, FHA loans have credit score requirements that are not as strict. You can get an FHA loan with a down payment as small as 3.5%.

VA Loans

VA loans are mortgage loans for veterans, active-duty members of the Armed Forces, and qualifying surviving spouses. The most popular benefit of VA loans for homebuyers is no down payment required. VA loans are insured by the Department of Veterans Affairs.

USDA Loans

Another type of government-backed loan, a USDA loan, helps people in rural and suburban areas buy homes. You can get a USDA loan with 0% down, but your home must be in an acceptable rural area and you must meet income eligibility rules.

2-3 months before buying

- Get a pre-approval letter.
- Start scheduling showings with your realtor.

If you have not already, set up saved searches from your realtor online so that you will be notified as soon as new homes that meet your criteria come on the market. Your agent can also set up searches for you that update directly from the local MLS for homes to show you. It is always a good idea to make a list of your top priorities, some of which might depend on whether you are looking for a starter home or something else entirely.

Here are some things you might want to consider when shopping for a house:

- Price
- Square footage
- Home condition and possible need for future repairs
- Access to public transportation
- Number of bedrooms
- Backyard/swimming pool
- Local entertainment options
- Local school district ranking
- Property value trends
- Property/real estate taxes

Rank your priorities from highest to lowest based on importance and share this with your real estate agent. This will give your agent a better idea of specific homes that fit your criteria and what is flexible vs must have. You may not get an accepted offer right away depending on your market and home criteria, so do not get discouraged if your hunt takes longer than expected.

Only you can decide which property is right for you. Keep in mind that this home may be a steppingstone to the next one down the road in a few years. Many homebuyers start off with a forever home in mind and end up buying and selling several properties throughout their life, with real estate goals that change over the years.

4. Make an offer

Once you find a home with a vision, make an offer with your realtor! Keep in mind, it might not be accepted right away.

When you decide to make an offer on a home, you must submit an offer in writing. Your offer includes details about yourself (like your name and loan details), the price you are willing to pay for the home and more information in regard to the timeline and everything negotiated in the contract. It will also include a deadline for the seller to respond to your offer. Your real estate agent will write the offer and will submit this to the listing/seller's agent on your behalf once you have signed for it.

Most offers also include an earnest money deposit. An earnest money deposit is a small amount of money, typically 1% – 2% of the purchase price. Your earnest money deposit goes toward your down payment and closing costs if you buy the home. If you agree to the home sale and later cancel, you typically lose your deposit if the contingency timelines are up.

From here, the seller can respond in one of three ways:

- **Accept the offer:** If the seller accepts the offer, you can move onto the next step.
- **Reject the offer:** If the seller rejects your offer, the ball is back in your court. You can choose to submit another offer if the home is still available or move onto another home.
- **Give you a counteroffer:** The seller can also come back with a counteroffer of their own. They may change the purchase price or the terms of the sale. You can accept the counteroffer, reject it, or make another counteroffer.

Negotiations may go on for some time after you submit your offer. Let your real estate agent help you manage negotiations and do not be afraid to walk away if you cannot reach an agreement. Once you and the seller agree to an offer, it is time to move on to the inspection and appraisal.

5. Complete escrow-related tasks and finalize plans

During the 30 to 45-day escrow period, your lender will set various checkpoints in order for their underwriters to approve your loan. This will likely include items like a home inspection, appraisal, and requests for additional documentation. This process may take longer if the underwriter requests additional documentation and depending on the timeliness the documents are received. If you have changes to your credit or income since you were pre-approved, further verification may be required.

Schedule the inspection

Lenders usually do not require a home inspection to get a loan, but you should still get an inspection before you buy a property.

During a home inspection, an inspector will go through the home and look for potential problems. They will test electrical systems, make sure the roofing is safe and in good shape, make sure appliances are working and much more. After the inspection closes, the inspector will give you a full report and a list of problems they found in the home and the urgency to repair.

When you receive your inspection results, go over each item line by line, and look for major issues. If a home has a serious health hazard (like lead paint or mold), ask the seller to correct the problem before you close. If you cannot reach an agreement, you may want to move on and consider other options. Read over your inspection results with your agent and ask whether they noticed any major red flags.

Bear in mind that you will be liable for any major repairs after your sale closes. A clogged toilet or a sink that does not drain are not major issues. However, if your home inspection reveals an expensive problem (like cracks in the foundation or poorly installed windows), you may want to reconsider the purchase. Think about what repairs you are willing to address later and what is a must have before you buy the home.

It is common for homebuyers to include a home inspection contingency in their purchase offer. It is usually called due diligence contingency that gives buyers the option to back out of a purchase (or negotiate repairs) without losing their earnest money deposit if the home inspection reveals major issues with the home. Typically, this is 8-12 days after the offer is accepted.

Get a Home Appraisal

A home appraisal is a review that gives the current value of the property you want to buy. You must get an appraisal when you buy a home with a mortgage loan.

Lenders require appraisals because they cannot lend out more money than a home is worth, and they will schedule the appraisal according to the contract timeline. If the appraised value comes back lower than your offer, you might have trouble getting financing and may need to renegotiate pricing terms. Be thoughtful about your offer and consider contesting the results of the appraisal if you believe the appraised value is too low.

Homebuyers should also include an appraisal contingency in their offer. Appraisal contingencies are often drawn up to allow buyers to back out of a purchase (or negotiate a lower price), without losing their earnest money deposit, if the home appraises for less than the offer amount. As with inspection contingencies, appraisal contingencies may vary, so make sure you understand the nature of your agreement.

Ask For Repairs or Credits

After you view your inspection results, you might want to ask the seller to correct some of the problems you found. You can do this in one of three ways:

- Ask for a discounted purchase price considering the results.
- Request that the seller give you credit to cover some of your closing costs.
- Ask that the seller repairs the problems before you close.

Your real estate agent will submit your requests to the listing/seller's agent. The seller might accept your request, or they might reject it. If the seller rejects your request, it is up to you to decide how to proceed. If you have an inspection contingency in your offer letter, you can walk away from the sale and keep your earnest money deposit.

Start preparing for the move

Now is also the time to contact a local moving company to get your move scheduled. You should file your change of address request with the post office and do some research on how you will set up utilities at your new home. If you are currently renting, you should give your landlord notice according to the terms of your lease.

Keep in contact with your Team

Maintain communication with your lender and realtor as the details of your loan are finalized. Be prompt about submitting any documentation that is requested. You will also need to let your lender know your preferred home insurance provider. As you work to finalize your loan, your real estate agent should also be kept in the loop.

Under a month:

- Schedule home inspector and have inspection completed during due diligence contingency.
- Shop for and select homeowners' insurance to provide to your lender.

6. Close on your new home

1-3 days before closing on your home, you will do a final walkthrough to visually inspect the condition of the home. This is especially important if you have requested repairs after your home inspection. This time allows you to check and make sure that the seller has made the repairs you requested and cleared out the property.

Walk through the home and make sure the seller has not left any belongings or trash. Check your repair areas if you requested them and keep an eye out for anything that looks out of the ordinary. You may also want to double-check your home's systems one final time to make sure everything is in working order. If everything looks good, it is time for you to confidently move toward closing. Next, you will head to the title company's office to sign your closing paperwork. Depending on the complexity of the deal, this could take a few hours.

Closing week:

- Schedule final walk-through
- Sign paperwork
- Get your keys!