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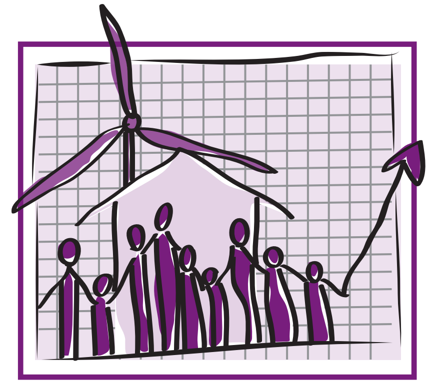

Buying Your First Home

Fact Sheet No. **9.937** Consumer Series | **Housing**

by K.R. Tremblay Jr. and R.C. Collins*

Quick Facts

- Home ownership has both advantages and disadvantages. It is not always the best choice at a given time.
- Buying your first home requires planning and saving.
- Prepare a checklist to help you shop for a home.
- Prequalify for a mortgage to see how much home you can afford.
- There are several government programs for first-time and low- to moderate-income home buyers.

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Home Ownership: The American Dream

Buying a home is one of the most important decisions a family can make. It has serious financial and emotional implications and is a major part of the American dream. However, home ownership is not always the best choice at any given time. It is important to consider both the advantages and disadvantages of home ownership.

For most families, the advantages of buying a home far outweigh the disadvantages.

Advantages

- Home ownership is a forced savings plan because your mortgage principal payments are retained as your equity in the home.
- If a home is properly maintained, it is usually a good long-term investment. Its value will most likely increase over time.
- You can deduct property taxes and interest payments from income tax.
- Because inflation causes prices and incomes to rise, over time mortgage payments become cheaper in "real" dollars.
- As your equity builds, you can step up to a larger home or borrow against your home to finance large purchases.
- Home ownership can enhance your family's sense of control over your lives and environment, as well as promote stronger community ties.
- You can customize the home to suit special needs and tastes.

Disadvantages

- Monthly payments (principal, interest, taxes and insurance) may be higher than rent payments, at least initially.
- You must pay for regular maintenance and periodic repairs. There is no landlord or manager to call if something goes wrong with your home.
- Owning is less flexible than renting; it's more difficult to pick up and move. Most first-time home buyers live in a home for seven years.
- Like any investment, there is no guarantee that its value will increase.

Prepare for Home Ownership

Buying your first home involves planning and saving. Attend a home buyer education class to help you prepare for home ownership. Possible obstacles to plan for are:

High costs. The cost of a typical starter home has increased dramatically in Colorado. Explore alternatives to the conventional single-family detached house: a condominium, a manufactured home, or an older home that needs repairs you can do yourself.

Credit. Many families are saddled with excessive debt, such as automobile payments, credit card accounts and medical expenses. Pay off your debt and delay major purchases until after you purchase a home. Get a copy of your credit report to see if any problems exist. Colorado law requires credit bureaus to send you a free credit report once a year if you request one. Unfavorable credit can stay on your report for seven or more years. Housing counseling can help improve credit.

Insufficient funds for a down payment. A major obstacle for many families is saving enough money for a down payment. In the case of conventional mortgages, down payments are often 20 percent of the purchase price. However, there are ways to reduce down payments to the 0 to 5 percent range. Investigate government-insured mortgages. The Colorado Housing and Finance Authority has attractive programs. Many local housing agencies and lenders have

*K. R. Tremblay Jr., Colorado State University Extension housing specialist and professor; design and merchandising; and R. C. Collins, Director, Neighbor to Neighbor, Fort Collins. 12/2005

For a copy of your credit report and other information on credit, call or use the Internet:

- Equifax 1-800-685-1111, www.equifax.com
- TransUnion 1-800-888-4213, www.tuc.com; or
- Experian 1-888-397-3742, www.experian.com.

low down payment programs for first-time home buyers. You may well have to curtail your spending and ask relatives for help to put together a down payment.

Insufficient funds for closing costs. When you purchase a home, the right of ownership passes from buyer to seller at the closing. Closing costs can reach $2,000 or more. Some of the programs that help with down payments can also help with closing costs.

Long-term affordability. The monthly principal, interest, property taxes and insurance (PITI) costs can be considerable. It is crucial to purchase a home that you can afford in the long run. Lenders typically require that no more than 28 percent of your gross monthly income go to PITI, and that your monthly PITI payments plus any other long-term debt payments not exceed 36 percent of your gross monthly income. Make sure your budget allows for monthly home payments plus a cushion to cover maintenance and repairs.

Select Your Home

Once you are financially ready to purchase a home, locate one that meets your needs and wants. The real estate section of the local newspaper is a good beginning, as are real estate shopper guides. Real estate Internet sites are another choice. Asking friends and relatives may produce a good find. Driving, biking and walking through neighborhoods are wonderful ways to picture yourself in a particular neighborhood and to determine what kinds of homes are available in different areas of a community. Stop at open houses every chance you get. Remember that location is crucial, as neighborhood choice influences lifestyle.

After you know what you can afford and which neighborhoods fit your lifestyle, select a real estate agent to help narrow your choices. Agents are a valuable source of information because they are knowledgeable about homes for sale in a specific area. Criteria for selecting an agent include trust, rapport, track record and level of commitment to first-time home buyers.

As you consider different homes, evaluate each based on needs and wants. Be flexible, realistic and responsible. Develop a checklist like the one at left. The checklist will help you answer the most important question of all: Can you and your family be happy living in this home? Remember to be realistic. Your first home will most likely not be your dream home.

Obtain Financing

While you shop for a home, also shop for a mortgage. Local housing agencies and lending institutions can prequalify you for a mortgage so you have a better idea of affordability. Mortgage lenders include commercial banks, savings and loan institutions, mortgage brokers and credit unions.

Several types of mortgages are available. Conventional loans typically require a 20 percent down payment and often are preferred by buyers searching for move-up homes. Products more suitable for first-time buyers may require as little as 0 to 5 percent down and have more flexible qualifying criteria.

Two possibilities for low- and moderate-income home buyers are Fannie Mae's Community Home Buyers Program and Freddie Mac's Affordable Gold Program. Many direct lending, subsidy and mortgage insurance products are also available through federal, state and local agencies such as the Federal Housing Administration, Veteran's Administration, Rural Housing Service and Colorado Housing and Finance Authority.

Besides the down payment, carefully compare mortgage options based on these criteria:

Annual percentage rate (APR). The APR is the total yearly cost of a mortgage as a percentage of the loan amount. It includes the contract interest rate, mortgage insurance and points (each point equals 1 percent of the loan amount). It is a better way to compare loans than the interest rate alone.

Interest rate lock-ins. The interest rate you are initially quoted may not be the same at closing. Because a higher rate may affect your ability to qualify, lock in a low rate as soon as possible.

Application and origination fees. Lenders frequently charge fees to cover processing, credit check, appraisal, points and other overhead costs. Try to minimize these expenses.

Term. For most first-time home buyers a 30-year term to pay off the mortgage is appropriate.

It is also crucial to determine if you want a fixed or adjustable rate mortgage. A **fixed rate mortgage** is most common for first-time buyers. Such loans are fully amortized with a fixed interest rate for

House Hunting Checklist

- Is the neighborhood safe?
- Are the homes in the neighborhood maintained?
- Does the house have enough bedrooms and bathrooms?
- Is there adequate storage space?
- Are there high quality schools in the area?
- Is the location of the house and neighborhood convenient?
- Is there a home owners association?
- Is the area quiet?
- Does the floor plan suit your lifestyle?
- Is the house energy efficient?
- Is the yard easy to care for?
- What community services are available?
- Are the appliances and fixtures adequate?
- What are the average maintenance costs for the house?
- How high are local property taxes?

the entire term – both the principal and interest are paid off at the end of the loan. Payments are usually monthly and stay the same over the life of the mortgage. It is ideal for families that plan to live in their homes for a long period of time.

An **adjustable rate mortgage** (ARM) has an interest rate that is adjusted periodically, usually every one, three or five years, based on money market conditions. Interest rates are determined by an index written into the loan agreement, and there is a cap limiting the amount that the interest rate can fluctuate. The primary advantage is that you might initially get a lower interest rate. The major disadvantage is that future increases may mean higher monthly payments.

Negotiate and Enter Into Contract

Once you have found both a home and a mortgage, make a purchase offer. You must have a contract, or offer, before the official mortgage application process can begin. The offer is typically given to the real estate agent who presents it to the seller. How much should you offer for a home? Seven factors to consider are shown at left.

In a normal housing market, sellers may come down an average of 4 percent off their asking price. However, in a "hot" market, buyers may compete with one another for a desirable home and actually pay more than the asking price. Negotiate until you get a price you can afford and think is reasonable.

To help in negotiations, hire a professional appraiser to determine the market value of the home. You also need a home inspection report. A qualified inspector provides an objective opinion about the condition of the home. Accompany the inspector as he or she assesses the quality and condition of the yard, house exterior, roof and related features, crawl space or basement, attic, electrical system, plumbing system, heating and cooling systems, kitchen and bathroom, and the home as a whole. Hiring an appraiser and inspector costs several hundred dollars, but it is money well spent.

When everything meets your approval and the seller accepts your offer, you enter into a purchase contract. Have your lawyer review it with you. The contract includes: full legal description of the property, amount of earnest money (good faith deposit of money to show that you are serious about purchasing), length of time the offer is valid, projected closing date, names, purchase price, financing details, title warranty, stipulations, and signatures and dates.

How to Compare Loans

Look at the following when comparing loans:

- Down payment required.
- Both the contract rate and the annual percentage rate (APR).
- Ability and conditions for locking in an interest rate.
- Application and origination fees.
- Term of loan.
- For adjustable rate mortgages, how often the rate can be adjusted, the index used, and the rate cap.
- Whether loan and closing costs can be rolled into the loan.

Loan Approval

The next step is to obtain financing for the home. This process is simplified if you have already been prequalified. The lender asks about your income, expenses, credit history, employment and the terms of the purchase offer. At this time, you complete the application form and pay an application fee, pay for a credit report and appraisal, receive an estimate of closing costs and truth-in-lending statement that provides estimated APR, receive the U.S. Department of Housing and Urban Development's handbook to settlement costs, and receive loan servicing and other state or local disclosures.

After the interview and application are completed, loan processing begins. The lender gathers a credit report, income and employment verification, deposit verification, previous housing expenses, and appraisal report. It can take anywhere from one day to six weeks to receive loan approval. Once it is approved, the lender will provide you a commitment letter. This is the formal loan offer. After carefully reading the commitment letter (preferably with your lawyer), you can sign it and agree to the loan.

Factors Affecting a Purchase Offer

1. The typical sales prices of homes in the area having approximately the same features as the home selected.
2. The condition of the home and any repairs or improvements needed.
3. The amount of money that you are prequalified to finance.
4. The availability of similar homes in the area in the desired price range.
5. Length of time the home has been on the market.
6. If the price of the home has been previously reduced.
7. If the seller is considering other offers.

Closing

The final step is the closing, a meeting between you, your lender and the seller. Other interested parties, such as your lawyer or real estate agent, may also be present. The closing can be broken down into three phases.

Review and signing of loan documents. In the first phase, you review and sign loan documents required by the lender.

Exchange of documents between buyer, seller and lender. You and the seller receive separate settlement statements detailing an exact accounting of expenses and credits. These statements are reviewed and each item is explained. All copies are signed and both you and the seller get copies.

Disbursement of funds. Once the documents are signed, dated and notarized, funds are disbursed. At this point, you provide a cashier's check for the down payment and checks to cover settlement costs. These costs typically include prepaying a portion of property taxes, home owner's insurance and mortgage insurance. Many of the closing and loan costs (ranging from $3,000 to $5,000 for a $100,000 mortgage) can be wrapped into the loan if you do not have enough cash in hand. In return, you receive the deed to the property and join the ranks of home owners.

Resources

Several books are available to help in the home buying process:

Bell, W. F. (2001). *How to get the best home loan*. New York: John Wiley & Sons.

Carlson Dunlap and Associates. (2004). *Inspecting a house*. Chicago: Dearborn.

Cauldwell, R. (2001). *Inspecting a house*. Newton, CT: Taunton.

Fields, A., & Fields, D. (2002). *Your new house*. Boulder, CO: Windsor Peak.

Friedman, J. P., & Harris, J. C. (2001). *Keys to mortgage financing and refinancing*. Hauppauge, NY: Barron's.

Irwin, R (2004). *Home closing checklist*. New York: McGraw-Hill.

Irwin, R. (2005). *Tips and traps for new home owners*. New York: McGraw-Hill.

Lank, E., & Amoruso, D. (2001). *The homebuyer's kit*. Chicago: Dearborn.

Summers, D. (2003). *How to buy your first home*. Naperville, IL: Sphinx.

Tribble, M. (2004). *My home workbook*. New York: Sterling.

Weiss, M., & Reyis, R. (2003). *The everything homebuying book*. Avon, MA: Adams Media.

Useful Internet Sites:

Colorado Housing and Finance Authority: www.colohfa.org

Consumer Information Center: www.pueblo.gsa.gov

Cyberhomes: www.cyberhomes.com

Fannie Mae: www.homepath.com

Home Advisor: www.homeadvisor.com

Manufactured Housing Institute: www.manufacturedhousing.org

Mortgage Bankers Association: www.mbaa.org

National Association of Realtors: www.realtor.com

National Association of Home Builders: www.BuilderOnline.com

U. S. Department of Housing and Urban Development: www.hud.gov