[Rock music] You're listening to the Road to Home Ownership. Hi, I'm Nikki, your host for today's podcast. Buying a home is one of life's most exciting and challenging undertakings. With commitment, planning, and learning, you can become a successful home owner. This podcast covers everything you need to help you start the home buying process off right including: preparing for home ownership, understanding mortgages, getting a loan, searching for a home and making an offer, and closing and tax benefits.

Preparing for home ownership. The first step to buying a home is saving money, and you should begin saving well before you begin planning to purchase a home. After all, there are quite a few expenses associated with buying a home.

These include:

> The down payment. In the past, a 20% down payment was pretty standard for a mortgage. Today, some lenders offer mortgages with as little as a 5% down payment or even lower in some cases. Keep in mind, if your down payment is less than 20%, you may be required to purchase private mortgage insurance or get a second mortgage at a higher interest rate.
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> Closing costs. These are fees required to receive a mortgage and transfer the mortgage of a home. These can include attorney's costs, appraisal fees, title insurance, recording fees, points and loan origination fees.
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> Post-purchase reserve funds. You may need to show the lender that you will have savings left over after you buy your home. Plan on saving at least three months' worth of mortgage payments.
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> Extras. If you plan to buy a fixer upper, appliances, or new furniture, include these costs in your savings plan as well.

The next step in buying your home is having a good credit score. Its valuable to understand how credit scores work. The most common scoring model is the FICO score. FICO scores range from 300 to 850; the higher you score the better. Your score is calculated using data from your credit report, which is compiled by three bureaus: Equifax, Experian, and Transunion. A lender may check your score from all three bureaus or only one.

Many lenders require a score of at least 680 to get a mortgage, and those with a score in the mid-700s and above usually get the best interest rates. If your score is lower than 680, you may only qualify for a subprime loan, which carries higher interest rates, or you may simply find it difficult to get any loan at all.

So, how is your credit score determined? The following are the factors used to calculate your score. First your payment history makes up 35% of your score. If you make a late payment, your score will take a hit. The more recent, frequent, and severe the lateness, the lower your score. Bankruptcies, judgments, and collection accounts also have a negative impact. The amount you owe is 30% of your score. Carrying high balances on personal loans and credit cards will lower you score. This is especially true if the balances are nearly maxed out. The length of your credit history counts for 15% of your score. The longer you've had the accounts, the better.

New and recent accounts make up 10% of your score. Having recent inquiries and opening new accounts can lower your score, however, mortgage or auto loan inquiries that occur within a short period of time are considered just one inquiry for scoring purposes. Finally, the types of credit used counts for 10% of your score. Having a variety of accounts such as credit cards, retail accounts, and loans, boosts your score. It's a good idea to check your credit report regularly, especially before applying for a mortgage.

Even if you always make your payments on time and don't have much debt, your report could contain errors that may result in a lower score. Check your report at least 60 days before you apply for a mortgage. This will give you time to resolve any issues you may find. You can receive a free credit report once a year through the annual credit report request service. Your credit scores can be purchased for a fee.

If you see any errors on your report, send a dispute letter to the relevant credit bureau indicating which information is incorrect. They must investigate your claim and remove unverifiable information. If your score is below 680, don't worry. There are many things you can do to boost it. From this point forward, always make your payments on time. Repay collection accounts. Pay down your debt. Keep balances under 40% of the credit limit. If you already have two to four accounts open, avoid opening further accounts. Keep older accounts active. Avoid excessive credit applications.

Understanding mortgages. Your monthly mortgage payment. If you're like most people, you'll need to take out a mortgage to buy a home. Paying it back will likely be your largest monthly expense. It's important to know that your payment pays for more than just the cost of the house. Payments can be divided into principal and interest. For the majority of mortgages, your first early payments will primarily cover the interest. As you continue to pay, a higher percentage will go towards the principal. This is called amortization.

Part of your payment may consist of money the lender collects on your behalf for property taxes, home owner's insurance, and in some cases, private mortgage insurance, PMI for short. PMI protects the lender against loss if you default on the loan. PMI may be required if your down payment is less than 20%. Every month the lender puts aside the money for these expenses in an escrow account and pays them when they're due. This ensures that these important bills will not be neglected. Together the principal interest, tax, and insurance payments are referred to as PITI.

If you purchase a condo, townhouse, or other type of unit with a homeowner's association you'll probably have to pay association dues. You may pay the dues directly to the association or through your lender. Your mortgage payment will probably be higher than your rent has been, but owning a home can provide a nice tax break. If you itemize your deductions on your income tax return you can deduct some home related costs, the most common ones being mortgage interests and property taxes. Since deductions lower your taxable income, your tax liability decreases. A tax professional or program can help you determine all the deductions you are entitled.

Next mortgage types. A fixed rate mortgage comes with an interest rate and monthly payment that remains constant over the life of the loan. This stability appeals to many buyers, though initially the interest rate is usually higher than other types of loans.

An adjustable rate mortgage starts out with a specific interest rate, but the rate and payment adjust at specific intervals. The interest rate and monthly payment may start off lower than for a fixed rate mortgage of the same amount, however they often become higher once a few adjustments occur. This may be a good option for people who plan to sell in a few years or expect their income to increase significantly, but it can be risky. If you can’t afford the payment increase, you may lose your home.

With an interest-only mortgage, you pay just the interest for a specific time period, usually three to ten years. Once that’s over, the payment increases to include principle and interest. The initial payment is lower than a fixed-rate mortgage since you are not paying any principle. However, once the interest-only period is over the monthly becomes higher because you are paying down the principal in a shorter period of time. And again, there’s always the risk that you won’t be able to afford the mortgage once the payments increase.

Next are mortgage terms. The traditional mortgage term, or length of the loan, is thirty years, but it can range from ten to fifty years. In general, the shorter the term the lower the interest rate. You get a lower payment with a longer term, but you pay more in interest in the long run.

Finally, there are government programs. Loans offered through federal government programs can come with more attractive features than conventional loans. The two most popular ones are VA loans, which are insured by the Department of Veteran Affairs, and are available to eligible veterans. No down payment is required. FHA loans are insured by the Federal Housing Administration. A down payment of at least 3.5 % if required.

In addition, many states and cities have programs for first-time home buyers. These programs may offer such things as down-payment assistance, below market-rate units, or low interest loans. Contact your local housing authority for information about programs in your area.

Getting a mortgage, when to apply. Some people wait until after they make an offer on a home to get approved for a mortgage, but it is best to do it beforehand. Why? Many sellers will not consider offers from those without a pre-approved mortgage. They want to know you have financing in place. It also gives you a better sense of the price of home you can afford.

A lender can either pre-qualify or pre-approve you. With pre-qualification, you're given an estimate of what you can afford. It's not a guarantee. On the other hand, when you're pre-approved, you get a commitment from the lender to provide a mortgage for up to a specific amount, barring any major financial changes or problems with the house. Pre-qualification is okay if you're just starting to look. However, if you're serious about buying a home, it's a good idea to get pre-approved. Pre-approvals last typically 60-90 days.

Finding a lender. Consider applying for a mortgage with a financial institution where you already have a relationship. Although applying online is an option with some lenders, you may want to apply in person if you have questions you like answered by a loan officer. Be careful when choosing a lender. While most lenders are honest and legitimate, there are some who are not. Avoid lenders who ask you to falsify information, sign blank documents, ignore your questions and concerns, or put excessive pressure on you.

Application criteria. Lenders consider many factors when deciding whether or not to approve a loan and how much to approve you for. Typical criteria include your credit score. As discussed previously, many lenders require a score of 680 for approval and mid 700s for the best interest rate. They also consider the down payment amount and other assets.

Lenders typically set a maximum loan to value ratio, which measures the maximum percentage of the home's price that can be financed. For example, if the lender sets a 90% loan to value ratio and the cost of the home is $100,000 dollars, the maximum they'll finance is $95,000. You'll need a down payment of at least 5% or $5,000 in this example. Besides the money for the down payment, lenders like to see that you have additional assets that can be used to pay the mortgage in case of emergencies.

Your employment history. Lenders usually want to see at least two years of consistent employment in the same field to prove stable employment and to know that you can repay the mortgage. Your income. Traditionally lenders have required that the mortgage payments, including taxes and insurance, not exceed 28%-33% of your gross income. This is called a housing expense or front ratio; however, many lenders have raised that ratio.

You'll likely have to provide two years' worth of W-2s and or pay stubs to document your employment and income. If you're self-employed, be prepared to provide two years' worth of tax returns and balance sheets. Your existing debt. Many lenders required that your existing debt payments plus your mortgage payment not exceed 36%-38% of your gross income, although some allow a higher percentage. This is called the total debt or back ratio. After reviewing your application, a lender will approve or deny your loan.

Many lenders use an automated system and can provide an immediate response. Other lenders have an actual person reviewing each loan. In these cases, you may have to wait a few days, or even weeks for an answer. If the loan is denied, the lender is required to tell you the reason why. You'll probably be disappointed, but use the feedback to make positive changes. If the loan is approved, the lender will tell you the amount you can borrow.

Within three business days of receiving your application, your lender must give you a truth in lending statement which shows you the amount borrowed, annual percentage rate, finance charge, total amount that will be paid back over the life of the loan, number of payments, payment amounts, late payment policy, and if there is a pre-payment penalty.

Examining your budget. Just because you're approved for a $350,000 mortgage doesn't necessarily mean you can afford the monthly payments. Lenders typically look at only a few factors, namely, your income, debt, and down payment. Most people have more expenses than just debt. Things like daycare and school expenses will reduce the amount of money you have available each month to pay back the loan. Creating a budget can give you a better idea of what you can really afford to pay. Subtract your expenses minus your current housing costs from your income to get an estimate of what you can afford. Don't forget to include property taxes, home owner's insurance, and maintenance costs.

Searching for a home and making an offer. Step one: Finding a real estate agent. People often wonder whether to use a real estate agent or search for a home by themselves. After all, with the internet full of home sale listings and resources, it's tempting to do it all yourself and save money on paying an agent. Well, the good news is, in most cases the seller pays your agent, not you. A good real estate agent will make the buying process much easier, finding available homes, arranging showings, and helping you write an offer.

Here are some hints to help you find a real estate agent. Ask for referrals. Many of your friends and relatives have probably bought and sold their homes through real estate agents. Make some phone calls and ask for recommendations. Comparison shop. Talk to several real estate agents and ask questions about the areas and types of homes you're interested in. This will help you determine if they're knowledgeable and a good fit for you. Avoid using the seller's real estate agent. Many people use the real estate agent representing the seller of the house they want to buy. Bad idea. You want an agent that is focused on getting you, and only you, the best deal.

Determining what you want. It's easier to search for a house if you know exactly what you're looking for. Consider these features beforehand: price, number of bedrooms and bathrooms, square footage, layout, type of home, such as single family or condo, location, school district, safety, noise, and whether repairs or renovations were done without proper permits.

The home search. Your real estate agent will have access to a variety of resources for finding homes including the multiple listing service or MLS, you can also drive around the neighborhoods you're interested in and look for sale signs. Your agent can then bring you to an open house or arrange showings at another time. Be sure to take pictures and make a checklist of features to help you remember each house. Before making an offer, visit the home more than once at different times of the day and night. This will help avoid surprises, such as loud neighbors, noisy trains, or heavy traffic. And don't be shy. Talk to your potential neighbors and get their opinion on the area.

Making an offer. Once you find the house you want, your agent will prepare an offer. Offers include the purchase price, closing date, and how long the offer is good for. To determine a price your agent will probably look at comps, similar houses that have sold in the neighborhood. Other considerations are how long the house has been for sale and are there other buyers with competing offers.

Offers may have additional components. These include seller concessions which are costs that the seller pays for the buyer such as closing costs and cash back for repairs or renovations. Inclusions refer to what stays in the house. If you want the appliances, blinds, chandeliers or anything else, make sure to put it in the offer. Contingencies are conditions that must be met in order for the sale to go through. A home inspection, financing, and an appraisal are common contingencies.

Once the offer is written, your agent will present it to the seller, along with earnest money or a good faith deposit. This is part of the down payment and is usually one to three percent of the purchase price. The money should go into an escrow account, not given directly to the seller. If the seller accepts the offer, the house is taken off the market and you're under contract. The only way to legally cancel a contract is if a contingency is not met. Walk away right now and you'll lose your earnest money department. The seller may counter, usually requesting a higher purchase price, though they can also counter on other parts of the offer. You can accept the counter or respond with your own counter. If you did not get the first house you put an offer on, don't get discouraged. There are likely many houses out there that meet your needs.

Closing and tax benefits. Pre-closing period. Once your offer is accepted, arrange an inspection of the property by an independent qualified professional. This is also the time to apply for a mortgage if you aren't already pre-approved or inform your lender that you have found a home if you are pre-approved. Your lender will start to prepare for closing and may need additional documentation such as proof of homeowner's insurance. During this time, it's a good idea to check in regularly with your lender and make sure there are no issues that may delay the closing process.

Your lender will likely check your credit report once more, and if major changes have occurred such as additional debt or recent late payments, your loan may be denied. However, if there are no problems, your loan will get final approval and your lender will be ready to pay out the funds. Consider doing a final walk through of the property a day or so before closing. Check to be sure that the property is in the same condition as before and that the seller left everything agreed upon. If you notice any problems, like carpet stains, now is the best time to bring them up since the seller hasn't yet received payment.

Closing day. This is the big day. The mortgage is finalized and the title of the house is transferred to you. In many states, closing is handled by the title company though you may deal with a closing company or attorney. You'll need to bring a photo id and a cashier's check to pay the closing costs and down payment. Get ready for a lot of paperwork to sign, but don't feel rushed. Make sure you understand what you're signing. Consider hiring a real estate lawyer to accompany you to explain what everything means. Keep in mind you have the right to review the documents at least 24 hours before closing. The documents you'll be signing include the mortgage note, which is your promise to pay the *[recording cuts out]* _______, the mortgage or deed of trust, which gives the lender the right to the title of the home if you fail to pay the mortgage, the HUD one settlement statement which shows your closing costs, and the truth in lending statement, which shows the amount you are financing, APR, and other loan terms.

If you see any unexpected fees, or the mortgage terms are vastly different from what you discussed, don't sign the documents. Ask for an explanation. Once you finish the mountain of paperwork, you will receive the keys to your new home. Congratulations! You're now a home owner.

And that's all for this podcast. This is Nikki saying goodbye.

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