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FIRST-TIME HOMEBUYERS GUIDE

Well, what exactly constitutes a “first-time” homebuyer? A first-time homebuyer might refer to someone who has never purchased a home before, though it could be much broader. Homebuyers who don’t have a substantial down payment could be eligible for down payment assistance through first-time homebuyer grants and loan programs, even if it isn’t their actual first time buying a home. To qualify for many of these programs, buyers must simply not have owned a home for at least the previous three years.

STEP-BY-STEP FIRST-TIME HOMEBUYER GUIDE

Step 1: Assess your finances

Assess your finances Check your credit reports and score, examine your budget, and assess your ability to make a down payment and pay closing costs. With a higher credit score, you can get favorable loan terms that will save you lots of money over the life of your mortgage — although you can still get a loan with a score as low as 500 (for an FHA loan) or 620 (for a conventional loan).

Look at how much debt you have relative to your income, or your debt-to-income (DTI) ratio. According to conventional wisdom, the ideal spend for housing costs, including the mortgage payment, property taxes, homeowners insurance and homeowners association dues, is 28% of your gross monthly income. For all your monthly debt payments, including housing costs, the ideal spend is 36%. Many mortgage lenders look for a DTI ratio of no more than 43%, but some go higher, up to 50%. The higher your DTI ratio, however, the more likely you are to pay a higher interest rate for your mortgage (because you’re considered a riskier borrower).

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Next is the down payment. If you're interested in a conventional loan and can put 20% down, you'll avoid paying private mortgage insurance (PMI), which covers the lender should you default on the loan. You don't have to put down 20%, however — you can pay as little as 3% or 5%, depending on the type of conventional loan you get, with PMI. If you're getting a VA loan or a USDA loan, you don't have to make a down payment at all. FHA loans, meanwhile, require a minimum of 3.5%.

Then, assess your ability to pay closing costs, which can range from 2% to 5% of the home's purchase price. Depending on how much your lender charges in fees, you could be paying a significant amount of money on closing day, so you'll need to have these funds set aside. Your real estate agent can negotiate how much you'll pay, or if you'll pay any closing costs at all.

There's also the earnest money deposit, which is a smaller deposit submitted with your initial offer to buy a home. Some states require a deposit of 10% of a home's purchase price from a buyer, while other states might allow earnest money of just a few hundred dollars.

Having considered these factors and what you can afford, gather your pay stubs and bank statements from at least the past two months, your W-2 forms and federal tax returns from the past two years and any other information related to other assets and debt you have. This information will help your lender determine the loan in which you qualify

Step 2: Decide which type of mortgage to get

There are a lot of different types of mortgages. Your first consideration is whether you want a fixed-rate or adjustable-rate mortgage (ARM). Fixed-rate loans tend to have slightly higher rates, but the rate never changes, so you know what your monthly payment will be for the length of your mortgage. An ARM typically starts with a lower rate for a period (such as five or seven years), then adjusts up or down at a predetermined interval (such as once a year). If the rate goes up, your monthly payment will increase with it.

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Also consider the term of your loan, such as 15 years or 30 years. Shorter-term loans have lower rates, but larger monthly payments, so while you'll have less flexibility in your budget each month, you'll pay less over the life of the loan in interest. It's up to you whether a lower monthly cost or overall savings is more important.

Most first-time homebuyers get a 30-year, fixed-rate loan. If you don't plan to live in a home for a long time, however, an ARM can be a good way to save some money. Fixed-rate loans offer more stability for those who plan to stay in one place.

There are also many loan programs to choose from, including conventional and FHA loans. Some programs you might not qualify for unless you meet specific requirements, so investigate the precise terms to see if any might be a good fit for you.

Step 3: Get quotes from at least three mortgage lenders

Getting a rate quote is a good starting point for comparing loan offers. Because mortgage rates change regularly and can vary considerably from lender to lender, aim to get rate quotes from at least three lenders. Often, you can get a quote for free through the lender's website if you provide some basic information, like the loan amount you're looking for, your down payment and credit score range. In general, you'll want to pay the lowest interest rate because that means less money spent monthly and overall.

If it's your first time buying a home, you might also want to get a sense of how rates fluctuate and the current rate environment, so you know what to expect when you seek a quote.

Keep in mind that while quotes can be a valuable means for comparison, your rate won't be finalized until you lock it in with the lender.

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Step 4: Get preapproved for a mortgage

After you've gotten quotes from a few lenders, you're ready to get preapproved for a mortgage. A preapproval is a preliminary commitment from a lender to loan you a certain amount of money, not a finalized offer. Getting one is necessary before you start searching for a home because sellers won't consider your offer unless they know you have the financing lined up. The preapproval letter typically spells out how much you're qualified to borrow, what loan program you're using and the expected down payment you can make.

When you request a preapproval, be prepared for your mortgage lender to dig into all aspects of your financial life. This is where the paperwork you organized ahead of time comes in handy.

Be sure you're getting a preapproval, not a prequalification. A prequalification could indicate that you might be approved for a mortgage but is better used to help you determine how much you might be able to afford. It will not pass muster when you make an offer for a home

Step 5: Find a Real Estate Agent

A real estate agent can help enormously in the home-buying process because the agent knows the area and the local housing market well, and can provide valuable insights about neighborhoods, school districts and more.

If you're not sure how to find an agent, start by asking around for recommendations for a buyer's agent. Many agents work by referral. You can also research online for highly rated agents and review testimonials from past clients.

Aim to interview at least three buyer's agents. Ask them about their experience and track record, and whether they specialize in any area, such as condos. Ask for references, as well, to verify whether their experience with the agent was positive.

In today's market, you could be competing against many offers, so you'll also want an agent who'll be able move quickly on a home you're interested in and help you navigate a bidding war, if that happens. Talk to your agent about their communication style and how

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they've helped guide other buyers through the current market.

When you're ready to look at homes, enlist an agent to help you find the right one and negotiate the best price. You'll likely need to sign an agreement with the agent.

Step 6: Shop for your home

This is the fun part (in the beginning, at least). Talk to your agent about your budget and top requirements so that you don't waste time looking at homes that don't meet your needs. If possible, visit homes in person, and avoid buying a home sight-unseen, even if it seems like the perfect fit based on an online description and photos.

During showings, tour the home and the neighborhood. How would you feel if you discovered the neighborhood was too congested with traffic, is next to a loud airport or the nearby schools are underperforming? The location is often just as important as the home itself. For a home in a homeowner's association (HOA), get a copy of the HOA documents so you know what the rules and fees are.

Step 7: Be prepared to make an offer — fast

If you tour a home in your desired location and price range and like what you see, be ready to make an offer fast! Your agent can run an analysis of comparable listings ("comps") that have recently sold in the area to help you make a competitive offer.

The offer should include an offer price, deadline for the seller to respond (usually within 24 to 48 hours) and any contingencies you want to request. At minimum, the offer should include appraisal and home inspection contingencies, which mean that if the home appraises lower than the price you offered or an inspection turns up significant issues, you can walk away from the deal without losing your deposit. If a bidding war seems likely, the offer should also include an escalation clause with a limit of how high a price you're willing to pay.

While some buyers waive contingencies to get their offer accepted, avoid doing this if possible — you won't want to buy a home and later find out it has issues way beyond what your budget can accommodate to repair.

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Once a purchase agreement is presented to the seller, your offer can be accepted, rejected, or countered with a different price. Tap your agent's experience to negotiate with the seller for the best possible outcome. If you do find yourself in a bidding war with multiple offers, it could help to write a letter to the seller describing why you love the home, but don't get discouraged if you lose out to another buyer. In today's market, with many homes selling quickly and for above list price, it's entirely likely you might not get the first home you place an offer on.

Step 8: Negotiate closing costs

If your offer has been accepted, it's time to apply for your mortgage. Within three days of your application, you'll get a loan estimate that details the loan terms and estimated closing costs, among other information. Some closing costs are negotiable; your lender might charge an origination and underwriting fee that could be waived or discounted if you ask, or offer a no-closing-cost option that rolls these fees into your loan. (You'll typically pay a higher interest rate to go this route, however.) Ask your lender to clarify any fees you don't understand.

If you need help with closing costs, you could also look to your state's housing finance agency or local housing organizations for down payment and closing cost assistance programs. If you meet program requirements, you could get a few thousand dollars to help cover expenses. You can explore first-time homebuyer programs by state.

Another consideration to make is whether you should pay for points to reduce your mortgage rate. Effectively, by paying points, you're prepaying some of the interest on your loan. Generally, each point costs 1% of the total value of your loan, so buying one point on a $250,000 mortgage will cost $2,500. Each point you pay usually reduces the rate by 0.25 percent.

In general, the longer you plan to stay in a home, the better it is to pay for points as you'll recoup the cost of the points by way of the lower monthly payment on your loan. To calculate the breakeven point, divide the amount you pay for a point by the amount you'll reduce your mortgage payment by each month. For example, if you were to pay $2,500 for one point and that will drop your monthly payment by $30, you'd need to stay in the home for about 84 months ($2,500/$30), or roughly seven years, to break even.

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Step 9: Hire a home inspector

After your offer is accepted, hire a home inspector to evaluate the property. Your agent can recommend a home inspector, or you can locate one through the American Society of Home Inspectors, International Association of Certified Home Inspectors, and the National Academy of Building Inspection Engineers. As you did when researching agents, consult the Better Business Bureau, HomeAdvisor, Yelp, or other online resources to check for complaints and read testimonials.

An inspector will check the home's structure, roof, heating, plumbing and electrical systems, but typically won't check for the presence of lead paint or mold. The inspection can take about two or three hours and range from $300 to $1,000, depending on the home's size and the extent of the inspection.

You and your agent should be present during the inspection so you can ask for clarification on any issues. Once you have the inspection report, review it with your agent and decide how to move forward. If the inspection uncovers major problems, you could try to ask the seller to fix them, but the seller might not be willing to if there are other offers that won't require them to pay for repairs. If you have an inspection contingency in your purchase agreement and the seller is unwilling to address the issues, you might choose to walk away instead.

Step 10: Get homeowners insurance, finalize your move and (finally!) close

Mortgage lenders require homeowners insurance, which helps protect your (and their) investment. Insurance premiums vary, so get quotes from several companies or work with an insurance broker who can shop rates for you. Assess your needs and ensure you buy adequate coverage to completely rebuild your home if it's destroyed or seriously damaged. If your home is located in a federally-designated flood zone, you'll need to buy flood insurance, too.

Depending on how quickly you plan to move, you'll likely want to start planning for the move before the closing. As you prepare for move-in day, contact your utility, cable, and internet providers to arrange new service for your move-in date. Then hire a reputable mover and start packing.

Finally, it’s time to put pen to paper and seal the deal. The closing is when you finalize the purchase contract and officially become a homeowner. Just before the closing, get updated pay stubs and other financial paperwork to prove your employment status hasn’t changed and that you’ll be able to make your mortgage payments. If you’re paying closing costs on closing day, obtain a cashier’s or certified check made out to the escrow company for the funds ahead of time. Don’t forget to bring your identification, too.

Within 24 hours of closing, you’ll do a final walkthrough of the property to make sure repairs, if any, were made and that the home is vacant. At the closing table, you’ll sign a lot of paperwork to finalize the loan and transfer ownership of the home from the seller’s name to yours.

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