A Guide for Buying Your First Home

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Buying a home is a true sign that you've officially entered adulthood. It's probably the most expensive single item you'll ever purchase and therefore falls into the category of *serious financial commitment*. If it's your first time, you've got your work cut out for you because there's a lot to learn. You definitely shouldn't go into this unprepared.

This guide lays out the basic home-buying information you need to know. Use it to get started but also feel free to pursue your own research after you read the guide. Ask anybody in the real estate world and they'll tell you: there's always more to learn!

The Home-Buying Process, Outlined For First-Timers

We'll start with a summary. Sometimes it helps to have a roadmap outlined in your mind before you dive into the details of a large undertaking. That's especially true with a multi-stage project like purchasing your first home. If you can master the general sense of what stages you'll be passing through, the nitty gritty of the details are more likely to fall into place later on.

So with that in mind, here's what can expect from the journey ahead of you on the exciting road to home ownership:

1. **Prep Work.** There are tons of things to do before you ever step foot in a prospective new home or talk to a realtor. Prep work includes checking your credit score for problems, getting your financials in order, and setting a budget.
2. **Determine a Location.** Next, you'll want to start honing in on a neighborhood that works with your budget. That will help you select a realtor later on, who specializes in that neighborhood.
3. **Shop for a mortgage.** Learn the lingo, shop around, and don't forget to ask about fees.
4. **Find an agent.** Referrals are a popular way to find a good real estate agent. Interview a few before making a decision.

5. **Start looking.** Attend open houses and get to know what kind of value you get for your money in the neighborhood(s) you've chosen.
6. **Make an offer.** There will be a round of counter-offers during the negotiation process.
7. **Make a deposit.** Assuming you finally reach an agreement on price, you'll need to fork over some money, called *earnest money*, to reassure the sellers you're serious.
8. **Get it inspected.** Hire a third-party home inspector to do a thorough once-over on the entire property. Re-negotiate, if necessary.
9. **Set a date for the closing.** The closing is where it all comes together and you walk away with the keys to your new home (barring any problems, that is).

That's all there is to it, one of the most significant purchases you'll ever make in your lifetime. Hopefully, it feels a lot more manageable knowing there are just nine steps to owning a home. Now let's dive a little deeper. Understanding the nuances can help you make better decisions and may even save you money.

Speaking of money, let's start with the part of the home-buying process that scares people the most: mortgages.

Mortgages 101

Most first-time home-buyers need a loan to pay for their home. Unless you're borrowing from family or you have enough cash to pay for the property outright, you're most likely going to end up borrowing the money from a financial institution.

Whether it's a bank or a mortgage company, here are the types of mortgages you'll be choosing from.

- **Fixed-Rate Mortgage.** The interest rate you pay over the lifetime of the loan doesn't change.
- **Adjustable Rate Mortgage (ARM).** The interest rate stays fixed for a period (usually three or five years) but after that will fluctuate based on what

interest rates are doing at the time.

- **Interest-Only Mortgages.** Normally, part of your monthly mortgage payment goes toward interest and part goes toward paying down the principal. Not this type. For a set period, you'll only be paying interest (sometimes for as long as a decade!). That lowers your monthly payments during that period. The downside is that in the meantime, you will not have built any equity in your home. Be warned: this type of mortgage is usually best for wealthy buyers who are juggling cash for investment purposes.

Why choose an ARM?

People often choose ARMs because the attractive initial rate is lower than the rate of a fixed-rate loan. However, when the ARM loan resets after the initial fixed period, it's anybody's guess as to what interest rates will be doing at that time in the future.

In other words, an ARM loan is a risk. People who take this risk usually aren't planning on staying in the home for long, figuring they'll sell the home before the adjustable rate kicks in.

What type of term?

Another choice you'll need to make is the term of the loan. For a fixed-rate loan, you can get a lower interest rate if you choose the 15-year term over a 30-year term. If your budget can handle the higher monthly mortgage payments of a shorter loan, it might be a smart choice.

Banks and down payments

If you're getting a mortgage, be prepared to adhere to a couple of rules. The first will be about your down payment. Lenders like to see their borrowers putting up a stake in the property, too, so they typically require a 20 percent down payment. How much you have saved up will directly correlate to the amount of money you can borrow and, therefore, how much house you can afford.

Ways to improve your lot with the lenders

The interest rate you pay on your mortgage will be a custom rate based on your financial situation. The rate you get is very much tied to your credit score, which is why, in the “Preparation” section of this guide, it was advised to get a free credit report. You don’t want mistake on that report to cause your lender to give you a higher interest rate. If your credit score is low, consider an FHA loan.

FHA Loans

As a first-time home buyer, you qualify for an FHA loan. These are loans insured by the Federal Housing Administration (FHA) and designed to help make housing more affordable for buyers. Rather than having to come up with a 20 percent down payment, you’ll only need as little as 3.5 percent for an FHA loan. They are also much more forgiving about bad credit. Plus, the interest rates for FHA loans are competitive these days, thanks to guidelines that have changed over the years.

There are some downsides, however, so you are encouraged to investigate this option thoroughly before making any final decisions.

One of the downsides is that you will have to pay mortgage insurance for the entire life of the loan. In non-FHA loans, you get to stop making those insurance payments once you’ve paid enough in to have reached 20% equity. Two more downsides: not all homes qualify for FHA loans and the home inspection will be extra thorough because the home has to be considered livable (no fixer uppers!).

More About Finances

Mortgage decisions aren’t the only finance basics you’ll need to know about. Here’s a quick rundown of other financials to take into account:

Closing Costs

The day you set for purchasing your home centers around an event called *the closing.* This is when you and your team meet with the seller and their team to exchange money for keys (and to push a whole lot of paper!). There are certain one-time costs you’ll need to cover.

These include a very long laundry list of fees that typically add up to around two percent but can go as high as five percent of the purchase price.

Good Faith Estimate & HUD-1 Statement

When you apply for a mortgage, part of the process involves the lender creating a Good Faith Estimate for you. This will detail what they estimate your closing costs will be. Then later on, when you're closer to your closing date, they'll provide an actual list of closing costs (not just an estimate). That final list is called the HUD-1 statement. Make sure not too much has changed and question any changes you do see.

Escrow

You may be asked to pay two months' worth of property taxes and mortgage insurance payments up front. You will deposit the money into an escrow account. It can be considered a closing cost since this is when it's due.

Understanding How Real Estate Agents Work

The first rule of thumb when choosing an agent is to work with someone you like. In addition...

1. They should be a good listener so they don't waste time showing you the wrong properties
2. They should be trustworthy (belonging to the National Association of Realtors means they adhere to a strict code of ethics)
3. They should have the right credentials (licensed by the state)

Referrals are a good way to find candidates and you should always interview a few before choosing someone.

What's the difference between a buyer's agent and a realtor?

There are actually a couple of professional terms you should know about:

- **Buyer's Agent.** They will guide you through the home search, negotiate your offer, recommend mortgage brokers, inspectors, and attorneys, and advise you when issues arise

- **Listing Agent.** This is the agent who represents the listing… *not you*. They're legally bound to help the seller, whereas the buyer's agent is legally bound to help you, the buyer.

If you attend an open house, remember that the agent hosting the event is the listing agent and therefore is working for the seller. You'll want to keep your cards close as far as your budget goes and it's probably wise to keep your feelings about the property to yourself.

Special Section for Condo Buyers

Condo buyers have an added step of homework to do when choosing whether to buy a property. Namely, it's the Homeowners' Association (HOA) that needs looking into because if it's badly run or running low on funds, that will have a huge impact on your finances if you buy into that community.

Your agent can advise and assist you with issues that arise during the home-buying process and they will act as an intermediary between you and the seller when it comes to the crucial phase of negotiating the offer. But when it comes to the intensive kind of research that's required to assess a homeowners association, you'll need to know what you're doing. Here's what you need to do:

1. Call the office of the company that manages the condominiums (or community) and ask for their annual budget as well as a financial statement.
2. Examine the budget and ask about any line items you find confusing or questionable.
3. Examine the financial statement and make sure the HOA has enough cash reserves to cover unexpected expenses. If they don't, owners will end up with an assessment or higher dues.
4. Ask for a 'reserve study', which is prepared by an outside accountant. This will tell you if there are any large expenses looming on the horizon, such as a new roof.

The Closing

Here's where it all happens. With its laundry list of costs plus the drama of gathering everyone together for a 'grand finale', the closing can instill trepidation in even the most seasoned of home buyers. One thing you can do to calm your anxieties is to understand what happens at a closing so there aren't any surprises… or so there are at least *fewer* surprises.

As long as we're talking surprises that can arise at closing, the good news is: last-minute upsets often originate with the buyer and it usually has something to do with funding (either that or buyer's remorse). So as long as you've got your funding all squared away and you're sure you love the property, you can feel confident that the closing has a better chance of going off without a hitch.

Even with rock-solid funding, however, you're still not in the clear. Here are a few more examples of what could go wrong at a closing.

1. **The title search reveals a problem.** The purpose of a title search is to make sure the property you're interested in purchasing is actually owned by the seller. If they haven't paid their bills, that could be the end of the deal. *Pro tip: hire a title search company or an attorney who specializes in this area to do a thorough and professional job.* Common title issues include:
    - Non-payment of state or federal taxes
    - A claim on the house by a relative or a co-owner
    - Non-payment of contractor's bills (called a *contractor's lien*)
    - Clerical errors in public records
    - Fraud (forged documents filed within public records or impersonation of the owner)
    - Unknown easements and encumbrances
    - Boundary disputes
2. **The home inspection reveals a problem.** Sometimes a home inspection unearths something horribly wrong with the structure of the property or a major pest infestation. In that case, there can be delays and the closing will be postponed until things get worked out. It will be up to you and the seller

to negotiate and you'll make the ultimate decision about whether the problem is a deal-breaker. *Pro tip: have your home inspection done ASAP after you've put down your earnest money.*

3. **Insurance companies won't insure the property.** This happens when there's been a major claim on the property and/or there's just too big of a risk for insurance companies to cover it. Lenders require insurance (unless you're putting down more than 20 percent) so the only way out of this pickle is to pay cash for your home. *Pro tip: find out about insurance ASAP before investing more resources into this property.*
4. **The appraisal comes back lower than expected.** Your lender won't loan you the full amount for the asking price if the property isn't appraised at equal or greater value. That means you'll be on the hook to cover the difference. *Pro tip: if this happens, get a second appraisal and never hire an appraiser who isn't qualified.*

Sending You on Your Way to Reach Your Goals...

There are, of course, dozens of other worrisome details to pour over and fret about when it comes to derailed closings. As long as you anticipate these events and take measures to prevent those which fall under your control, you've done your best to make the deal go forward.

And that's good advice in general for the entire home-buying process. It's all about arming yourself with good information and taking steps to avoid those obstacles which are predictable. That, plus plenty of self-awareness of your needs and desires for your first home, should smooth the way toward a hassle-free transaction on the big day.

You've taken a productive first step by reading this e-book. Now it's time to go out and apply everything you've learned so you can be on track toward reaching your goal of home ownership. Good luck!