Frequently Asked Questions
HOME BUYERS

How Much House Can You Afford?

There are several ways to gauge how much you can afford to spend on a house. Before you go house-hunting, get pre-qualified for a mortgage so you'll know in what price range you can shop.

It is not unusual for first-time buyers to be somewhat baffled about how to estimate what mortgage payment they will be able to handle each month, plus how much money they'll need for a down payment and closing costs.

That's why it is a good idea to get pre-qualified through a lender before you even start to look for a home. Pre-qualification lets a buyer know exactly how much a lender is willing to loan them. With pre-qualification in hand, the buyer can save a lot of time and frustration.

Pre-qualification does not obligate buyers to take a loan from the lender, nor should it involve any fees (until later, when they actually apply for the loan).
At the same time, you must understand that pre-qualification is not pre-approval for a loan either which is a much more involved formalized process that results in an actual letter of credit from a lending institution for a specific loan. Depending on your unique circumstances, you may wish to consider pre-approval as an option, but it is not necessary-consult with your real estate professional to decide what's right for you. The less formal process of pre-qualifying is a tremendous tool for buyers to have when making an offer. Usually, pre-qualified buyers have an edge when making a purchase offer because the seller knows that the buyer is pre-qualified, and that there is at least one lender ready to make it happen.

In addition, it allows you the flexibility to choose the mortgage that is best for you at the time of actual purchase-which is sometimes months down the road. That can be important given the volatility of interest rates. When a lender pre-qualifies, they are more concerned about the buyer's paying ability than the price of the property.

For this reason, lenders are interested in more than just a buyer's income. They also want to know how much existing debt a buyer has, what their on-going financial obligations happen to be, and what the buyer's monthly budget looks like.
Lenders use an established debt-to-income ratio, usually between .28 to 1 and .38 to 1, to calculate the amount of the loan they are willing to give to a buyer. For instance, a lender who uses a .3 to 1 debt-to-income ratio has determined that payments toward debt reduction-including existing debt plus new debt associated with buying a home cannot be more than 30% of they buyer's gross monthly income.

An important factor that may influence a lender to authorize a loan with a higher debt-to-income ratio - (where debt payments take a higher percentage of a buyer's income) - is a larger down payment. Buyers who put a larger percentage of the purchase price down (5%, 10%, 15%, 20%, etc.) are considered better "risks," because the theory is that the more a person has actually invested in the purchase, the less likely they are to default on the loan.

Buyers usually discover that the pre-qualification process will produce a home purchase price that is roughly 2 1/2 to 3 times their gross annual income. The 2 1/2 -to-3 guideline is only a general rule of thumb, however, and it doesn't take a buyer's full financial situation into consideration.

Since the lender's calculations will also consider a buyer's actual debts and ongoing expenses, the loan pre-qualification amount may be higher or lower. Regardless of the price bracket a buyer targets, they should keep pre-qualification in mind.

How much should you budget to own your own home?

Aside from the down payment, the three largest expenditures involved with the purchase of a home are usually your monthly mortgage payment, insurance and taxes. Obviously, the amount of your mortgage payment depends upon your down payment, rate of interest and the price of the property. Take, for example, a home that has a $200,000 mortgage. A 7% fixed mortgage for 30 years, will run approximately $1330 per month. What about taxes? The rate will often times vary from city-to-city, but generally you might expect your yearly tax bill to total around 1.25% of the purchase price. That means for a home with a market value of $250,000, yearly taxes might run around $3125. A local real estate agent can help prospective homeowners refine these figures.

In addition, it is important to keep in mind that there are many additional expenses incurred with home ownership, some of the most obvious are utilities and trash collection. Smart homeowners should also budget for one other item, maintenance and upkeep of the home. If possible, a small amount should be set aside each month to pay for those "rainy day" repairs such as painting, plumbing (hot water heaters, garbage disposals), adding storm windows (to improve energy usage), insulation (in attics), etc.

But home ownership is not just a one way street-that is, aside from spending money on repairs and maintenance, homeowners can profit from their property. The most significant benefit is the tax deduction. It is no secret that among the last real income tax deductions available to consumers today are the interest paid on the home loan, and the property taxes. This can amount to thousands of dollars in deductions each year.

And, of course, the primary benefit of home ownership is appreciation-equity that builds every month. A home, aside from being a place that provides shelter, can be a profitable investment, and the rising value of the property oftentimes provides another "savings" account. So, when it comes to buying a new home, remember one thing ... the purchase of a property requires budgeting and planning.

How do you go about finding a mortgage?

The commotion of house hunting is finally over. You found just the right house, and your offer has been accepted. It was a great buy. Now, just one more hurdle-getting a loan-and you're home free. Often buyers are so eager to get this "final detail" behind them; they rush through this portion of the transaction, and end up with less-than-ideal terms. Borrowers, however, have something lenders want----their business. This positions them to negotiate the best possible price (cost of loan), terms and service.

Let's look at price, or the cost of the loan. The first thing to do is find out what the current rates are, information readily available on the internet, in your newspaper or from your real estate agent. When comparing rates, figure the annual percentage rate (APR), which includes interest, extra fees and costs amortized over the life of the loan. Also determine the number of points, if any, that the lender will charge to make the loan. (A point is equal to one percent of the loan amount.)

Next, consider what loan options the lender offers. There are six or seven basic types of loans, which vary in their duration. Check how rates are calculated (fixed versus variable), and whether charges are fully amortized over the life of the loan, or whether you'll have to pay points up front and/or balloon payments at the end.

How difficult is it to qualify for a mortgage if you have a past credit problem?

Credit problems can make it harder to qualify, but it's quite possible for buyers with poor credit to obtain a home loan.
Anyone who has had a financial problem-whether it was a matter of late credit payment, delinquent taxes, or even a judgment that was filed-should expect this data to be a factor when applying for a mortgage.

How critical a factor? Minor lapses will probably have little or no effect. However, buyers with serious problems may still qualify for a loan, but they may have to pay a higher rate of interest or provide a larger down payment.

There are three steps that a person with past credit problems should take before applying for a loan.

First, request a credit profile from ALL three major credit reporting agencies.

Second, the buyer should optimize his or her credit profile by citing prompt payment of rent, utilities, and other bills not reported on the credit profiles.

Finally, the buyer should be prepared to provide comprehensive and candid explanations for any late payments to the loan officer. This is important because problems not reported by the buyer but discovered by the lender will reflect unfavorable.

Many lenders are understanding about one-time problems such as the loss of a job, a medical emergency, etc.

Buyers with patterns of delinquent payments might want to consider adding six months or a year of flawless credit to their track record before pursuing their home-buying plans.

So remember-if you are thinking about purchasing a home, but are worried about your past financial record-don't give up.

There are solutions, lenders and agents who are in business to help.

What are the five most common mistakes made by first-time buyers-and how can you avoid them?

A good home-buying decision is one that fits your lifestyle and your budget-a house you'll be able to resell when the time is right. Sound simple? Not always.

Five common mistakes frequently made by first-time buyers.
1. Looking outside your price range. To avoid disappointment, contact a real estate agent who can help you pre-qualify before you start looking for a home. The agent can also provide valuable insight on taxes and other expenses associated with a home (utility bills, etc.)
2. Buying on impulse. Buyers-especially first-timers-may be impressed by the first two or three homes they view. Look at a good selection. List the positives and negatives. Narrow the prospects to three or four, and then return for a closer look. Evaluate more than just the property. Look at the surrounding area and community amenities. Is this what you-and your family-want and need?
3. Not planning ahead. Think seriously about any personal changes you are planning in the next five to seven years. For instance, if you are planning on having children, consider how the home will meet both your current and future needs. If a double-income is necessary to qualify for financing-and make your payments-do your plans foresee an income sufficient to continue making payments?
4. Failure to focus on location. Don't just focus on the house, examine the neighborhood. Is the area safe, well maintained, moderately quiet and close to work, stores, and schools?
Find out about zoning and what new construction is planned on any vacant land in the immediate neighborhood.
Will the property be easy to market when you are prepared to sell it?

5. Failure to understand the home buying process. Once you select a home, get involved. Find a real estate agent willing to spend time with you, and don't hesitate to ask questions. Have them explain the negotiation, financing and escrow processes and other elements involved in the transaction.

Home-buying involves knowing the price, and what's inside and around the property. Consider all your options carefully.
This may be the most important financial transaction of your life.

Should a buyer get a professional inspection for the home they are buying?

Definitely. Hiring a professional home inspector can save a great deal of grief for buyers. The one exception would be when the home is new and carries a written warranty by the builder.
Many buyers mistakenly believe that the only reason to have a home inspection is to make sure that the house they're buying doesn't have defects serious enough to warrant backing out of the transaction. But there's more to it than that.
Certainly, an inspection will usually reveal major problems that may even surprise the seller. The obvious ones are corroded plumbing, antiquated and unsafe electrical systems, or structural and foundation problems. And, the discovery of such problems may cause the buyer to re- think his or her offer.
Although a competent inspector can uncover deal-crushing defects, these problems are usually not commonplace. Typically, the seller will already have told the buyer about anything major. More often, inspections reveal less serious problems; problems that may not be serious but can be aggravating. For instance, there could be a minor electrical defect, or inferior ventilation of a heating system or fireplace. If so, the buyer is usually in the position of having the purchase price reduced, or the defect corrected.
More important, it also prevents the minor problem from developing into a major disaster a year or two down the road.
There is, of course, the possibility that the home inspection will produce another outcome: everything is fine. In this case, they buyer gains piece of mind, confident about the major investment he or she is about to make. That, too, is an enormous benefit for the cost of the inspection.

How does a buyer find a home inspection?

By asking their Real Estate Agent, friends, or lender. Inspectors are also listed in the Yellow Pages under "Home Inspection Services." But, a word of advice, don't hire a contractor. Contractors earn their living doing repair and renovation work, so their recommendations aren't likely to be as objective as those of a professional inspector.

Does a home warranty protect a buyer in the event something goes wrong after they have purchased a property?

Sometimes. That's because home warranties are often times misunderstood and not every warranty provides the same protection. All warranty companies are not equal, either. Warranties, of course, were designed to protect buyers from problems that emerged after they moved into a dwelling. For example, if a major appliance breaks or the roof leaks, the ideal warranty kicks in and pays for the repairs.

On the surface, this sounds simple and straight-forward. But, most of the time it is not. First, all warranties differ. Aside form the obvious differences, the amount of deductible required, they may also vary as what is covered and what is not. For instance, with some warranties if the hot water heater works on the day of closing, but suddenly does not work six months later, then it may be covered. And, with other policies if the water heater was not in good working condition when the home was purchased, and it breaks a week or two later, there is no coverage.

Warranties can be critically important when it comes to new construction, too. Obviously, the reputation of the builder is an important consideration. However, problems with new homes can be enormously expensive if they are not covered by a warranty.
There are two types of defects when it comes to new homes - patent or latent. Patent are those problems which can be seen. Cracked plaster, a fence that is off-kilter, etc.
Latent problems develop later, and may not show up for five or six months. Ground shifting, for example. Latent problems are usually more expensive than patent problems.

Thus, the warranty for a new home can be one of the most important documents executed during the buying process. Whether you're purchasing a new home or a resale, remember that warranties definitely have a place when it comes to protection and peace or mind in the real estate transaction, but make sure that you check them out carefully.

Is a final walk through, an inspection of the property by the buyer before they move in, really important?

Yes, it is. The intent of a pre-closing inspection is to give the buyer one last opportunity to verify that they are getting all that was promised in the sales contract. Although buyers still have legal recourse if they discover-even after closing-that the condition of the home is not as it should be.

The best time to identify problems is before closing, when the seller will be motivated to correct any deficiencies in order to close the transaction.
Typically, a buyer takes possession of a property one to three months after signing the sales agreement. But, a lot can happen before the actual move-in. Appliances and fixtures can break down, and walls, carpets and doors can be damaged during the seller's move-out.
Sometimes the seller will simply have forgotten that he or she had agreed to leave the refrigerator or window coverings with the house. Whatever the reason, problems identified before closing have the best chance of being remedied.

If possible, schedule the inspection right before the closing, such as the day before. Ask your Real Estate Agent to attend the inspection with you. What should you be inspecting? Using a copy of the sales contract as a checklist, first make sure that all items that should be in place (appliances, built-in furniture, window coverings, fixtures, etc.) are there. Test each appliance to make sure they work properly. Test all electrical switches and the garage door opener, if there is one. Run the garbage disposal and turn on every water faucet, checking under the sinks for leaks. Flush the toilets. Inspect the floors, carpets, walls and doors for recent damage.

If you discover that something is damaged or missing, make a note of it and inform your agent immediately. In most cases, the seller is usually able to take care of small problems immediately, either by making a needed repair or offering compensation to handle it. And, if there are major problems the seller can even sign a statement acknowledging the deficiency and agree to correct it.

Although pre-closing inspections take time and may be inconvenient, they are important and well worth the buyer's time.

What are "contingencies" and why are they important?

A "contingency," is an escape-clause that is added in-writing to a contract which allows a buyer to back out of the transaction if certain conditions aren't met.

Some contingencies, often called `riders'-like attorney approval of the contract, or the passing of a home inspection-are obviously designed to protect buyers from a poorly written contract or a defective home.
Other purchase contingencies may hinge on the buyer's current living situation, or his or her cash-flow. For example, when it comes to contingencies many first-time buyers can be better prospects for a seller's home than move-up buyers. Why? Because offers from homeowners usually are contingent upon the sale of their present home. And, even if a move-up buyer has an offer for their home in-hand, their buyer's offer may be contingent on another contingency (or sale) and so on down the line. If one transaction in the chain falls through, they all might.
Cash offers can also be more attractive to sellers.

Why?

After all, the seller will get their money at closing whether or not the buyer has cash or takes out a loan. True, but cash offers don't require lender approval, and loan approval is never a certainty and may delay or prevent closing. (Incidentally, for this reason, buyers who get pre-qualified for a loan have an edge over other buyers. A pre-qualified buyer is the same as a cash buyer.)

Buyers offering a larger-than-customary amount of "earnest money", (a deposit that accompanies an offer) can be more appealing too. More money deposited with the signed contract often demonstrates greater sincerity and motivation to close the transaction.

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