Home Buying Made Simple

A practical guide for future homeowners

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Course Objectives

1. Assess your readiness to buy a house.
2. The importance of having a personalized plan.
3. Understand mortgage types and credit.
4. Establish a realistic budget.
5. Navigate the buying process.
6. Understand common mistakes to avoid.

The House Buying Timeline

1. Building a Plan
   - Target Location, Finances/Budget, Desired House Features, Timeline.
2. Pre-Shopping Tasks
   - Credit score, Build a Team, Mortgage Pre-Approval, Exit Plan for current residence.
3. Finding the Right House and Making an Offer
4. Inspections and Closing
5. Post-Purchase

Why Planning Matters

1. Largest purchase for most households.
2. Long-term financial commitment.
3. House buying is a stressful process.
4. Mistakes can be costly.

Renting vs. Owning

This class presumes you have made the decision to buy a house; since each situation is different, I suggest assessing the Rent vs. Buy decision on a case-by-case basis.

Tradeoffs:

1. Flexibility (short-term vs. long-term commitment).
2. Independence.
3. Upfront costs vs. equity growth.
4. Maintenance responsibility (time and cost).
5. Amenities.

I typically recommend against the purchase of a "starter home" intended as a short-term (~5 years) residence, from a financial cost perspective.

Signs You May Be Ready To Buy A House

1. Stable income.
2. Emergency savings in place.
3. Manageable debt.
4. Plan to stay in residence for 5+ years.

Know Your Financial Picture

Build an updated:

1. Balance Sheet
   a) Understand the impacts of a down payment, closing costs, and post-closing purchases (furnishings, appliances, etc.).
2. Income Statement
3. Budget (two versions: current residence and desired residence)
   a) Understand the projected changes to housing expenses.
   b) Update this budget for each house being considered for an offer.

Factors That Lenders Use to Evaluate You

1. Credit score
   - Convention mortgage: credit score of at least 620 to qualify.
   - Government-backed mortgage: may accept scores as low as 500.
   - **Scores of 740 or higher usually unlock the most competitive terms.**
2. Debt-to-income (DTI) ratio
   - Front-end DTI: Only covers housing expenses (mortgage principal, interest, taxes, and insurance). **Banks prefer this to be 28% or less of your gross monthly income.**
   - Back-end DTI: Includes housing expenses plus all other recurring monthly debts (credit cards, auto loans, student loans, etc.). **Banks prefer this to be 36% or less.**
   - Exceptions exist, often based on borrower's cash assets and/or credit scores.
3. Assets
   - Lenders will typically require assets on-hand to cover closing costs, down payment, moving expenses and reserves to cover at least 6 months of emergency expenses.
4. Employment history

Credit Score Basics

1. Your credit score affects mortgage approval and interest rate.
2. Higher credit score = lower cost.
3. Check reports well in advance of starting your home search and base your homebuying financial budget on the projected interest rates that your credit score will yield.
4. Freeze credit data at least 12 months before intended purchase.

Types of Mortgages

Type	Features	Best For
Fixed-Rate (FRM)	Rate does not change over life of loan; Monthly principal & interest payment is fixed; Higher interest rate than ARM.	Buyers who can afford the higher initial rate and are likely to stay in the home for >5 years.
Adjustable-Rate (ARM)	After initial fixed period (5/7/10 years), the interest rate may increase or decrease based on market; Monthly principal & interest payments may change over time. Lower INITIAL interest rate than FRM.	Buyers who are likely to move within the initial fixed period or shortly thereafter.
FHA, VA, USDA	**FHA:** loans via private lenders which are regulated by the Federal Housing Admin.. Low down payments; loan max limits; requires PMI. **VA**: loans via private lenders guaranteed by the Veterans Admin.; no PMI required; as low as zero down payments; requires a funding fee. **USDA**: offered by the US Dept of Agriculture;as low as zero down payments; requires PMI.	FHA: those with low credit scores or limited down payment funds. VA: veterans, servicemembers, or surviving spouses. USDA: low- to middle-income borrowers in rural areas.

Pros and Cons of ARMs vs. FR Mortgages

Mortgage Type	Pros	Cons
Adjustable-Rate Mortgages (ARMs)	Lower initial rates mean lower early monthly payments. Potential for savings if interest rates remain stable or decline. Possibly lower costs in the early years.	Rate increases after the initial fixed period can lead to higher payments. Monthly payments can fluctuate, making budgeting harder. Fees may apply for early payoff.
Fixed Rate Mortgages	Consistent interest rate and monthly payments throughout the loan term. Predictable payments make budgeting easier. Stable long-term planning with no surprises.	Higher initial rates compared to ARMs. Less flexibility if interest rates fall, requiring refinancing to benefit from lower rates. Potentially higher overall costs if rates drop or remain low.

Monthly Payment (PITI)

1. **P**rincipal
2. **I**nterest
3. Property **T**axes
4. Homeowner’s and Mortgage **I**nsurance

Monthly cost that is often overlooked: HOA fees.

Other recurring homeowner-related expenses will be discussed later.

Mortgage Payment Examples

All examples assume $450,000 purchase price w/ 10% down; $405,000 initial mortgage amount.

Type	Monthly P+I	Total Interest Paid	Notes
30 yr ARM 5 years @ 5.0%, then 7.5%.	$2,176; $2,748	$549,949	After the initial 5-yr period, the rate will be adjusted every 6-12 months based on market rates.
30 yr ARM 5 years @ 5.0%, then 4.0%.	$2,176; $1,963	$314,365	After the initial 5-yr period, the rate will be adjusted every 6-12 months based on market rates.
30 yr Fixed @ 6.5%	$2,560	$516,555	
30 yr Fixed @ 6.5% Paid biweekly	$2,776	$394,828	Loan is paid off in 24 yrs, 1 month. This requires the bank to apply the biweekly payments against loan balance when payment is made.
30 yr Fixed at 6.0%	$2,428	$469,145	

Down Payment Planning

- **Be sure to include projected Closing and Move-In Costs (explained later) in Down Payment planning.**
- Down Payment Amounts
  - FHA loans: typical require at least 3.5% down.
  - VA and USDA loans allow as low as zero down payments.
  - Conventional loans: typical require at least 5% down w/ PMI; >=20% down payment avoids PMI.
- State and local assistance programs may help.
- When planning how much you can put down, ensure you have ample resources left in your Emergency Fund and for other short-term needs (furnishing, fees/dues, moving expenses, etc.).
- Gifts are allowed as part of down payments but must be well documented.

Set a Comfortable Budget

1. Avoid being house-poor.
2. Leave room for savings towards other needs and goals.
3. Plan for furnishings and repairs.

Stress-test your post-purchase budget for job changes or ownership cost increases.

Your Home Buying Team

1. Agent
2. Lender

   https://myhome.freddiemac.com/blog/homebuying/6-tips-consider-when-shopping-lender.

3. Inspector
4. Appraiser
5. Attorney
6. Financial Advisor

Mortgage Pre-Qualification vs. Pre-Approval

	Pre-Qualification	Pre-Approval
Definition	An estimate of how much you might afford.	A lender's conditional commitment to lend you a specific amount.
Process	Basic financial info (income, debts, assets) shared verbally or online.	Full mortgage application with detailed (W-2s, bank statements, tax returns) documentation.
Credit Check	Typically, a soft inquiry (doesn't hurt score) or no check is done.	A hard inquiry (can temporarily lower credit score).
Outcome	A rough idea of borrowing power, not a commitment.	A formal letter stating the maximum loan amount, which boosts your credibility with sellers.

Pre-Qualification is helpful for establishing home affordability, but Pre-Approval is needed when preparing to shop.

Pre-Approval leads to stronger offers, higher odds of offer acceptance and faster closings.

Finding the Right Home

1. Location
2. Features
3. Condition
4. Resale potential

Making an Offer

1. Price
2. Earnest money
3. Other required deposits
4. Contingencies
5. Timeline

Inspections & Negotiations

1. Identify issues
2. Request repairs or credits
3. Know when to walk away

Reference EA House Inspection Guide.

Closing and *Move-In* Costs

1. Loan fees (rate buy-down, bank fees, attorney fees, etc.).
2. Title search and insurance.
3. Taxes and Homeowners insurance.
4. Realtor commissions.
5. *Moving expenses.*
6. *Furnishings.*
7. *Immediate repairs or modifications needed.*

Total closing costs are typically 3-5% of home price for the buyer.

According to a 2024 Zillow survey, 42% of buyers said the final costs of closing on their home were more than they expected.

Reference HUD Closing Cost Statement.

Life After Closing

Congratulations – you are now a Homeowner!

Be sure to update your budget to reflect changes related to:

1. Rent vs. Mortgage
2. Home Maintenance
3. Property Taxes
4. Homeowners Insurance (much higher than renters)
5. Utilities (typically higher in a house vs. apartment)
6. HOA fees

Create a log to keep track of your closing costs and capital improvements.

These can be added to the cost basis when the home is sold to reduce capital gain taxes.

First-Year Planning

1. Update your emergency fund and short-term savings goals to address:
   a) Updated recurring costs per previous slide.
   b) Furnishing expenses (savings goal).
   c) Maintenance costs (add to emergency fund calculation for unexpected repairs and savings goal for big-ticket items).
   d) Future improvements (savings goal).
2. Review your Life and LTD coverage due to the new (significant) financial commitment you now possess.
3. Ensure your Estate Planning documents are in place and up-to-date.

House Buying Mistakes to Avoid

1. Trying to time the market.
2. House hunting before getting pre-approved for a mortgage.
3. Not leveraging professional assistance (your house buying team).
4. Not shopping around for mortgage options and assistance programs.
   - Different banks.
   - Various loan types (VA, FHA, conventional, etc.).
   - Government and private home purchase assistance and incentives.
5. Not accounting for all projected costs when building a house budget.
6. Buying more house than you can afford.
7. Buying a “starter” home with plans to move within 5 years.
8. Settling / Sacrificing desired features or location.
9. Draining savings – failing to maintain an Emergency Fund.
10. Letting emotions overwhelm sound financial guidelines. Don’t let aesthetics override practical factors like neighborhood, commute, condition or long-term resale value.
11. Skipping inspections. Structural, plumbing, or roofing issues may lead to large repair bills later.
12. Making big purchases between loan approval and closing, which may impact loan approval.

Key Takeaways

1. Create a task-based timeline.
2. Build a detailed home purchase financial plan. Know your numbers.
3. Identify your home purchase team.
4. Check your credit scores and freeze your credit data.
5. Build savings in line with projected down payment and closing costs.
6. Talk to several lenders. Mortgage rates and terms will vary and have significant financial impacts.
7. Get pre-approved for financing BEFORE starting to look at houses.
8. Research real estate agents.
9. Don’t rush the purchase - know when to walk away.

Questions?