FDIC

June 24, 2019

FEDERAL DEPOSIT INSURANCE CORPORATION
consumer **news**

Thinking About Buying Your First Home

Buying your first home can be intimidating, so take some proactive steps to make the process more manageable

A house could be the biggest purchase you will ever make, and the process of shopping for a home and obtaining a mortgage can be overwhelming. However, there are steps you can take to make the process more manageable and the purchase more attainable.

1. Know Your Credit History and Score

One of the key factors in getting approved for a loan is your credit score. Your credit history determines your score, and the higher the score, the better the loan terms become. You are entitled to a free credit report once every 12 months from each of the three nationwide credit bureaus: Transunion, Experian, and Equifax. Go to www.AnnualCreditReport.com, the official site for consumers to obtain free credit reports, or call 1-877-322-8228. If you notice any errors on your report, work on correcting them as soon as possible. The Federal Trade Commission offers helpful suggestions on how to fix errors on credit reports at https://www.consumer.ftc.gov/articles/0151-disputing-errors-credit-reports.

A high credit score helps you not only get approved for a mortgage, it also improves the terms available. Here is a breakdown of the five major components that make up your credit score.

- **Payment History** – Reported payments account for 35% of your total credit score. Late payments will affect your score negatively, so it's important to consistently make payments on time
- **Credit Utilization** – How much of your credit is in use makes up 30% of your score. If you reach the credit limit on your credit cards, it lowers your credit score. Do your best to start paying down credit card balances to free up your credit.
- **Length of Credit History** – How long you have been using credit and making payments as well as the amount of time each of your credit accounts have been open is 15% of your total credit score. If you're trying to clean up your credit, closing accounts may not necessarily be the answer. It may be best to pay off accounts and keep them open to maintain long standing accounts.
- **New Credit** – Be cautious when opening new credit accounts, which accounts for 10% of your score. Opening too many new accounts in a relatively short period of time could hurt your score.
- **Credit Mix** – The remaining 10% of your score relies on the variety of credit accounts you have. Having a mix of revolving credit accounts, such as credit cards, and installment loans, including auto loans and student loans, with positive payment histories show that you can manage different types of credit and will increase your score.

Remember, the higher your credit score as a potential buyer, the lower the risk to a potential lender.

2. How Much Can and Should You Spend?

When reviewing mortgage applications, lenders pay close attention to your debt-to-income ratio (DTI). DTI shows how much of your monthly gross income – your income before taxes or other deductions are taken out – goes to monthly debt payments. Many lenders prefer that your total monthly debt payments, which include housing payments, auto loan payments, student loan payments, and minimum credit card payments, not exceed 40% of your gross monthly income. Some lenders prefer a DTI of 36% or less. Others may accept a higher ratio.

When looking at your finances to determine how much you can afford for a monthly mortgage payment, keep in mind that the payment will include not only the loan principal and interest but also taxes, homeowner's insurance, and possibly mortgage insurance (lenders require you to pay mortgage insurance when your down payment is less than 20% to protect the lender in the event you default on the loan). While you will need more information to get an exact figure of the house price you can afford, such as the interest rate on your loan and how much of a down payment you will have to put toward the purchase, look at your DTI as discussed above to get a better idea of the monthly payment that will fit your budget.

Many websites have calculation tools that can help you determine how much you can afford and the amount your monthly payment will be under different scenarios. The U.S. Department of Housing and Urban Development's (HUD) maximum financing calculator is a good place to start and can be found at http://www.mortgagecalculator.org/calcs/FHAMortgageQualifier.html

For more information on figuring out how much you can afford, visit: https://www.consumerfinance.gov/about-us/blog/mortgage-moves-how-much-can-you-afford/ and https://www.consumerfinance.gov/owning-a-home/process/prepare/decide-how-much-you-want-spend/

3. Save, Save, Save

Having savings makes it easier to purchase a home. Saving can be hard given the challenges many first-time home buyers face with high housing costs and student loan debt, but most lenders require a down payment, and you will likely be responsible for closing costs. You will also want to have money available once you complete the purchase for maintenance or repairs in your new home. So let's look at the possibilities.

To increase your savings, see if there is a way to tighten your budget and lower your current housing costs. Automating your savings may help keep you on task with obtaining your savings goals too. Check with your bank about linking a savings account to your checking account and creating a regular automatic deposit to the savings account. In addition, automatic savings apps, which help you save by rounding up certain purchases to the nearest dollar and setting the money aside, can add a little extra to your savings.

The Consumer Financial Protection Bureau and Federal Trade Commission have useful resources for those interested in learning more about ways to save. Visit https://www.consumerfinance.gov/start-small-save-up/ and https://www.consumer.ftc.gov/articles/pdf-1020-make-budget-worksheet.pdf.

You may also be able to take advantage of down payment and closing cost assistance programs offered by government agencies and non-profit organizations. Be sure to take the time to research what is available and what your qualifications are to apply for these special programs. Start with HUD's website for more information about assistance programs in your state: https://www.hud.gov/topics/rental_assistance/local. HUD also provides lists of approved housing counselors in each state that can help with the home buying process: https://apps.hud.gov/offices/hsg/sfh/hcc/hcs.cfm.

4. Start Organizing Documents

When you apply for a mortgage, most lenders will want one or two months of paystubs, two years of tax filings, three to six months of bank account statements, information about any retirement savings, and other documentation specific to your financial situation, such as explanationsof any recent large deposits or withdrawals from your bank account. It can be overwhelming to pull together so much information in a short timeframe, so start early. By getting these documents in order at the beginning of your house hunting journey, you give yourself time to ensure you have all of the documents the lender requires.

When you're ready to buy a house, understanding the costs and benefits, researching your credit and housing options, and building your savings are the best first steps toward owning your first home. In next month's article, we'll take a look at the next step in the home buying process: applying for a mortgage.