We build your sweet Home...

HOME BUYING GUIDE

STONE BANK

WELCOME TO **BUYING A HOME**

When you feel those new house keys in your hand and hear that little soft jingle in your pocket after buying your home, you will feel energized with a renewed passion for life. There are few joys in life that come as close, and there are some very good reasons why you should feel so good.

Buying a home gives you access to wealth by building equity when you make your mortgage payments, while having something tangible that you own to show for it. As you make your monthly payment and begin living your new life, you slowly begin to accumulate something called Home Equity – simply by making your payment.

Equity is the difference between what you owe on your home and the market value. Building equity means that as you pay your Mortgage, the Principal Amount (the total amount you borrowed) of the loan decreases and the home value could go up. Many people have been able to retire and live a comfortable life as millionaires because their home built up so much equity over the course of their lives. As a result, they then sold their home, took the money and launched their own successful business.

GOODBYE LANDLORD **HELLO HOME!**

However, before you begin seeing dollar signs, I must also warn you that sometimes the home values decrease for any number of reasons. But don't worry about that too much because according to the National Association of Realtor's, home prices have increased an average of 6.5% each year for the last fifteen years.

One of the many joys of home-ownership is that each and every month you actually get to touch, feel, see and smell your home. This means that you can actually track where your money is going and it forces you to save money each month by paying your mortgage payment and building equity. This is a forced savings plan which provides a roof over your head. The first several months of waking up in your new home will fill your mind with a flurry of emotions. The thought most often shared by new homeowners is the overwhelming feeling of, "Is this is all mine?"

DOING THE MATH
BEFORE PICKING A HOME

Figuring out how much you can afford can be really simple. However, if you do not have the right instructions to follow, then figuring out how much you can afford can be as complicated as debating who has the best tasting slice of pie in town.

In this section, I'm going to review how you can calculate how much you can realistically afford, but more importantly, I will show you how to calculate how much a Mortgage Lender will approve you for in a three-step system consisting of:

1. Calculating how much you can comfortably afford each month, including ALL of your monthly debt payments.
2. Calculating your maximum monthly mortgage payment from a Lender's perspective.
3. Coming up with a maximum purchase amount.

✓ Calculate Your Monthly Cash Flow

The first step in knowing how much you can afford is to know the current cash flow for your household. So that requires you to take a snapshot using the simple expense budget. Now, before you do this necessary step, I want you to know that you may very well be surprised by how much you are currently spending each month on non-essentials; but then again, that is why you are doing this now and not later.

There are two ways to use this housing budget and both ways are valid methods of figuring out your monthly cash flow.

The first method is to examine your previous full month of income and expenses and use those to fill out the budget. This method is simple if you do most of your banking online and pay your bills with your debit card or electronically from your account.

The second method is to start from today and track your spending for a full 30 day cycle. This method is most useful when you operate your household on a cash payment basis, or do not have a clue what each specific payment is on your bank statement, meaning you primarily pay everything with cash.

MAXING OUT DEBT + INCOME

Lenders usually require that your Principal, Interest, Taxes and Insurance (PITI) payment should not be more than 36% of your gross monthly income. That is called your front-end DTI ratio. Your overall debt payments each month should not be more than 43% of your overall monthly gross income, which is called your back-end debt ratio. Now in regular everyday English that simply means you should have the majority of your income remaining after paying your bills and taxes. However, all you have to do is turn on the television to see that somewhere along the line lenders began to get this very simple concept confused. Do the Math!! We will look at a real life example to bring this concept to life.

This simple equation means that your PITI payment cannot be more than $1,440 per month, and once you add in all of your other bills you cannot be paying out more than $1,720. Now keep in mind that lenders use these guidelines for an estimate of what they will and will not do, but over the years I have seen many hundreds of exceptions to this rule. So, if you should find yourself outside of these guidelines by a couple of percentage points, you just might still qualify for your dream purchase price. Just check with your mortgage professional.

When a lender is crunching the numbers to come up with your maximum purchase amount, there are two quick and easy formulas that are used. The primary goal of both formulas is to figure out your debt to income ratio (DTI).

Your debt to income reflects the income you make each month compared to how much you spend each month on your bills.
The first thing Lenders want to know is your front-end DTI ratio. The front-end DTI calculates your maximum monthly PITI payment without your other monthly bills being taken into account. The highest percentage lenders will usually allow for your PITI payment is 36%. This means that your PITI payment can only be 36% of your total gross income. For example, if you make $1,000 in income per month then your maximum PITI payment would be $360. ($1,000 x 36% = $360).

The second DTI ratio is known as your back-end debt ratio. Lenders use it to compute your maximum monthly debt payments, including your PITI payment and all other debts that are reporting on your credit reports. The highest percentage which lenders usually allow for your back-end DTI is 43%. Therefore if you make $1,000 per month, then the amount most Lenders want to see for paying bills, including your PITI payment, is $430.

PICKING OUT YOUR **MORTGAGE PROFESSIONAL**

Once you find your mortgage professional, give them the basic information that is needed to run an accurate mortgage pre-approval.

GATHER FACTS AND COMPARE COSTS:

Make a list of several lenders you will start with - Mortgages are typically offered by community banks, credit unions, mortgage brokers, online lenders, and large banks. These lenders have loan officers you can talk to about your situation.

Get the facts from the lenders on your list - Find out from the lenders what loan options they recommend for you, and the costs and benefits for each.

Get at least three offers - in writing - so that you can compare them - Ask at least three different lenders to give you a Loan Estimate, which is a standard form showing important facts about the loan.

Compare Total Loan Costs - Review your Loan Estimates and compare Total Loan Costs. Total Loan Costs include what your lender charges to make the loan, as well as costs for services such as appraisal and title.

APPLYING FOR **YOUR HOME LOAN**

When speaking with your chosen mortgage professional, be prepared. It takes weeks for some buyers to get all the required paperwork together. However, other people do it in minutes.

INFORMATION YOU'LL NEED:

- W2's from the last two tax years
- Last two years of complete tax returns
- Two most recent pay stubs
- Previous two months of bank statements
- Proof of down payment, if needed
- Basic forms that verify your identity
- Completed real estate loan application

UNDERSTANDING YOUR **CREDIT SCORE**

Credit scores are three digit numbers ranging from a poor score of 400 to an excellent score of 850. These "scores" are the result of many factors that ultimately "tell a story" about how well you pay back money that you have borrowed. Mortgage lenders use credit scores to determine your ability to repay your loans. They gather your credit scores from three major credit bureaus that monitor over 40 different components to come up with a number for your credit scores.

The three major credit bureaus are:
• Equifax FICO – BEACON score®
• Transunion FICO – EMPIRICA®
• Experian FICO – Experian/Fair Isaac Risk Model®

In addition, a company called Fair, Isaac and Company (FICO®) acts as a mediator between the three major credit bureaus and your mortgage lenders, which is why you will see the credit scores referred to as FICO® scores. It is important to know that the three credit bureaus are separate from FICO®, whose job is to make sure the scores from all three credit bureaus use a standard procedure to be calculated. In the best-case scenario your middle FICO® credit score usually has to be above 620 in order to approve you for a mortgage. However, in order to get the very best interest rates, you will want to have credit scores above 720.

Now, Mortgage Lenders rely on these companies to determine what type of mortgage they can offer you because it gives them a pretty accurate picture of your payment history or credit worthiness. For example, if you have a credit score of 720+, you can get a mortgage with an interest rate that is below the average rate for a normal home-buyer without paying any extra fees. One such example of fees you may be able to avoid when your scores are above average is loan discount points.

Paying a point means that if you are borrowing $200,000, then one point would be $2,000 (200,000 x .01). Therefore, loan discount points are dollars that are added to your financed amount or paid out of pocket to get the interest rate of your mortgage reduced.

CONSIDERING YOUR **ADDITIONAL COSTS**

If there was ever one area that should be stressed to a prospective home buyer is this: When purchasing a home, it is important to remember to count the total cost of homeownership. Let me repeat that: When purchasing a home, it is important to remember to count the total cost of homeownership. Why? Because without the total cost you will find yourself with plenty of house, and little to no money to purchase necessities like furniture and appliances, or even the maintenance on your home. By knowing and planning for the true cost of homeownership you can sometimes avoid the unfortunate struggle some folks face.

PREPARE FOR A **DOWN PAYMENT**

As of the time of this writing the average home-buyer in America is required to put down at least three to five percent.

However, if you are coming up a little short in this department, then you will be happy to know there are some great 'no down payment' programs available for some home-buyers, which can eliminate the need for a down payment.

ADDITIONAL **OUT OF POCKET COSTS**

The next area of costs related to buying a home will range from a couple hundred dollars to thousands of dollars. The good news is that most of these costs can be financed within the loan itself, but there are others you will have to pay upfront, and they are:

Inspect + Appraise

The appraiser and home inspector have to be paid at the time their services are issued, and these costs could add up to be over six hundred dollars.

Service

You might be able to simply get your service transferred to the new place, but invariably there are always some companies who require deposits.

Closing

This is the biggest cost factor in the entire process because this could easily run five to ten thousand dollars. However, these can be financed within the loan

Repair + Improve

Unless you buy a brand new construction home, you will have to fix or change some things as soon as you move in. You need to have an emergency or reserve fund for when this happens.

ANTICIPATING YOUR **ONGOING COSTS**

When it comes to ongoing costs of owning a home, it is important to keep in mind that much like your car, a home also needs many forms of regular maintenance. Just to give you an idea of what to expect, the major ones are roof inspections every several years, updated electrical or mechanical systems, and landscaping, to name a few. Some of the other ongoing costs include:

• Yard maintenance
• Updating housing systems as needed (Electrical, Mechanical, Plumbing)
• Replacing indoor fixtures and appliances
• Improvements or overall changes to your home
• Real Estate Taxes
• Homeowners insurance

UNDERSTANDING THE **HOME APPRAISAL**

An appraisal is an estimate of the home value you are considering purchasing. The appraisal value is an opinion of value by a licensed appraiser who walks around the inside and outside of the home, inspects and verifies the square footage, overall condition of the home and makes sure everything looks like it is in working condition, or at least could be at some point in the near future. An appraiser also takes into consideration what other similar homes have sold for in recent months when calculating the value.

After doing the visual inspection and the research on the history of the home the appraiser then takes a couple of days to put together a detailed and comprehensive report of his/her findings and will compare the appraised home to the sale prices of similar types of houses in the neighborhood.

All of the work that the appraiser is doing comes down to one thing: determining the value of the home that is being appraised, called the subject property. There is no limit to the amount of comparisons that can be made to other homes in order to really get the best snapshot of the home value. The most common home comparisons are square footage, condition of the home inside and outside, any amenities such as types of floors or countertops, and the basic overall condition. It is also important to note that based on what the appraiser finds in his/her visual inspection and research, a home’s value can be increased or decreased because of what other properties are selling for in the same area.

SIZE MATTERS

As a general rule of thumb, a single family home with three bedrooms and two bathrooms will, in most cases, appraise for a slightly higher value than a home within the same neighborhood with the same general interior and exterior and only two bedrooms and one bathroom.

The main reason you want a licensed and experienced Appraiser is to get a fair, unbiased, independent third party evaluation. Not only is this to your benefit, but it benefits the Lender as well, considering they don't want to loan out more money than a home could be sold for in a fair market. This also includes the Buyer like YOU, who does not want to get taken advantage of by some greedy Seller, Bank or Auctioneer.

The appraisal is like the last line of defense for you as a Buyer if your Real Estate Agent is not successful in pulling in the reins on a home that is selling for too much. Your appraisal must be done by a licensed Appraiser who can readily produce proof of having a state issued license to determine home values. So, your friend, the Real Estate Investor does not qualify, unless he or she has an Appraisers License.

The other side of the coin is, the Appraiser has to be approved to do appraisals for the specific Loan Product & Lender that is providing your home loan. Your Mortgage Lender will coordinate the hiring of an Appraiser for your prospective home. Unless you only want to know the value to satisfy your curiosity, there are very few instances where a first-time Home-buyer will seek out and hire an Appraiser.

The reason why Home-buyers do not hire appraisers directly is because the Mortgage Lender determines if the Appraiser is approved to perform the appraisal. Would you want to spend $400 or more for an appraisal only to learn that your Mortgage Lender will not accept the appraisal? So, be sure and let your Mortgage Lender order the appraisal.

UNDERSTANDING THE HOME INSPECTION

If you are buying a home, wouldn't you want to know if everything is working as it should? What good does it do you to negotiate a great deal on the purchase price, but after moving into your new home you realize that the sellers were willing to go as low as they did because of all the problems the house has? A home inspection can also give you the leverage in negotiating for costly repairs to be corrected before agreeing on a final purchase price.

It is not like with the appraisal, where you actually need it to come in for a certain value in order to get the mortgage. It is also not a code inspection to make sure the house is up to code according to town laws. The intended purpose of the home inspection, is to provide detailed information about the physical condition and systems of the house.

The cost of a home inspection for an average single family home will be different, depending on the types of tests you want performed. As a good rule of thumb, you should be prepared to spend anywhere from three to five hundred dollars to get all of the testing done.

Yes, that is a lot of money; however, do you know how much it costs to replace a septic system? Or how much it costs to upgrade an electrical system? At the end of the day you need to know any and every possible thing that can go right or wrong with the home BEFORE you buy the home.

Being able to sleep at night knowing that you have made a good decision is worth many more times the cost of a home inspection. The other factor which makes the cost well worth the investment, is that a home inspection with a single family home in average condition only takes about three to four hours, and sometimes can take up to half the day.

Now let's do the math: Three to six hours to save tens of thousands of dollars and years of aggravation. Where do I sign-up?
If the house is smaller or is brand new, then the inspection usually is done in a shorter time frame than if it is an older home with many different electrical and plumbing systems. It may also take longer if you are asking the home inspector questions about each step of the process while he's in the home.

The most important point to remember is that you are not paying the inspector by the hours, but you are paying him/her for a complete and comprehensive report about the condition of a prospective home. You are paying them for their experience, education, knowledge about homes and their overall competence.

Don't hesitate to ask questions. After all, you're paying them for their time and expertise.