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House-Purchase Prep: Baby steps that lead to front porch steps

Buying a house will most likely be the largest purchase in anyone's life. But it can't be done overnight. It takes time, money and preparation. So start the basic groundwork as soon as possible.

The science of saving

Start saving today. The ideal down payment is 20% or more of the home cost, but 4% was the average down payment for first-time buyers in 2008. A down payment lower than 20% means you'll pay private mortgage insurance, qualify for fewer types of mortgages, and probably pay a higher interest rate. According to the National Association of Realtors, in 2008 the typical first-time home buyer in the U.S. spent \$165,000 on their new home. This means that the typical first-time home buyer needed to save \$6,600 for a 4% down payment.

While saving, make sure to earn as much interest as possible. Park some income in a high-yield savings account and take advantage of rates that hover around 2%--3%.

Income indicator

Income is a key variable a lender will look at in approving you for a mortgage. Typically lenders want the housing expense ratio--mortgage payment, insurance, taxes--to be 28% or less of gross income. They also look at the total expense ratio--housing expenses plus fixed monthly bills--which shouldn't exceed 36% of gross income. If you don't meet these requirements, you might not qualify for a mortgage. Even if you do qualify, a high ratio might be an indication that you should wait until you have more income to buy a house, so that housing expenses aren't overwhelming.

Credit matters

Aside from income and a few other factors, a financial institution will base a large part of their decision to lend on your credit score. Your credit score and credit history affect the interest rate on a mortgage. Find out your credit score by going to myfico.com. Also, get a free copy of your credit reports from each of the three major credit reporting agencies (Equifax, Experian and TransUnion) at annualcreditreport.com. Verify that the information is correct; 79% of credit reports have errors, most caused by simple human mistakes. Contact the credit agencies to fix any inaccurate information. If your credit isn't as good as it should be, take the time to build up your score.

The end game

Regardless of how long it takes until you're ready to buy a house, the last prep step is getting pre-approved for a mortgage by a financial institution. Doing this before house shopping establishes how much you're able to borrow, and gives you the confidence that you're ready to purchase if you find the right house.

It takes more than reaching the magical age of "old" to buy a house. If you want to purchase one eventually, there's no time like the present to start getting ready.

The Bottom Line: Preparing now (by securing a better credit score and a larger down payment) can shave off thousands of dollars over the life of a mortgage.

Sources: realtor.org; money-rates.com; credit.com; ftc.gov; frbsf.org; myfico.com; bankrate.com; annualcreditreport.com; uspirg.org; msnbc.msn.com; fool.com

Stats

69% of first-time home buyers used savings and 26% received a gift from a friend or relative for their down payment, according to a 2008 survey.

Source: realtor.org

34% of first-time home buyers learned about the house they purchased from a real estate agent, and 32% from the Internet, according to a 2008 survey.

Source: realtor.org

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