Save On That Mortgage!

The NPERS publication titled, "Where Did Your Money Go?" reviewed the three main sources of fixed debt—mortgages, car loans, and school loans—and how to calculate a "debt to income ratio" (DTI). This companion article examines mortgages and provide tips on how to save during the home-buying process.

Don't buy more home than you can afford.

How do you know what you can afford? An often quoted rule of thumb is 2½ times your annual salary. This calculation fails to take into consideration your current debt load and could end up creating an excessively high "Debt to Income" ratio (DTI). Review your current debt, and try to estimate future debt. As explained in the previous article, before signing on the dotted line, calculate the monthly payments for all fixed debts and try to keep your DTI ratio at or below 36%.

Remember the monthly mortgage is only one of the expenses associated with owning a home. When will you need a new roof or paint? Will you need assistance with lawn maintenance or snow removal? Are there large trees that will require trimming? You'll need enough money to cover these costs. It may be prudent to mentally add in an additional amount to the monthly mortgage to cover maintenance and "surprises." At all costs, resist the urge to look at houses outside your budget.

Start saving now for that down payment.

Ideally, you will have saved enough for a 20% down payment. You may be able to obtain a loan with less, but 20% down will get you better rates and avoid the additional cost of mortgage insurance.

Mortgages that are not insured by FHA, VA, the Department of Housing and Urban Development (HUD) or any other government agency are considered "conventional loans." These loans often *require* a down payment of 20%. You may be able to obtain a conventional loan with less than 20% down, but generally these loans have higher interest rates.

There may be other options if you cannot afford 20% down. Individuals with an acceptable credit rating may be able to get an FHA loan with as little as 3.5% down. In Nebraska, the Nebraska Investment Finance Authority (NIFA) offers loan programs to assist first time home buyers who meet income and credit rating qualifications. Military personnel may qualify for VA loans. VA loans do not require a down payment, but will add a "funding fee" to the cost of the loan. This fee will vary, but will usually run just over 2% for first time buyers.

Conventional, FHA, and NIFA loans require mortgage insurance for individuals who cannot afford the 20% down payment. This insurance will increase your monthly payments and is not tax deductible. VA loans do not require mortgage insurance.

Check your credit, compare rates, and get pre-approved.

Before you start searching for a mortgage lender, make sure your credit history has no surprises. You cannot erase prior damage, but you can clean up any errors on your credit report. The August 2010 *Retirement News* for School, Judges, and Patrol members (October 2010 for State and County members) has a handy article on how to obtain a credit report and dispute any inaccuracies.

Buyers with good credit will have greater luck securing lower interest rates and obtaining loans with limited downpayment funds. If your credit rating is poor, you may need to put off purchasing a home and focus on rebuilding your credit.

Once you have determined how much you can afford and checked your credit, it's time to select a mortgage lender. There are a multitude of different types of mortgages and lenders. Many buyers simply go with a lender recommended by their real estate agent. This lender may indeed have a competitive rate, but how would you know? Interest rates and closing costs can vary significantly from lender to lender. Taking the time to compare can lead to significant savings. Contact your local banks for rates. Go online and obtain quotes. Don't jump on the first plan offered and walk away from lenders who use "high pressure" tactics.

Now it's time to get your loan pre-approved. Don't confuse this with pre-qualification, which provides no guarantee of actually obtaining a loan. Pre-approval limits your chances of having your loan denied once you have found your dream home.

Get help.

Once your finances are in order it's time to begin hunting for and purchasing your new home. Many individuals may need assistance with this process and enlist the services of a realtor. You may be tempted to rely on the listing agent, but the listing agent works for the *seller*, not you. You need to enlist the aid of your own "buyer's" agent.

Do your research before selecting an agent. Like any profession, some real estate agents are better than others. Ask family, co-workers, friends, and other associates for recommendations. Sit down and interview at least three agents from different firms before making a decision. Pick an agent you are comfortable with and don't be afraid to replace them if they are not meeting your expectations.

Don't buy the "wrong" home.

You may be living in this house for many decades. Purchasing a trendy two bedroom condo may be a poor choice if you are planning on starting a family in the near future. It may be tempting to buy a "fixer-upper" but only if you have the time, expertise, and finances to make repairs in a timely manner. That leaking roof or settling foundation may end up devouring more of your life and finances than you imagined.

You may be planning on living in your new home for years to come, but life is often full of unexpected surprises. What if your job requires a transfer to another State? Or worse, what if you fall on difficult financial times? If you have to sell, what about the future resale value? When looking at potential homes, consider the preferences of other typical buyers. A home in a "bad" neighborhood with less than desirable schools may not matter to you—but will have a negative effect on resale values. You don't want to be ensnared with a home that will be difficult to sell.

Before buying, do some research on the neighborhood. Avoid buying in less desirable neighborhoods. Having the finest house in the neighborhood may not be a good thing. How does the crime rate compare to other areas? How well maintained are other properties on the block? Is there a chance your street will get widened and wipe out those trees in the front yard? Scrutinize the houses next door for warning signs of getting saddled with unpleasant neighbors. It might not be a bad idea to knock on a few doors before buying. This will give you a chance to meet some of the neighbors and ask them what they like or dislike about the neighborhood.

Research and negotiate.

You don't want to pay too much. Before submitting a bid, review the prices recently paid for similar houses in the area. Be careful of letting your emotions get the better of you. No matter how much you may love a house, keep it to yourself and don't let yourself spend more than you can afford.

Hire an inspector.

The final step in the process is having the home inspected. Your mortgage lender will require a basic inspection, but it's a good idea to pay for a second inspector. A second more thorough inspection can potentially save you thousands of dollars in future repairs. When submitting your bid, make sure your offer states the bid is contingent on the home passing an inspection performed by an inspector of your choosing.

Before selecting an inspector, ask family, co-workers, friends, and other associates for recommendations. Your real estate agent should also be able to provide recommendations. Check each recommendation with the Better Business Bureau for complaints. Ask them to list their prior training and work experience. Preferably, an inspector will have experience as a general contractor or construction engineer. Do they have the required licenses for your area? Ask each candidate for a sample inspection report and compare for thoroughness. Confirm in advance the inspector will check the overall foundation and structural features of the house, plumbing, electrical/wiring, the presence of mold or pest infestations, and the heating and air conditioning systems.