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guide to:

BUYING YOUR FIRST HOME

- How to find the home that's right for you
- Choose the right mortgage
- Calculate your monthly mortgage payment

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The LendingTree Smart Borrower Center offers a range of articles about mortgages and financing a home and can help you decide which type of loan best meets your needs.

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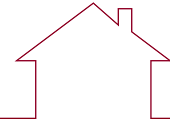
Guide to

Buying Your First Home



Buying your first home is exciting. When you become a homeowner, you aren't just purchasing a house, you're putting down roots in a community that, hopefully, you'll be a part of for years to come.

But with that excitement comes responsibility. Chances are your first home will be your largest single purchase to date, and there are many important decisions you'll have to make. What sort of house is right for you? What kind of mortgage makes the most sense? This guide will walk you through the home buying process and help you make the best choices for your particular needs.

GETTING READY TO BUY

Check your credit

Before you do anything else, obtain a copy of your credit report. You can obtain a free copy from all three credit bureaus through the Annual Credit Reporting Service at www.annualcreditreport.com or you can apply for your free credit report and score through www.lendingtree.com. Look it over carefully and ensure that everything is accurate. Errors may affect your ability to get a mortgage, so it is important that you contact the credit bureaus to correct them. This can take several weeks or longer, so it's wise to do it well in advance of shopping for a home.

Size up your savings

Saving enough for a down payment is usually the biggest challenge facing a first-time home buyer. Traditionally, mortgage lenders asked for a down payment of 20 percent, and this is still a good goal to strive for, as it will save you the cost of *private mortgage insurance* (PMI). However, with the median price of homes in the U.S. at about $250,000, a 20 percent down payment can easily be $50,000 or more. Plus, you'll also need to cover the loan's closing costs, which can be several thousand dollars. But if you are unable to save that much, don't worry. There are many options for home buyers with down payments as low as 5 percent.

Estimate how much house you can afford

You want your first home to be a place where you feel content and comfortable, not a source of financial stress. It can be fun to browse real estate listings in search of your perfect dream home, but without a careful budget, you can end up buying more house than you can comfortably afford. The LendingTree Home Affordability Calculator can help. It allows you to input your monthly income, debt

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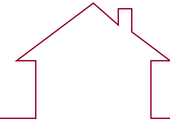

payments and other factors, and then estimates the price of home that you can afford to buy.

Consider the hidden costs of ownership
When you bought your first car, you learned quickly that the cost of driving was more than just the monthly payment on the loan – gas, insurance and maintenance add up quickly. The same is true of homeownership. The LendingTree home affordability calculator factors in taxes and insurance, but you will have other monthly expenses, such as homeowner's association dues (if you buy a condo or town home), maintenance and utilities. Consult your real estate agent, or friends and family members who own homes to help you gauge how much these expenses are likely to cost. Remember, only you can determine what constitutes a comfortable monthly mortgage payment amount. If you qualify for a larger amount but are unsure of your ability to make the monthly payment, consider it very carefully. Only sign up for what you think you'll be able to cover without stress or worry.

FIRST THINGS FIRST

Get pre-approved for a mortgage
Once you've estimated how much you can afford to spend, you need to get pre-approved for a mortgage by talking to different lenders. This involves providing some basic information about your income, debts and assets so a lender can give you an idea of how large a mortgage you will likely pre-qualify for.

In the pre-approval stage, the lender will review your financial situation, including your income and credit history, and determine how much they are actually prepared to lend you. This will allow you to narrow down your price range before you go house hunting.

Pre-approval is not mandatory, but it does have advantages. Your lender will provide you with a letter stating the exact amount you are qualified to borrow. This can be a help when you're looking for a home, since it shows potential sellers that you are a serious buyer who can afford the price you're offering. If you find yourself competing with other buyers, the pre-approval letter can also give you an advantage over others who have not yet secured financing.

When granting pre-approval, two things your lender will want to know are:

- **Your loan-to-value ratio (LTV)**
  The *loan-to-value ratio (LTV)* takes into account the size of your down payment and what portion of the value of the home you wish to finance. It is calculated by dividing the total amount of the mortgage by the sale price or the appraised value of the property:

  Mortgage amount ÷ Value = LTV

  If you are purchasing a home with a value of $250,000, a down payment of $50,000 and you apply for a $200,000 mortgage, then:

  $200,000 ÷ $250,000 = 0.80, or an LTV of 80%

  Lenders want to know this percentage because the higher your LTV, the lower your *home equity*. If you have low equity, lenders view you as having a greater risk of defaulting on the loan and therefore may charge you a higher mortgage rate. In general, borrowers with LTVs of 80 percent and below qualify for the best rates.

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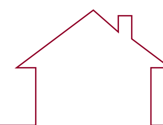

- **Your debt-to-income ratio**
  The standard rule for most lenders is that your debt-to-income ratio should be no higher than 36 percent. In other words, when you add up all of your regular monthly debts such as car, mortgage and credit card payments (minimum required payments – not the full outstanding balance) and divide that amount by your total gross monthly income, you should get a number that is less than 36 percent. Lenders also like the total of your housing expenses alone to not exceed 28 percent.

Find a real estate agent

It's good to have an expert on your side to help you find a home. Hiring a real estate agent will not only provide you with this expertise, but his or her commission is usually paid by the seller out of the sale price of the home.

You will want to select an agent who is familiar with the neighborhoods you are interested in, who understands your tastes and your financial situation, and who will work patiently with you until you find just the right home. You can seek recommendations from family or friends or connect with licensed agents in your neighborhood free-of-charge through our partner RealEstate.com.

FINDING THE RIGHT HOME

Searching for the right house can be fun. But it's a choice you'll want to make carefully since you'll likely be living with it for years to come. Consider the following:

Location

You know the cliché about the three most important factors in real estate being location, location and location? There's a lot of truth to that. Your main concern will be finding a home located in the right area. That means in an area where most of the homes are in your price range, and hopefully where you are reasonably close to your work. Drive or walk around the neighborhood to get a feel for your proximity to public transit, grocery stores and other services. If you have children, make sure you thoroughly research the schools in the area.

The home's features

Think carefully about the features that are important to you, such as: Number of bedrooms, yard and kitchen size, and type of floor plan. Make a list and give it to your agent so he or she can help you find a house that suits your needs.

As you walk through different homes, remember to focus on the structure and layout, not the decor. The sellers will take their belongings with them, and it's relatively easy to replace an ugly light fixture, rip out a carpet or repaint a color you don't like.

Separating needs and wants

As you consider a home's features, make a distinction between necessities and luxuries. You're unlikely to find a house that fits all of your criteria perfectly, so setting priorities can help you and your agent focus the search. If you need four bedrooms, there is no need to waste time visiting a bungalow with only three. However, if you prefer a finished basement but can live without one, you'll have more options.

Make notes, take photos

Once you've seen a dozen or more houses – especially if you visit several in one day – details will blur together. Was the home with the great kitchen also the one with the tiny yard? Make notes about each home you're considering, and ask the seller if you can snap photos or shoot some video during

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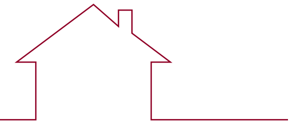

your walk-through to help jog your memory later. Once you've narrowed your choices, ask your agent to arrange second showings, during which you can make an even more detailed comparison.

MAKING AN OFFER

After you have decided on a house you'd like to buy, you and your agent will sit down together to draw up a formal offer. If the seller accepts your offer – formally called a purchase agreement – it becomes a legally binding contract. Even if your state does not require it (and some do), it's a good idea to have an attorney review your offer before it's finalized, especially if you've never tendered an offer before. A full-service real estate agent should be able to tell you if this is necessary, and may be able to review the document for you.

Price

Most sellers do not expect to get their full asking price, except in the hottest markets. How far below the asking price you want to go in your initial offer depends on a number of things. Is the home in need of repairs that were not factored in to the cost? Is the seller asking too much in relation to other homes in the neighborhood? Has the home been on the market for weeks or just a few days? Your agent should evaluate the market and use comparable homes to come up with an offer price.

It's a delicate balance – low-balling may insult the seller and jeopardize the negotiations, but you don't want to offer more than you have to. Keep in mind also that in a competitive market where the seller may receive multiple offers, you may find yourself offering *more* than the asking price. This may cause problems when it comes to securing a mortgage, however, if your lender's appraisal reveals that you paid significantly more than the home is worth.

Conditions

It's a good idea to make your offer conditional upon a professional home inspection. That way, if the inspector finds a crack in the foundation or a termite infestation, you will be able to back out of the deal or oblige the seller to fix the problem. If there are any fixtures – like appliances or an antique chandelier, for example – that you want included in the deal, be sure to write these into your purchase agreement. Conditions, of course, make your offer less attractive, especially if the seller is entertaining more than one.

What's included?

If you have talked to the seller about leaving behind any appliances, furniture, drapery or the like, make sure these items are listed in the offer. Most fixtures (items that are physically attached to the house or property that can't be easily removed) are considered a part of the house unless specified otherwise. If you're unsure, add it to your list. If it's not in writing, it's not part of the deal, and the seller is free to take the items with them when they move.

Closing date

You and the seller will have to agree on a date for the deal to close, often between 30 and 45 days from the signing of the offer. If you are not tied to a specific date, you may find that sellers will be more agreeable to your offer if you accommodate their preferred closing date.

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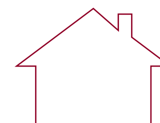

CHOOSING YOUR MORTGAGE

There are a variety of different types of mortgages to choose from and it's important to choose the one that best suits your needs. Many mortgages now carry prepayment penalties if you pay off the balance of the loan early, so be sure to ask about these up front.

Fixed-rate mortgages

A fixed-rate mortgage offers you consistent monthly payments and an interest rate that doesn't change during the life of the loan. The payment includes a gradually changing mix of interest and principal so that the loan will be fully paid off at the end of the term. This payment stability can mean less risk and less worry about the future.

These loans are attractive for buyers who plan to stay in their house for several years. If you desire the peace of mind that comes with regular payments and a stable interest rate, this loan type may be for you – especially if you feel that interest rates will rise in the future.

Adjustable rate mortgages (ARM)

With an adjustable rate mortgage, the interest rate changes periodically, usually in relation to an index, and payments may go up or down accordingly. Most ARMs adjust every one, three or five years. Most lenders tie ARM interest rate changes to changes in a particular index. These indexes go up and down in accordance with interest rates. To determine the interest rate on an ARM, lenders add to the index rate a few percentage points called the margin. The amount of the margin can differ from one lender to another, but it is usually constant over the life of the loan. For example, if the index is at 4.5 percent and your ARM has a margin of 2.5 percent, your loan's interest rate would be 7 percent.

ARMs typically have a lower initial rate than fixed-rate mortgages. The trade-off is that you do not have the same long-term security – if interest rates rise in the coming years, your loan will become more expensive. To protect you from drastic increases, however, ARMs usually have caps that limit the amount the rate or payment can go up.

Adjustable rate mortgages are often a good choice for buyers who plan to move within three to five years. Longer-term home buyers who are willing to accept more risk might also opt for an ARM to obtain the lowest interest rate possible. If you believe interest rates are likely to go down, ARMs will be particularly attractive to you.

Hybrid mortgages

Hybrid mortgages start with a fixed rate period – usually three, five, seven or ten years – and then convert to an adjustable rate. You will often see them referred to as 3/1, 5/1, and so on. The first number is the length of the fixed term in years and the second number indicates how often the rate will be adjusted after that fixed term is over. In other words, with a 5/1 hybrid mortgage, your rate will remain fixed for five years, and will change annually after that.

Hybrid mortgages give you the consistency of a fixed monthly payment for three or more years and their initial rates are usually not much higher than those of an annually-adjusted ARM. They may be a good choice if you plan to move or refinance soon after the fixed term is over. Ask if you will incur a prepayment penalty if you pay off the balance of your loan early.

Option ARMs

Also called flex ARMs, option ARMs are adjustable rate mortgages that offer maximum flexibility. These ARMs are adjusted monthly, but the monthly

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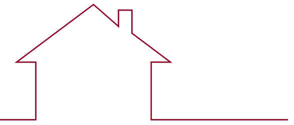

payment remains fixed during the introductory period – only the interest rate and the loan balance go up. In addition, borrowers who choose option ARMs have up to four payment options, ranging from a small minimum payment to the fully amortized amount. These home loans can be attractive because the minimum payment is very low, especially during the introductory period. If you consistently pay only the minimum, however, the principal on your loan may go up rather than down. That's why this type of mortgage requires a lot of financial savvy and discipline.

Option ARMs can be a good choice for homeowners who are self-employed or work on commission. If you are considering this type of mortgage, you must ensure that you have the discipline to make more than the minimum payment. Otherwise, you may find yourself owing more than you initially borrowed.

HELP FROM THE FEDS

Some buyers who may not otherwise be eligible for traditional mortgages may still qualify for government-insured mortgages, which are available to home buyers with special circumstances. They can be structured with either fixed or adjustable rates, often require no or very small down payments and may offer lower interest rates.

FHA loans

Specifically designed for first-time homeowners, FHA mortgages are granted by private lenders, but are insured by the Federal Housing Administration so they present minimal risk to lenders. As a result, it is easier to qualify for them if you have a low income. FHA loans require just a 3 percent down payment, helping first-timers overcome what is often the biggest obstacle to ownership. FHA loans come with an insurance premium added to the monthly payment, but their overall cost is often lower than a conventional mortgage.

VA loans

Americans who have served in the armed forces for a certain period may be eligible for VA loans, which are administered by the Department of Veterans Affairs. Like FHA loans, they are provided through private lenders and backed by the federal government. It's possible to arrange financing up to 100 percent, and lenders must follow strict guidelines in regards to the fees they can charge. However, you will be required to pay an up-front premium, and a Certificate of Eligibility from the VA is required in order to apply.

COMPARING MORTGAGES

If you use LendingTree to find a mortgage, you will receive offers from up to four lenders. When you compare these loans, the interest rate and monthly payment are just two numbers to consider.

You may also have to factor in the cost of *discount points*, which are upfront fees you pay to lower your interest rate. (One point is equivalent to one percent of the mortgage amount.) Lender fees and closing costs can also vary, and these too have a big impact on the cost of borrowing.

For example, suppose you are considering a 30-year fixed rate mortgage for $175,000. Lender A offers you a rate of 6.5 percent with one point and closing costs that add up to $3,800. Lender B's loan is at 6.4 percent but carries a charge of two points and closing costs of $4,100. Which one is a better deal?

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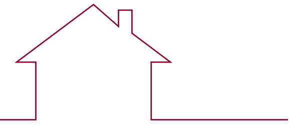

To help borrowers compare loans more easily, lenders must post the loan's *annual percentage rate (APR)*. The APR takes into account the loan's interest rate, points and fees and expresses them as an annual percentage. All lenders must use the same formula when calculating APR, and must include it on the *Truth in Lending (TIL)* form they give you when you apply for a mortgage.

LOW DOWN PAYMENT OPTIONS

There are at least two options for borrowers who cannot put the traditional 20 percent down.

Private mortgage insurance (PMI)

Many lenders will approve a mortgage with a smaller down payment if you purchase private mortgage insurance, which protects the lender if you default on the loan. PMI may involve an upfront payment, as well as annual premiums. The annual premium is about half of one percent of the mortgage amount and is added to your monthly payment. Your lender is obligated to automatically cancel PMI once your equity reaches 22 percent based on the original property value, if your payments are current.

Piggyback loans

Another way to make up a shortfall in your down payment is through a second, piggyback loan (usually a home equity loan or line of credit). Say you want to buy a house worth $200,000 and you have saved $20,000 (or 10 percent). You can obtain a first mortgage for $160,000 and a piggyback loan for $20,000. This is called an 80/10/10 arrangement, because you are financing 80 percent of the home with the mortgage, 10 percent with the piggyback loan, and 10 percent with your down payment. Because no single loan represents more than 80 percent of the home's value, you avoid having to pay PMI.

LOCKING YOUR INTEREST RATE

During the period between your successful offer and your closing date, interest rates may change, so it can be a good idea to lock in the rate on your mortgage. By requesting a rate lock, you can better protect yourself against fluctuations in the market that could leave you with a monthly payment higher than what you budgeted for. Follow the market carefully when deciding on a rate lock.

The most common rate lock is 30 days, though they are also available for 15, 45 or 60 days, and sometimes longer. Lenders may or may not charge a fee for locking in your rate, so make sure you ask. Usually, the longer the lock-in period, the higher the fee.

THE ROAD TO CLOSING

So you've found a home and decided on the right mortgage. Time to sit back and wait for your closing date, right? Not just yet. To keep the mortgage process on track, you'll need to make sure several things are in order.

Have the house appraised

Your lender will arrange for your new house to be appraised to determine your loan-to-value ratio – that is, the percentage of the home's value you are borrowing (Generally, it cannot exceed 80 percent unless you pay private mortgage insurance) – and any risk factors in regards to its condition or marketability. If the appraisal reveals that the home is worth less than you paid for it – and this is quite

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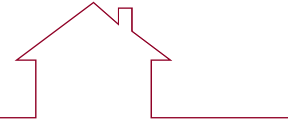

possible in a hot market where you found yourself in a bidding war – you may not be approved for the full amount of the mortgage.

Make sure your down payment is seasoned

Borrowers who use their own funds – as opposed to a gift from family members – for a down payment are considered to be lower risk and therefore often receive the best rates. Your lender will ask about the source of your down payment. If your bank statements show that the funds have been in your account for the last 60 days, they will be considered "*seasoned*." If the money came from a family member, that person may be asked to sign a letter stating that the funds were a gift, not a loan. Large, unseasoned funds will need to be thoroughly explained and documented and may be disqualified.

Keep some assets in reserve

Lenders want to know that you have liquid assets (cash or investments) to cover closing and moving costs and to serve as an emergency fund for future unforeseen expenses. You should be able to demonstrate that you have enough on hand to cover two or three months of mortgage, tax and insurance payments.

Disclose all debts

Your lender requires you to disclose any loan or financial obligations you may have, including alimony and child support payments in order to verify that you have an acceptable debt-to-income ratio. If you decide to get a car loan or make a large draw on a line of credit after your pre-approval, you may jeopardize your mortgage closing.

Documentation

Be sure to provide your lender with all the necessary documentation – employment records, pay stubs, federal income tax returns, bank statements, etc. – as quickly as possible. Any delays in verifying your documentation may hold up your closing date.

Insurance

Any mortgaged property must be insured to protect both you and the lender. Ask your lender about the coverage you need – such as hazard (fire) and flood insurance – and make sure your policy meets all these requirements.

The title search

Your lender will hire a company to examine municipal records to determine who in fact legally owns the property you are purchasing, and whether there are any outstanding liens (unpaid property taxes, overdue utility charges, money due to contractors, etc.). Your lender will also take out a title insurance policy to insure against errors. If the title search turns up any problems, your closing may end up being delayed. As the buyer, you may be expected to assume the costs of both the title search and the policy.

CLOSING COSTS

The day has finally come – your home purchase is closing. It's an exciting day, but also one that involves a lot of paperwork. You can make it easier by having all your mortgage documents at hand, and by setting aside enough money to cover your closing costs.

How much money will you need for closing? When you were pre-approved, your lender was required by law to give you, within three days of the application, a *Good Faith Estimate of Settlement Costs* (GFE). Mortgages may involve a number of upfront charges, including discount points and *origination fees*, which are set by the lender. There are also fees

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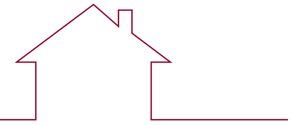

for third-party services, such as the appraisal, credit check, home inspection, title search and insurance, and legal services.

When your mortgage closes, you will receive a second document called a *HUD-1 Settlement Statement*. This is the complete financial breakdown of the entire sales transaction as it pertains to both the buyer and the seller, including current property tax rates, environmental assessments, loans being paid and other considerations. Because some of these fees are not set directly by the lender, the good-faith estimate and the actual charges may vary, but in most cases the amounts will not differ significantly. Call your closing agent or attorney a few days ahead of time and ask for your Settlement Statement. Review the costs carefully, and ask about any that you don't understand or that appear to be mistakes. Ask your closing agent or attorney for the final amount you will be required to pay and bring a cashier's check in that amount from your bank to your closing.

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WORKSHEET 1:

Calculate Your Monthly Payment

The monthly payment you make to your lender will usually include not only the principal and interest due on your loan, but also a portion of your property taxes and insurance. Lenders often require you to prepay some of these expenses, which they hold in an *escrow* account and disburse when they come due.
This arrangement helps spread the costs over 12 months and assure the lender that the payments are always up to date.

Taken together, these four components of your monthly payment – principal, interest, taxes and insurance – are know by the acronym *PITI*.

Use this worksheet to calculate your total PITI:

Step 1: Your mortgage

Use the LendingTree mortgage calculator to determine the principal and interest you will pay each month.

Example	
Loan amount	$150,000
Interest rate	6.5%
Term	30 years
Monthly payment (principal and interest)	**$948.10**

You	
Loan amount	
Interest rate	
Term	
Monthly payment (principal and interest)	

Step 2: Your property taxes

If you do not know the annual property taxes on your new home, ask your real estate agent or check with your local tax office.

Example	
Annual property taxes	$2,400
Divide by 12 to obtain monthly cost	**$200**

You	
Annual property taxes	
Divide by 12 to obtain monthly cost	

Worksheet continued on next page

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WORKSHEET 1:

Calculate Your Monthly Payment

Step 3: Insurance

Determine what insurance coverage your lender requires – hazard (fire) insurance is mandatory, and in some areas policies must also include flood insurance. If you are paying mortgage insurance, determine the annual premium.

Example		You
Annual homeowner's insurance premium	$600	Annual homeowner's insurance premium
Divide by 12 to obtain monthly cost	**$50**	**Divide by 12 to obtain monthly cost**
Annual PMI premium (if applicable)	$750	Annual PMI premium (if applicable)
Divide by 12 to obtain monthly cost (if applicable)	**$62.50**	**Divide by 12 to obtain monthly cost**

Step 4: Add the above amounts

Take the monthly totals above and add them together to determine your PITI amount.

Example		You
Principal and interest	$948.10	Principal and interest
Property taxes	$200	Property taxes
Homeowner's insurance	$50	Homeowner's insurance
Mortgage insurance	$62.50	Mortgage insurance
Total PITI	**$1,260.60**	**Total PITI**

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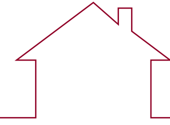
Glossary



Annual percentage rate (APR): The annual cost of a loan, including interest and other fees. Federal law requires lenders to calculate APR in the same way, and to display it prominently, so it is a good basis for comparing the cost of mortgages. The APR is included on the Truth in Lending Statement.

Discount points: Additional points you can pay a lender to lower the interest rate on your loan at closing. Each point is equal to 1 percent of the loan amount (e.g. two points on a $100,000 mortgage would cost $2,000).

Escrow: An account held by the lender into which the home buyer pays money for tax or insurance. The lender then pays the tax assessor and insurer from this account as payments come due.

Good Faith Estimate of Settlement Costs (GFE): A document that lenders are required to give to borrowers within three days of filing a mortgage application. It estimates the costs to be paid upon closing.

HUD-1 Settlement Statement: A document that lists the actual (not estimated) closing costs associated with a mortgage. HUD refers to the U.S. Department of Housing and Urban Development, which requires closing agents to use this form.

Loan-to-value ratio (LTV): The relationship between the amount of the mortgage loan and the appraised value of the property. If your home is worth $200,000 and your mortgage is $150,000, your LTV is 75 percent.

Origination fee: A fee commonly charged by a lender for processing a loan application.

PITI: Principal, interest, taxes and insurance, added together in a monthly payment.

Private mortgage insurance (PMI): A form of insurance that protects the lender if a borrower defaults on a mortgage. Borrowers who put less than 20 percent down when they purchase a home are typically required to have PMI.

Seasoned down payment: A down payment made with funds that were saved by the borrower, as opposed to being received as a gift. Funds are considered seasoned if they have been in the borrower's account for at least 60 days.

Truth in Lending (TIL) form: A document that lenders are required to give to borrowers within three days of application. It must clearly disclose the loan's annual percentage rate.

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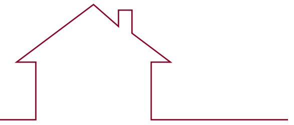

Thanks for trusting LendingTree to help you find a loan. We put you in control of your loan by asking lenders to compete for your business. Comparing real loan offers from different lenders just makes sense. Just like you comparison shop for other large purchases, smart consumers know a loan is no different. Except at LendingTree, we do all the work, and you reap the benefits.

WHY IS LENDINGTREE BETTER?

- **Low rates:** Up to four offers that could lower your monthly payments.
- **Personal service:** 24/7 customer service and online tools to help you make a smart borrowing decision. Our Customer Care Consultants will help you understand your options, and help you select the best loan for you.
- **Our Network:** Our Lender Network has more than 200 lenders. Some are household names, while others are smaller, with regional, product or customer segment specialties that may make them ideal for you.
- **Trust:** Join the 20 million people who started their search for a better loan through LendingTree.

LendingTree. When Banks Compete, You Win®

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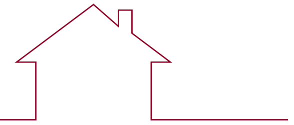
Additional Resources



WHERE TO LEARN MORE

www.LendingTree.com/smartborrower

The LendingTree Smart Borrower Center offers a range of articles about mortgages and buying a home and can help you decide which type of loan best meets your needs.

Additional sources of information:
The Federal Reserve Board:
www.federalreserve.gov/consumers.htm

Federal Citizen Information Center:
www.pueblo.gsa.gov

Department of Housing and Urban Development:
www.hud.gov

Center for Responsible Lending:
www.responsiblelending.org

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