Northwestern Mutual®

Everything You Need to Know About Buying A Home

From mortgages to closing costs, here's how to prepare.

You've been thinking about it for a while and have decided that you want to take the plunge — into buying a home, that is.

Whether you're buying your first home or you're ready to find your dream home, you're about to take on a lot of financial responsibility, and falling in love with a property that's a stretch — or totally out of reach — for your budget is no way to start. Here are some key things to understand about the homebuying process before you commit to your new home.

BUYING A HOME IS MORE THAN A MORTGAGE

Your mortgage payment covers principal and interest on your home loan, but it's actually just one facet of the big picture. There are a number of other costs to consider:

HOMEOWNERS INSURANCE

Premiums can range from $300 to $1,000

PROPERTY TAXES

Median property taxes range from 0.18 percent to 1.89

annually. For a rough estimate, divide the value of your home by $1,000 and multiply by $3.50.

percent of the home's assessed value and are determined at both your county and state level, so be sure to check your county and state's tax rates.

PRIVATE MORTGAGE INSURANCE (PMI)

If you don't have a 20 percent down payment, your lender will probably require you to get PMI to protect against default. PMI rates usually range from 0.3 percent to 1.2 percent of the loan.

HOMEOWNERS ASSOCIATION (HOA) FEES

These fees can range from $200 to $400 per month for most cities, although fees can vary or increase dramatically depending on variables like location and services offered.

Once you have a handle on the monthly home-related expenses involved, you can begin to zero in on what you can afford. Another way to back into a realistic number is to use the rule of thumb typically used by lenders: **Your monthly housing expenses should not exceed 28 percent of your pretax income, and your total combined debt (your housing costs combined with all other monthly debt, such as student loans, credit card payments and the like) should not exceed 36 percent.**

QUALIFYING FOR A MORTGAGE — THE FINER POINTS

Once you've targeted how much you can afford, you need to qualify for a mortgage to finance your home. The less financially stable you appear, the less likely you'll be able to get a mortgage with favorable terms — or get one at all. Your standing in four different areas will impact this, and determine how much interest you may have to pay on your loan.

CREDIT SCORE

Most lenders require a score of at least 620. If you're unsure of your credit score, you can order it through one of the three credit bureaus — **Equifax, Experian** or **TransUnion** — or see it for free through sites like **CreditKarma** and Credit.com.

DEBT-TO-INCOME RATIO

You can refer back to the lenders' rule of thumb: Your monthly housing payment and total debt payments shouldn't exceed 28 percent and 36 percent of your pretax income, respectively.

DOWN PAYMENT

Buyers who have a small down payment are considered riskier to lend money to than those with a larger one. A larger down payment could also help you score a better interest rate.

EMPLOYMENT HISTORY

A track record of job stability lowers your risk profile with lenders.

WHY GET PRE-APPROVED

How does all of this fit in with the “pre-approved” mortgage we hear so much about? It’s definitely helpful to have one, but understand what it really is — or rather, isn’t. A pre-approval is ultimately a letter from a lender that shows you’re qualified to borrow a specific amount of money, which can give you a competitive edge against other bidders.

Even though it’s not the mortgage, per se, it’s a tool that shows you’re serious and qualified to borrow. To that end, some sellers won’t even consider an offer unless it comes with lender pre-approval. Your lender’s inquiry will usually show up on your credit report, so ideally you only want to get it done once. Because pre-approval letters are typically valid for about 60 to 90 days, you want to be careful when you decide to seek out a pre-approval — it should be when you’re serious about the house hunt.

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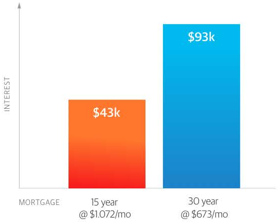
CHOOSING THE RIGHT TYPE OF MORTGAGE

Mortgages are not one-size-fits-all. There are three main factors you should look at when choosing a loan: the **term**, **interest rate** and **type of loan**. All can have a different financial impact in the short and long run.

As a general rule of thumb, the longer the term (or life of the loan), the lower the monthly payment, but the more you’ll pay in total interest. For example, let’s say you have a $150,000 loan with a 3.5 percent interest rate. If you have a 15-year mortgage, your monthly mortgage payment (principal and interest only, excluding taxes, homeowners insurance and PMI) would be $1,072, and the total you’d pay in interest over the life of the loan would be $43,020. If you had a 30-year mortgage, your monthly payment would be $673 — but you’d pay $92,485 in total interest.

15-YEAR VS 30-YEAR LOANS

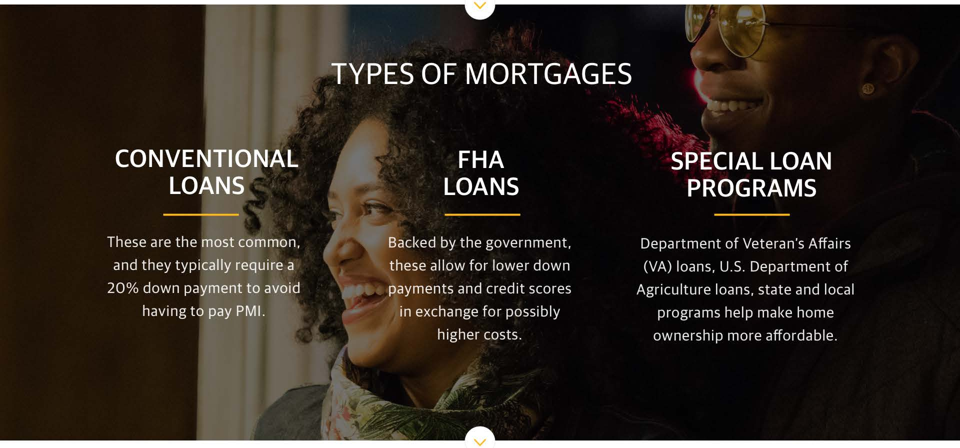


It is possible that your interest rate could change over the life of your loan. That’s because you can opt for either a fixed-rate or adjustable-rate mortgage.

With a fixed-rate mortgage, you lock in your interest rate for the life of your loan, regardless of whether national interest rates change. This is great if interest rates rise. If they fall, you could refinance to try and take advantage of the lower rates, though there will be additional costs associated with refinancing.

With an adjustable-rate mortgage (ARM), your interest rate remains constant for a set period of time, say three, five or seven years. When that period is up, your interest rate would then adjust. If national rates rise, your mortgage rate can increase; if they fall, your payment could decrease.

Finally, there are three main types of mortgages you can apply for: **Conventional loans, Federal Housing Administration (FHA) loans** and those that fall under **Special Loan Programs**. The Consumer Financial Protection Bureau outlines these in detail as well as the pros and cons of each to help you make a more informed decision. But at a high level, here are easy ways to distinguish among them.



TYPES OF MORTGAGES

CONVENTIONAL LOANS

These are the most common, and they typically require a 20% down payment to avoid having to pay PMI.

FHA LOANS

Backed by the government, these allow for lower down payments and credit scores in exchange for possibly higher costs.

SPECIAL LOAN PROGRAMS

Department of Veteran's Affairs (VA) loans, U.S. Department of Agriculture loans, state and local programs help make home ownership more affordable.

Bottom line: Shop around. This is going to be one of the biggest purchases of your life, so it's important to understand what options are out there that could save you the most money.

CLOSING THE DEAL

Once you've made an offer on a home and it's been accepted, the process of actually paying for the home will begin, and that happens in different phases.

When you make the offer, you'll need to submit "earnest money" – about 1 to 2 percent of the purchase price of the home. If you back out of buying the home for any reason that isn't stated in the contract, the earnest money goes to the seller. If the deal closes, it's then applied to your down payment. The down payment is anywhere from 3.5 to 20 percent (or more) of the purchase price. Putting at least 20 percent down negates the need to purchase PMI, and also helps you get a better interest rate.

So if possible, aim to put down at least 20 percent.

Finally, there are closing costs to consider, and these typically run you between 2 and 5 percent of the purchase price. There are a number of fees involved that you'll need to pay for, such as appraisals, inspections and taxes.

HERE IS A CHECKLIST OF SOME COMMON CLOSING COSTS THAT CAN HELP YOU PREPARE:

- ✓ Loan Origination or Processing Fee
- ✓ Appraisal
- ✓ Home Inspection
- ✓ Loan Discount Points
- ✓ Homeowners Insurance
- ✓ Prepaid Interest

- ✓ Credit Report Closing Fee or Escrow Fee
- ✓ Title Search or Exam Fee (to ensure no one else can claim to own your property)
- ✓ Survey Fee (for the survey company that may have to verify property lines)
- ✓ Attorney Fees
- ✓ Property Tax
- ✓ Recording Fees (charged by your local recording office, which records the deed)
- ✓ Escrow Deposit for Property Taxes and Mortgage Insurance
- ✓ Homeowners Association Transfer Fees

Once you've been handed the keys — congratulations! You're officially a homeowner.

It's now a good time to revisit your budget, as you'll have to account for costs that often add up for new homeowners, such as furniture you may want to buy or appliances you may want to replace. It's also time to look into the types of insurance policies you need to protect your new investment, as well as your ability to pay for it. Consider talking to a financial planner or professional in order to help you navigate your early years of homeownership.

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