A Guide to Buying and Financing Your Home

The information presented here is for general reference only, and may or may not be appropriate for your specific situation. A conversation with a financial professional will allow your specific facts, goals and overall financial situation to be taken into consideration before advice is given. First Tennessee does not offer tax or legal advice. You should consult your personal tax and/or legal advisor concerning your individual situation.

It's the largest and most complex purchase most people will make in their lifetimes: buying a home. Given this, it's critical to prepare and plan carefully for the home-buying process.

We've created this guide to help you do just this. Inside, you'll find tips and strategies to help you find the right home for you, at the right price, and using the right financing vehicle.

If you have any questions about the material included in this guide, please feel free to contact us.

Home Ownership: Are You Ready?

The mortgage and real estate crises aside, home ownership can be one of the best investments you can make—if you're prepared. Before taking the plunge, ask yourself a few questions:

Are you prepared for the responsibility? When you're a renter and the water heater or air conditioner breaks, no problem—just call the landlord and he'll fix it! As an owner, though, all home repairs and maintenance are your responsibility.

Of course, there's also the financial responsibility. To buy a home, you'll likely take on a mortgage for hundreds of thousands of dollars that stretches out as far as 30 years.

How secure is your income? Few people have a crystal ball to see into their employment futures, but it pays to have a relatively stable job and income before embarking on home ownership. To qualify for a mortgage, it helps to show that you've been consistently employed for at least two or three years.

Also, keep in mind that if you recently started a new business or are newly self-employed, it might be more difficult to receive mortgage approval.

Have you planned for the future—both short and long term? For most people, buying a home should be considered a long-term commitment. Therefore, you should have a good idea of your plans over the next three, five and even 10 years when it comes to your job, career and family. For example:

- *Do you plan to get married soon?* If so, consider buying something together with your spouse so you're both in agreement.
- *Do you plan to start or grow your family?* If so, keep this in mind as you decide what size house to buy and its location.
- *Do you plan to change jobs?* If so, and this change may involve relocating to a new city, this may not be the best time to buy.

If you've gone through these questions and decided that yes, you are ready to buy a home, you may now be wondering, "So how, exactly, do I get started?"

Find a Lender

The first thing you'll want to do, even before you begin shopping for a home, is to meet with a lender. In fact, this should happen before you meet with an agent and will help the process go more smoothly later for a number of reasons. For instance, there have been many changes in guidelines since the financial crisis. So, if this isn't your first home purchase, some of the requirements from your previous home purchase may have changed. And if you are a first-time homebuyer, you could qualify for special programs. Also, the lender can assess your creditworthiness upfront—before you get emotionally attached to a home. You'll share information, such as income, assets, debts and expenses, with the lender in order to get a good idea of the price range you can afford. That way, when you make an offer, it may be better received if the seller knows you've already met with a lender.

Find the Right Agent

An experienced agent who specializes in the area where you're looking can prove invaluable as you navigate the shopping and home-buying experience. And keep in mind that as a homebuyer, working with an agent costs you absolutely nothing out of pocket, because agents are typically paid by the home seller from the proceeds of the sale.

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MEDIAN AGE OF FIRST-TIME HOMEBUYER

$61,600
MEDIAN INCOME OF FIRST-TIME HOMEBUYER

$156,000
MEDIAN PRICE OF HOME PURCHASED BY FIRST-TIME HOMEBUYER

Source: National Association of Realtors

Real estate agents perform a wide variety of tasks for homebuyers. This starts with **narrowing down your search** area to a reasonable size. To help you do this, your agent will ask you questions about where you work, the importance of schools, your recreational activities and interests, proximity to family and friends, and desired amenities (like a community swimming pool and tennis courts, for example).

With a reasonable search area and price range defined, your agent can now begin **suggesting potential homes to look at together**. To save time, your agent may send you email links to potential homes so you can view them online before actually visiting. Based on these reviews, you and your agent can plan a day (or weekend) to visit all of the homes that are possibilities.

When you find a home you think you might like to buy, a good agent will be able to **suggest the best offering price**, based on the sale prices of similar homes in the immediate area (these are known as "comps"). Remember: A home's asking price is just that—the price the owner *hopes* to get for the home. It's usually just a starting point in negotiations to buy a home.

Negotiations are where the best agents earn their money. Having a real estate agent **present your offer and negotiate the price** directly with the seller's agent takes the emotion out of the process. The agent can negotiate from an objective standpoint, which is hard for homebuyers to do. After all, if you've fallen in love with your "dream home," it will be much harder for you to walk away if you and the seller are a few thousand dollars apart.

An experienced real estate agent has negotiated the purchase and sale of many homes during his or her career. Experience goes a long way in the negotiation of a purchase as large and complex as a home. Also, if your agent is dealing directly with another agent, they may be able to work out compromises that lead to a win-win negotiation for both sides.

Financing Your Home

Once you and the seller agree on a price, you will sign a purchase and sale agreement, which stipulates the price and the target closing date, among many other details. At this time, you will likely be required to pay an agreed-upon amount of money that's known as "earnest money" into an escrow account as a good-faith gesture and deposit.

At this point, you will likely shift your attention to **financing your home**. Unless you've saved up enough money to buy the home outright with cash, you'll finance it with a **mortgage** from a bank or mortgage company.

There are many different varieties of mortgages, but they all fall into one of two broad categories: **fixed-rate mortgages and adjustable-rate mortgages (or ARMs)**. As the names imply, the interest rate on a fixed-rate mortgage stays the same throughout the life of the loan, while the rate on an ARM will change to reflect current market rates after a set period of time, which usually ranges anywhere from one to 10 years.

To decide which type of mortgage is best for you, answer these two main questions:

1. *How much risk are you willing to take?* A fixed-rate loan eliminates the risk that rates could rise in the future, thus raising your monthly mortgage payment. Conversely, rates could also fall, in which case your monthly payment would go down.

2. *How long do you plan to stay in the home?* If you know you will be in the home for a relatively short time—say, three years—you could benefit from a three-year ARM, since interest rates on ARMs are generally lower than fixed rates. It might be smart to err on the side of caution, though, by going with a slightly longer term (like maybe a five-year ARM) to provide some cushion in case you stay a little longer. Also, refinancing out of the ARM could be an option if you end up staying in a home longer than you expected.

Your other big mortgage decision will be the **term of the loan**, or how many years until the mortgage is paid off. A traditional 30-year mortgage is most common, though many people today are opting for shorter-term loans of 10, 15 or 20 years. These cut the length of time until you own your home "free and clear" and save thousands of dollars of interest over the life of the loan. However, keep in mind that your monthly payment will be higher. Having a total mortgage payment that fits comfortably into your total budget is a must.

How's Your Credit?

The interest rate you pay on your mortgage will go a long way toward determining the amount of your monthly

payment and, hence, how much home you can afford to buy. And the main determinant of your interest rate will be your credit score, which is also known as a **FICO® score**.

Therefore, it's wise to **check your credit score** early in the process of shopping for a home, which will give you time to take steps to improve your score and/or correct any errors well before you apply for a mortgage. The first step is to obtain copies of your credit reports from each of the three national credit reporting bureaus (Experian, Equifax and TransUnion). You can order a free copy of your credit report once a year from each bureau by visiting www.annualcreditreport.com. Mortgage lenders typically use your middle score when pricing your loan.

Errors in credit reports are not uncommon—one study determined that 70 percent of credit reports contain at least one error. So **check your reports carefully**, especially with regard to incorrect credit limits, late payments, collections or any other negative items. If you spot errors, contact the reporting agency immediately and arrange to have them fixed.

You can go a step further by ordering a FICO Standard Report from www.myfico.com. For a nominal cost, you'll get one FICO score and one credit report from Equifax or TransUnion, along with an explanation of the positive and negative factors affecting your score.

Leading up to the Closing

The time period from the signing of a contract to purchase a home until the closing date will be a busy one. Here are a few of the most important things you'll need to accomplish during this time:

- **Continue working with your lender.** You'll need to pull together a wide variety of financial and employment information, including recent pay stubs, investment and savings account statements, and tax returns for the past two years. Doing this early on can speed up the process. Be prepared to provide other documents that your lender may request as the approval process for your loan continues.

- **Arrange for homeowner's insurance.** Coverage needs to begin on the day you take possession of the keys. Talk to your insurance agent about coverage: you may be able to get a discount by using the same company through which you have car, life and other insurance. Your agent will also help you determine what additional protection you may need, such as for contents or added liability coverage.

- **Schedule a home inspection.** While not required, most experts recommend that buyers hire their own independent inspector to professionally inspect the home before closing. This will help uncover any potential problems or repairs that aren't obvious to your unprofessional and untrained eye. Your real estate agent should be able to recommend reputable home inspectors.

  A professional home inspection usually costs a few hundred dollars, but can pay for itself many times over depending on what the inspector finds. You can ask the seller to make the repairs before closing, or request that an allowance be added to the contract that deducts the amount of money needed to make repairs from the purchase price. In a worst-case scenario, if the inspector uncovers major problems or repairs, you may be able to back out of the purchase altogether.

- **Prepare to move.** In the midst of the excitement of buying a home, you also need to start packing up all your belongings and preparing for the big move. Start early and try to accomplish a little bit each day so you're not overwhelmed the last few days before moving day.

  Also decide whether you'll need to hire a professional moving company. If you're moving from a small

apartment, you may be able to recruit a few friends and "move it yourself." But if you have lots of furniture and heavy items and/or are moving to a different city, you may be better off hiring professional movers. Be sure to arrange for them early, as movers' schedules can fill up quickly and the date you have to move may be inflexible.

Finally, don't forget to arrange for the transfer of all of your utilities, including data services.

At the Closing Table

Before the closing, your lender will provide you with a good-faith estimate (or GFE) that details all of the various charges and fees that will appear on the settlement statement (also known as a HUD-1) you'll receive at closing. Review the GFE carefully and ask your lender or settlement agent if you have any questions about it.

The GFE will include the amount of money due from you at closing—this includes your down payment, closing costs and other fees, less the earnest money. A cashier's check is usually required, so be sure to plan on obtaining this prior to the closing date. The closing will typically take place in the office of a real estate attorney who represents you and your lender. Your agent should be present, while the seller, the seller's agent and the seller's closing attorney may be present as well.

The attorney will walk you line-by-line through the final settlement statement, explaining all of the charges to make sure you understand them. You'll be asked to sign a number of other closing documents as well. The attorney will explain each of them to you, but be sure to ask if you have any questions. You've invested a lot of time and money to get this far, so don't hesitate to take a few extra minutes if necessary to make sure all your questions are answered.

Once all the documents are signed and the funds delivered, you'll be the proud owner of your new home. Now, there's only one thing left to do: plan your housewarming party!

YOUR CREDIT SCORE

How it's determined and how to improve yours

The following factors go into the determination of your credit and FICO scores:

35%—Bill payment history

30%—Outstanding amounts owed

15%—Length of credit history

10%—New credit

10%—Types of credit used

Given this, here are a few do's and don'ts for improving your FICO score:

- ***Do*** *pay your bills on time*. A single late payment can drop your score by 100 points or more.
- ***Do*** *pay down large credit card balances*. Try to keep your balances below 30 percent of the card's limit.
- ***Don't*** *consolidate credit card balances*. It's usually better to have lower balances on several different cards than a high balance on one card.
- ***Don't*** *cancel multiple credit cards*. It's a myth that this will help your score; in fact, it may actually hurt your score by lowering your available credit.

About a quarter of all Americans (27%) have a FICO score of 750-799, while 13% have a score that exceeds 800. Fifteen percent have a score between 650 and 699, 18% have a score between 700 and 749, and 27% have a score of 649 or lower.

FICO scores can have a huge impact on mortgage interest rates, changing the rate by as much as one-and-a-half percentage points. This can change the monthly payment on a $200,000 mortgage by **as much as $200**.

** Source: www.myfico.com*

Crunching the Numbers

One of the most important things lenders look at when analyzing a mortgage application is what's called your debt-to-income ratio. This helps them determine whether or not you'll be able to afford your mortgage.

Different lenders have different criteria, but in general, they want your monthly mortgage payment to be no more than 29% of your gross (or before-tax) income. Consider the following example, and then plug your numbers into the worksheet below to see if you might qualify for a hypothetical mortgage. (This worksheet is for illustration only, and is not intended to guarantee that a mortgage will be provided by any lender. Many other factors are also taken into consideration.):

Example

Gross monthly income	$ 5,000
Multiply by 29%	x .29
Allowable housing costs	**$ 1,450**
Home purchase price	$ 250,000
Less 20% down payment	-50,000
Mortgage amount	$ 200,000
Monthly P&I payment (30-year mortgage at 5%)	$ 1,074
Taxes and homeowner's insurance	250
Mortgage insurance and condo/HOA fees	75
Total monthly mortgage payment	**$ 1,399**

Borrower qualifies

Personal Worksheet

Your gross monthly income	$ _____
Multiply by 29%	x .29
Your allowable housing costs	**$ _____**
Your home purchase price	$ _____
Less ____% down payment	- _____
Your mortgage amount	$ _____
Your monthly P&I payment (____-year mortgage at ____%)	$ _____
Your taxes and homeowner's insurance	$ _____
Your mortgage insurance and condo/HOA fees	$ _____
Your total monthly mortgage payment	**$ _____**

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