

Step 1:

Know When You're Ready

Whether this is the first time you've thought about buying a home or it's been on your mind for a while, it may be hard getting started because the process can seem overwhelming. Here are some things that you'll want to know and do even if you don't plan on buying a house for a few years. Taking the homebuying process one step at a time makes it more manageable and prepares you for buying a house, whenever that time comes.

This step covers:

- **Renting vs. buying**
- **Things to consider before buying**
- **Credit score**
- **Improving your credit score**
- **Establishing credit**

To rent or to buy?

You'll learn:

- **Some responsibilities and freedoms that come with homeownership**
- **Flexibilities you can appreciate while renting**
- **Why it's important to keep track of your finances**

Maybe you're just starting to look for a place of your own and can't decide if you should rent or buy. Or maybe you've been renting a place for a while and want to explore the possibility of buying a home, but you aren't sure if you're ready. While only you can decide the best option for yourself, it's important to analyze the pros and cons of each and see how those align with your priorities. Here are some things to think about when it comes to the big question, "Do I rent, or do I buy?"

Benefits of renting

Renting is a great option if you plan to move around and don't want to commit to one location because it provides more flexibility if you decide to relocate. Another benefit of renting is that maintenance costs for things like lawncare and broken dishwashers are usually the rental management's responsibility. Plus, renting gives you a chance to try out different types of living spaces and explore different neighborhoods to see what works best for you.

While renting is often thought of as more affordable than buying, this is not always the case. It may be a good option if you need some time to save up for a **down payment** and other costs associated with buying your own place; in some cases, however, your monthly **mortgage** can end up being less than your monthly rent.

Benefits of buying

Buying might be a better option for you if you plan on staying in one location for at least five years or so, and you're ready to truly call a place your home. Homeownership gives you the opportunity to take pride in caring for the property you own. It allows you to build **equity** over the long term and has potential for tax advantages that don't come with renting. One more benefit of buying: You can customize your space the way you like, from painting the rooms to hanging curtains, to nailing a picture on the wall, without worrying about running it by your landlord.

Down Payment:
The amount of cash a borrower may need to pay in order to buy a piece of property; equal to the purchase price minus the amount of any mortgage loans used to finance the purchase.

Mortgage:
A legal document that pledges property to the mortgage company as security for the repayment of the loan. The term is also used to refer to the loan itself.

Equity:
Ownership interest in a property. This is the difference between the home's market value and the outstanding balance of the mortgage loan (as well as any other liens on the property).

Rent vs. Own Comparison

	Renting	Owning
Advantages	✓ Can cost less ✓ Shorter-term commitment ✓ More flexibility if you need to relocate ✓ Maintenance and repair costs are not renter's responsibility	✓ Can build equity ✓ Value of home may appreciate ✓ Satisfaction in homeownership ✓ Possible tax incentives ✓ Make the space your own
Disadvantages	✗ No tax incentives ✗ Rent could increase ✗ It's not an investment ✗ No building of equity	✗ Longer-term commitment ✗ Responsible for all maintenance and repairs ✗ Relocation involves more than just moving ✗ Upfront costs are higher

Track your finances

In considering whether to rent or buy, it's important to see where your money is going. Keeping track of your expenses can give you a better idea of areas where you could cut back and tuck a little extra money away to save for a house. It may seem tedious, but keeping track is a great way to get a more accurate view of your financial situation.

Decide what's right for you

It's important to do your research. If you end up deciding you're not ready to buy, be sure to read the next steps to learn how you can prepare for when the time is right. Even if you don't have the funds for a down payment right now, if it's something you can start saving for, homeownership could be an option in the future.

Things to consider before buying

You'll learn:

- **How to estimate how much you can spend on a home**
- **Why location can be a determining factor in your home choice**
- **About different types of homes**

If you've decided it's the right time to buy a home, congratulations! Now what? Before you start to seriously look at houses to buy, there are some steps you can take to make sure you're in a good position to purchase a home. The first part of the homebuying process takes time. To start, here are a few things to think about.

Estimate what you can afford

At this point, you probably don't know exactly how much money a **lender** will approve for your mortgage. However, you can start thinking about the initial down payment amount as well as the ongoing monthly mortgage payment you are comfortable with. Keep in mind that affordability is different for everyone. That's why it's important to figure out your range for what you feel comfortable spending based on your financial situation. Using an affordability calculator is a good place to start. Also consider your income. Are you self-employed? Full-time or part-time? Commission-based? It's important to think about whether your income tends to fluctuate or is steady and reliable.

Think about location

What matters most to you when deciding where to live? For example, do you want to be near parks, grocery stores, schools, restaurants, work, or public transportation? Location impacts costs, so it's a good idea to look in a few neighborhoods to get a better idea of what you can afford.

Think about type of home

Whether you choose a single-family home, condo, townhome, or manufactured home, the type of home you decide on will come down to your wants, needs, and price point. Keep in mind that some types of housing have extra fees, such as **condo fees** or a **homeowners association fee**, which you'll be required to pay. Those fees may cover the cost of general community maintenance or amenities such as a pool.

Lender:
An organization or person that lends money with the expectation that it will be repaid, generally with interest.

Condo Fees:
Amounts paid, usually monthly, by unit owners to meet daily operating costs as well as contributions to the required reserve fund. Condo fees are not included in your monthly mortgage payment and must be paid directly to the condo/homeowners association, usually through a professional management company. It is important to understand what is and is not included in the fees, as it varies from condo to condo.

Homeowners Association Fee:
Amounts paid, usually monthly, by unit owners to meet daily operating costs as well as contributions to the required reserve fund. HOA fees are not included in your monthly mortgage payment and must be paid directly to the homeowners association, usually through a professional management company. It is important to understand what is and is not included in the fees, as it varies from association to association.

Single-family detached home
A residence structure with a single living unit consisting of one building and one address.

Condo
A form of homeownership that combines individual ownership of a unit with shared ownership of common facilities.

Townhouse
A house that has two or three levels and that is attached to a similar house by a shared wall.

Manufactured home
A dwelling of at least 400 square feet and at least 12 feet wide, constructed to the "HUD Code" for manufactured housing, which is built on a permanent chassis, installed on a permanent foundation system, and titled as real estate.

Determine your down payment

Determining how much you have for a down payment impacts the prices of homes you can buy. Plus, if you're saving up, it helps to identify a goal to save toward. Depending on the mortgage you get, your down payment could be as low as 3% of the house price. If you decide you can save $3,000, you could potentially buy a $100,000 house. Keep in mind, though, that you won't want to put all your savings toward a down payment and should have some money left over for other expenses.

Credit score

You'll learn:

What a credit score is and why it matters
How your credit score is determined
How you can find your credit score

Credit score. You've heard of it. But what is it, and why is it important for buying a house? Your credit score gives lenders an idea of how likely you are to make your payments on time. Credit scores can range between 300 and 850. Interest rates are often tied to a person's credit score, and the best rates are typically offered to those with higher credit scores. While many factors go into determining your credit score, the number is a pretty good snapshot of your financial health and history.

Why credit score matters

Because a **credit score** is an indicator of financial health, it's used as a tool for lenders to determine things like loan limit amounts and **interest rates**. Utility companies may even use it to determine if you need to pay a deposit before services begin. While it's true that lenders often reserve their lowest rates for people with better scores, you don't always need a high score for homeownership to become a reality. Even with a score of 620 or lower, you may still qualify for a mortgage.

What affects your score

Many factors go into your credit score. Details can be found on your **credit report** and include: your payment history, how much money you owe compared to available credit, how long you've had credit, the different types of credit accounts you have, and how many new credit and loan accounts you've opened. Each of these factors impacts your score differently, and the formula for figuring out your credit score differs among each of the three **credit bureaus**. Plus, if you've had any **charge-offs**, **liens**, or **bankruptcies**, these are also reflected in your score.

Factors that can affect your score



Payment history



How much you owe vs. available credit



# of new credit and loan accounts



How long you've had credit



Tax liens



Charge-offs



Bankruptcies

Credit Score:
A credit score predicts how likely you are to pay back a loan on time. Companies use a mathematical formula—called a scoring model—to create your credit score from the information in your credit report. There are different scoring models, so you do not have just one credit score. Your scores depend on your credit history, the type of loan product, and even the day when it was calculated.

Interest Rates:
A percentage of a sum borrowed that is charged by a lender or merchant for letting you use its money. A bank or credit union may also pay you an interest rate if you deposit money in certain types of accounts.

Credit Report:
A credit report is a statement that has information about your credit activity and current credit situation such as loan-paying history and the status of your credit accounts.

Credit Bureau:
An institution that for a fee provides historical credit records of individuals provided to them by creditors subscribing to their services.

Charge-off:
To treat as a loss; to designate as an expense an amount originally recorded as an asset.

Lien:
A legal hold or claim of a creditor on the property of another as security for a debt. Liens are always against property, usually real property.

Bankruptcy:
A legal proceeding in federal court in which a debtor seeks to restructure his or

Know your credit score

First, know that there are a few different credit reporting agencies. By federal law, you get three free credit reports a year—one from each credit reporting agency (Experian, Equifax, and TransUnion) via annualcreditreport.com. You'll need your address, Social Security number, birthdate, and other basic identifying pieces of information. It's a good idea to check your score regularly in case there are reporting errors. As a way to monitor your credit throughout the year, you can stagger when you get your credit report from each agency. Also, many banking and credit card companies will provide you with your credit score, free of charge.

Credit score & buying a house

Purchasing a home is a big investment. This is why lenders want to make sure you'll be able to pay it back on time, and your credit score is one of the most important indicators of this. Your lender will consider your credit score and credit history, combined with other factors such as your income in relation to your debt obligations—also known as your **debt-to-income ratio (DTI)**—and employment history, to determine your eligibility for a loan.

her obligations to creditors pursuant to the Bankruptcy Code. This generally affects the borrower's personal liability for a mortgage debt, but not the lien securing the mortgage.

Debt-to-Income Ratio (DTI):
Your debt-to-income ratio is all your monthly debt payments divided by your gross monthly income.

Improving your credit score

You'll learn:

- **Where you can see, and if necessary, fix your credit report**
- **Ways to pay down debt**
- **The impact of new credit accounts on your credit score**

If you're thinking of buying a home and are concerned that your credit score is too low, you can take steps to improve it. First, make sure there are no errors on your credit report—so double check that accounts listed, and your payment history, are accurate. Pay close attention to any late payments, charge-offs, collections, closed accounts, or tax liens. Creditors will report these on your credit report quickly but can at times be slow to report when you've satisfied past-due obligations. Making sure these are accurately reflected can boost your

credit score. Then, take a look at areas where your credit history is negatively affecting your score. These are the areas to work on. And while every financial situation is unique, here are things you can do to help improve your score.

Fix reporting errors

Before you get into improving your credit score, it's important to make sure there are no errors on your credit report. Take advantage of annualcreditreport.com to get your free annual credit report from each major credit bureau—Experian, Equifax, and TransUnion. If you do find errors, contact each agency separately and let them know in writing that the information is inaccurate along with proof of why it's inaccurate. Then, reach out to the company that misreported the information. For example, if it's a credit card company reporting a late payment that wasn't late, get in touch with them in writing about the error and make sure they remove this from the report.

Pay bills on time

One of the biggest contributors to your credit score is on-time payments. If you've made late payments or missed payments in the past, these are hard to fix and could cause late fees. Late payments typically start getting reported to credit bureaus when payments are 30 to 90+ days past due. As a way to avoid this, if possible, set up payments so they are automatically deducted from your bank account when they're due. The best thing you can do going forward is to get payments in on time and know that past credit problems may become less of a problem as time moves on.

Pay down debt

Paying off debt, especially credit card debt, can make a big difference in your credit score. It'll increase your available credit and help lower your debt-to-income ratio. There are different ways to go about paying off debt, like paying more than the minimum monthly payment, halting credit card spending, creating a budget, using only cash to make purchases, and paying off your most expensive debt first. These are just some suggestions. Be sure to do your research to find the approach that works best for you.

Ways to pay down debt:

1. **Pay more than the minimum payment**
2. **Halt credit card spending**
3. **Create a budget**
4. **Use only cash to make purchases**

Avoid opening new accounts

If you're trying to improve your credit score, avoid opening new credit card accounts. This can negatively impact your score for many reasons, including the risk of taking on more debt and lowering your average account age. It also increases the number of inquiries to your credit report, which can affect your score. With that said, don't close accounts you already have open as they help with factors like average account age and how much available credit you have.

Establishing credit

You'll learn:

- **Why bank accounts are important to your credit**
- **How to use credit cards responsibly**
- **Why it is critical to pay your bills on time**

If you haven't begun establishing credit through credit cards, student loans, or other bills, you'll want to start right away. Most lenders need to see that you can make payments on time and responsibly manage credit. Here are a few ways to start building up your credit.

Open checking & savings accounts

The first thing you can do before starting to build up your credit is to open a checking account or savings account, if you have not already done so. Mortgage lenders will most likely require this information on applications as it helps document your source of funds for a down payment. Also, if you open a credit card or other credit-establishing account, it's usually easier to pay bills and make other financial transactions through your checking account.

Use credit cards

When used responsibly, credit cards are a great way to build up a favorable credit report. If you don't have a credit card yet, you could try applying for one from a department store or applying for a **secured card** from a bank. Both of these options usually have lower balance limits and higher interest rates. Then, after a year of establishing some credit, you could try to apply for an **unsecured card** from a major financial institution to replace a store card or secured card.

Secured Card:
Credit card that typically requires a cash security deposit. The larger the security deposit, the higher the credit limit. Secured cards are often used to build credit history.

Unsecured Card:
A credit card with no security deposit required.

> **The thing with credit cards, though, is that it's important to avoid maxing them out or carrying a balance from month to month. Make sure to charge only what you can afford to pay in full, on time.**

If you carry a balance, you'll end up paying interest on that purchase, which could cost you way more than what you originally owed, and it will affect your credit score. As credit card debt builds up, it becomes harder and harder to pay off.

Pay bills on time

This could be one of the most important factors in building credit: paying your rent, loan payments, and other bills on time. For revolving accounts, it's important to pay at least the minimum payments, but preferably full balance amounts. Generally, using 30% or less of available credit is favorable and will be an important factor when lenders determine if they're willing to lend you money. If you're paying off student loans, it's extremely important to avoid defaulting, as it can take years to recover your credit score from this.