10 Things to Consider for First Time Home Buyers

If you're like most people, a home is the largest purchase you will ever make. Buying your first home can seem exhilarating and stressful all at the same time. While it would appear that finding the right home at the right price would be nice and simple, often people make mistakes that prevent them from achieving this dream.

If you're aware of those issues ahead of time, you can protect yourself from costly mistakes and get the best value for your purchase.

The following are all things to consider before purchasing your very first home:

1. Is it Better to Buy or Rent?

The concern that seems to be at the very forefront for first time homebuyers is the question of value: Is buying a home really worth the investment?

While some may think home ownership typically costs more than renting, the truth is that in many cases it is actually less. In addition to the advantage of fixing up your home the way you would like, there are some additional perks that would make homeownership extremely appealing.

Among some of those excellent perks is the tax cutting benefit associated with home ownership. Deductions such as all or part of your mortgage interest, points paid to get the loan, interest on certain home equity loans, and your annual property tax payments are all items that can help reduce your tax bill each filing season.

In general, you can deduct interest charged on a loan used to acquire or improve your principal residence in the year that it is paid. In the early years of a loan, most of your monthly payment is interest, so this can be a huge benefit. If you are in a 28% federal tax bracket, this can have the effect of lowering your costs by almost a third, depending on which state you live in. This is really nothing more than a subsidy to home owners, and it is a very popular deduction. In addition, you may deduct interest on an additional $100,000 of mortgage debt, which can be used for any purpose. This is called the "Home Equity Loan" exception, allowing you to tap into your home equity for any purpose. This gives home owners the ability to do something called "debt-shifting." For example, if you lived in an apartment and had a credit card balance of $10,000 at 18% interest, none of that interest would be deductible. However, if you bought a house, obtained a home equity loan for $10,000 and paid off the credit card, then ALL of the interest expense would automatically be deductible. Furthermore, the rate on the home equity loan would likely be around prime plus one or two per cent which would usually be much lower than credit card rates.

In addition, there is the profit on the sale of your home. If you have owned and occupied your principal residence for at least two of the past five years, you are entitled to earn up to $500,000 on the sale of that house and pay no federal income tax whatsoever. Of course, that is assuming you are married. Singles could earn up to $250,000 tax free. And the best part is: you can do this as often as every two years for the rest of your life. You don't have to re-invest; you don't have to be age 55; the key requirement is that you MUST own and occupy the house as your principal residence for at least two of the five years before selling. The beauty of this tax shelter is that it applies to every principal residence you will ever own as long as you meet the IRS rules.

Investment real estate also offers some tax-shelter opportunities. It is possible to make a small down payment on real estate and yet base your depreciation deduction on the entire purchase price. Along with the depreciation on the investment property, there will be mortgage interest and real estate tax deductions, as well as a write-off for upkeep and maintenance costs. Of course, in this situation, capital gains will apply to the profit.

When it comes right down to it, long term homeownership is far better and less risky than renting because of the ability to build equity for the duration of the home ownership. What's more, you now own an asset is that is appreciating instead of making monthly rent payments that help contribute towards someone else's asset. It is this very asset that will most likely help provide financial security in the future especially considering that it will be yours to eventually sell. Unfortunately, a renter doesn't have this option.

2. How Much Home Can You Afford?

As a first-time home buyer, it's important to have an accurate idea of how much you can afford. Finding out how much home you can afford is not that difficult. Banks will tell you that you can spend as much as 28 percent of your gross monthly income (GMI) on your mortgage, taxes and homeowners' insurance premium, and up to 36 percent on your total debt. If you take out an FHA loan, you can go as high as 42 percent of your GMI. The problem is that 42 percent of your GMI will feel like nearly 60 percent of your take home pay, or even more if you are contributing to a 401(k). To calculate a more comfortable housing budget, begin by figuring out the total expenditures each month. Make a list of all the monthly expenses (excluding rent), such as vehicle costs, student loan payments, credit card payments, groceries, health insurance, retirement savings, and so on. Don't forget major expenses that only occur once a year such as any annual insurance premiums or yearly vacations. Then subtract this amount from the total take-home pay and that will be the final amount left to spend on your new home each month.

3. What About a down payment?

Saving money for a down payment is always a good idea. In fact, it is one of the most important things a buyer can ever do when looking to buy a home. Cash is still king and having money set aside will give you more negotiating power as well as make your offer look much stronger to the seller. In addition, putting a reasonable percentage into the down payment will also mean starting off with some equity in the home thereby minimizing your risk.

4. Should You Get Pre-Qualified or Pre-Approved?

Make sure to get pre-approved for a loan before placing an offer on a home. It's often the case that what you think you can afford and what the bank is willing to lend you may not match up, especially if you have poor credit or unstable income. Worse yet is a mortgage lender who tells a potential buyer that he is "pre-qualified" for a loan. This can be confusing, but with a pre-qualification, often only a portion of your finances are verified. It's possible to discover later that the amount you were "pre-qualified" for was far different than what you would qualify for. What you need is a "pre-approval" in which more information, like your credit, is checked, giving you a better idea as to how much you could spend on your first home. Keep in mind, however, that even if you were to be pre-approved for a mortgage, it's always possible that your loan could fall through at the last minute due to a major purchase that might alter your credit score, such as financing a car. With a pre-approval in hand, you would be in a better position to negotiate because the seller would see that your offer was more solid. This also eliminates any wasted time looking at homes outside your price range and falling in love with a home you can't afford to buy. Typically, pre-approvals are good for 60 to 90 days. If you don't find a home within that period of time, you may need to re-qualify with your lender.

5. Should You Have the Home Inspected?

The answer is yes. You should never buy a home without inspecting it, and typically most purchase agreements are contingent upon inspection. Hiring a qualified and licensed professional to inspect your new home before buying it is the only sure way to guarantee that the home is in good condition. A knowledgeable home inspector is just as important as a great real estate agent because getting a home inspection can save you thousands of dollars in the long run, as long as it is thorough. The home inspector should provide a very detailed summary report listing the condition of each item, and then recommending potential repairs. If problems surface, the seller may opt for adjusting the purchase price of the home or simply making repairs. If the home is in bad shape or exhibits a monumental problem, the possibility still exists that you may no longer decide to purchase it. If that’s the case, you simply get your deposit back and resume your house hunting. This will be an occasion when you will be glad that you had the insight to request an inspection.

6. What Are Closing Costs?

This is probably the most frequently asked question by first-time home buyers. All mortgage lenders are required by law to disclose in writing the estimated closing costs and fees in advance. Before closing, you should receive a document outlining the actual costs you will need to pay at closing. This estimate is commonly called a “good faith estimate.” Keep in mind that various additional costs may apply depending on your state, mortgage type, and down payment amount. You will also be asked to bring a valid picture ID, a certified check (if applicable) for any down payment due (unless you are wiring the money) and any other additional documents that your circumstances may require. Be sure to ask to take a final walk through the property shortly before the closing to make sure the home is in the condition you expect it to be.

7. Don’t Be Too Picky

Women will relate to this. Let’s say you need a new pair of shoes. You go to the mall. At the very first shoe store, you find a fabulous pair of shoes. You try them on and they fit perfectly. They are not only glamorous but just the right price. But instead of buying them, you spend a lot of time running around to every other shoe store in the mall trying on shoes until you are ready to drop from exhaustion. At that point you finally realize that the very first pair you tried on was actually the perfect pair and so you return to the first store to buy them – only to find they are gone. Not only are you disappointed that you missed out on what seemed to be the perfect pair of shoes, but you are frustrated and exhausted from the entire exercise. Do not shop for a home like this. When you find the perfect home, buy it before someone else does.

On the other hand, it’s certainly fine to make a realistic wish list of everything you would like to have in a home. But don’t be so inflexible that you end up renting for a significantly longer time frame. Sometimes first-time homebuyers need to compromise on a few things because their funds are limited.

That compromise might be things such as having to live on a busy street, accepting outdated decor, making some repairs to the home, or forgoing an extra bedroom. But even if you can’t afford to replace the hideous wallpaper in the bathroom right now, it might be worth it to live with it for a while in exchange for getting into a house you can afford. If the home otherwise meets your needs in terms of the big things that are difficult to change, such as location and size, don’t let physical imperfections turn you away. Besides, doing home upgrades yourself, hiring a contractor is still often cheaper than paying the increased home value to a seller who has already done the work for you.

8. Don’t Compromise on the Important Things

While compromise can be a good thing, it might work against you when it comes to purchasing a home. Compromising could cost you money in the long run. For example, if you’re planning on having children and you know you will eventually need three bedrooms, it might not be in your best interest to settle on a two-bedroom home. By the same token, buying a condo just because it’s cheaper may not be the way to go either. If you’re already frustrated with all the things that go along with apartment life, such as noisy neighbors and paper-thin walls, a condo isn’t going to solve much. While it’s true that you may have to make some concessions to afford your first home, the idea is not to make a compromise that will cause a major strain and additional frustration.

Keep in mind that the school district will also affect the value of your home. Even if you don’t have children, it pays to check out a neighborhood’s school district before purchasing, as living in an area with a sought-after school system raises your property value.

9. Don’t Forget to Consider Additional Expenses

Once you’re a homeowner, you will find that there are additional expenses on top of your monthly payment. Unlike renting, you will now be responsible for expenditures such as property taxes, home insurance and any repairs the house may need (which will occasionally include major items like replacing a roof or furnace). If you’re interested in purchasing a condo, monthly maintenance costs will need to be paid regardless of whether anything needs to be repaired because condo owners are part of a homeowner’s association. Typically, this association will collect a couple of hundred dollars per month from the owners of each unit in the building in the form of condominium fees.

10. Choose to Hire an Agent

When you finally begin to seriously shop for a home, it’s best to have chosen an agent before walking into an open house. That’s because agents are held to the ethical rule that they must act in both the seller and the buyer parties’ best interests. If you begin working with the seller’s agent, that might not work in your best interest. Finding an agent to represent you and your best interests is always a wise thing to do.

In summary, there is quite a bit to think about when buying your first home. Remembering these tips should help you navigate the process and avoid potential pitfalls and costly mistakes. If research and planning is done before purchasing, you will most likely become an educated consumer who has a good chance of finding the best home for the best price.