Buying a Home: CNN Buyer's Guide

This is an article written by CNN Money in 2018. Our Managing Broker added comments that follow each numbered item in the article and they start with a golden colored 'DSR (Due South Realty) Note'. The sections are updated regularly to reflect the market in Colorado. Getting all your "ducks in a row" will be important and we think you'll find this article and the comments helpful. Good Luck on your House Hunt!

1. Start with your credit.

Credit reports are kept by the three major credit agencies: Experian, Equifax, and TransUnion. They show whether you are habitually late with payments and whether you have run into serious credit problems in the past.

A credit score is a number calculated from a formula created by Fair Isaac based on the information in your credit report. You have three different credit scores, one for each of your credit reports.

A low credit score may hurt your chances for getting the best interest rate, or getting financing at all. So get a copy of your reports and know your credit scores. Try Fair Isaac's MyFICO.com. Errors are common, so if you find any, contact the agencies directly to correct them, which can take two or three months to resolve. If the report is accurate but shows past problems, be prepared to explain them to a loan officer.

DSR Note: Go to Credit Karma as well. I've heard good things about them not only providing your score but steps to improve it. Also, most lenders can help you not only understand what you qualify for in a loan but also provide you with pointers on how to improve your credit score, so when it is time to buy, you're ready!

2. Set your budget

Next, you need to determine how much house you can afford. You can start with an online calculator. For a more accurate figure, ask to be pre-approved by a lender who will look at your income, debt, and credit to determine the kind of loan that's in your league.

The rule of thumb is to aim for a home that costs about two-and-a-half times your gross annual salary. If you have significant credit card debt or other financial obligations like alimony or even an expensive hobby, then you may need to set your sights lower.

Another rule of thumb to consider: All your monthly home payments should not exceed 36% of your gross monthly income. The size of your down payment will also determine how much you can afford.

DSR Note: Not bad numbers mentioned up above, but it really depends on a couple other figures than just what they've mentioned here. What about your lifestyle? Short term dreams and aspirations or long-term dreams and plans? First time home buyers have no equity from a previous home to bring to the purchase so be careful going 2.5 or 3 times your gross salary – make sure you can invest some of your hard-earned money into a savings account. If you are later in life, then you need to be very careful this doesn't consume your savings. I recommend talking to your financial planner, if you don't have one, get one.

A home is an asset, but it's also a major expense! I've heard some in home maintenance fields suggest that 1% of the value of the home should be spent annually in upkeep and maintenance. Not a bad starting figure. Working with a financial planner will help you walk through different scenarios and not just tell you what you can afford but will reveal what you can afford and maintain with other life priorities as well. Most agents also know several lenders and should know one who is well suited for you. Ask your agent and they will help.

3. Line up cash.

You'll need to come up with cash for your down payment and closing costs. Lenders like to see 20% of the home's price as a down payment. If you can put down more than that, the lender may be willing to approve a larger loan. If you have less, you'll need to find loans that can accommodate you. Various private and public agencies -- including Fannie Mae, Freddie Mac, the Federal Housing Administration, and the Department of Veterans Affairs -- provide low down payment mortgages through banks and mortgage companies. If you qualify, it's possible to pay as little as 3% up front.
[A warning: With a down payment under 20%, you will probably wind up having to pay for private mortgage insurance, a safety net protecting the bank in case you fail to make payments. PMI adds about 0.5% of the total loan amount to your mortgage payments for the year.]

Once you've considered the down payment, make sure you've got enough to cover fees and closing costs. These may include the appraisal fee, loan fees, attorney's fees, inspection fees, and the cost of a title search. They can easily add up to more than $10,000 -- and often run to 5% of the mortgage amount. If your available cash doesn't cover your needs, you have several options. First-time homebuyers can withdraw up to $10,000 without penalty from an Individual Retirement Account, if you have one, though you must pay taxes on the amount. You can also receive a cash gift of up to $15,000 a year from each of your parents without triggering a gift tax.

Check on whether your employer can help; some big companies will chip in on the down payment or help you get a low-interest loan from selected lenders. You can also tap a 401(k) or similar retirement plan for a loan from yourself.

DSR Note: A good financial planner provides some great insight on where and how you can best move your money around and if it is wise to take it out of your 401(k) at this time. I would add that paying PMI is something that should be avoided if at all possible, as this payment never goes toward principal and only into the bank’s pockets.

4. Find an agent.

Most sellers list their homes through an agent -- but those agents work for the seller, not you. They're paid based on a percentage, usually 5% to 7% of the purchase price, so their interest will be in getting you to pay more.
You need an "exclusive buyer agent." Sometimes buyer agents are paid directly by you, on an hourly or contracted fee. Other times they split the commission that the seller's agent gets upon sale. A buyer's representative has the same access to homes for sale that a seller's agent does, but his or her allegiance is supposed to be only to you.

DSR Note: Starters, in Colorado we are not paid between 5% and 7%! That may be the total amount paid to both real estate agents, but not to just one agent. We're usually paid close to 3%.

As far as working for you, I prefer to work with people as a "Buyer's Agent" and this makes your interests my top priority. Our state contracts will indicate how the agent is to be paid. Usually we use the phrase "… the Buyer is responsible to pay the Broker, but the Seller will most likely pay." So far 100% of my transactions have been paid for by the Seller.

You want a Buyer's Agent to help you wade through the various options and details. Interestingly enough, at the end, you are not paying any more than if you didn't use a real estate agent. So why not get an expert and someone knowledgeable in the contracts, the negotiations, and the area to help you with the purchase? Even five years ago this would not have been an issue, but it is becoming more so. Why should you employ an agent? People think they can find everything online, and not need an agent. Although it is true; you can find most of what you want on the major real estate sites but finding a home and buying a home are two different things. First, I'd say 90% of the time people come to me with their ideas for their next home, but in the end, we end up with something totally different. Maybe reality sets in with limits of budget, location, and dreams.

Sometimes it is simply going out and actually looking at homes, walking in them causes the change. A good Realtor will help you through the process. They will ask questions about your 'gut reaction', budget, the house, and what really is a good fit for your needs. Plus, a Realtor isn't doing this just once every 7 years, they are in homes all the time and engaging people about the home buying process. Get them involved and you'll not only make a better decision on 'finding THE HOME', but also in ensuring it is properly processed from contract to close!

I'd also add here, your next step should be to find a lender you can work with (not step 8). Once you are comfortable with them, then they will help you tweak your budget and will give you the detailed information you need to decide. The market is still HOT in Colorado and although I will show you homes for 1 day... without a lender I won't go out on day 2. If the home you are thinking of is under $550,000, it will move quickly, and we will need a lender letter to accompany our offer if you even stand a chance of getting the home. Also, I highly recommend local lenders over the BIG Banks. There are good loan officers in the big banks, just make sure you can meet with them face to face, if not you will be treated like a number and I've watched several closings almost not happen because the BIG Banks were more barriers to the process than conduits to closing. Talk about stress for everyone!

5. Search for a home.

Your first step here is to figure out what city or neighborhood you want to live in. Look for signs of economic vitality: a mixture of young families and older couples, low unemployment and good incomes. Pay special attention to districts with good schools, even if you don't have school-age children.

When it comes time to sell, you'll find that a strong school system is a major advantage in helping your home retain or gain value. Try also to get an idea about the real estate market in the area. For example, if homes are selling close to or even above the asking price, that shows the area is desirable. If you have the flexibility, consider doing your house hunt in the off-season -- meaning, generally, the colder months of the year. You'll have less competition and sellers may be more willing to negotiate.

Be wary of choosing search criteria that are too restrictive. For example, select a price range 10% above and 10% below your true range. Add a 10-mile cushion to the location you specify.

DSR Note: I've slightly hinted to this one from my previous comments on the value of a Realtor, but I'll add this- the online information you have access to has increased dramatically, but you still do not see all the updates and behind the scenes information an agent sees.

Plus, a local agent knows the area. They can tell you about the schools, the stores, the local amenities, and provide information or point you in the direction to get information, so you will know your community before buying a home. You do not have to do it alone.

6. Make an offer.

Once you find the house you want, move quickly to make your bid. If you're working with a buyer's broker, then get advice from him or her on an initial offer. If you're working with a seller's agent, devise the strategy yourself.

Try to line up data on at least three houses that have sold recently in the neighborhood. If you really want the house, don't lowball. The seller may give up in disgust. Remember, that your leverage depends on the pace of the market. In a slow market, you've got muscle; in a hot market, you may have none at all. There's no foolproof system for negotiating a fair price. Occasionally it's best to deal directly with the seller yourself. More often it's better to work exclusively through intermediaries.

Be creative about finding ways to satisfy the seller's needs. For instance, ask if the seller would throw in kitchen and laundry appliances if you meet his price -- or take them away in exchange for a lower price.
Once you reach a mutually acceptable price, the seller's agent will draw up an offer to purchase that includes an estimated closing date (usually 45 to 60 days from acceptance of the offer).

DSR Note: This one I have a hard time with the author. He has some correct assumptions, but it is RARE a Seller wants to talk to you, the Buyer. This is why they have an agent. The Listing Agent is there to help a person sell their home at top dollar and they know this.

Interestingly, Sellers fall into two broad categories: those who think too highly of their home, and those who would sell it all for pennies on the dollar because they have a time pressure to sell. The agent tries to mitigate these two positions and bring reality into the picture. Therefore, as a buyer in Colorado, you will be working through an agent unless it is a For Sale by Owner (FSBO). I do not recommend dealing with a professional negotiator without a professional negotiator – so find a Realtor you can trust.

Remember, in the end, they want to go to the closing table and want to sell this house and not hold on to it. No one wants to leave money on the table though, so understanding the market is key. Another point is that just selecting 3 homes nearby does not mean you understand the value of the home. There is a lot more in a CMA (Comparative Market Analysis) than simply picking 3 homes. Finally, most homes here close in 30 to 45 days, not 60. If you're buying a home priced under $550k, it does not last long at all! Since Covid, homes under $650k have moved quickly! In this market, you need to be ready to move on a home once you find one that interests you. These homes will NOT last long!

7. Enter a Contract.

Have your lawyer or buyer's agent review this document to make sure the deal is contingent upon:
1. your obtaining a mortgage
2. a home inspection that shows no significant defects
3. a guarantee that you may conduct a walk-through inspection 24 hours before closing.

You also need to make a good-faith deposit -- usually 1% to 10% of the purchase price -- that should be deposited into an escrow account. The seller will receive this money after the deal has closed. If the deal falls through, you will get the money back only if you or the home failed any of the contingency clauses.

DSR Note: In Colorado there are approved legal documents that should be used unless an attorney is involved, which is very rare. There are more points to be aware of than just the three listed above and there are also "escape hatches" available for use. An experienced agent can assist you through the process to ensure you are purchasing the home you desire and need. These "escape hatches" protect your earnest money, so if you decide not to purchase the home, you do not lose your earnest money and can walk away looking elsewhere for that dream home.

8. Secure a loan.

Now call your mortgage broker or lender and move quickly to agree on terms, if you have not already done so. This is when you decide whether to go with the fixed rate or adjustable rate mortgage and whether to pay points. Expect to pay $50 to $75 for a credit check at this point, and another $150 to $300 on average for an appraisal of the home. Most other fees will be due at closing.

If you don't already have one, look into taking out a homeowner's insurance policy, too. Most lenders require that you have homeowner's insurance in place before they'll approve your loan.

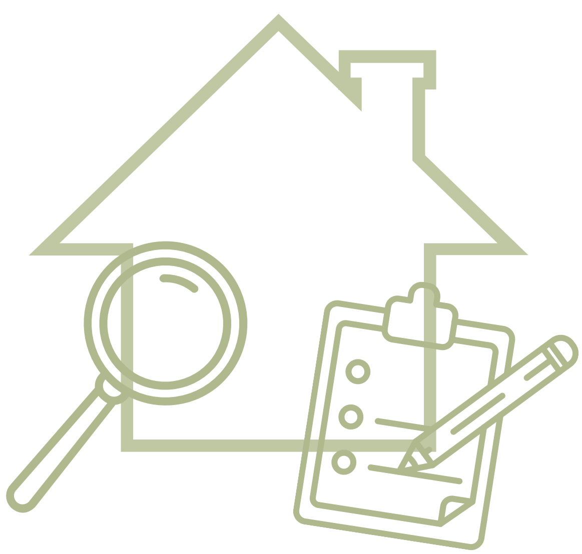
DSR Note: By this point you need to be well acquainted with your lender and know their process to purchase a home. Locking in the rate happens at predetermined times set by the lender and a good one will help you get the best rate possible at the right time. The further out the lock is from the closing date, the higher the cost probably will be associated to locking the rate. I recommend for most home buyers to not get an ARM but to get a fixed rate, especially these days when rates are around 3%, under 4%. An ARM can work for an investor who isn't planning on holding the home for too long or for someone anticipating to sell sooner than later.

Additionally, to buy a home in Colorado you must have homeowner's insurance – it is not an option. Once under contract, start looking around, but do not buy it until after inspection and appraisal. Your lender will be in touch with you on this as well. They can't release a loan to you until you have an approved homeowner's insurance policy.

9. Get an inspection.

In addition to the appraisal that the mortgage lender will make of your home, you should hire your own home inspector. An inspection costs about $500 on average and up to $1,500 for a big job, and it takes two hours or more. Ask to be present during the inspection because you will learn a lot about your house including its overall condition, construction materials, wiring, and heating. If the inspector turns up major problems like a roof that needs to be replaced, then ask your lawyer or agent to discuss it with the seller. You will either want the seller to fix the problem before you move in or deduct the cost of the repair from the final price. If the seller won't agree to either remedy you may decide to walk away from the deal, which you can do without penalty if you have that contingency written into the contract.

DSR Note: In Colorado you have to choose to waive this contingency, otherwise you have an Inspection Objection date that you can terminate the contract over – and technically without cause. An Inspection is important and needs to be done. During our Covid times and multiple offers, many have forgone this, but our recommendation is DON'T or have your agent be creative in not making it sound like a big deal. Talk to your agent about home inspectors they recommend.



10. Close the deal.

About two days before the actual closing, you will receive a final HUD Settlement Statement from your lender that lists all the charges you can expect to pay at closing. Review it carefully. It will include things like the cost of title insurance, which protects you and the lender from any claims someone may make regarding ownership of your property. The cost of title insurance varies greatly from state to state but usually comes in at less than 1% of the home's price.

The lender might also require you to establish an escrow account, which it can tap if you fall behind on your mortgage or property tax payments. Lenders can require deposits of up to two months' worth of payments. The actual closing is often somewhat anticlimactic. It's a ritual affair with customs that differ by region. Your lawyer or real estate agent can brief you on the particulars.

DSR Note: This is dated. I had to change this because the HUD is no longer in use. The forms used are now the Closing Disclosure and the Loan Estimate. I think these are better and easier to read and understand. They must be in the buyer's hands 3 business days prior to the close. After the initial adjustment to this new form, closings are regularly occurring at 30 days again. This adjustment has in general led to less stress at the closing table and greater predictability. Yes, he is right, the closing is often somewhat anticlimactic, but in the sense that you need to have done your finger exercises prior to the event because you'll be signing a forest worth of paper! A closing can last anywhere from 45 to 90 minutes depending on the details.

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