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Home Buying Preparation Timeline –Part I

Buying a home is a big step – one that should be carefully planned out and prepared for. Ideally you should start preparing yourself and your finances for the purchase about one year in advance. This is the first part in an article series designed to give you a rough home buying preparation timeline. We will first take a look at the things that need to be done the twelve to six months before you plan to buy a home.

The Twelve to Six Month Countdown List

At this point, you know your goal is to buy a home. Now you need to figure out what it is going to take to do so. There are three basic things that mortgage lenders base your mortgage acceptance on: your credit score and history, your debt-to-income ratio, and your assets.

Credit

Your credit report is a highly influential document these days. Lenders use it as a reflection of your responsibility with credit sources. They also use your credit score as a gauge of how much risk there are assuming by lending you money. In fact, the interest rate that they will offer you on a mortgage is often directly related to your credit score - the higher your score, the better your rate. So your task is to start now to make your credit score as attractive as possible to lenders. It generally takes at least six months for any credit practice improvements to be reflected in your score, so don't delay!

First, pull a copy of your credit report and score from one or all of the three major credit reporting agencies, TransUnion, Equifax, and Experian. With your report in hand, scan the document for any blatant errors. Be sure to report these immediately to the credit bureaus to have the information corrected. Next look for reasons by your credit score may be lower than you want. Once you have identified problems areas in your credit habits, it's time to go to work! The most important factors in improving your credit score include making very punctual payments on all your credit accounts (you may want to consider setting up automatic bill payments) and lowering the balances on all your credit accounts. During the next year you should also steer clear of opening or closing credit accounts, as this will generally bring down your score.

Debt-to-Income Ratio

Your income is an important factor in obtaining a home loan. Lenders want to make sure you have a stable, sufficient income to be able to support the mortgage payments. Beyond simply determining your income, lenders will want to know how you are using your income to see whether you could afford the loan. Mortgage lenders often use the 28/36 rule in determining whether or not you qualify for a loan. The 28 part of the ratio means lenders like to see that your total monthly debts are equal to or less than 28 percent of your monthly income. Those debts would include credit card payments, student loans, car payments, etc. The 36 in the ratio means that lenders prefer that your total debts plus your mortgage payment will not exceed 36 percent of your monthly income. Some lenders will be more lenient on these percentages, but they are a good rule of thumb. Starting a year before you want to buy, you should evaluate your debt and make a plan for reducing it to within the 28/26 ratio. Reducing your debt will also improve your credit score!

Assets
A third factor lenders will use in determining your eligibility for a home loan is your assets. This next year should be a year of saving. Not only do you need to save as much as possible for a good down payment, but you also have to be prepared to pay for the loan closing costs (which could run anywhere from several hundred to a few thousand dollars.) Once you actually get into a home, there will be plenty of expenses related to the upkeep of the house. Plus some lenders may even require that you have a couple mortgage payments' worth of money saved away in order to avoid default for awhile if you have some sort of financial crisis or emergency.

Look for the next part of this series that will outline the important preparation steps to take during the three to six months before you buy a home.