Thursday, 8 Oct 2009

Seven Tips For Homebuyers

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Special to CNBC.com

Inventories are high, prices are low and housing markets across the country are still testing the bottom following the real estate recession that wiped out more than $4 trillion worth of homeowner equity since 2006.

Tough times if you're a seller. But those in the market to buy have assumed an enviable position indeed.

"Buyers are paying 20 to 40 percent less than they would have paid two years ago and far less in some markets," says Eddie Fadel, a mortgage broker and author of "Don't Rent, Buy!" "You have more bargaining power right now."

Low interest rates and federal incentives (such as the $8,000 tax credit for first-time homebuyers) are giving would-be buyers greater motivation still to get off the fence.

Yet, despite all the upsides, many house hunters remain hesitant to commit, fearing prices in their target neighborhoods may fall further in the months ahead.

At the same time, tighter lending restrictions have made it harder to qualify for a mortgage loan, keeping the dream of home ownership out of reach for all but the most credit worthy consumers.

As such, Barry Zigas, director of housing policy for the Consumer Federation of America, says those looking to benefit from the buyer's market today must come to the table prepared, armed with a clean financial bill of health and plenty of research to ensure they get the best deal on their purchase.

“Consumers should be well-informed when they start the process,” says Zigas. “Opportunities [to buy at the bottom] are greater in some markets right now than in others so it’s hard to generalize, but I will say that just because a house might decline further in value over the short term is not necessarily a reason not to buy it.”

If the price is right, you plan to stay put and you’re able to get good financing, he notes, there’s no real reason to wait. Here’s a seven-point plan to put yourself in the driver’s seat when shopping for a home.

Your first order of business is to obtain a copy of your credit report from the three major reporting agencies, Equifax, TransUnion and Experian.

It’s free and the earlier in the process you review it, the more time you’ll have to correct any errors and make changes that can improve your score.

“Anyone thinking of becoming a homeowner should get a copy of their reports and check them,” says Zigas. “They’re not always accurate. They may include old credit lines that you closed or incorrect information.”

It may cost a small fee, but it’s also worthwhile to request your actual credit score, the number banks use to determine your level of credit risk—and thereby, what interest rate to charge you.

“These days, if it’s much under 660, the consumer will find it much harder to get a loan on favorable terms,” says Zigas, noting before the real estate bubble burst, banks were lending to those with scores as low as 620.

Today, you’ll need a score of 720 or better to land the lowest rates.

You can help raise your score by paying future bills on time, eliminating lines of credit and paying off any outstanding debts you may have, including student loans, car loans and credit card balances.

Purchasing Power

Next, you’ll need to determine how much you can reasonably afford to spend on a home. You may qualify for more, but mortgage finance giant Freddie Mac says a quick rule of thumb is to multiply your annual gross income by 2.5.

For example, if your annual household income is $50,000, you might be able to qualify for a $125,000 home. It depends, of course, on interest rates, your credit history and any existing debt. Lenders use two ratios to determine how much house you can afford.

For the housing expense ratio, they recommend your monthly mortgage payment be less than 28 percent of your monthly gross income and that your recurring debt plus your monthly mortgage payment be no more than 36 percent of your monthly gross income.

Banks also look at your debt-to-income ratio to make sure your total debt is not greater than 30 percent to 40 percent of your monthly gross income. That includes credit cards, student loans, alimony, child support, car loans and housing expenses.

Remember, just because you qualify for a loan amount does not mean it's within your budget.

Houses come with lots of expenses beyond the principal and interest payments, including homeowner's insurance, property taxes, utilities, repairs and maintenance.

Talk to Builders

While the notion of buying a distressed property, such as a foreclosure or bank-owned home, at bargain basement prices may appeal, Fadel says consumers should tread with caution.

Many come with legal headaches, not to mention costly surprises such as mold damage, structural problems or damaged ceilings or roofs. Plus, in today's competitive market, he notes, it's hardly necessary to take any risk at all.

"Many builders across America are willing to take 20 to 30 percent below what they would have accepted a year ago, even below their construction costs to clear out inventory, and these are brand new homes that come with a ten-year warranty in many cases," he says. "You don't have to buy someone else's headache."

Making An Offer

When you do find your dream home, don't rush in. Research the neighborhood carefully and talk with realtors to be sure your offer is within range of comparable sales in the area.

Web sites such as Zillow.com, Homekeys.com and Realtor.com, which provide online estimates of a house's market value, can help. Look at recent transactions that closed and are published in local newspapers.

And don't be afraid to play hardball. Sellers in this market are likely to give you what you ask for, within reason.

"If the inspection turns up problems with the house, it's reasonable to ask the seller to finance them or make a contribution towards the repairs," says Zigas.

You can also ask for concessions, in which the seller contributes money towards your closing costs (up to certain limits)—unheard of in the seller's market of a few years ago, but par for the course today.

At the same time, with prices down as much as they air in some markets, there may be more interested and qualified buyers than you think so be careful in making a low-ball offer and be prepared for a bidding war.

Getting A Loan

These days, securing a mortgage can be the hardest part of the equation.

Generally speaking, you'll need to document a steady employment history, have good credit history, and have a low debt-to-income-ratio to even qualify.

If you fall short in any one area, be prepared to make up for it with a larger down payment or higher interest rates.

Despite the credit crunch and disappearance of zero down and no-doc loan programs, the**Federal Housing Administration** still offers programs for cash-strapped borrowers with little money for a down payment.

FHA-insured loans require a 3.5 percent down payment, far less than most conventional loans require. They also allow for higher debt ratios and they offer greater flexibility on both the borrower's credit rating and the source of their down payment (which can include gifts).

Such loans have no income limit, but do come with a maximum loan amount, which ranges from $271,050 in lower cost parts of the country to $729,750 in higher priced markets.

Before signing anything, says Zigas, consumers should research all options available, from adjustable rate loans to points that lower your interest rate, to be sure they're getting the loan that's best for them.

Ready, Set Buy

Homebuyers who are in it for the long haul and know their market are almost sure to benefit from a confluence of factors, including low interest rates, better bargaining power and discount prices.

Those who have their financial house in order may want to consider jumping in, says Zigas.

“Trying to bet on the market’s ups and downs is not a reasonable strategy [for home buyers],” he says. “If a house is comfortably within your reach, yeah, it might go down [in price] some more, but if the community is strong it’ll come back and you get to live in the house in the meantime [building equity and benefiting from tax deductions]. If they do their research, then it might be the right time to buy.”