Tired of Renting?

Smooth the transition to homeownership with these best practices.

So you have decided to be a homeowner. You've been saving and building up enough funds to put 20% down and avoid private mortgage insurance. Now, you want to make sure you have your financial bases covered.

What are the best steps you can take to transition to homeownership? How can you get your finances in order and be ready to apply for a first mortgage, knowing that today's mortgage lenders are looking for evidence you can afford the loan?

1 First, prepare a financial statement.

This statement clearly lists all of your current assets and liabilities and determines your net worth. In business, the financial statement is not complete without an income statement. In personal finance, this can be called a budget, or income and expenses.

2 Second, figure out your monthly income and expenses.

There are two components to the budget:

a. You will want to confirm all of your income sources. Lenders will look to get copies of your paystubs, tax returns, and bank and brokerage statements as evidence to support your reported assets and income.
b. Next, calculate your expenses. Be sure to include all your expenses. You can use several prior months bank statements to confirm your average monthly expenses. Keep in mind any quarterly, semi-annual or annual expenses, as well as taxes.

The result of these two components will tell you how much discretionary income you have. Income minus expenses equals discretionary income.

From a best practices point of view, your next step will be to review your expenses and calculate the costs of homeownership. As a renter, you are not liable for property taxes, property maintenance, HOA dues, homeowner's insurance and warranties; and your rent may or may not have included utilities. You will want to factor in these kinds of ongoing and regular expenses.

After adjusting your expenses for the cost of homeownership, your cash flow should still be positive. Generally, your mortgage costs should not exceed 28% of your gross income, and your total debt service should not exceed 36% of your gross income.

3 Third, Murphy's Law emergency fund.

Murphy's Law assumes that anything that can go wrong will go wrong. It's best to have an emergency fund or savings set aside – just in case.

Now that you have a good estimate of what it will cost to live in your new home, calculate the monthly average of your estimated living expenses in your new home and multiply this by 3 to 6 months. The result will be the minimum and maximum emergency funds you will want to have on hand. Just in case there is an economic crisis, such as a pandemic.

4 Fourth, calculate the additional funds you will need to furnish your new home.

Chances are you are buying a home with more space and we all know nature abhors a vacuum. This means you will want to spend money on furnishings, art and accessories.

5 Fifth, get prequalified.

Before you start looking for a home, connect with a lender and discuss your particular finances and goals. The mortgage specialist will run a credit check and help you establish the price range and costs you can afford. Ideally, you will get pre-qualified. Pre-qualifications are still subject

to homeowner's insurance, appraisal, verification of assets, employment, etc., but they go a long way in helping you get the home you want.

The lender will issue you a prequalification letter for conforming loan amounts, established by county. In the county of Maricopa, Arizona the conforming loan amount is $510,400. Non-conforming loans are over this amount. Lenders use automated underwriting systems which establishes the loan amount, conditions and items needed to complete the loan.

6 Sixth, do your homework.

There are lots of resources on the net which act as lead generators. Consider checking out www.HUD.gov and www.fhfa.gov/Homeownersbuyer. Chances are, if you've done steps 1 through 6, you will be well prepared to succeed at homeownership.

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