

Prepare to Finance a Home

Develop a budget: Instead of telling yourself what you'd like to spend, use receipts to create a budget that reflects your actual habits over the last several months. This approach will better factor in unexpected expenses alongside more predictable costs such as utility bills and groceries. You'll probably spot some ways to save, whether it's cutting out that morning trip to Starbucks or eating dinner at home more often.

Reduce debt: Lenders generally look for a debt load of no more than 36 percent of income. This figure includes your mortgage, which typically ranges between 25 and 28 percent of your net household income. So you need to get monthly payments on the rest of your installment debt—car loans, student loans, and revolving balances on credit cards — down to between 8 and 10 percent of your net monthly income.

Increase your income: Now's the time to ask for a raise! If that's not an option, you may want to consider taking on a second job to get your income at a level high enough to qualify for the home you want.

Save for a down payment: Designate a certain amount of money each month to put away in your savings account. Although it's possible to get a mortgage with 5 percent down or less, you can usually get a better rate if you put down a larger percentage of the total purchase. Aim for a 20 percent down payment.

Keep your job: While you don't need to be in the same job forever to qualify for a home loan, having a job for less than two years may mean you have to pay a higher interest rate.

Establish a good credit history: Get a credit card and make payments by the due date. Do the same for all your other bills, too. Pay off entire balances as promptly as possible.

Start saving: Do you have enough money saved to qualify for a mortgage and cover your down payment? Ideally, you should have 20 percent of the purchase price saved as a down payment. Also, don't forget to factor in closing costs, which can average between 2 and 7 percent of the home price.

Obtain a copy of your credit report: Make sure it is accurate and correct any errors immediately. A credit report provides a history of your credit, bad debts, and any late payments.

Decide what kind of mortgage you can afford: Generally, you want to look for homes valued between two and three times your gross income, but a financing professional can help determine the size of loan for which you'll qualify. Find out what kind of mortgage (30-year or 15-year? Fixed or adjustable rate?) is best for you. Also, gather the documentation a lender will need to preapprove you for a loan, such as W-2s, pay stub copies, account numbers, and copies of two to four months of bank or credit union statements. Don't forget property taxes, insurance, maintenance, utilities, and association fees, if applicable.

Seek down payment help: Check with your state and local government to find out whether you qualify for special mortgage or down payment assistance programs. If you have an IRA account, you can use the money you've saved to buy your first home without paying a penalty for early withdrawal.