How to prepare to buy a home

Home ownership is a big part of the American Dream. You may dream of having a place to call your own. Be sure to educate yourself on your options before you settle into your mortgage. There is no reason why you should sacrifice your financial health in order to avoid turning a dream into a financial nightmare!

Steps to Take Before Your Down Payment

Before you consider spending money on a down payment, Yahoo! Finance recommends paying off your debts first. High-interest debts (credit card debt, for example) interfere with your ability to save in the future. These debts also limit how much you can borrow from a lender. Mortgage companies will not loan money to you if your monthly expenses (including credit card expenses) are more than 40% of your income.

MSN Money columnist Liz Pulliam Weston suggests that before you shop for a house, you should qualify for a pre-approved loan first. In order to do this, a lender will thoroughly examine your income and credit history. The lender then guarantees that he will loan you a specific amount of money to pay for your new home. As a result, you will look much more attractive to sellers and brokers. They will be sure that you can pay for your new home.

Planning Your Home Payment

Your first step in planning your home payment should be figuring out what you can afford to spend. Generally, it is recommended that your home expenses (including your mortgage payment and homeowner's insurance) not exceed 28% of your gross income. Keep this figure in mind when shopping for new homes.

As you consider your mortgage options, be sure to go with the mortgage that fits your needs best. It is extremely important to shop around. You may be surprised by how many mortgaging options exist.

Some of your options include the traditional 30-year mortgage. Although you may pay more interest than you would with other mortgages, you lock in your interest rate and if interest rates go up in the future you would be making lower payments than other, variable rate loan options. The main advantage of a 30-year mortgage is stability.

You could also choose a more non-traditional mortgage option. Some homeowners take on two mortgages, or "piggy backed" loans. The first loan would pay for 80% of your home in the form of a 30-year mortgage. The second loan would pay for 10% of your home with a 15-year mortgage. You would pay for the last 10% of your home with your down payment.

The advantage to piggy backed loans is that you will not have to put as much money down when buying your home. You will also not have to pay for private mortgage insurance (PMI). You would normally have to pay for private mortgage insurance if you cannot afford the standard 20% down payment. However, piggy backed loans are more expensive than 30 year mortgages and you may have to pay higher closing costs.

If you have credit problems you could take out a loan from the Federal Housing Authority, or FHA. According to Yahoo! Finance, you could make a down payment on a home for as little as 3% down. You could also include your closing costs as part of your FHA mortgage. However, there is a limit to how much money you can borrow through an FHA loan. Investigate how much you stand to borrow from your region's FHA funds.