Step 2:

Saving for Homeownership

If you are considering buying a home, then it's time to start saving money. Saving is one of the most important steps in the homebuying process, and it can also be the step that takes the longest. Saving up enough money requires a lot of time and effort. It can also be hard, especially if you're trying to pay off debt, such as student loans, credit cards, or car loans. However, when purchasing a home, it's extremely important to save enough money to cover housing-related fees and additional expenses, such as unexpected costs associated with being a homeowner. Here are some considerations to make when you start to put aside some cash.

This step covers:

- Create a budget
- Understanding debt
- Other homebuying expenses to consider

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Create a budget

You'll learn:

- **Things to think about for your savings strategy**
- **Why you might need less down payment than you think**
- **Other homebuying related expenses to factor in**

While many different saving methods are available, one tried-and-true method is to understand your total income and expenses and create a budget. For instance, you can budget based on your habits and goals. Budgeting can give you a clear view of your spending habits and where your money is going. That way, you can identify how much to set aside from each paycheck. A budget only works, though, if you're committed to it. As an example, here are income and expense worksheets from the Consumer Financial Protection Bureau (CFPB):

View CFPB Budget Sheet

View CFPB Income Benefits Tracker

Set goals

There are many different strategies for saving. Before you start to save, set some goals for yourself, such as how much you want to put aside and a deadline for saving that amount. Then, find a strategy that works with your financial situation and lifestyle. For example, you can use direct deposit to automatically transfer a specific amount from your paycheck into a savings account. That way, the temptation to spend the money isn't there. Also, consider looking at your expenses and determine where you can cut back. Doing things like buying generic grocery items instead of name brands, cutting cable TV, and packing a lunch instead of buying it can save a good chunk every month. Do some research to find the best strategy for you, and keep in mind that every dollar really does make a difference.

Save for a down payment

When it comes to saving for a down payment, you may not need as much money as you think. Coupled with other eligibility factors, some mortgage products require down payments as low as 3% of the total home price. Some state and local programs offer **down payment** assistance to eligible borrowers. Being a first-time homeowner may also open up opportunities to receive incentives that can help you reach your down payment goal. Talk to your local lender to learn what options may be available to you.

Down Payment:
The amount of cash a borrower may need to pay in order to buy a piece of property; equal to the purchase price minus the amount of any mortgage loans used to finance the purchase.

Consider other expenses

Besides saving for a down payment and financial emergencies, you'll also want to plan for costs associated with buying a home. Consider saving for **closing costs**, **homeowners insurance**, taxes, and other moving-related expenses. If you're feeling overwhelmed, remember that every little bit helps, and the more you save, the less you will borrow later. These costs are detailed more in depth in Step 2, under Other Homebuying Expenses to Consider.

Closing Costs:
Various fees required to conclude a real estate transaction.

Homeowners Insurance:
Covers a home's structure and the personal belongings inside in the event of loss or theft; helps pay for repairs and replacement.

Other costs:	
	1. Closing costs 2. Home insurance 3. Taxes 4. Moving-related expenses

Understanding debt

You'll learn:

- What "debt-to-income" is and why it's important to lenders
- How to calculate your DTI
- Actions you can take to decrease your DTI

Understanding debt can be tricky, but it's important to learn how it works and what lenders consider when determining mortgage eligibility. Keep in mind, while you may want to pay down debt before you apply for a home loan, you might not need to pay it all off. Here are a few things that are important to understand about debt.

What is debt-to-income ratio

Basically, **debt-to-income ratio (DTI)** is how much debt you have compared to your income. As **credit scores** help lenders determine how likely a borrower is to make payments on time, DTI helps them determine whether you'll have trouble making monthly mortgage payments. Lenders view this as a key indicator of how well you manage money and whether you can afford to take on more debt.

How DTI impacts qualifying for a home loan

As long as the DTI ratio is under 50% you may qualify for a mortgage loan. If it's above 50%, you'll want to take steps to lower it before applying for a mortgage. Your DTI ratio will be a strong factor when determining how much you'll be approved to borrow, your **interest rate**, and other loan terms. So even if it's near 50%, you may want to lower it before applying for a mortgage.

How to calculate DTI

You can figure out your DTI ratio by adding up your total monthly debt payments and then dividing that amount by your gross monthly income, which is the total monthly income before taxes are deducted. Your monthly debt payments may include your rent, any student loans or car loans, alimony and child support, minimum credit card payments, and any other debt. When you apply for a loan, the new monthly loan payment will become a factor when determining your total DTI vs. what you currently pay for housing/rent.

For instance, let's say that every month your total monthly debt payments are $900. Then, if you make $28,000 a year, your gross monthly income is $2,333. To calculate DTI, divide $900 by $2,333, which comes out to 0.39. Then multiply this by 100 to get your current DTI ratio of 39%.

Example of Debt-To-Income Calculation:

$$\frac{\underset{\text{monthly debt payments}}{\$900}}{\underset{\text{monthly gross income}}{\$2{,}333}} \times 100$$

= 39% DTI

Debt-to-Income Ratio (DTI):

Your debt-to-income ratio is all your monthly debt payments divided by your gross monthly income.

Credit Score:

A credit score predicts how likely you are to pay back a loan on time. Companies use a mathematical formula—called a scoring model—to create your credit score from the information in your credit report. There are different scoring models, so you do not have just one credit score. Your scores depend on your credit history, the type of loan product, and even the day when it was calculated.

Interest Rate:

A percentage of a sum borrowed that is charged by a lender or merchant for letting you use its money. A bank or credit union may also pay you an interest rate if you deposit money in certain types of accounts.

Ways to improve your DTI

If your DTI ratio is high, you can improve it by trying a few techniques. First, review your budget to find some extra money to put toward paying off your debt. You can also review your current credit report for an overview of all your debts and the payments associated with them. Avoid large purchases, especially if it adds to your debt. This can be hard, but the purchases you make while trying to qualify for a home loan may impact your approval status. Last, give yourself time to pay it down. It won't happen overnight.

Other homebuying expenses to consider

You'll learn:

What closing costs are
Costs associated with moving
Expenses you may incur when making your home your own

The down payment will most likely be your biggest expense, but you'll want to plan for other homebuying expenses so you're better prepared.

Closing costs

Closing costs include the various fees involved when securing a mortgage. Typically, these include fees for a loan application/origination, a **title search**, **title insurance**, taxes, and **lender** costs. It also involves upfront expenses like homeowners insurance, **mortgage insurance**, and an initial **escrow** account for future insurance and tax payments. A general rule is that these expenses are typically between 2% and 5% of the **home purchase price**. In some instances, the seller may pay for these costs, and your real estate agent may know whether to request this in the offer.

Title Search:
A process whereby the title company retrieves and examines public records that document the history of a property to confirm its legal ownership.

Title Insurance:
Insurance through a title company to protect a property owner or lender from loss if title proves imperfect.

Lender:
An organization or person that lends money with the expectation that it will be repaid, generally with interest.

Mortgage Insurance (MI):
Insurance that protects the mortgage company

Moving costs

Once you're ready to move into your new home, you may need to hire people to move your furniture, wardrobe, and other items. If you have friends or family to help, you may still need to account for the cost of a moving truck. Also consider materials like boxes and bubble wrap for packing your belongings. If your move-out date happens before your move-in date, you may need to rent storage space and possibly find temporary housing, which could mean paying for two places for a while.

Utility hookups

Setting up your new household requires getting connected to a lot of services. Be prepared for initial setup costs for things like gas, electric, internet, cable TV, and public utilities (e.g., water and sewer fees as well as disposal costs for trash and recycling). Sometimes, you may need to pay hefty installation fees for internet/cable connections, and gas and electric companies often require initial deposits.

against losses caused by a homeowner's default on a mortgage loan. Mortgage insurance (or MI) typically is required if the homeowner's down payment is less than 20% of the purchase price.

Escrow:
An account (held by the mortgage company or mortgage servicing company) whereby a homeowner pays money toward taxes and insurance of a home.

Home Purchase Price:
The final selling price of a home.

Common utilities to set up

- **Internet**
- **Gas**
- **Electric**
- **Cable**
- **Water & sewage**
- **Garbage collection**

Furniture

In most cases, buying a home means you'll have more space to fill. While this is a positive change, it can also be expensive. So, it's good to put aside some money for home furnishings. While you don't need to furnish your entire home all at once, consider some basic items you will need. Avoid impulse purchases, and take the time to shop for good deals.

Home improvements

One of the best things about owning your home is that you can make changes that suit your taste and preferences. You may be able to negotiate that the seller addresses certain repairs and upgrades so you're not responsible for them. If you think you may want to throw a fresh coat of paint on some walls, redo some carpeting, change out light fixtures, or make larger improvements when you first move in, consider planning for these costs ahead of time.