Part I — Self Assessment

Starting a home-shopping / home-buying process means answering a lot of questions. Are you ready to buy a home? How much of a mortgage can you afford? How's your credit? What size house do you need? What area do you prefer to live in? How are your cash reserves?

The more Q&A, research and soul-searching you do in advance, the smoother the process will be later on. Let's look, then, at some key questions you should ask yourself in the self-assessment phase.

What Can You Afford?
Before house hunting, determine how much of a mortgage you can comfortably afford. "Comfortably" means you can pay your mortgage each month and still have money for living expenses, savings, and quality-of-life niceties. In other words, you don't want a mortgage payment that forces you to "squeak by" each month.

To determine your mortgage comfort-zone, you need three things: a budget, a price and a mortgage calculator. For the price, just start with the cost of a house you think you might be interested in buying.

At first, don't worry about whether the price is too high — you'll find that out soon enough when you run the numbers.

Next, run the home price through a mortgage calculator at current interest rates and at a 30-year fixed mortgage. (You might choose a different mortgage type later on; but this exercise is just to get a ballpark mortgage payment based on home price, so choose the 30-year fixed option for the sake of simplicity.)

Mortgage calculators can easily be found on the Internet. Just type "mortgage calculator" into any major search engine, and you'll find several.

Sample Mortgage Calculation
Let's say I've done some research and found that a home in my preferred area with the number of rooms I want, and offering the features I have in mind, comes to about $200,000. I plan to get a loan for 80% of this amount and then split the remaining 20% between a down payment and a second mortgage.

> **Side note:** If your down payment is less than 20%, most lenders will require that you pay mortgage insurance (see glossary at the end of this guide). One way to get around this is to obtain a second mortgage from a second lender. A common example is the 80-15-5 breakdown; which means 80% from a primary lender (first mortgage), 15% from a secondary lender (second mortgage), and 5% down payment (out of pocket).

Getting back to our calculation, I want to find out what my mortgage payment would be on $160,000 (80% of the home price of $200,000). So I go to www.mortgage-calc.com — one of many mortgage calculators online — to run the numbers.

For "principal," I enter $160,000. For "interest rate," I enter 5.75%, which is the current interest rate at the time of this writing. Most mortgage calculators will have this field filled in for you, based on current rates. For "number of years" I put 30.

Remember, we're just trying to get a ballpark monthly mortgage payment. There are many different loan types to choose from, but for demonstrations purposes we've chosen a common type of mortgage (30-year fixed).

I hit the "Calculate" button, and this is what I get:

Your Monthly Payment for 30 Years

for an Interest Rate of 5.75 %

on a Loan Amount of $ 160,000:

$933.72 a Month

I would run these numbers through at least one more calculator, just to validate them. Then I would repeat the process for my second mortgage amount. Of course, if you can afford to put 20% down and avoid the second mortgage scenario, the math is much simpler.

Now I can more accurately figure this price range into my budget — a quick and easy way to see if I'm in or out of my comfort zone, and to find out exactly what my comfort zone is in the first place.

We will talk more about mortgages in Part 7, "Types of Mortgages."

How's Your Credit?

Continuing in the self-assessment phase, you need to take a good, hard look at your credit situation. Try to do this a few months before beginning your home search to prevent delays later on. Start by ordering copies of your credit report.

Credit reports are maintained by three credit agencies: Experian, Equifax and TransUnion. These agencies maintain any and all information pertaining to your personal credit — payment habits (including late payments), bankruptcy and other issues.

Your credit score is based on the information in your credit reports, which come from the three aforementioned agencies. Three agencies, three reports, three credit scores ... all about you!