

Where to begin

The key factor in figuring how much home you can afford is your debt-to-income ratio. This is the figure lenders use to determine how much mortgage debt you can handle, and thus the maximum loan amount you will be offered. The ratio is based on how much personal debt you are carrying in relation to how much you earn, and it's expressed as a percentage.

The ideal ratio

Mortgage lenders generally use a ratio of 36 percent as the guideline for how high your debt-to-income ratio should be. A ratio above 36 percent is seen as risky, and the lender will likely either deny the loan or charge a higher interest rate. Another good guideline is that no more than 28 percent of your gross monthly income goes to housing expenses.

Doing the math

First, figure out how much total debt you (and your spouse, if applicable) can carry with a 36 percent ratio. To do this, multiply your monthly gross income (your total income before taxes and other expenses such as health care) by .36. For example, if your gross income is \$6,500:

	\$6,500	(Gross monthly income)
x	.36	(Debt-to-income ratio)
=	\$2,340	(Total allowable monthly debt payments)

Next, add up all your family's fixed monthly debt expenses, such as car payments, your minimum credit card payments, student loans and any other regular debt payments. (Include monthly child support, but not bills such as groceries or utilities.)

	Minimum monthly credit card payments':	_____
+	Monthly car loan payments:	_____
+	Other monthly debt payments:	_____
=	Total monthly debt payments:	_____

*Your minimum credit card payment is not your total balance every month. It is your required minimum payment -- usually between two and three percent of the outstanding balance.

To continue with the above example, let's assume your total monthly debt payments come to \$750. You would then subtract \$750 from your total allowable monthly debt payments to calculate your maximum monthly mortgage payment:

	\$2,340	(Total allowable monthly debt payments)
-	\$750	(Total monthly debt payments other than mortgage)
=	\$1,590	(Maximum mortgage payment)

pest infestations, heating and air conditioning, as well as the electrical system. It's also a good idea to make sure the inspector is reputable -- check to see if he or she is certified with the American Society of Home Inspectors.

Next we'll take a look at the ultimate -- and perhaps the easiest -- financial mistake you can make when buying your first home.

Mistake 1: Falling In Love with a House

Falling in love can be an amazing thing. It makes you happy to be alive and allows you to see the inner beauty of another. Falling in love can also be a terrible thing. It makes a fool out of you and blinds you to someone's faults until the spell wears off and it's too late. Likewise, although it sounds ideal, falling in love with a house could be your worst financial mistake. It easily leads to a **Mr. Blandings syndrome**, where you stubbornly ignore the solid advice of friends and experts.

Stewart Cohen/Riser/Getty Images

Who ever loved that loved not at first sight? But beware what a home's love spell can do to your wallet. Sure, different people have different needs. Some people seek out homes that they feel an emotional connection to. But, you should still take extra caution once you find your dream house -- think about how you will feel once the honeymoon phase's over. You may choose to overlook a home's idiosyncrasies now, but you may suffer buyer's remorse when you must deal with a cramped kitchen or creaky floorboards everyday.

Ultimately, falling in love with a house will very likely blind you to its financial value. You might find yourself offering a bid that far exceeds the true worth of the house, which makes for a bad investment. And, if you expose your infatuation to the seller or the seller's agent, they'll realize you'll be willing to overpay.

Not only can it lead to overpaying, but it can also allow you to fall into the several of the other mistakes that we've discussed in this list, such as trusting a verbal agreement, not considering resale value and foregoing an inspection.

Overall, when buying a house, it's a good idea to keep a cool head and an open mind, and always be prepared for the worst. Murphy's Law, which could have been written specifically for homebuying, states that if something can go wrong, it will. Still thirsting for more homebuying information? You'll find it in the links on the next page.

should also specify that you won't owe the agent normal compensation if you end up finding a house on your own, without his help.

If all goes well, the seller will live up to his or her word and everything will be hunky-dory. Or will it? Next we'll take a look at some of the unexpected charges that can add up.

Mistake 3: Forgetting About the Hidden Costs of Homebuying

If everything goes according to plan, you may be closing a deal and reaching the end of your homebuying journey. Even here, you could make the common mistake of thinking all of this will be painless. Closing costs, which include several fees that cover final housekeeping matters, are just one example of hidden fees that many first-time homebuyers neglect to prepare for. They can cost you a few thousand dollars or up to 5 percent of the purchase price [source: Greary].

David Gould/Getty Images

Fees often pop up in the fine print of numerous agreements homebuyers sign.

While there are other fees you may pay in your home purchase, here's a list of common fees you should expect to pay:

- **Appraisal Fee:** When you apply for a home loan, the lender needs to make sure everything is on the up-and-up. They want to know if you are borrowing \$700,000 for a \$300,000 house. That's why you send an appraiser to estimate the cost of the house you are purchasing, and you'll pay a fee for this.
- **Credit Report Fee:** Although you may see your credit report annually for free, your lender might require that you cover the costs they pay to view and verify your report. This may be in addition to a **loan application fee** you pay your lender.
- **Escrow Fee:** This fee pays for a third, neutral party to handle the funds during final negotiations.
- **Notary Fee:** To get the business documents notarized, you will be asked to pay the fee for a notary.
- **Homeowner's Insurance Fees:** Your lender will most likely require you to purchase homeowner's insurance which may include additional fees.
- **Property taxes:** If the seller has already paid property taxes on the home, you may need to reimburse him or her [source: Motley Fool]. See if you qualify for any property tax exemptions and register for them. Moving costs, although not exactly hidden, are easy to overlook in the stress of homebuying. People become **house poor** when they have spent so much on buying a home that they don't have enough to afford other common expenditures.

And don't forget about the costs of getting a house inspection... you did get a house inspection didn't you? We'll talk about this major mistake next.

Mistake 2: Skipping the Home Inspection

Peter Dazeley/Digital Vision/Getty Images

Getting a professional to inspect a house is the only way to ensure there are no major problems.

We learned in Mistake #4 not to take someone at his or her word until you get a written, signed agreement. Likewise, when you're buying a house for the first time, you can't just depend on asking the seller or real estate agent about problems with the foundation or plumbing. Not only might the seller or agent be less than candid about the answers, but chances are they're not construction experts.

If you skip the step of getting your own professional inspection, you risk living in a home that costs almost as much in repairs as you paid for it in the first place. As much as you're attracted to unique fixtures and structures in old houses, they may turn into a major liability.

So, when you make your offer to the seller, make sure they know that your offer is contingent on your approval of the house passing inspections. Before the inspector gets to work, make sure you agree on what he or she will check. This should include the overall foundation and structural features of the house, plumbing, the presence of mold or

When you're shopping for a house, if you already know you want to resell it later, keep in mind that you're taking a risk. If you've have seen house flipping shows, where nonprofessionals intend to buy, renovate and sell a home, you have an idea about how difficult and unpredictable selling a house can be. Don't bank on the idea that you'll come out ahead.

In the next section, we'll learn whether a realtor's advice is as good as gold.

Mistake 5: Blindly Following Your Realtor's Advice

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Get familiar with the role of a real estate agent to understand what his or her motivations and take their words with a grain of salt.

As we've seen, first-time homebuyers have a lot of confusing matters to deal with. From fixing credit to trying to figure out complex housing market trends, they have a lot on their plate during what is already a stressful financial decision. This is why real estate agents, who try to facilitate the process, appear as godsend to some buyers.

However, this means that confused, trusting homebuyers often forget to consider the motivations and the limits of a real estate agent. First, to understand the role of real estate agents better, let's take a look at different kinds:

- **Seller's Agent:** A seller hires a seller's agent to help him or her sell a home. These kinds of real estate agents are very common, and chances are, if you look into several houses during your search, you will encounter one. As they were hired to help sell the house, take note that they might embellish its positive features and play down the negative aspects of the house.
 - **Buyer's Agent:** As a buyer, you can hire a buyer's agent. Unlike the seller's agent, a buyer's agent's job is not to sell a particular home, but to find you a home you'd be interested in and help you along in the purchase. But finding the appropriate buyer's agent for you is crucial. Interviewing several and finding one with significant experience would probably be wise. Also, avoid signing with a buyer's agent who requires a long-term contract [source: Brodrick].
 - **Dual Agent:** These agents represent both the buyer and the seller in a negotiation. A dual agent can't divulge confidential information about one client to another. However, this type of agent could face a conflict of interest. So you may be better represented in this transaction by an agent who's working just for you.
- So, as you deal with real estate agents, remember whose interests they represent. Although an agent may offer financial advice, take it with a grain of salt and keep in mind that they're not experts in personal finance. Also, a seller's agent may not tell you the true reason why the client is selling the house. He probably won't tell you how low of an offer a seller is willing to accept. Likewise, if you'd rather not buy a home at the highest price, don't tell the seller's agent the most you'd pay for a house.

Just as gullible first-time homebuyers may too willingly follow the advice of a real estate agent, they may also consider a handshake a done deal. Read on to find out how to avoid that pitfall.

Mistake 4: Trusting a Verbal Agreement When Homebuying

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A handshake won't hold up in court if a seller decides to go back on his word, but a signed agreement will. You've jumped through all the hoops -- you did the research, got pre-approved, found the house you want and put in an impressive bid to show you're serious. After some back-and-forth haggling, finally you get the call -- the seller has accepted your bid! You crack open a bottle of bubbly to celebrate all your hard work.

A day later, you rush over to finish off the paperwork only to find when you get there that the seller has backed out. A few hours after the seller agreed to your offer, another buyer swooped in and outbid you. You've fallen for the oldest mistake in the book -- trusting a verbal agreement.

These sorts of double-crosses happen all the time. So, it's always good to secure agreements in writing before you start celebrating and packing up the moving truck. Verbal agreements are not binding, and you will find that you have little legal recourse.

This unwritten rule goes for the real estate agents as well. If you choose to hire a buyer's agent, wait until you have a signed an agreement with the agent as a matter of housekeeping. It should state that the agent will keep your information confidential, so that they won't, for example, go telling the seller how much you're willing to shell out. It

Mistake 7: Not Getting a Preapproved Home Loan

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Getting pre-approved will mean that more sellers will take your interest and especially your bids seriously. It's easy to fall into the trap of thinking you first find the house you want, and then you can start thinking about the loan process, especially if you've already taken care of your credit. However, it's not quite that simple.

It's a good idea to put yourself in a seller's shoes. As a seller, you may be taking in several bids and trying to cipher through and compare them; you may not base it solely on amount. Were you to accept a suspiciously high offer, the buyers may not be able to live up to their bid. Once the buyer actually goes through the loan application process, he may not get as much financing as he hoped, or promised. As the seller, you've already put a lot of time and effort into selling your home, and you'd like to finish things up without too much hassle and delay -- especially before those other, more legitimate-looking bids move on.

For these reasons, sellers prefer bids from prospective buyers who already are pre-qualified or pre-approved for a loan. Some sellers may refuse to consider you at all unless you've got a pre-approval letter from your lender. In addition, some realtors won't even show a property to a buyer without this pre-approval.

To understand what this entails, let's look at the difference between being pre-qualified and pre-approved:

- **Pre-qualified:** Although it's usually free, this process is very unofficial and sometimes unreliable. To become pre-qualified, you simply inform a lender of your own credit status, your income and assets, as well as your existing debt. Based on that information, the lender will give you a ballpark figure of what kind of loan they might offer you. Getting pre-qualified may give you some peace of mind regarding what you can afford. But because it's primarily based on your word alone, it won't mean much to a seller.
- **Pre-approved:** A pre-approval is more reliable and will consequently make you look more impressive to a seller. During the process, the lender actually verifies your financial and credit information. Based on this verified information, your loan officer will give you an idea of how much the bank will loan you. However, don't bet the farm on this figure either -- the lender isn't legally required to live up to it. The terms can depend on you taking up their offer within a specific period of time, or upon an inspection of the home you want to buy [source: Geffner]. Although getting pre-approved may require you to pay a fee, it may make the difference between getting the house you want or not. It can give you an edge ahead of another bidder's offer, which has no pre-approval behind it.

Now that you've done your homework and prepared yourself as an attractive buyer, remember that a house is a long-term investment and takes thinking ahead, which we'll talk about next.

Mistake 6: Not Considering Home Resale Value

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Put yourself in the seller's shoes and consider how easily you'd be able to turn around and sell the house yourself. As a homebuyer, the process of selling a house may not cross your mind yet. After making the difficult decision to buy your first house, you may even feel obligated to live there forever.

However, life is full of unexpected changes. Job transfers, family illnesses, falling in love with someone who lives on the other side of the country -- any of these might call you to pick up and leave your beloved house behind at any time. Or, say you were to fall on hard financial times and your mortgage payments, which seem reasonable now, later become a major liability. If or when the time comes, will your house be easy to sell? And will selling it give you a nice sum to put down on another home?

You're making an investment, so it would be a mistake to ignore these questions. When you are looking at particular houses, it may be a good idea to consider the preferences of other typical homebuyers -- not just your own [source: Greary]. Maybe this means choosing a home that has several bathrooms and a nice big yard even if you have no personal preference about these features. And it helps to know about the loud factory nearby. Although you may be a sound sleeper in the early mornings, your future prospective buyers may not be. It also helps to know if developers plan to improve the neighborhood soon, which may boost the value after you purchase a home.

Using this information about your payment history and accounts, the agencies calculate your credit score and can offer it to interested parties like credit card companies, your prospective employer or even you. When you apply for a credit card or any kind of loan, the lender wants to know if you're likely to make payments consistently and on time. They don't have the means or the time to get to know you personally and talk to your friends to see how responsible you are with money. Instead, they'll make an inquiry into your credit history. If your credit report is less than stellar, they may reject you or tack a steep interest rate onto your loan.

Maybe you think, I can't change my past, so why is looking at my own credit so important before I start house shopping? What you may not realize is that there's a good chance your report has an error on it right now. One study found that about 79 percent of reports contain some wrong information, and as many as 25 percent have seriously damaging errors [source: CNNMoney].

Fortunately, there's a solution. You are entitled to a free credit report every year (at AnnualCreditReport.com). If you find an error, the Federal Trade Commission (FTC) recommends that you contact the credit reporting agencies in writing stating what you dispute [source: FTC]. Try to include copies of documents that support your claim. The agencies address the issue with the creditor institution and must respond within 30 days.

Fixing possible errors isn't the only reason to check your credit reports. Looking at them will give you a better idea about what interest rates to expect and help you budget for them. Remember to check the reports long before you apply for a loan to give yourself time to fix errors and possibly start improving your credit. Take full advantage of your right to see your credit reports once a year.

Next, we'll step back to look at the big picture that too many people forget to consider.

Mistake 8: Not Understanding Housing Market Trends

Even with a clear idea of their own financial status -- what they can afford and how trustworthy they will appear to a lending institution -- many people fail to pay attention to the big picture. If you're anxious to buy now just because of your own financial situation or restrict yourself to a particular location, you may not see the forest for the trees.

The housing market isn't static -- it fluctuates. Sometimes it favors those looking to buy -- a **buyers' market**. Other times it favors those looking to sell -- a **sellers' market**. To understand why these shifts happen, let's look at the contributing factors, like **supply and demand**. Inhabitable or desirable housing can be scarce or in surplus. Low supply increases demand -- and prices -- to favor sellers. On the flip side, when supply is high and there are more houses on the market than buyers, the situation favors buyers. Other factors include interest rates, consumer confidence and the overall condition of the economy [source: Max].

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When there are more homes for sale than buyers, prices typically go down, and this is a smart time to buy. Keeping track of all these factors can be daunting, but you'll find many websites, newspapers and magazines that organize up-to-date information for you. This includes the real estate section of the Wall Street Journal and the National Real Estate Investor magazine, among others. A good indicator of the current housing market is the **Housing Market Index (HMI)**, based on the reports of homebuilders themselves.

Those looking to move from one house to another might have difficulty finding the best time and way to balance a favorable purchase and sell.

For an existing homeowner, juggling buying another home while selling the first -- without taking a loss -- may be challenging. But for first-time homebuyers, the situation is simpler -- wait for the market to shift towards a buyer's market, if you can. But this process comes with its own dangers. For those witnessing housing prices fall, it's tempting to just keep waiting for them to get even lower. Patient buyers will wait and wait until finally, it's too late, and prices rise steeply again. Many warn against this pitfall and recommend that buyers strike when the iron is hot, which can be hard to determine [source: Lewis].

Besides timing, consider how the market changes in your preferred location. Just as housing markets vary with time, they also vary by location. Looking at data about the housing market in your local area might be the best bet in your house hunt. On the other hand, moving to another location may give you significantly better bang for your buck. For the same price you pay for a small house in the city, you can get a bigger house and a large yard a bit farther out.

All this research will give you a leg up in your house search. Being more informed will give you an accurate idea of what things are worth today, and that is invaluable in the negotiations stage.

After they've researched, some people still forget to consider that a home purchase is a two-way street. A buyer looking for an impressive house may forget that he or she must impress the seller, especially during a competitive seller's market. Read on to learn how to do just that.

Mistake 10: Not Budgeting for Your First Home Loan

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Figuring out your budget ahead of time will save you headaches in the future.

Homeownership may seem like a wise alternative to renting, but it's not necessarily going to be cheaper -- at least in the short term. If you're like most people and need to take out a loan to buy a house, you'll have to make monthly mortgage payments. It's a common mistake to assume what you can or can't afford. Before you make this decision, take a good, hard look at your income and expenses to find out the truth about what you can comfortably afford to pay every month for the next 15 or 30 years.

The easiest way to do this is to make a **budget**. This entails listing all your **income**, including wage and investments as well as all of your expenses, from monthly payments to food and even hair cuts. To figure out how much you can afford per month on something like a mortgage, it's a good idea to measure your budget in what you make and spend in the time span of a month. But just a month of income and expenses will only be a snapshot of your financial picture. Also look at a few months of your financial activity to consider non-monthly expenses like vacations, wedding and birthday gifts.

After you've gathered this information, study it to discover some financial habits you may not have considered before. Am I spending too much on lattes? This may open your eyes to where you are wasting money. As a result, you may decide to save more before purchasing the house of your dreams. Of course, never underestimate the power of habit, and only make realistic expectations about yourself and your ability to cut down on certain expenses.

It may be helpful to include with your budget a list of what you need and want in a house -- from the number of bedrooms to the ideal location. Put these in the order of priority, so you have an organized list to use later on. This step, plus the analysis outlined in Mistake No. 8, will help you set a price range within your means.

Creating a budget may seem like a tiresome chore or even downright drudgery. But one way to make it fun is to treat it like a game or a mystery that you must solve to find out where your money disappears [source: Barlow].

Some people skip budgeting altogether and just use their current monthly rent payments as a gauge to determine how much they can afford on monthly mortgage payments. However, this could be misleading for a few reasons. First, this simplification would neglect the fact that part of your rent payment includes maintenance costs. Those things that are your landlord's responsibility now, like paying for the repair of a broken dishwasher, will be your financial responsibility when you own a house, and have nothing to do with your mortgage payments [source: Barlow]. Secondly, if you can afford to pay more, you should take the work to find out -- otherwise you may pass up your dream house because you don't realize you can afford it.

Also, when you're finding out what you can afford, keep in mind that emergency expenses pop up occasionally -- like a costly surgery for your family dog or the loss of your job.

Next, we'll talk about another little chore that could save you a lot of money and headache if you address it early.

Mistake 9: Not Performing a Credit Check Before Homebuying

So you thought you did away with grades and competitive scoring when you finished school? Turns out, a three-digit summary of your creditworthiness may be the obstacle or the key to your perfect home. Despite your present sense of financial responsibility, if you have a dark past of not always paying bills on time, it could mean you're going to have a very hard time securing a good loan during your house hunt.

Your **credit score** is a number between 300 and 850 that is meant to represent how credit-worthy you are. Credit reporting agencies calculate this number based on your **credit report**. This report shows not only how consistently you've made payments in the past, but what kind of accounts you've opened and how long you've had them. And this information, of course, is of particular interest to the companies who are considering granting you a loan now. The companies that you pay regular bills to, like utility and credit card companies, tell **credit reporting agencies** -- like Experian, Equifax and TransUnion -- about their financial dealings with you.

Martin Poole/Digital Vision/Getty Images

Protecting your credit means more than shielding your information, but also actively making sure your potential lenders are seeing the right facts.