5 steps to help you prepare for buying a house

Before you even start your home search, you'll need to get a few things in order

by Romana King
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This November will be the 5th anniversary of Financial Literacy Month (FLM). It's a month-long awareness campaign to promote the importance of making informed financial decisions and developing healthy financial habits—decisions and habits that can make or break your desire to become a homeowner. So, before you even start your Multiple Listing Service search, you'll need to get prepared. To help you, here's a five step process that can support your decision in buying a house.

Step 1: Start saving

It seems obvious but you really have to start somewhere and the best place to start when you plan on purchasing such a large asset is by saving your own money. And saving up for a down payment doesn't mean cramming cash under your mattress.

You can use RRSP money you've already saved by utilizing the federal Home Buyers' Plan. (For information on how this works, go here.) You can also hit up family for a loan or cash gift or you can develop a work strategy that would help you earn some extra income and boost your savings.

Step 2: Build strong credit

When it comes to borrowing money, just remember: Credit is king. And your credit is measured using your credit score—a historical tally of how responsible you've been as a credit consumer.

The key to a strong credit score is to be consistent about paying your bills. This doesn't mean letting one bill become overdue as you pay another bill off. "The key to a good credit score is to make payments as agreed," explains Regina-based CFP and Money Coach, Bruce Thompson. That means a minimum monthly payment for most credit cards and personal loans. "Some people make the mistake of holding off making a payment and then pay-off the total in a lump-sum," says Thompson, "but that actually doesn't help your credit score. It hurts it because late payments are a black mark against your credit rating."

Since a low score can actually prevent you from buying a home (because you won't qualify for an affordable mortgage rate) you'll need to concentrate on building and maintaining a strong credit score.

If you're starting from scratch, consider applying for a pre-paid credit card. Then use it and pay it off each month. The key is not to max out the card, but to consistently use and pay off the balance. When you've got a strong enough credit score, apply for a credit card. "Two cards with limits of $2,500 will very quickly help you build a strong credit score," says Thompson, "as long as you use and pay off the minimum balance each month."

Step 3: Know your credit score

Now that you're building up your credit, you'll want to confirm that the report lenders will examine is accurate. In Canada, there are two companies that collect and distribute credit reports: Transunion and Equifax. Both allow you to access your credit report for free, but you can only request this report once per year and the request has to be made in writing. (For the Equifax request form, go here. For the Transunion request form, go here. Keep in mind Transunion also distributes this free report if you visit one of their offices in person or call.)

Once you get your free report in the mail, give it a quick scan. All loans, credit cards and payments should be listed—and you need to make sure the information is accurate. If it's not you'll need to file a dispute with the credit rating agency. (For Equifax, go here. For Transunion, go here.)

Everyone should check their report for accuracy and fix any mistakes at least once per year, especially since it can take months to correct errors.

Step 4: Reduce debt

While you might be focused on increasing your savings, you should remember to reduce your debt. Lenders want to see that you're managing your debt and keeping your credit card balances low. In fact, mortgage lenders will use debt ratios to determine whether or not you qualify for a mortgage. These ratios compare minimum monthly payments on all debt to gross monthly income.

In Canada, if your debt-to-income ratio is over a certain threshold (for some ratios it's 32% and for some it's 40%), you won't qualify for a standard mortgage. In this case, you'll need to pay off your debt before you can even think of buying a home. (For more on how debt ratios are used, go here.)

Step 5: Learn a new language

If you've read this far and you're still in the market to buy a home, the next step is to learn the language of home buying. For instance, learn the difference between a variable and fixed-rate mortgage, so you can opt for the loan that bests suits your needs. Learn the difference between a mortgage term and the amortization, and get educated on how mortgage default insurance works. By educating yourself you'll be in a much better position to make smart home buying decisions.