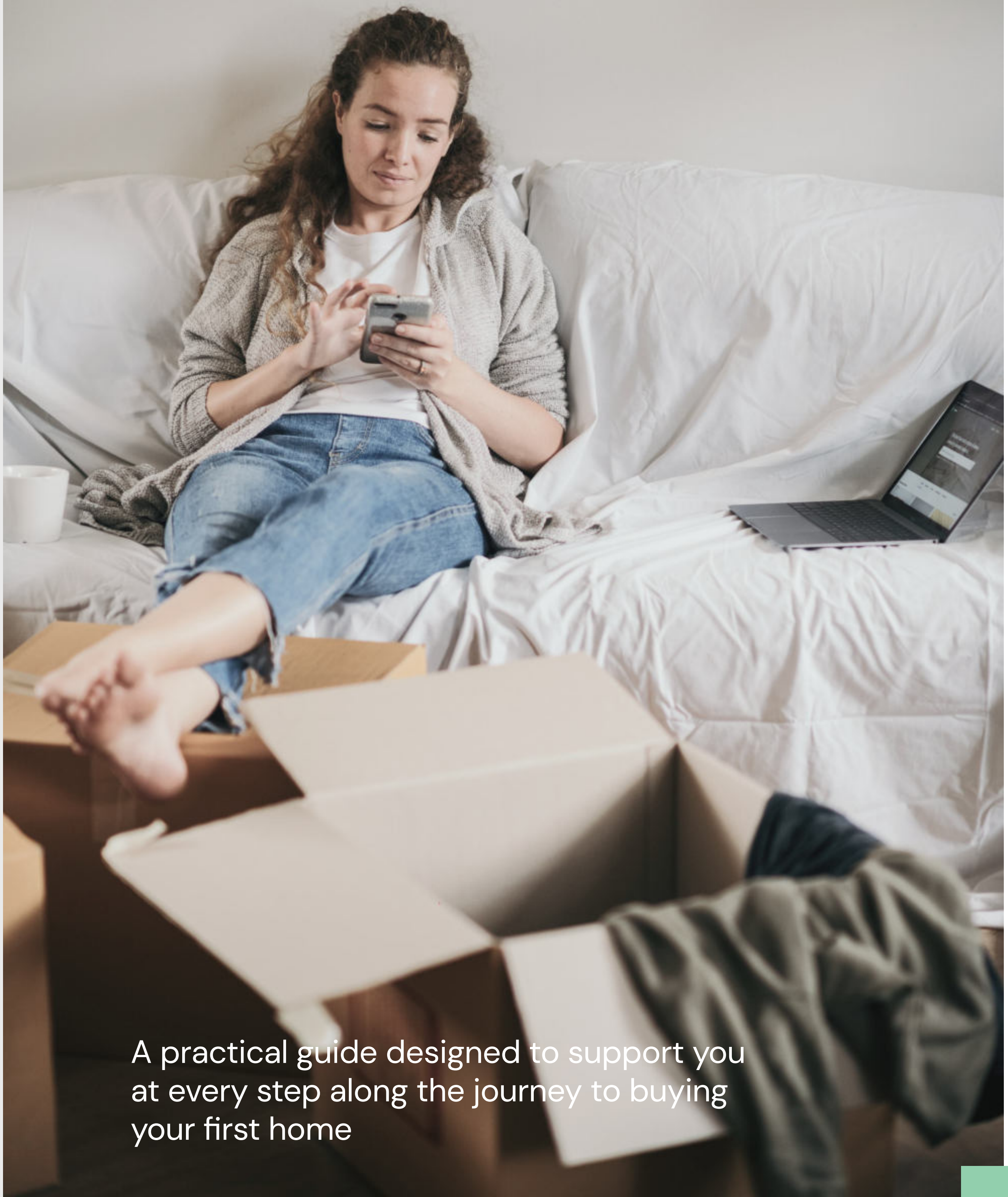
First Time Buyers: Part 1 - Preparing your Finances



A practical guide designed to support you at every step along the journey to buying your first home

wr ethical.

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Remember, your home may be repossessed if you do not keep up repayments on your mortgage.

Welcome

Welcome to the opening guide in our First Time Buyer's series – Preparing Your Finances. We're starting this series here because it is arguably the most fundamental part of the journey to buying your first home. As the guide will explain, it is also the stage which can potentially take the most time.

We all have different life experiences which bring us to the point of being ready to buy a home. If you are reading this guide, then you may have reached this point, or at least think you are getting close.

This guide will help you to assess your financial health and tackle your credit score, provide practical information on saving a deposit and finally plan for your future costs in your new home.

Like any great journey, being successful on the path to buying your first home needs careful planning. Before you set off on this journey you need to prepare your resources – in this case that largely means your finances.

We'll help you to understand how to put your best foot forward when it comes to reviewing your finances, ready for others to take a look and see if they are prepared to trust you with their money – the credit check. We'll offer some practical guidance on budgeting for your new life once you are into your first home.

In each of the guides in this First Time Buyer's series you'll find the advice laid out step by step to read through and begin to tackle in a logical order. We've offered examples of how much time you might want to allocate to each stage of the process, but individual circumstances vary tremendously, so feel free to work at your own pace.

1. Assessing your financial health

Start 12 months before you aim to move in to your new home and allow yourself three - four weeks to complete this step. In an ideal world, we would recommend that you start this a year before you aim to move in (although six months before is still do-able).

Assessing your financial health

To effectively assess your financial health you're going to want to start by bringing together information about your income(s), current expenses, savings and debts into one place; a spreadsheet, an app, a whiteboard or even on paper - whatever you are most comfortable with. We suggest looking at 6-12 months of expenses to get a true picture of what your normal spending patterns look like.

If you are already renting, and are saving for a deposit, you may have a pretty good idea of this already, but it is still a useful exercise. Buying your own place will change the way you spend money, and it's not simply a case of swapping rent payments for mortgage payments.

Ensure to collect the complete information from anyone who will be part of the mortgage application - this might be just you or perhaps you and your partner. This wouldn't include anyone giving you money to boost your deposit. If it's a joint application then completing this exercise together is a great way to put you on the same page about the journey and ensures that you are both equally committed. It can also be a great opportunity to have an honest conversation about any 'skeletons in your closet' about old debts or ongoing expenses which need to be addressed.

Once you have gathered the information, you need to 'model' your budget. This may sound scary but in reality is really simple, you can think about this as lining up your total income vs your expenses on a monthly basis. The outcome of that battle determines your balance, which is the amount of money available to save, or to repay expensive debts.

Top Tip: Don't forget to make allowances for months where you know that your income may be higher (or lower), or where your expenses are going to be higher. For example, Christmas, birthdays or summer holidays can be a time of increased costs.

Two strategies to handle this are; to set a small amount of your balance aside each month to save for these occasions, or, to write a plan which does not aim to save money in those specific months.

Generally speaking it makes sense to pay off debts which have high interest rates before you start saving. We recommend seeking specialist advice on this matter but offer the below as general guidance:

- Organise and prioritise debts based on interest rates and minimum payments
- Create a repayment plan to reduce debts systematically, overpaying as much as you are permitted to do without incurring penalties
- Lenders place more emphasis on 'revolving credit' such as overdrafts and credit / store cards than longer term agreements such as car or furniture finance, so clear these first
- Loans that will be cleared by your completion date will generally be ignored by lenders for assessing affordability
- If your debts are large, or you feel like they are unmanageable, it is worth getting some outside help. There are several excellent debt advice charities out there, including CAP UK (one of the charities we support) & StepChange. The government website provides a broad list of free debt advice providers

- Student loans are treated differently, so whilst they will have a small impact on your mortgage affordability, in general you don't need to worry about paying these off
- If you are easily able to manage your credit commitments, but have a relatively small deposit, there may be circumstances where it makes more sense to prioritise building that deposit - talk to a mortgage advisor if you think this may apply to you

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The final step in assessing your financial health is to identify areas where you can potentially save money. We're not foolish enough to preach about miraculously saving a deposit by not ordering a coffee or buying avocados. However we do encourage you to consider reviewing what you spend day-to-day, as well as unnecessary expenses, including subscriptions which can be reduced and noting when you splurge (making unplanned expenditure).

If you can reduce your monthly outgoings for a period of 6-12 months the savings can really start to stack up. Try to keep this part of the project realistic, it's no good planning to live on a meagre amount of money which will make you miserable and lead to arguments, ultimately scuppering your plans before you achieve your savings goals.

The WR Ethical Viewpoint

Reviewing your finances can also be a great time to think about the environmental impact you are having personally - often these two can go together. For example, deciding to cook at home more, and order less takeaways should save you money and be good for the environment. As would taking holidays closer to home, or cycling more and driving less (if that's an option for you). And while you are looking at your subscriptions, you may want to consider changing your energy tariff to a 100% renewable one, and whether you could be regularly supporting charities close to your heart.

2. Grab £1000 from the government

This section should be tackled 12 months before you aim to move in. Allow yourself approximately one week to complete this task

Government top-ups while you save

The government has several schemes designed to help first-time buyers on to the property ladder. It will be useful to fully research and understand each of these schemes as part of your longer term preparation for buying a property - and we cover them all later in the series. However, there's one in particular which you need to start thinking about very early in the process as it is focused on helping you to save for your deposit. The scheme is called a Lifetime ISA (LISA) and it is designed to help UK residents when they are buying their first home or retiring.

What is a LISA and how can it help you?

A LISA is a type of savings account that can be opened by people aged 18-39 who are saving for their first home (or retirement). Saving into a Lifetime ISA can give your money a boost because the government adds to your savings - and protects your interest earnings from taxation. As great as this is, there are also some strict rules around withdrawing your money that you need to know about too. Details can be found at https://www.gov.uk/lifetime-isa.

- You can open a LISA if you're aged 18 to 39, and save up to £4,000 tax-free each year, up to and including the day before your 50th birthday
- The government pays a 25% bonus on top of your contributions up to a maximum of £1,000 a year
- Your £4,000 Lifetime ISA allowance forms part of your overall £20,000 annual ISA allowance
- You can withdraw from your LISA a minimum of 12 months after your first payment in
- There is a maximum property price (£450,000 at time of writing)
- When you're ready to buy you need to ask your LISA provider to transfer the money directly to your conveyancer / solicitor
- A LISA can be used in conjunction with other Government schemes aimed at supporting first time buyers

Top Tip - If you expect to buy your first home within 12 months then this scheme may not be the best option for you. If it is likely to be more than 12 months before you buy but you are not yet ready to start saving you should consider opening your LISA account with £1 now to start the clock ticking.

3. Saving for a deposit

Start as soon as possible and allow as long as is needed to reach your planned goal.

Saving for a deposit

So you've worked out how much money you can save each month, reviewed your debts and current savings, and now need to get ready for the practical steps of saving for your deposit.

There are many ways to save money and you should settle on a method that works for you and your personal circumstances. With that said, there are certain habits that we observe in those who are successful in reaching their savings goals. We've outlined these below for you:

- Set a clear savings goal and create a plan to save regularly. Try to celebrate your progress towards your target as you hit mini milestones. It can be incredibly rewarding to see your total climbing and will keep you motivated.
- Consider automating monthly deposits into a dedicated savings account - doing this at the start of the month rather than at the end is a really great way to be disciplined about prioritising your savings.
- Review where the money you are saving is going to live. Research savings accounts and investment opportunities which reflect your attitude to risk vs reward plus ensure you have access to the money when you need it. Earning a good level of interest on your money is particularly important in a period of high inflation.

- Working out where to put your money isn't necessarily straightforward.
    - For cash, then look at interest rates, and also consider tax - this is where an ISA can help. Often these savings accounts are run by the same people that offer mortgages - so we can advise on their ethics, by using data from Ethical Consumer.
    - If you are looking at investing in a fund or portfolio, then there are a range of online guides that recommend ethical investment funds and platforms (again, these are rated by Ethical Consumer).
    - If you are looking at saving over £150/month, or £20,000 total, or for a period of more than 5 years, then it will often make sense to get tailored advice from a qualified financial advisor - we've got in-house specialists who can work with you on that.

As you progress from planning to actually saving, you may find that the reality month to month turns out to be a little different. That's perfectly okay as long as you are not overspending unnecessarily and are willing to realign the timeline for when you will reach your target deposit.

Getting to know your Loan to Value (LTV) Ratio

When thinking about how much deposit you will need, it's important to understand something called the loan to value ratio (LTV) which is usually expressed as a percentage. While it may initially appear complicated, you'll quickly become familiar with the concept. LTV is an important number to be aware of as it directly impacts the type of property you can buy and mortgage interest rate which you will pay.

It's a way of comparing the amount of money you want to borrow (the mortgage amount) against the value of the property you want to buy. Let's look at an example:

- You want to buy a £200k property and have a £20k deposit
- You will require a mortgage (loan) of £180k (£200k - £20k)
- £180k (loan) is divided by £200k (property value)
- In this scenario the answer would be 0.9, which expressed as a percentage means an LTV of 90%

As a general rule of thumb, if you have a smaller deposit, you are borrowing more of the property's value from the lender, resulting in a higher LTV. A higher LTV means higher risk to the lender. This is because if you can't make your repayments, they may have to sell the property and cover their costs. So, lenders will place limits on what their maximum LTV is for different property types, and will charge a higher interest rate for a higher LTV (meaning your monthly repayments will be higher).

In the previous example, if you were able to save an additional £10k towards your deposit, the amount you would need to borrow will decrease to £170k. The LTV would then decrease to 85% of the £200k property value. The interest charged on the resulting monthly payments would likely be lower than were your deposit £20k.

A few examples may help with this:

- There are 100% LTV mortgages available (i.e. no deposit), but not many lenders offer them.
- 5% deposit mortgages generally charge around 0.5% higher interest than 10% deposit mortgages.
- Whilst many lenders offer a 5% deposit mortgage for a house, not nearly as many do if you are buying a flat.
- Quite a few lenders want you to have a bigger deposit if you are buying a new build property, a recently refurbished property or an ex local authority property.

Other costs to factor into your savings

As a final thought on planning your savings, don't forget to make allowances for various other costs you will encounter either before or as you move in to your new property:

- Furniture & appliances
- Allowance for repairs and maintenance - whether a fresh lick of paint on day 1, a broken boiler 6 months in, or a new kitchen.
- Moving costs; solicitors; removals; surveys; mortgage product fees and stamp duty (which may be £0, depending on the value of your home).

This topic is examined in detail later in the series, however when setting out your savings budget it is important to be aware of and plan for them as they can be significant.

4. Talk to friends & family

This should be done ongoing throughout your home buying journey (obviously) but can be particularly useful once you have firm plans for your finances

The home-buying journey can seem like a long and daunting one, and will certainly have highs and lows - some that are foreseeable, some totally unexpected. Thankfully though, it is a well trodden path, and you will almost certainly know others who have already been down it.

Talk to them about their experiences, get their tips and tricks, and share how you are feeling. One of the most remarkable things about helping lots of people find their first place is seeing how families and friends come together to help, when there is a goal in mind. Whether it is financial, emotional or practical support that is offered, having others along for the ride will make things easier for you.

Perhaps recognising the importance of the journey, and getting it right, the Financial Conduct Authority classes all first time buyers as 'Vulnerable'. You may or may not feel this applies to you, but it's worth stopping to reflect that the authority whose job it is to make sure that the mortgage process works well thinks you are!

So, don't be afraid to; ask for help, feel out of your depth, or share your experiences.

5. Getting to grips with your credit score

Initial checks should be started approximately nine months before you aim to move into your new home. Depending on your score, you may need to work on this for a few months to make improvements.

Tackling Your Credit Score

Up to this point we have been focused on your own internal view of your finances however we will now turn to the external perspective, namely your credit score.

Credit scoring is a system used to assess your likelihood to repay by companies who offer you any kind of credit; phone, car, house, credit card, loan etc. There are three major agencies who operate credit scoring in the UK, but whichever of these systems a lender uses, they are broadly looking at the same information about you and your financial history.

Your credit report covers financial information such as how much you borrowed, whether you have repaid on time, current balances etc. In addition a credit report will include information about your address history, your phone & utility bills and the number of applications you have recently made for credit, or if you have ever been declared bankrupt.

Before lending you thousands of pounds, a lender wants to have a good idea about whether you are the sort of person who is going to pay it back - looking at your credit history allows them to assess this.

Tackling your credit history early in the process of buying a home is really important as it will have a significant impact on; which lenders will offer you a mortgage, the amount they will lend and possibly the rate of interest charged.

With this in mind, in order to maximise your mortgage opportunity, there are a couple of actionable steps you should take at least nine months before applying for your mortgage.

First, obtain a copy of your credit report from all three of the main credit reference agencies (it is rare they all hold the same information). The easiest way to do this is to use checkmyfile

Upon receipt of your report you need to carefully review it, looking for errors or discrepancies. Should you have any questions or concerns, you can contact the agency directly to review or appeal. Do this early in the process as it will take time to investigate and update your credit report, if anything untoward is found.

Explaining what is ‘good’, ‘bad’ and in-between is beyond the scope of this guide, but we are always happy to go through a report with you. Do bear in mind that lenders rarely go off the number - they have their own criteria and calculations, which are different from what you will get from the credit reference agency.

Once you are satisfied that your credit report is accurate then you may need to consider steps to improving your score. If you think you need to make improvements, then do check with a mortgage adviser to understand your options – things are frequently not as bad as they first appear. If you do need to improve your score, it can take time, but it is a totally trackable activity. It can be very rewarding to see your monthly improvements. Here are some fundamentals to implement:

1. Always pay your bills on time
2. Ensure you're on the electoral roll where you actually live, and your bank has this address too.
3. Reduce existing debts to improve your credit utilisation ratio - lenders don’t like to see someone who is using up every penny of their available credit
4. Don’t make credit applications in the run up to applying for your mortgage
5. Stay out of your overdraft (even if it is authorised, or interest free).
6. If you are worried about your score, and it needs to improve, then it can be helpful to monitor it regularly to track improvements. You can usually do this for free with a credit reference agency directly.

6. Future costs planning

This section of the guides is best tackled when you are about three months out from completion (although you're welcome to read it sooner!) You should allow two - four weeks to complete this task.

Planning for costs in your new home

Planning your finances to enable you to buy your first home is not the end of the line when it comes to thinking about your monthly expenditure.

There are lots of ongoing costs which you will need to plan for when you move into your new home. While some are straightforward such as utility bills, tv and broadband, there are plenty which you may not have encountered before if you are renting or living at home with your parents:

- Council Tax - varies by area and property value so make sure you get the figures from the estate agent or local authority early in the process
- Life Insurance / Critical Illness / Unemployment Cover - consider what support you will need to keep you all in your new home should the worst happen
- Maintenance budget / costs - set aside budget to cover costs of the upkeep of your new home
- Service Charge - mostly applicable in flats with common areas although some new build estates do include them. Be aware as they can be a significant cost
- Ground Rent - this is usually a relatively small amount paid annually if you are buying a leasehold property
- Buildings Insurance - your mortgage will stipulate that you must have this in place to cover the cost of significant damage to your property
- Contents Insurance - to cover you against losses related to the items within your home (furniture, decor, your expensive items)

It is worth knowing that not all of these bills will happen monthly; some will be quarterly, bi-annually, annually or even 10 out of 12 months in the case of council tax.

To avoid being caught unaware by a sudden large bill, you can budget for these bills to smooth out the payment cycles. To do this, work out what the total cost for a year is and pay 1/12th of it into a dedicated account or ‘pot’ each month.

Conclusion

You're on your way to financial control

Getting your finances ready to move home is a significant undertaking and navigating the journey successfully shows that you are indeed ready to become a homeowner.

This guide couldn't possibly cover every circumstance but instead should provide you with a structured approach that you can refer back to from time to time.

The team at WR Ethical are committed to supporting as many first time buyers into their home as we possibly can. This means that whichever stage of your journey you are at then we would love to hear from you. Even if you feel that buying a home is still a long way off, our expertise in this area means we will be able to help you to reach your goal.

When you're ready then the next guide in our First Time Buyer's series is waiting for you - Getting a Mortgage