

Chapter

1

The Dream of Owning a Home

In This Chapter

- ◆ Discovering the many advantages of owning a home
- ◆ Understanding the drawbacks of owning a home
- ◆ Learning who the real estate people are
- ◆ Reviewing the buying and selling process

Owning a home is still as enticing as it ever was, but is it right for everyone? Is it right for you? Is it right at this time? Factors such as interest rates, your job situation, and your family life, among others, can influence your decision. In fact, you may, after reviewing the information in this chapter, decide buying isn't right at this time. This chapter helps you make that decision by explaining the advantages and disadvantages of buying a home.

On the other hand, if you do decide you are ready to be a homeowner, this chapter provides you with an overview of the home-buying process so that you know what to expect. In addition, you learn about the people you will work with if you do pursue a home purchase. Let's get started!

4 Part I: Getting Started

The Great Things About Owning a Home

The first—and best—advantages of owning a home are intangible—the control and autonomy that ownership affords you and the sense of pride in that ownership. There’s just something special about owning your own place. In addition, homeownership offers many financial and commonsense advantages.

For example, Uncle Sam encourages homeownership by offering a big tax break when you own your own home. You can deduct some, if not all, of the interest you pay on the loan, as well as some of the costs involved in financing your home. Your property taxes are also deductible. On a modest home, you may be able to deduct 8,000 dollars or more per year. That’s *thousands* of dollars of tax savings, depending on your tax bracket.

As another example, if you rent an apartment or home, you don’t have much control over the rent. Landlords can raise the rent—sometimes as much as they want. As a homeowner, on the other hand, you have the advantage of fixed housing costs. If you pay 800 dollars the first month of a 30-year fixed mortgage, you’ll pay 800 dollars the last month, for principal and interest. (If you get an adjustable-rate mortgage, however, the payments may vary somewhat. The types of financing are covered in Part 3 of this book.)

Bet You Didn’t Know

You can paint all the rooms in your home chartreuse and knock out walls to remodel if you want. It’s your home, and you can do anything, right? Well, almost. Keep in mind that many communities require you to secure a building permit for substantial structural changes to your home. In addition, you might have to get “permission” from your neighborhood homeowners association to make improvements or add particular items to the outside of your home. If you are thinking about doing some remodeling to a home you plan to purchase, be sure to ask about any restrictions or covenants before you sign on the dotted line.

Building Your Home Equity

Homeownership also adds the advantage of enforced savings. Unlike a rent payment, which goes bye-bye after you pay it, some of the money you pay on your home goes toward building up your *equity*. You can take out a loan against your equity, and you can get back the equity when you sell your home.

Chapter 1: The Dream of Owning a Home 5

Suppose you sell your home for 150,000 dollars, the real estate agent's fees (around 6 percent in this example, but note that this percentage varies by area) come to 9,000 dollars, and you still have 130,000 dollars left to pay on the principal payment to the mortgage company. This means that you will probably receive a check for 11,000 dollars for the sale of your home ($\$150,000 - \$9,000 - \$130,000 = \$11,000$), minus any selling costs you incur.



Real Estate Terms

Equity is the financial interest or cash value of your home, minus the current loan balance, minus any costs incurred in selling the home.

Equity is based on the percentage of the home you own. Usually, when you first purchase a home, the bank owns most of it, because you only had a small percentage to put toward the down payment. When you start making payments, most of the payment goes toward the interest on the loan (of course, the mortgage company gets its money first), but a drop or two goes into the equity bucket.

As you pay off more of the loan, more money goes toward the principal (paying off the amount you loan). When you sell your home, your payout (not considering expenses) looks like this:

Price You Sell the Home

What You Owe on the Home

Your Profit

You can see that the less you owe on the house, the more profit you receive.

The type of loan you select (covered later in this book) and your payments enable you to control how quickly your equity builds up. For example, you can usually pay your house payment plus an additional amount. The additional payment amount should go straight toward the principal, depending on your loan type.

Bet You Didn't Know

If you make the payments for 30 years on a home with a 30-year mortgage, you will likely pay two to three times the original amount you borrowed to purchase your home (depending on your interest rate). That's simply part and parcel of the loan process. When you apply for a loan, the lender will provide an approximation of the amount of the loan over its term (for instance, 30 years). It can be scary to think about. But real estate is usually a good investment, and your home most likely will have appreciated (gone up in value) considerably over those 30 years.

6 Part I: Getting Started

Considering Your Home as an Investment

Most homes appreciate—or increase in value—over time. That is, your home is likely to be worth more when you sell it than when you purchase it. Home prices have been soaring because of record low interest rates. For instance, a recent *Time* magazine article found that the median U.S. home price (206,000 dollars) had jumped 15 percent over the past year and 55 percent over the last five years. Also, because of availability (or lack of), some home markets are especially “hot.” *Time* cited some of the hottest markets and the relevant rise in home prices in that market:

City	Price Increase
Los Angeles	135%
San Diego	132%
Las Vegas	117%
Miami	128%
Washington	108%

On the flip side, prices have lagged (yet still risen) in these markets: Utah (6 percent), Tennessee (5.5 percent), Nebraska (5.4 percent), Mississippi (4.9 percent), and Indiana (4.1 percent).

You can use the money you make on the sale of your home to finance a bigger and better home or to finance your retirement. Some people invest in homes and then resell them quickly to make money. This process, called *flipping*, is similar to ticket scalping. The Learning Channel (TLC), for instance, has a new show (*Property Ladder*) that focuses on purchasing a home, fixing it up, and then reselling it.



Real Estate Terms

When someone purchases a house with plans to make improvements and then quickly sell the house (hopefully at a profit), this is known as **flipping**.

Keep in mind that not all homes appreciate in value. If you are mainly interested in the investment value of a home, note the risks involved. To finance homes at higher prices, some buyers use riskier mortgages. Homeowners also take out loans against their equity and spend this money on a variety of necessities and

luxuries. (Chapter 15 talks about home equity loans as well as refinancing.) By cashing out their equity, homeowners take on more debt. If interest rates rise or the market declines (prices drop), the home is at risk for *foreclosure* if the homeowners cannot

Chapter 1: The Dream of Owning a Home 7

make payments. Also, markets don't continue to rise forever. Like investing in the stock market, home prices can peak and decline. Some experts think the home market is a bubble waiting to pop. Just keep these factors in mind if you are purchasing a home solely or mostly for the investment value.



Real Estate Terms

When someone fails to make payments on a home, the mortgage company may force payment by seizing and selling the property. This proceeding is known as **foreclosure**. If this happens to you, it can very seriously affect your credit rating (in a bad way).

The Flipside: Some of the Drawbacks of Owning a Home

When the roof is leaking, your mortgage payment is late, and your new neighbors' 90-pound German shepherd howls at the moon every night, you may realize that the advantages associated with owning a home come with some drawbacks.

One big downside of buying a home is that you must make the monthly mortgage payments. If you don't make your payments or are unable to make your payments, the lender can foreclose on the home, basically taking your home away.

Homeownership requires responsibility and commitment; you can't pull up stakes and leave as easily if you own a home. If you're a renter, you can give your notice and take off. You don't have any financial responsibilities to the landlord after you leave. When you have a home, on the other hand, you have commitments you must settle before moving on. For instance, you have to sell the home, and this might take longer than you expect.

Paying Bills

In addition to the actual loan, you will have to pay property taxes, homeowners insurance, and possibly even mortgage insurance fees; mortgage insurance fees are required depending on how much money you put down for your down payment amount. (Refer to Chapter 12 for more information on mortgage insurance.)

8 Part I: Getting Started

And the list continues. As a homeowner (versus a renter), you'll also have to pay for the following:

- ◆ All the utility bills, including power, gas, phone, water, sewage, cable TV, and so on.
- ◆ Maintenance and upkeep on the home and property. For instance, as a homeowner, you are responsible for fixing the leaky roof, mowing the grass, painting the garage, spraying for insects, and so on.
- ◆ Homeowner's association fees. Many new homes, condominiums, co-ops, and townhouses have association fees you must pay in order to live in a particular area.

When Buying a Home Might Not Be Right

In some cases, buying a home isn't the best idea. The following are some scenarios of when you are probably better off not buying.

- ◆ **You know you're going to keep the home for only a short time.** For instance, if you may be transferred to a new job or get married and move within a year, you may want to consider renting rather than buying. When you haven't owned a home for very long, it's difficult to break even, let alone make a profit, when you sell it. You don't have much equity built up, plus you have all the costs of selling the home to consider. So be sure you are going to stay put at least long enough to break even when you sell.
- ◆ **You aren't sure that you're going to like the area where you're considering a purchase.** Do your homework first. Don't just jump in and buy a home because it's, say, close to where you work. Try visiting the local supermarket or taking your kids to the neighborhood park—anything that will allow you to get to know some of the neighbors and get a “feel” for the area. This is especially true if you are moving to a new city. You may want to rent first to get a good sense of the lifestyles of the various neighborhoods. And then buy when you can make a more informed decision.
- ◆ **You cannot count on a steady income to make your payments.** The lender may not approve you for a loan. If you're approved and you cannot make the payments, the lender may foreclose. You will lose all the money you have invested, and your credit rating will be severely tarnished. If you have an unsteady income, you may want to wait until you're sure you can make the long-term financial commitment of buying a home.

Chapter 1: The Dream of Owning a Home 9

- ◆ **You don't have the money for a down payment.** The rest of the chapters in this part cover the costs of purchasing a home, and although there are a lot of workarounds for coming up with a down payment, you probably should seriously consider whether you can still make the house payments on a home even if you do find a way to handle the down payment. This book gives a good overview of where you need to be financially. Don't despair if you don't have a big wad of cash; homeownership is possible. Simply keep in mind that not just the down payment, but also consistent monthly payments are required for homeownership.



Buyer Beware

You can find programs for no down payment or low down payments, but you most likely pay a premium for this type of loan agreement. If you do look into no or low down payment options, be sure to understand the costs associated with them. It might be worth it to wait and start a savings program for a down payment.

- ◆ **You're buying a home to live in solely as an investment.** As mentioned, you should be aware that, although most homes do appreciate in value, appreciation is not guaranteed. Many things that you have no control over affect the value of your home—local economy, national economy, abandoned buildings or new businesses in the neighborhood, a landfill, or even tacky neighbors who paint their homes chartreuse.
- ◆ **Interest rates are high.** Although interest rates have been at all-time lows, they have started to rise. If rates rise significantly, you may want to wait for a more favorable loan market before buying. If you do buy a home at a high interest rate, when rates drop, consider refinancing (more on this in Chapter 2).
- ◆ **Home prices are high or you are living in a particularly hot market.** As mentioned previously in this chapter, prices have risen dramatically in some markets. If you live in a particularly pricey market, it may make more sense to rent. Renting is usually cheap comparably in high-priced or hot home markets.
- ◆ **Your family situation is unstable.** For instance, if you think you might be getting divorced or other family issues may cause financial strain, consider waiting.

Don't let the drawbacks get you down, though. Homeownership is quite satisfying and a great learning experience.

10 Part I: Getting Started

General Advice, Players, and the Process for Home Buying and Selling

You'll find that you have a lot to learn about real estate and owning a home. To start, let's take a look at some general guiding principles that are handy to keep in mind as you make your way through the whole home-buying process. Also, consider who you'll meet along the way (and who will hopefully help you!) Finally, consider a quick overview of the whole process of buying as well as selling a home.

Some General Home-Buying Principles

Home buying can be overwhelming. Here are some things to expect as you make your way from dream to reality:



Real Deal

You can learn a lot from this book about buying and selling a home, but remember also to ask friends and colleagues about their experiences. And when dealing with agents and homeowners, don't be afraid to ask them about everything.

- ◆ **Everything will vary.** You'll find that there aren't many tried, true, and trusted facts about the home-buying and home-selling process. Every home buyer and home seller's experience varies wildly. One person may sell his home in the first week it is on the market; it may take another person six months. One person may feel an adjustable mortgage is the only way to finance. Another person may say it's insane to gamble like that and insist on a fixed-rate mortgage. Everything varies according to your situation and what you want.
- ◆ **Everything will change.** Laws about what tax benefits you get, laws about what the seller must tell you, and real estate practices can change at any time.
- ◆ **There is no perfect time to buy.** Some buyers get caught in the "I'll wait until I can afford my dream home" trap. These buyers wait and wait until they think the market is perfect, they find the home they've always wanted, or they can afford the home they've always wanted. Unless you have a compelling reason to wait, you shouldn't. The perfect market, perfect home, or perfect price may not come along. Buy what you can afford and then trade up. Or buy something close to what you want and remodel.

Chapter 1: The Dream of Owning a Home 11

- ◆ **Almost everything is negotiable.** From the price you pay for the home to the date you can move in, negotiate, negotiate, negotiate. When you make an offer, you can and should ask for the moon if that's what you want. This book provides many tips and ideas on how to negotiate the best deal.

Bet You Didn't Know

Keep your eyes and ears open for changes in interest rates. Factors like how well the stock market is doing, what the unemployment rate is, the price of gas and fuels, and other business and economic issues affect the interest rates (like the Federal Reserve altering interest rates). You can get more information about the current financial market by reading publications like the *Wall Street Journal*. You can also try numerous websites. Check out www.bankrate.com for up-to-date information on all things financial.

- ◆ **Negotiate to win-win.** Many people think that a successful deal happens only when they impose their will on another and get their way entirely (a win-lose situation). The best deals, though, are when both negotiating parties are happy (a win-win situation). If you buy a home at the price you want and the terms you want, and the sellers also get the price they want at acceptable terms, you both benefit.

With these concepts to keep in mind, you are probably wondering who will help you along the way.

Bet You Didn't Know

You may find some quirky advice is true as well. For instance, there's the **law of expanding possessions**, which states, "If you have a two-bedroom home full of junk and move to a four-bedroom home, you will have a four-bedroom home full of junk." Also, be prepared for the **never-ending redecorating principle**. When you move in, you may find that the living room carpeting doesn't match your furniture. After you re-carpet, you may find that some of that same furniture looks shabby compared to the new carpet. So you'll need a new couch. And coffee table to go with the couch. And end tables. With all the new furniture, you'll quickly see that the wall color needs updating. After you paint the living room, you'll quickly see that the dining room needs an overhaul. And so on and so on.

Rest assured that one day everything will be perfect. That's the day you put the For Sale sign up.

12 Part I: Getting Started

Some People Who Can Help During the Process

Armed with some general principles, let me next introduce the cast of characters you will most likely work with to make the process as easy as possible.

- ◆ **Realtor (or agent).** If you want to buy a home, it is a good idea to have a Realtor working for you. This is the person who will help you find your dream home and help you get the best deal. Notice that I didn't say, "get you the best price." I said "deal" because sometimes there are other things you can negotiate for that will make the deal sweeter.



Real Deal

If you know people in the real estate business, contact them and pick their brains for the name of a good Realtor. Referrals are usually the best way to find an agent. The same goes for finding a mortgage company. If you know someone who has successfully closed on a home with a particular lender (and broker), that is a good place to start.

- ◆ **Sales associate (or new-home consultant).** If you are trying to build or buy a newly constructed home, you might be dealing with a sales associate who serves as the broker for the new homebuilder.
- ◆ **Lender (or mortgage broker).** Unless you have the cash lying around to pay for your new home, you will be financing your home with a mortgage company. Your mortgage broker will serve as the liaison between you and the mortgage company that he or she has set up for you to work with.
- ◆ **Escrow officer (loan officer).** When that fateful day arrives when you must sign on the dotted line, this person walks you through the process.
- ◆ **Seller.** This is who sells you the home or the company who builds, or that built, your new home. This also might be you, if you are selling your home.
- ◆ **Buyer.** This is you and your partner, if you are purchasing the home with someone. Or, this might be the people who are buying your home from you, if you are selling your home.

Now that you are a little more familiar with all the parties involved in the purchase and sale of a home, let's move on to the actual steps involved.

What to Expect When You Buy a Home

You have decided that you are tired of living in your apartment or rental home, or maybe Mom and Dad are trying to push you out of the nest. You want to become one of the millions of Americans who have embarked upon homeownership. Now what do you do?

Here is a (best-case scenario, mind you) quick-and-dirty, step-by-step process for purchasing a home:

1. Take a look at your finances and credit history, and determine (on your own) how much you think you can afford. (Also pay close attention to Chapter 2.)
2. Obtain financing from an approved lender. This means you need to get pre-qualified or, better yet, preapproved.
3. Narrow your criteria for the type of home you are looking for.
4. Start a savings plan (if you don't already have one) for the down payment and closing costs associated with purchasing a home.
5. Find a real estate agent you feel comfortable with who listens to your wants/needs and will work *for* you.
6. Start looking for your dream home, whether it is a current home for sale or a new build.
7. Read and understand everything you can about your financing options. This can be confusing, but it is a very important part of the home-buying process.
8. Make an offer on a home, possibly a counteroffer, and close on the deal.



Buyer Beware

If you do obtain financing, don't go hog wild buying new furniture or making other expensive purchases. Your deal may fall through if your financial situation changes a lot before the closing.

Along the way, you will find it necessary to choose a homeowners insurance company, get the home inspected, perform a walkthrough, and take care of other odds and ends that must happen before the keys are turned over to you. Don't worry. This book covers all the necessary steps, providing background information and tips for each.

14 Part I: Getting Started

What to Expect When You Sell Your Home

If you own a home that you need to sell, you will want to pay close attention to Part 5 of this book. Most likely, you will perform the tasks required to sell your home right along with (or before) closing on your new home.

Here is a (best-case scenario again) quick-and-dirty, step-by-step process for selling your home:

1. Find a real estate agent that makes you feel comfortable, listens to your wants/needs, and works *for* you. If you don't want to work with an agent, skip this step.
2. Get the home ready for people to view; possibly move out.
3. Price the home realistically and market it strategically.
4. Deal with the different purchase offers you receive (hopefully at least one or more).
5. Close on the home and hand over the keys.

It all may sound a little scary, and it may seem like you will never get everything to happen when it is supposed to happen. Well, this book will help you with that.

The Least You Need to Know

- ◆ Homeownership includes many advantages, including having a place to call your own, tax savings, and appreciation in the value of your home.
- ◆ You should carefully consider the wisdom of purchasing a home if you don't plan to live in the area for long, you're not sure you are going to like the area, you do not have a steady income, or you are unable to come up with a down payment *and* money for monthly house payments.
- ◆ Learn all the different people who will be helping you purchase your home. Make sure they are reliable and that they are willing to work for you. The best way to ensure this: ask others for referrals from friends and family members.
- ◆ The process of selling a home can take a few days, months, or even years, depending on many factors you decide on along the way. Part 5 helps you make this process go as smoothly as possible.