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4 A Roof Over Your Head

The biggest single expense

The biggest single expense in most budgets is housing. If you're paying too much for housing, then it will be hard to make the rest of your budget work out. Therefore it's important to make smart housing decisions.

Some people have homeownership as a goal. If you would like to own your own home, there are two parts to the process. The first part is managing your finances well so that you qualify to buy a home. When that's done, the second part is easy. The second part is actually seeing the process through, from house-hunting to moving in.

Many things about buying a home have changed in recent years. Even if you own your own home now, it's useful to get up to date about the process so that you can advise family, friends, and neighbors about how it works.

Buy or rent?

Before moving toward a home purchase, however, it's important to back up and ask: Should you try to buy a home at all? In years past, the decision was considered a no-brainer. Home prices, it was thought, could only go up — so waiting was costly. If you waited, all you'd have to show for it was a pile of rent receipts.

Today there's a greater understanding that some people are better off renting housing than buying. To understand why, let's look at the benefits and drawbacks of homeownership.

Benefits of homeownership

The most important benefit of homeownership, to many people, is also the hardest to describe: it is having your own roof. When you own a home, you have control over it. If you want to paint the interior walls purple and pink, you can. If you want to keep motorcycle parts in the bathtub, you can. The home is yours. There's a sense of independence and freedom that comes with homeownership.

Housing is also an investment opportunity. Over time, well-maintained houses tend to increase in value — some because of the passage of time, and some because of improvements that homeowners make. When you resell your house at some point in the future, you may well receive more money than you paid for it. The gain is yours to keep.

Homeownership gives you a predictable housing cost. With a fixed-rate home loan, you'll know exactly what you owe on the loan every month. You won't have to wonder how much the rent might go up, because you're not paying rent any more. Your housing cost won't be totally fixed, since taxes and insurance will also be included in the payment. Taxes and insurance rates can go up or down — usually up. But the biggest part of your housing expense will be fixed and predictable.

Homeownership has tax benefits. If your tax situation allows you to itemize your deductions, you'll find that the interest you pay on your home loan is deductible. The deduction lowers your taxes by taking away from your taxable income. No similar benefit is available to renters. And when you resell the house, the gain on the sale is tax-free up to $250,000 for individuals and $500,000 for married couples.

Drawbacks of homeownership

With such an impressive list of benefits, it's easy to see why renters get restless to own a home. Still, homeownership is not for everyone. There are drawbacks associated with most of the benefits of homeownership.

While owning a home gives you your own roof, it also gives you your own repair bills. When something breaks, you have to fix it or pay someone who can. If you have been living in rental property with a responsible landlord, you may not be aware of how much it costs to have repairs done. And your repair expenses in a home are rather unpredictable. You just don't know when a water heater will go out or a furnace will fail.

Although housing is an investment opportunity, it's also an investment risk. There is no guarantee on houses like the guarantee on a bank deposit. When you take your money out of a savings account or certificate of deposit, you know you'll get what you put in, plus any interest you have earned. But when you sell a house, there's nobody who will guarantee you can sell it for the amount you paid. If you sell it for less, the loss is yours to absorb. Most houses go up in value over time, but entire neighborhoods or even cities are sometimes hit by declines in housing prices.

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When you own your home instead of renting, you have reduced mobility. You can't just pack up and leave. In rental housing, you give the proper notice and take off. When you own a home, you have to go through the process of selling the house when you leave. Typically that takes months.

Finally, housing is subject to high costs. It may cost you more to buy a house than to rent the same property. And even if the monthly costs of homeownership fit your budget, you'll also have to come up with money for the costs involved in buying the home and moving in.

Buying a house is a big decision, but if you take all these factors carefully into account, you can make a good decision.

First steps toward homeownership

Whether you're ready to start house-hunting or just dreaming, your best course of action is the same. You have to spend less than you receive, and save the difference in a secure place. Your goal is to get ready to do two things:

1. Come up with the money you'll need to close the deal (pay the closing costs) and make the first, large payment (the down payment) on the house; and
2. Faithfully make the monthly payment every month.

How much money does it take to get started? The answer used to be "20 percent of the home's price plus closing costs." This 20 percent rule of thumb meant that it took years for most people to save up enough money to buy a house. Today that has changed, with the appearance of low-down and no-down loans. For these home loans, you don't need much upfront money. However, you do need to be sure that you can afford the monthly payments. Getting behind on a home loan is even more serious than getting behind on rent. If you don't make payments on a home loan, you can lose your home and all the money you have put into it.

When you know how much you'll need in upfront money and monthly payments, then it's just a matter of sticking with your financial plan until you have enough money saved. There's no room for shortcuts here. Sometimes prospective homebuyers are tempted to put some money they have saved into risky short-term investments, hoping to reach their goal sooner. That can be a bad mistake, even if the short-term investments are legitimate. As good as many investments are to hold over long periods, they're quite risky if you jump in and then hope to jump out a few months later with a major gain.

Why to take a class and visit a lender first

Attending a session like this one on homeownership is a very positive thing to do. You'll become familiar with the process. You won't be surprised by the different steps on the way to homeownership.

You'll also learn about some of the professionals you'll be working with:

- ***Mortgage lenders.*** Since very few people can pay cash for a home, lenders play an important role. They will make you a loan backed up by the home itself.
- ***Real estate agents.*** These are the people whose job is to bring a buyer and seller together. Working with the seller, a real estate agent will set the price of a home to be sold and will advertise and promote the home. As buyers come along, the real estate agent will be involved in negotiating the price. Then as the sale moves toward completion, the real estate agent will help run down details that need to be taken care of. As a homebuyer, you may be working with a real estate agent, too. The two agents usually involved are both paid by the seller, but other arrangements are possible.
- ***Real estate attorneys or settlement agents.*** When all the paperwork is done for the sale and loan, a closing will be held. A real estate attorney or settlement agent should represent you at the closing so that your interests will be upheld. The worst stories in home buying often have one thing in common: The owner was not represented at the closing. This is no place to "do it yourself" to try to save a few dollars.
- ***Home inspectors.*** Early in the process of buying a house there may be a home inspection. It is required by some lenders, and it's almost always a good idea whether it is required or not. The inspector will look for any major problems with the house so that they can be dealt with before the closing. Without a home inspection, you run the risk of having very costly problems surface after you have moved in.

This may sound like a lot of people, and a lot of people to pay. But most of the fees charged by these professionals will not have to be paid upfront. Typically the fees are paid by the seller, or included in closing costs, or bundled in with your monthly payments.

Where do you start? You'll want to visit a lender early on, so that you can find out what loans are available. More importantly, the lender can help you find out what you can afford. Nothing is more disappointing than finding your dream house, only to learn later that you can't qualify to buy it. If you know your range and have worked with a lender before house-hunting, you'll also be prepared to make a more credible offer when the time comes.

You'll also want to visit a real estate agent early in the process, well before you begin house-hunting. Don't feel that you need to be right ready to buy before finding a real estate agent.

Before house-hunting: Your priority list

It's possible to spend way too much time looking for a house. Your house-hunting will be far more effective if you make a list of your priorities first.

Some aspects of a house will be very important to you. Think about someone who now lives close to a pharmacy and values that highly. That person may be unwilling to move to any house that isn't similarly situated. On a scale of 1 to 5, being close to a pharmacy might be a 5 for that person.

Some aspects won't be as important. You might like to have a fireplace in a new home, but it's not critical to you. It might be a 1 on a scale of 1 to 5. It's important to be realistic when you start house-hunting. Not everything you want will be present in every house that you can afford.

If you make a priority list, it can help you to think about what you really want in a house. That way, you can concentrate your effort on checking out houses that satisfy your most important wants. There's no use in doing a detailed walkthrough of a house that you won't find acceptable because it lacks something you believe is important.

Your priority list may change over time. Your family size may change, or your financial status may change. All this means that something you once regarded as unimportant may have become vital when you begin looking to move again into a different house.

In making your priority list, be honest with yourself. Ask yourself what you really must have in a new house. There are many things about a house that would be nice, and you'll get some of them. However, it's rare for a home purchaser to find a house that has every feature he or she wants.

Don't be in a hurry

The single most important rule for homebuyers is this: Don't be in a hurry. A home is the largest single purchase most people will make. It makes no sense to spend an hour comparing television sets to get the best deal, and then rush into a housing deal without being careful.

Many things can go wrong when you buy in a hurry. Although it's often important to get settled in a house by a specified time (such as the start of the school year, or Christmas), it's better to make other arrangements rather than get a bad deal on a house.

Buying a house isn't like buying a car. You can test drive just about every kind of car there is, used and new, before making a purchase. But when you buy a house in a given season, you're limited to considering the small percentage of houses that are for sale in that season. Markets like these are called "thin." There aren't many buyers and sellers at a given time. The best house for you might come onto the market three months or a year after you begin looking. You won't get the opportunity to buy it if you rushed to make a deal in your first weeks of house-hunting.

There's also time needed for a home inspection and follow-up. If the home inspector finds nothing wrong, fine. But if the home inspector finds structural problems or pest damage, it will take time to work out the details. Ordinarily, major problems will be fixed at the seller's expense, but if the expense is large enough there may be provisions for the buyer or the seller to back out.

Your offer

When you go house-hunting with your real estate agent, remember that the most important feature of any house is its location. You can change almost anything else about a house if you buy it, but you can't change its location. So don't hesitate a minute if you find a house that looks great to you except for the paint color or the appliances — you can change those features. But do hold off if the location isn't right.

When you find the right house in the right general price range, you'll be ready to make an offer. Most often, houses don't sell for the original asking price. A lower offer from you is expected, followed by negotiations that often end up somewhere between your first offer and the seller's asking price. You'll sign the offer and place down a deposit, which is one of the few expenses that you do have to meet upfront. After the negotiations are successful, both parties will have signed.

Your offer is not a casual thing. It is a proposed contract and it may become legally binding. So don't make an offer unless you're prepared to go through with the purchase.

Offers usually contain conditions, known as contingencies. These contingencies must be met for a sale to be completed. The most common contingencies are for finance and home inspection. The finance contingency means that if you don't qualify for the loan, you don't have to buy the house. That's good, because without a loan most people wouldn't be able to buy the house. The home inspection contingency spells out what will happen if the home inspector finds major problems. Minor problems, such as marks on the walls or sticky doors, won't be noted by the home inspector.

Once all contingencies have been met, your offer becomes a legally binding contract.

Between contract and closing

Many things must happen between the acceptance of the contract and your becoming the legal owner at the closing. Here are some of the steps:

- ***Appraisal.*** An appraiser will do a detailed study of the house and similar sales. The objective will be to determine the fair market value. Your lender will make a loan for a certain percentage of the fair market value, so the appraisal helps determine how much money can be loaned.
- ***Inspections.*** In addition to the visit by the housing inspector, local government inspectors and others may need to inspect the property. There may be a separate pest-control inspection.
- ***Title examination.*** The property's legal records will need to be examined to make sure that the owner has the clear right to sell the property. If the owner owes tax bills or hasn't paid contractors who worked on the property, that will have to be cleared up before the sale goes through.
- ***Survey.*** For some properties, a survey will be required. Surveyors will come out with precise measuring instruments to see that the property lines are where they should be, so that the legal description matches what you think you're buying. During a survey, for example, you might discover whether a fence or utility building is on the wrong side of a property line.

All these events take time. First-time homebuyers are sometimes frustrated with the slow pace, but the process is important in protecting everyone's rights. Patience is important.

The closing

Finally the big day arrives. At the closing, you become the legal owner of the home and assume the obligations of the home loan. You'll walk away with the keys to your new home.

You should be prepared to sign your name many times. This is where having a good real estate attorney or settlement agent on your side is important. Without somebody on hand to advise you, you'll probably sign your name to documents you don't even understand. These are serious documents, too. The most important ones are:

- ***The loan papers.*** In signing these papers you agree to make payments every month, commonly for 15 or 30 years. These papers will also specify fees for late payments and the terms on which you can make extra payments to pay the loan off more quickly.
- ***The deed of trust.*** This is a legal document that gives the lender the right to remove you and sell the property if you don't keep up on your payments.

After signings and handshakes, the home is yours!

As you live in the home

Now you can enjoy the benefits of homeownership. It's important to maintain or even improve the home as you live there. If you do, you'll get the benefits of the maintenance and improvements for yourself, and you'll be able to sell the house for more if you move.

Things go wrong with houses. This is a basic reality. Yet not everyone is a Mr. or Ms. Fix-It. Some people have the ability and inclination to fix anything that goes wrong with a house, while others will have to hire someone to do the work. In either case, it's important to get work done if leaving it undone has the potential to create major costs in the future. For example, if you see door trim coming loose, that's just a problem of appearance, and it won't matter much if you wait to have it fixed. But if you see a dark stain on an upper-floor ceiling, that's a sign that you have a water leak. If you don't have that problem fixed promptly, it may become very expensive to fix later.

Home improvements can be fun. Some of them, such as repainting the walls in a kitchen or living room, are inexpensive and add greatly to the look and atmosphere of a home. Some are moderately expensive, such as replacing worn carpet and flooring. Other home improvements are quite expensive and don't increase the value of the home much at all. Swimming pools are famous for their high expense and low added resale value.

If you have trouble

If you have trouble making your house payments, don't panic. The main rule is to communicate with the lender. Let the lender know what's happening. Often you can work out a plan to get back on track. You won't be ruined by one late payment, but you can be ruined by continuing late payments if you try to maintain silence with the lender.

Some people think that everything will be OK if they say and do nothing when they get behind on their house payments. But the problem won't go away. If you say and do nothing, the late fees and penalties will begin to add up. Your credit rating will suffer. If you get further and further behind, foreclosure will result. That's when you are removed from the house, which is then sold to satisfy the loan and any penalties.

Lenders don't want to foreclose. It's a costly and unpleasant process. They'd far rather hear from you and work out a way to get you back on track. So if you're having trouble making payments, communicate with the lender.

Refinancing and predatory lenders

Interest rates on new home loans go up and down over time. One of the smartest things you can do, especially if interest rates are high when you buy a home, is to stay alert to refinancing opportunities. When you refinance, you get a new loan at a lower rate. Then you will be able to reduce your monthly payments or keep the same payments and pay the loan off sooner.

It costs money to refinance. There has to be a new loan, and closing costs must be paid again, though usually the costs aren't as high as they were with your original purchase. If interest rates fall enough, you can easily make back your costs before long with the lower monthly payments.

Refinancing that you initiate is usually a good thing. If you pay attention to what you'll pay and what you'll save, you'll know whether you're getting a good deal.

However, there are lenders who sometimes take advantage of people seeking to refinance. These lenders, called "predatory lenders," aggressively contact refinancing candidates and use high-pressure sales tactics to push loans on people. The loans they push have unfavorable terms, and you would never seek them out. That's why the predatory lender has to use high-pressure tactics.

Some predatory lenders sweeten their sour deals by offering you "cash out." That is, they give you a sum of cash just for refinancing. In truth, they're not giving you anything — they're taking money and adding it onto the balance of your loan, so you have to pay it back, often with higher interest than the interest you paid on your original loan. Two general rules of thumb apply:

- Compare the interest rates of loans using the Annual Percentage Rate (APR) that the lender has to disclose. You refinance to lower your interest rate, not to raise it. If the APR is higher, stick with the loan you have.
- If it sounds too good to be true, it usually is.

The American dream

Homeownership is said to be part of the American dream. Owning your own home gives you independence and privacy. If you make good decisions, it can be an important part of your financial future.