Unit 9:
Housing

Housing is usually the largest expenditure for most individuals. This is why it is important to make wise, informed choices in regards to housing. It is also important to know your rights when it comes to housing.

Fair Housing

There are certain rights that all citizens have in connection with housing. Under the Fair Housing Act, there are certain things that are prohibited to discriminate against. This is for both renting and buying. Go to the following website and read down to the section called "If You Think Your Rights Have Been Violated".

Fair Housing -- It's Your Right
(http://www.hud.gov/offices/fheo/FHLaws/yourrights.cfm)

Unit 9:
Renting vs. Buying

Some people assume that it is always better to buy a home than rent. This is not true. There are certain reasons when it would be better for a person to rent. One of these reasons is mobility. If you know you will be moving soon or often, renting is a great option. Even though owning a home gives a person some tax advantages, closing costs can eat up a great deal of the tax benefits if someone is buying a home every few years. Each time you buy a home you must pay closing costs ranging from about $2,500-$5,000. It may take 2 or 3 years for someone to get enough tax benefit to offset the closing costs.

Other people prefer renting because of the low maintenance. Someone else is doing the repairs and the yard work. Some people prefer to rent when interest rates are high or they are worried about being laid-off. It is important to look at your own situation before deciding if you want to rent or buy.
As the textbook states, when looking at cash flow only, renters appear to win. They don't have to pay closing costs and a down payment. When taxes and appreciation are counted, owners usually win. Read the information on the following website:
Common Questions from First-Time Homebuyers
(http://www.hud.gov/buying/comq.cfm)

Unit 9:
Buying - Before You Start Looking

If you do decide that it would be a good time for you to buy a home, there is a lot to do and learn.

Before you start looking

I recommend doing three things before you ever starting looking at homes. They are:

1. *Become educated* - There is so much to learn about the home buying process. The Fannie Mae Foundation provides a free booklet [go to http://www.homebuyingguide.org or call 1-800-688-HOME (4663)]. The Family Life Center in Logan provides a free, monthly educational workshop. Many extension offices also provide home ownership education or can tell you where to get more information.
2. *Set your own payment limits* - Some people start the home buying process and let lenders or realtors tell them how much they can afford for house payments. You need to decide what range your payment can be in based on many factors such as household size, income, other debt, savings needs, etc. When you do start looking, tell lenders and realtors how much you want to pay for TOTAL house payments, including taxes and insurance. To help you figure out how much you can afford, there is a worksheet provided called "How Much House Can You Afford." It is not required that you complete this worksheet, however, it is one of the options of the You Pick assignment. If you want to do the home buying assignment for the You Pick assignment, follow the directions in the syllabus carefully. (Note: the worksheet is a pdf file so you will need Adobe Acrobat to open it.)
3. *Prequalify with a lender.* Before you start looking at homes, go to a few different lenders and tell them you would like to "prequalify" for a loan. There is no cost to you for this. When you prequalify, you are only finding out how much the lender thinks you could borrow. You are not actually applying for the loan yet, that does cost. This is an important step. If you start looking before you do this, you may fall in love with a home that you can't afford. It is best to find out how much you can qualify for first, and then look only in that price range. But remember that you don't have to borrow the maximum you qualify for. Still set your own limits and buy a home that you can really afford. You will probably want to do things like buy furniture and fix things up, not to mention be able to afford the utilities.

If you extend yourself on your house payments, life can be pretty miserable.

Unit 9:
Buying - Types of Loans

If you do find a home you like you will need to decide which loan you want to get. There are many different types. We will discuss only the basics here. The basic types are government insured and conventional.
Government insured - If you get a government insured loan and default on the loan, the government will back the loan and the mortgage company will not loose out. Most of these types of loans are through FHA (Federal Housing Agency). They allow borrowers to have a little more debt and lower closing costs than most other loans. The borrowers must pay mortgage insurance. This is an additional cost on top of the loan. It does not protect the borrowers, just the lenders. The interest rates can be fixed or variable (may go up or down). Some states such as Utah have a program for moderate to low income people to reduce the interest rate on loans. There are also different loans for rural areas and for veterans.

Conventional - These loans are not backed by the government. You still have to pay mortgage insurance if you have less than 20% of the price of the home for a down payment. If you don't have that much to begin with, you can have the private mortgage insurance taken off once the equity in your home is greater than 20%. These loans generally require less total debt and a higher down payment. Although, some conventional loans have lowered these standards in order to compete with the FHA type loans. These loans can also have a fixed or adjustable rate.

With a fixed interest rate, the interest rate stays the same for the life of the loan. With an adjustable rate the interest rate can increase or decrease (they usually only increase). There are certain caps on the interest rate that will keep it from going up too fast or too far. For example, one loan may say that the interest rate can only increase 1% in 6 months and a total of 5% for the life of the loan. This helps, but a 5% increase would still make the monthly payment go up a lot. Be careful with variable rates. They do have advantages though. Most variable rates start out lower than a fixed rate. If you knew you were only going to stay in the home for 3 to 5 years, a variable rate may be good. It starts out lower and can only increase a set amount in that 5 year period.

2/1 Buydowns (pronounced "two-one buydown") - There is a loan called a 2/1 buydown that helps people qualify for a loan that they may not otherwise qualified for. Since some lenders do a lot of 2/1 buydowns, it is important that you understand what they do in case a lender offers you that option. If interest rates are at 7% interest, a 2/1 buydown will start with the interest rate of 5% the first year, 6% the second year, and finally 7% the third year. It will then stay at the 7%

rate the rest of the loan. Also, the payment starts out lower the first year and then goes up the second and third year. This sounds pretty good, right? Well, there is a big catch. The amount of money you save the first two years from having a lower payment must be paid at closing. You pay the exact amount with a 2/1 buydown as with a regular loan. The difference is that a regular loan pays it in the monthly payments and the 2/1 buydown pays it at closing. The only thing it can do is qualify someone for a loan that may not otherwise qualify. Is that a good thing? Usually not, in my mind. If they can't qualify for a regular loan now, maybe they should wait until they can. There is one time when it may work out well. Sometimes the sellers will pay for a 2/1 buydown as an incentive. If the sellers are paying for the extra amount at closing, it might be fine. Most likely they have kept the price higher to cover that though.

Unit 9:
Buying - Closing Costs

Many people cannot get into a home because of the closing costs. They might be able to afford the payments, but they can't afford the big chunk of money needed at the beginning for closing costs. The biggest part of the closing costs is the down payment and can vary widely. Down payments usually range from 0 to 20% of the purchase price of the home. Remember, the more you put down, the smaller the monthly payments will be.

Another part of the closing costs has to do with the title of the home. First you must pay to have it searched. You and your lender both need to know that the title is clear. Someone may have a lien on the property. The IRS can put a lien on a home for not paying taxes. A contractor may put a lien on a home if the homeowner did not pay for the work done by the contractor.

Also, you have to pay title insurance. If the title company missed something and there was really a lien on the property, the insurance will cover that mistake. For example, my father-in-law purchased some land. He paid for the title search and the title insurance. A year later the county told him that the previous owner did not pay one year's property taxes and he was responsible for that. He contacted the title company because they had searched the title and declared that it was clear when he purchased it. Eventually, the title company took care of the back taxes because my father-in-law had paid the title insurance to cover that.
Look again on page 252 of the textbook to see what other things may be included in the closing costs. Some of the things in the table are not always required (such as a survey fee).

Unit 9:
The House Payment, Part 1

A house payment usually has four parts and sometimes 5. It is called PITI. The P is for **principal**. This is the amount that is actually going toward paying off the loan. The first I is for **interest**. This is the part that requires the most over the life of the loan. The T is for property **taxes** that are due each year. The last I is for hazard **insurance**. This is the insurance that protects you, the owner. It protects you from things like fire and theft. As mentioned before, some people also pay a monthly amount for mortgage insurance. This is the one that protects the lender, not you.

Property taxes and hazard insurance are each paid once a year. The lender divides those yearly amounts by 12 and adds that extra to the principal and interest payment. They take that part of the payment and put it in a savings account called an escrow account. When your taxes and insurance are due, the payment comes out of your escrow account. The bill is sent directly to the lender, not you. Most first time home buyers are required to have this escrow part of their payment. Some people prefer to pay the taxes and insurance on their own and not have an escrow account. Some lenders will agree to this and others won't. They want to make sure their investment is protected and the taxes are current. One thing that is important to understand about the taxes and insurance part of your payment is that they will likely increase. If you have a fixed interest rate you may think your payment will never increase for 30 years. It is only the principal and interest portion that will remain the same. Property taxes usually go up and insurance premiums usually go up also. As they increase, your lender will require you to pay more into your escrow account each month. You may get a statement at the end of the year stating that your payment is increasing by $6 each month the next year. It usually doesn't go up drastically. One time I even had mine go down $5 a month. That usually doesn't happen, but they had over estimated my taxes or insurance and my escrow account had surplus in it.

Unit 9:
The House Payment, Part 2

There are three tables in the book that I would like you to look at and study until you understand them. They are on pages 243 and 247. The table on page 243 (9.1) shows how the principal and interest payments are calculated each month. You can see that of the $733.76 payment the first month, only $67.09 is going toward the loan. The rest is going to interest! The next month a little more is going to principal because the balance started out lower that month (but not much - only $67.09 less). The next table on page 243 (9.2) shows how that will look for the life of the loan. The principal payment keeps increasing until it finally gets to be larger than the interest payment. This type of a loan is an "amortization" loan.

You can see in the table on page 247 (9.4) how much total interest would be paid toward a loan of $100,000. If the loan is for 30 years at 6% interest, the total amount paid to interest would be $116,000. But if the interest rate was 8%, $164,200 would be paid in interest alone! You can see how interest rates makes a big difference on how much interest is paid.

For a $100,000 loan for 30 years at 9% interest, the total interest paid would be $189,800. Is there anything you can do to change paying that much in interest? If you paid one extra payment a year on this loan, it would cut over **eight years** off the loan and save over **$64,000** in interest. If you paid just an extra $20 a month it would cut **four years** off the loan and save over **$32,000** in interest. Even better, if you could afford $170 more a month you might be able to get a 15 year loan at 8.5% interest and save over **$113,000** in interest.

If you had some extra each month, would it be better to pay your home off, or invest or save the money? A financial planner would tell you it is better to invest the money because mortgage interest is tax deductible and you could make more interest investing than you are paying on the mortgage. I have asked my students this question before and here are some of the comments they have made. First on the side of paying off the home.

1. You are guaranteed to save a set amount of interest if you pay off your house early where the stock market can't guarantee anything.
2. You can invest a lot more once your house is paid off.
3. You won't loose your house if it is paid for as long as you can afford the taxes and insurance.
4. Peace of mind comes with being out of debt.

Now for the other side.

1. Your home mortgage is tax deductible; you should keep that dept to help with taxes.
2. You can probably make more in investing than you will pay in mortgage interest.
3. Time is an important factor when investing. The earlier you start the more you will make.
4. Peace of mind comes with having money set aside.

Let's talk about two of these. First of all, as for the mortgage interest being tax deductible, that is true. However, it is not a dollar for dollar savings. For every dollar you are paying in interest, you are savings only a percent of that in taxes. The percent is the tax bracket you are in. If you are in the 28% tax bracket, you will save 28 cents for every dollar you spend in interest. So, you are actually spending more than you are saving.

Time is a big factor for investing, especially when you are talking about retirement. Even though you could invest more after your home is paid for, it won't make up for the time you have lost by waiting. The earlier you start saving for retirement, the better off you will be.

So, here is my suggestion. If you don't have an emergency savings account and you are not saving for retirement, I would recommend you put the extra money there. If you are doing quite well in those areas it might be good to put some extra on your home. You can save a LOT in the long run. Generally I like to have people split the extra money. Put some on your home and save or invest some. It all depends on personal circumstances.

Unit 9: Refinancing

If interest rates drop is it a good idea to refinance? Again, it depends on a several factors. Lower interest rates do help save a lot of money. However, remember that you have to pay closing costs each time you take out a mortgage loan and that includes refinancing. If you go through your same lender you may be able to get a streamline loan that will have reduced closing costs. A lot of people put their closing costs back into the new loan making their balance higher than it was. If you plan to stay in the home for a long time, you may be able to recoup the closing costs by saving interest. Also, if you refinance a 30 year loan to another 30 year loan you may be paying on the loan for a lot longer if you have been paying on it for a few years. All these things need to be considered. Page 246 of the textbook has a worksheet you can use to help make that decision.

Unit 9:
Home Equity Loans

Some people use the equity in their home as collateral for a new loan. It is called a home equity loan. These loans have some nice features: the interest is usually tax deductible and the interest rate may be lower than on other types of credit. They also have some drawbacks. The main one is that your home can be repossessed if you don't make those payments. This is true even if you are current on your original mortgage.

Often home equity loans are a line of credit. You don't take out the money until you are ready to use it. Then, it is available to use again when needed. The lender may even provide you with checks to use your line of credit. Sometimes this is a little too convenient and people borrow more money than they should. Home equity loans often have a variable rate (it may go up) and may have transaction fees and an annual fee. If it has an annual fee, you may have to pay something like $50 just to have the line of credit open even if you don't use it. Also make sure you look at closing costs and other fees included in the loan. Be very careful with home equity loans. Your home is one of the biggest investments you will ever make. Make sure you will be able to make the monthly payments if you decide to borrow against your home.

Unit 9:
Mortgage Default

If you ever think there is a possibility that you won't be able to make your payments - **CONTACT THE LENDER!** They will likely work out a plan with you if you contact them ahead of time. If you wait until you are two or three payments behind, you might have your home repossessed. Call the mortgage company and ask for the "recovery" type department.

If you don't work out a plan with the lender, they will eventually start foreclosing on the house. Once this process has started, it is harder to work anything out with them. Also, new fees will be added on such as attorney fees.
How can you avoid ever getting to this point? First of all, don't push the loan amounts. Just because the lender will lend you the money doesn't mean you can afford that loan. Set your own limits and get a house LESS than you can afford. Have an emergency savings account in case you loose your job or have unexpected expenses. Make your mortgage payment a top priority. Pay it before you pay other bills. Finally, keep other debt to a minimum. If you have a lot of other debt it is harder to make your mortgage payment.