Standard 10: **The student will explain and compare the responsibilities of renting versus buying a home.**

Buying a House

Hank and Peggy decide it is finally time to buy a house. They have a good idea what features they want and where they would like to live.

Almost every Sunday, they have been going to open houses to see what is available and to check out prices.

They have also been saving money for a down payment and for closing costs.

In addition, they have been reading various magazines to learn about housing styles and new construction techniques.

Even though they feel prepared to buy, they still feel overwhelmed about making a good decision. Their friends keep telling them to just find a house and buy it, but they think there must be more to it than that.

If Hank and Peggy asked you for advice, what would you encourage them to do?

Lesson Objectives

⇒ Discuss the reasons that people buy.
⇒ Explain the elements of a mortgage (e.g., down payment, escrow account, due date, late feeds and amortization table).
⇒ Explore the different types of lenders and housing loans.
⇒ Recognize other costs associated with homeownership, such as maintenance, homeowner associate fees, etc.
⇒ Evaluate the costs and benefits of homeownership.

Personal Financial Literacy Vocabulary

Closing costs: Costs paid when buying a house or real estate.

Down payment: The part of the purchase price paid in cash up front, reducing the amount of the loan or mortgage.

Equity: The difference between how much a house is worth and how much is owed on it.

Mortgage: A loan to finance the purchase of real estate, usually with specified payment periods and interest rates.

Introduction

Buying a house is the most expensive purchase many people make during their lifetime. Homeownership is often the fulfillment of a dream, a source of pride, and a sense of independence. Few people can afford to pay cash when purchasing real estate—especially with the average home price in the United States approaching $175,000. Financing a home requires a mortgage, and mortgages include interest which increases the overall price of the house.

Unlike other purchases, the cost of insurance can be included in the monthly payment as well. Adding interest and insurance to the mortgage payment is a convenience, but also increases the monthly payments. Additional costs of homeownership include the cost of landscaping, mowing, pest control, and contributions to a savings account to cover the costs of any emergency expenses such as replacing a hot water heater or washing machine.

Lesson

When you hear the word "house," what is the vision that comes to mind? Are you picturing a big two-story house in the suburbs with a three-car garage? A small Victorian-style home in an inner-city neighborhood, complete with a garden and white picket fence? Or, do you think of a condominium in an upscale neighborhood? Whatever you envision as a house says something about you and your values. It also says something about the lifestyle you see for yourself. Chances are the house you picture is very similar to the house you lived in or stayed in while visiting a favorite family member.

The term *house* today has several different meanings. It can be a traditional structure commonly called single-family housing, built on a lot or acreage. It could be a duplex or townhouse, or even a modular or mobile home. As housing prices continue to increase, people are choosing a variety of options to satisfy their desire to own a home.

While you may choose to rent a house, most people who live in a house are the owners of their property. As the owner, you are responsible for all of the maintenance and upkeep—both inside the house and outside. The additional expense for maintenance can be substantial, depending upon the house. The best way to cover the cost of these expenses is establishing a savings account especially for that purpose. If you will include the contribution to your savings account in the amount budgeted for buying a house, it will help you stay within the amount allocated for housing. Of course, you need to remember to make that payment to your savings account each month—whether as a payroll deduction or an automatic draft on your checking account.

Advantages and Disadvantages of Homeownership

Most people prefer owning a home because it provides them with greater privacy and security than living in an apartment. In addition, you are establishing a sense of permanency when making the decision to buy because it represents your desire to settle down and build a future. It also allows you to remodel or redecorate to satisfy your own tastes because it is yours—not someone else's property. So, if you want to paint your garage pink and your front porch lime green, you can do it because it is yours.

While many neighborhoods today have covenants or certain homeowner restrictions, you still have much greater freedom than renting. Before buying, you should inquire about any neighborhood restrictions and get a copy of the homeowner's association policies. That way, you will know any limitations on how you use your property before making a choice.

One of the biggest advantages to owning a home is building equity, which means that your property gains value over a period of time. The difference between the price you paid for it and the current value is called **equity**. For example, if you buy a house for $150,000 and you can sell it for $170,000, you have $20,000 in equity ($170,000 - $150,000 = $20,000). In some ways, a home is an investment, and like with any other investment, you hope to earn money while owning it. While building equity is not guaranteed, most houses tend to increase in value over time. That helps explain why the location where you buy is so important.

In addition to building equity, owning a home has some tax benefits. Because you are paying interest as part of your monthly mortgage payment, you can deduct the interest from your taxable income on your federal income tax return and on most state tax returns. The ability to deduct the interest provides a savings on your overall tax burden. In addition, you pay property taxes on your home — which also is deductible from your taxable income. The ability to deduct your interest and property taxes helps offset the additional costs of homeownership.

Buying a house also has its disadvantages. Unlike renting an apartment, owning home is a substantial financial commitment. It requires a down payment on your mortgage, and oftentimes you will need to pay additional fees such as points and title insurance. Points are a one-time fee you pay to the bank or mortgage company when you borrow money. Title insurance is a charge to inspect the history of the property to ensure the seller can legally sell you the property. In addition, you will not be able to pack up and move as easily because you are a homeowner and responsible for the mortgage until the house is sold to a new owner.

As an owner, your living expenses tend to be higher than living in an apartment because you must pay all costs for utilities, repairs, water, landscaping, painting, and so on. While apartment living offers a somewhat carefree lifestyle, owning a home requires a time commitment and work. You also face the risk of having the property decline in value and losing money on your investment.

Basically, what was an advantage to apartment living is a disadvantage to owning a home — and what was a disadvantage to renting is an advantage to homeownership. Because your perception of advantages and disadvantages will differ from another person's, only you can decide which option is best for you at various stages of your life. To help you summarize the benefits and costs of owning a home, use the table below to list three advantages and disadvantages.

Advantages	Disadvantages
1.	1.
2.	2.
3.	3.

Financing a House

Determining how much house you can afford is the first step to buying a home. Keep in mind that just because you can afford a certain amount does not mean you have to pay that much for a house. Most people are inclined to overbuy — spending more than necessary on a house—then facing higher than anticipated utility bills, property taxes, insurance premiums, etc.

Preapproval

Most potential homebuyers will start by getting preapproved for a mortgage. You can check with your local bank or mortgage company to determine the maximum amount they will qualify you to purchase. Again, that is the maximum amount, but you can always spend less. The preapproval process means a financial institute has done all of the necessary paperwork and evaluation to determine the maximum amount they will loan to you. That process includes reviewing your loan application, your credit report, and other financial information about you. Being preapproved for a loan is different from prequalifying. Prequalifying simply gives you a rough estimate as to the amount you might qualify to receive. If possible, it is better to be preapproved than prequalified before you start looking for a place to buy.

When preapproving you for a home loan, banks want to determine how much you can afford to pay monthly for your housing costs, including the house payment, taxes, insurance, and interest. Some banks will use a housing expense ratio, which says you can afford to pay up to 28% of your monthly gross income in house payments. Others will use a debt-ratio formula which says your house payment should not be more than 36% of your overall debt.

Housing Expense Ratio

Suppose your gross monthly income is $2,000. Your house payment — including taxes, insurance, and interest — should not exceed $560 a month.

($2,000 x .28 = $560)

Debt Ratio Formula

Suppose you pay $500 a month in bill payments (car, credit cards, etc.) and your gross monthly income is $2,000. Your house payment — including taxes, insurance, and interest — should not exceed $220 a month.

($2,000 x .36 = $720
&
$720 - $500 = $220)

Closing Costs

Closing costs are the expenses you need to pay when getting a housing loan. In most cases, you will need to make a down payment on a house somewhere between 3% and 20% of the purchase price. You also will need to pay about another 5% on other closing costs. These costs include title insurance, attorney's fees, property survey fees, recording fees, lender's origination fees, appraisals, credit reports, termite/mold inspections, escrow payments, and the home inspection report.

Down payments are required to protect the lender in case you default (or fail to pay) your loan. If you cannot pay the full 20% down, you will be required to purchase private mortgage insurance called PMI. The PMI basically helps guarantee your down payment to the lender. Another option is taking out two loans: one for the mortgage and one for the down payment. This option generally results in higher interest rates and higher monthly payments. Also, some lenders may refuse to accept this option because it tends to be higher risk than paying for PMI.

Escrow payments are payments made to a special account held by the lender to pay your property taxes, homeowner's insurance, and other fees that are paid as part of your monthly loan payment. Sometimes called a reserve account, an escrow account may or may not be required for a loan, depending on your lender.

MORTGAGE CALCULATOR

Check out the mortgage calculator in this lesson:
http://www.econedlink.org/lessons/index.cfm?lesson=NN121

THREE WAYS TO REDUCE YOUR MORTGAGE COSTS

1. Make a larger down payment. It lowers the amount of money you borrow. If you borrow less, you will pay less interest which reduces the overall cost of your loan.
2. Shop around for interest rates. The lower the annual interest rate, the less interest you will pay.
3. Make extra payments on your loan. The faster you pay off the loan, the less interest you will pay. When making an extra payment, be sure to put a note on your check requesting the payment go toward the principal.

Fixed Versus Adjustable Rates

When qualifying for a mortgage, you can generally get two different kinds of mortgage loans. One is called a **fixed rate loan**, and the other is called an **adjustable rate loan** (sometimes referred to as an **ARM**). Adjustable rate loans start with lower than average interest rates that gradually increase. While that sounds good, keep in mind your payments also increase along with the interest rates. If the interest rate takes a big hike, your payment will also take a big hike — making it more difficult to meet your monthly financial obligations. A fixed rate loan has the same interest and the same monthly payment as long as you have the loan.

ARMs tend to be a greater risk than fixed rate loans. However, if you plan to live in the house for only a few years, it might be a good deal to consider. Be aware that some lenders use ARMs as "temporary" or "teaser" rates as an incentive for you to use them. Unless you read your loan agreement carefully, those low interest rates may jump within a few months – leaving you with much higher payments than you cannot easily afford.

As a general rule, if you need an ARM to qualify for a house or to set the payments at an amount you can afford, then you are buying too much house. It is always better to buy less than put your financial future at risk.

COMPLETE: Mortgage Calculations – Activity 10.3.1

Ask your teacher to review your answers before continuing with this lesson.

Congratulations on Your New House

Locating the right house also can be challenging. Because you are investing a high percentage of your income in your purchase, you probably want to look around and get plenty of advice on neighborhoods before making an offer on a house. Many people prefer to work with a realtor, a licensed professional who specializes in real estate. Real estate agents often specialize in different neighborhoods or different price homes. You might want to talk with friends or family members who have used an agent to get their recommendation. You can also call several real estate offices and visit with one of their agents before making a decision.

Realtors are trained in helping you make good choices about real estate. A good real estate agent can show you homes that are for sale in your price range, help negotiate the terms and sales price when making an offer, and assist in finding the right people to do home inspections or minor repairs. While real estate agents may work with both buyers and sellers, they have an obligation to fairly represent both parties in a transaction. Typically, the seller of the house – not the buyer – is responsible for paying the agent's fees.

When buying a house, you have the option of offering less than the listed price. The deal is not completed until both the buyer and the seller accept the terms and price offered. It is always wise to include several contingencies in your initial offer. A contingency is a condition that must be met or the deal is cancelled. Some examples of contingencies include the house passing a home inspection by a professional inspector; the house appraising for an amount similar to the sales price; your ability to secure satisfactory financing for the house, and your ability to sell your house.

Be prepared to negotiate on the price or the contingencies. However, you do not have to compromise or give in on anything that is not good for you. Even though you think it is the "perfect" house, you need to be comfortable with the terms of the contract. Know your limits and stick with them.

QUICK HOUSE BUYING TIPS

- Do know how much you can afford.
- Do get preapproved before starting your housing search.
- Do not use all the money the bank will lend.
- Do not buy the most expensive house on the block.

As part of the offer, you also need to be prepared to put down a deposit on the house called earnest money. Your deposit is held by a third party, such as a real estate agent or a title company, until the closing. At that time, it is applied toward the down payment. You will probably forfeit your earnest money if you change your mind about buying the house after the contract has been signed by both parties.

Your hard work and effort to find a house and get a mortgage should feel like an accomplishment. But that is just the beginning of your investment. Taking the time to maintain your house and upgrade it as necessary will help protect your investment.

What did you learn from this lesson?

Conclusion

There is an old saying that three things give property value: location, location, location! When buying a house, the location is certainly an important factor to consider. Buying a house is similar to making any other investment. You want to buy smart. That includes finding the right house in the right location, then continuing to maintain it as long as you own it. Having a good idea about what you want and what you can afford will help you make a good choice when buying a home. While others may encourage you to spend more or buy what they like, the ultimate decision is yours. Comparison shopping for a mortgage is as important as shopping around for the right house. The rate of interest and the mortgage terms will have a big impact on the total amount you pay for your purchase.

Obviously, Hank and Peggy have thought about buying a house for several months. But, they seem to be stuck in the "looking" stage.

If you advised them to go to a lender to get preapproved for a loan and then contact a real estate agent to help them find the right house, you would be giving them excellent advice.

While their friends make it sound easy to just go buy something, you realize there is much more involved in making a good decision about buying a house.

Name: ____________________________ Class Period: ___________________________

Buying a House
Review Lesson 10.3

Answer the following questions and give the completed lesson to your teacher to review.

1. Which of the following is an advantage to buying a house?

    a. Limited expenses for maintenance.
    b. Lack of ability to make decorating changes.
    c. Multiple options for size and location.
    d. Increased responsibility for maintenance.

2. Which of the following is a disadvantage to buying a house?

    a. Needing a down payment and earnest money.
    b. Finding a place that meets your needs.
    c. Finding a real estate agent to help you locate a house.
    d. Negotiating the terms of an offer with the seller.

3. When looking for a house, you should consider all of the following EXCEPT the

    a. price of the house.
    b. color of the walls in the dining room.
    c. neighborhood where the house is located.
    d. payments you make on other debt you owe.

4. When applying for a mortgage,

    a. the monthly payment is all that matters.
    b. the interest rate is all that matters.
    c. shop around until you find the best terms, including interest rate and monthly payment.
    d. borrow money from the same place as your friends; if it is good enough for them, it should be good enough for you.

5. When negotiating an offer on a house, your top priority is

    a. making an offer that is best for you.
    b. making an offer that is best for the seller.
    c. buying the house, regardless of what it costs.
    d. guessing what the seller will accept.

Name: ____________________________ Class Period: ___________________________

Mortgage Calculations – Activity 10.3.1

Use the information in your lesson to make the required calculations to answer the following questions. Be sure to show your work.

1. Dane and Amber plan to buy a house for $130,000. They want to make a down payment of 20% to avoid PMI charges. How much money will they need for a down payment?

2. Benny and Sylvia have a combined gross income of $3,500 a month. They want to buy a house instead of continuing to rent. Using the Housing Expense Ratio, how much house payment can they afford?

3. Marcy has just gotten a promotion at work and she wants to buy a house. She currently pays $350 a month for a car payment and $200 a month on her credit cards. She has a gross monthly income of $4,000. Using the Debt Ratio Formula, calculate her potential maximum monthly house payment.