

LEARNING MADE EASY



7th Edition

Home Buying Kit

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great price

Find your
best mortgage

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and checklists online



Eric Tyson, MBA
Ray Brown

Bestselling authors of *Selling Your House For Dummies*



Home Buying Kit

7th Edition

**by Eric Tyson, MBA,
and Ray Brown**

**for
dummies®**
A Wiley Brand

Home Buying Kit For Dummies®, 7th Edition

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Contents at a Glance

Introduction	1
Part 1: Getting Started with Buying a Home	5
CHAPTER 1: Deciding Whether to Buy	7
CHAPTER 2: Getting Your Financial House in Order	21
CHAPTER 3: What Can You Afford to Buy?	37
CHAPTER 4: Why Home Prices Rise and Fall	67
Part 2: Financing 101	81
CHAPTER 5: Understanding and Improving Your Credit Score	83
CHAPTER 6: Selecting a Mortgage	99
CHAPTER 7: Mortgage Quandaries, Conundrums, and Forms	129
Part 3: Property, Players, and Prices	155
CHAPTER 8: Where and What to Buy	157
CHAPTER 9: Assembling an All-Star Real Estate Team	197
CHAPTER 10: What's It Worth?	227
CHAPTER 11: Tapping the Internet's Best Resources	247
Part 4: Making the Deal	257
CHAPTER 12: Negotiating Your Best Deal	259
CHAPTER 13: Inspecting and Protecting Your Home	287
CHAPTER 14: It Ain't Over till the Weight-Challenged Escrow Officer Sings	309
Part 5: The Part of Tens	325
CHAPTER 15: Ten Financial "To Do's" After You Buy	327
CHAPTER 16: Ten Things to Know When Investing in Real Estate	335
CHAPTER 17: Ten Things to Consider When Selling Your House	343
Part 6: Appendixes	351
APPENDIX A: Sample Real Estate Purchase Contract	353
APPENDIX B: Sample Short-Sale Addendum plus Short-Sale Information and Advisory	365
APPENDIX C: Example of a Good Inspection Report	373
APPENDIX D: Glossary	393
Index	411

Table of Contents

INTRODUCTION	1
About This Book: The Eric Tyson/Ray Brown Difference	2
Icons Used in This Book	2
Beyond the Book	3
Where to Go from Here	4
 PART 1: GETTING STARTED WITH BUYING A HOME	 5
CHAPTER 1: Deciding Whether to Buy	7
Weighing the Advantages of Owning versus Renting	8
Ownership advantages	9
Renting advantages	14
The Pitfalls of the Rent-versus-Buy Decision	16
Renting because it seems cheaper	16
Fretting too much over job security	16
Buying when you expect to move soon	17
Succumbing to pushy salespeople	17
Ignoring logistics	17
Overbuying	18
Underbuying	18
Buying because it's a grown-up thing to do	19
Buying because you're afraid that escalating prices will lock you out	19
Misunderstanding what you can afford	20
 CHAPTER 2: Getting Your Financial House in Order	 21
Surveying Your Spending	22
Gathering the data	22
Analyzing your spending numbers	27
Reckoning Your Savings Requirements	28
Setting some goals	28
Retirement-savings accounts and a dilemma	29
Other reasons to save	31
Protecting Yourself, Your Dependents, and Your Assets	32
Insuring yourself	33
Insuring your assets	34
Invest in Yourself	36

CHAPTER 3:	What Can You Afford to Buy?	37
	Lenders Can't Tell You What You Can Afford	38
	The Cost of Buying and Owning a Home	39
	Mortgage payments	39
	Property taxes	48
	Insurance	49
	Maintenance and other costs	50
	The tax benefits of homeownership	51
	Closing Costs	54
	Accumulating the Down Payment	57
	The 20 percent solution	57
	Ways to buy with less money down	58
	Where to invest the down payment	60
CHAPTER 4:	Why Home Prices Rise and Fall	67
	What Drives Real Estate Markets and Prices?	68
	Jobs, glorious jobs	70
	Available housing	71
	Inventory of homes for sale and actual sales	72
	The rental market	74
	Tax rules and changes	75
	How to Get a Good Buy in Any Market	76
	Seek hidden opportunities to add value	77
	Buy when others are scared to buy	78
	Find a motivated seller	78
	Buy during slow periods	79
	Become a great negotiator	80
	Buy in a good neighborhood	80
	PART 2: FINANCING 101	81
CHAPTER 5:	Understanding and Improving Your Credit Score	83
	The Record You Can't Ignore: Your Credit Report	84
	What your credit history comprises	84
	What goes into your credit report	85
	Why you should check your credit report	85
	The Most Popular Kid on the Block: FICO Scores	86
	How scores work — the short version	87
	How a FICO score assesses your credit history — the long version	88
	What FICO scores ignore	95
	Why your score is what it is	96
	Getting Hold of Your Report and Score	96

CHAPTER 6: Selecting a Mortgage	99
Getting a Grasp on Mortgage Basics	99
Fixed or Adjustable? That Is the Interest(ing) Question	100
Distinguishing fixed-rate mortgages from adjustables	100
Looking at hybrid loans	102
Starting out risky: Interest-only mortgages	102
Making the fixed/adjustable decision	104
Deciding on your loan's life: 15 years or 30?	109
Finding a Fixed-Rate Mortgage	111
The all-important interest rate	111
The finer points of points	112
Other lender fees	114
Arriving at the Absolute Best Adjustable	115
Where an ARM's interest rate comes from	116
How often does the interest rate adjust?	118
Limits on interest-rate adjustments	118
Locating the Best, Lowest-Cost Lenders	120
Shopping on your own	120
Working with a mortgage broker	123
 CHAPTER 7: Mortgage Quandaries, Conundrums, and Forms	129
Overcoming Common Mortgage Problems	129
Insufficient income	130
Debt and credit problems	130
Dealing with Appraisal Problems	133
You've overpaid	134
The appraiser doesn't know your area	134
The appraiser/lender is sandbagging you	135
Those Darn Mortgage Forms	135
The laundry list of required documents	136
Permissions to inspect your finances	139
The Uniform Residential Loan Application	140
I. Borrower information	142
II. Financial information — Assets and liabilities	145
III. Financial information — Real estate	147
IV. Loan and property information	148
V. Declarations	149
VI. Acknowledgments and agreements	150
VII. Demographic information	152
Other typical documents	152

PART 3: PROPERTY, PLAYERS, AND PRICES.....	155
CHAPTER 8: Where and What to Buy	157
Location, Location, Value	159
Characteristics of good neighborhoods.....	160
Selecting your best neighborhood	161
Fundamental Principles for Selecting Your Home	163
The principle of progression: Why to buy one of the cheaper homes on the block	163
The principle of regression: Why not to buy the most expensive house on the block.....	165
The principle of conformity: Why unusual is usually costly	166
Defining Home Sweet Home	167
Detached residences.....	167
Attached residences	173
Finding a Great Deal	183
Finding a fixer-upper.....	183
Taking over a foreclosure.....	187
Seeking a short sale	190
Pooling Your Resources: Ad Hoc Partnerships	193
Types of residential co-ownership	193
Structuring a successful co-ownership.....	195
CHAPTER 9: Assembling an All-Star Real Estate Team	197
The Team Concept	198
Lining up the players.....	198
Avoiding gratuitous advice.....	199
Reeling in a Real Estate Agent	200
Types of agent relationships	201
How agents get paid	204
Characteristics of good agents	205
Selecting your agent	207
Getting the most from your agent	215
Bagging a Broker	217
Landing a Lender.....	219
Procuring Property Inspectors	219
Electing an Escrow Officer	220
Finding (or Forgoing) Financial and Tax Advisors.....	221
Looking for Lawyers	223
Selecting your lawyer	224
Getting the most out of a lawyer.....	225

CHAPTER 10: What's It Worth?	227
Preparing to Tour an Endless Parade of Homes	227
The Three Elusive Components of Worth	228
Value is a moving target	229
Cost is yesterday	229
Price is what it's worth today	231
Fair Market Value	232
When fair market value isn't fair — need-based pricing	232
Median home prices versus fair market value	234
Determining Fair Market Value: Comparable Market Analysis	235
The basics of a helpful CMA	236
The flaws of CMAs	240
Getting a Second Opinion: Appraisals versus CMAs	242
Why Buyers and Sellers Often Start Far Apart	243
Inept agents	245
Unrealistic sellers	246
CHAPTER 11: Tapping the Internet's Best Resources	247
Finding Useful Information	248
Get your feet wet at Realtor.com	248
Discover more at these sites	248
Doing Some Preliminary Shopping	249
Surveying homes for sale	250
Watching out for sites promoting foreclosures	250
Sifting through school information	252
Perusing "best places" to live	252
Familiarizing yourself with financing options	253
The Drawbacks of Searching for Houses in Cyberspace	254
Conflicts of interest	254
Bankruptcies	254
Misleading home-valuation tools	255
Untrustworthy mortgage calculators	255
PART 4: MAKING THE DEAL	257
CHAPTER 12: Negotiating Your Best Deal	259
Understanding and Coping with Your Emotions	260
Examining the violent forces at work	260
Controlling yourself	261
The Art of Negotiating	263
Being realistic	264
Examining your negotiating style	265
Negotiating with finesse	267

The Negotiating Process.	269
Making an offer to purchase	269
Leaving an escape hatch: Contingencies	271
Getting a counteroffer	272
The Finer Points of Negotiating.	275
Negotiating when the playing field isn't level	275
Spotting fake sellers	277
Lowballing.	280
Negotiating credits in escrow	283
CHAPTER 13: Inspecting and Protecting Your Home.	287
Conducting Thorough Inspections	288
All properties should be inspected	288
The two types of defects: Patent and latent	290
Patent defect red flags	290
Types of property inspections	291
Inspecting inspectors	293
Insuring Your Home	299
Homeowners insurance	300
Title insurance	302
CHAPTER 14: It Ain't Over till the Weight-Challenged Escrow Officer Sings.	309
An Escrow Is a Good Thing.	310
Know thy escrow officer	310
Cover all the bases	311
'Tis the season: December escrows	315
Follow through.	317
How You Take Title Is Vital	318
Joint tenancy.	318
Community property.	319
Tenants-in-common	319
Getting help drafting an agreement.	319
Getting Possessive.	320
Moving day	320
Final verification of condition	322
Coping with Buyer's Remorse	322
PART 5: THE PART OF TENS.	325
CHAPTER 15: Ten Financial "To Do's" After You Buy	327
Stay on Top of Your Spending and Saving.	328
Consider Electronic Mortgage Payments.	328
Rebuild Your Emergency Reserve	329
Ignore Solicitations for Mortgage Insurance.	329
Ignore Solicitations for Faster Payoff	330

Consider Protesting Your Tax Assessment	331
Refinance if Interest Rates Fall	331
Keep Receipts for All Improvements	332
Ignore Solicitations to Homestead	333
Take Time to Smell the Roses	333
CHAPTER 16: Ten Things to Know When Investing in Real Estate	335
Real Estate Is a Solid Long-Term Investment	336
Real Estate Investing Isn't for Everyone	336
REITs Are Good if You Loathe Being a Landlord	337
Don't Invest in Limited Partnerships	337
Avoid Timeshare Condos and Vacation Homes	338
Residential Properties Are Your Best Investment Option	339
Consider Fixer-Upper Income Property	339
Consider Converting Small Apartment Buildings to Condos	340
Consider the Property's Cash Flow	340
Your Rental Losses Are Limited for Tax Purposes	341
CHAPTER 17: Ten Things to Consider When Selling Your House	343
Why Are You Selling?	344
Can You Afford to Buy the Next Home?	344
What's It Worth?	345
Have You Done Your Homework to Find a Good Real Estate Agent?	345
Do You Have the Skills to Sell the House Yourself?	346
Have You Properly Prepared the House for Sale?	347
Do You Understand the House's Hot Buttons?	348
What Are the Financial Ramifications of Selling?	348
Do You Know the Rules for Capital-Gains Taxes on the Sale of a House?	348
PART 6: APPENDIXES	351
APPENDIX A: Sample Real Estate Purchase Contract	353
APPENDIX B: Sample Short-Sale Addendum plus Short-Sale Information and Advisory	365
APPENDIX C: Example of a Good Inspection Report	373
APPENDIX D: Glossary	393
INDEX	411

Introduction

W elcome to *Home Buying Kit For Dummies*, 7th Edition!

For about the cost of a couple of movie tickets or your monthly Netflix subscription, you can quickly and easily discover how to save thousands — perhaps even tens of thousands — of dollars the next time you buy a home.

How can we make such a claim? Simple. Each of us has spent decades personally advising thousands of people like you about home purchases and other important financial decisions. We've seen how ignorance of basic concepts and practices translates into money-draining mistakes. And we know that many of these mistakes are both needless and avoidable.



REMEMBER

No one is born knowing how to buy a home. Everyone who'd like to buy a home must learn how to do it. Unfortunately, too many people get a crash course in the school of hard knocks — and learn by making costly mistakes at their own expense.

We know you're not a dummy. You've already demonstrated an interest in discovering more about home buying by selecting this book, which can help you make smart moves and avoid financial land mines.

In the event that you're still wondering whether to buy this book, consider that buying a home may well be the largest purchase that you ever make. Buying a home can send shock waves through your personal finances and may even cause a sleepless night or two. Purchasing a home is a major financial step and a life event for most people. It certainly was for us when we bought our first homes. You owe it to yourself to do things right.

About This Book: The Eric Tyson/Ray Brown Difference

We know that many home-buying books are competing for your attention. Here are several other compelling reasons why this is the best book for you:

- » **It's in plain English.** Because we work with real people and answer real questions, our information is current, and we have a great deal of experience in explaining things. This experience can put you firmly in control of the home-buying process (rather than having it control you).
- » **It's objective.** We're not trying to sell you an expensive newsletter, seminar, or some real estate product you don't need. Our goal is to make you as knowledgeable as possible before you purchase a home. We even explain why you may *not* want to buy a home. We're not here to be real estate cheerleaders.
- » **It's holistic.** When you purchase a home, that purchase affects your ability to save money and accomplish other important financial goals. We help you understand how best to fit your home acquisition into the rest of your personal-finance plan.
- » **It's a reference.** You can read this book from cover to cover if you want. However, we know you're busy and you likely don't desire to become a real estate expert, so each portion of the book stands on its own. You can read it piecemeal to address your specific questions and immediate concerns.

Icons Used in This Book

Sprinkled throughout this book are cute little icons to help reinforce and draw attention to key points or to flag stuff that you can skip.



TIP

This bull's-eye notes key strategies that can improve your real estate deal and, in some cases, save you lots of moola. Think of these as helpful little paternalistic hints we would whisper in your ear if we were close enough to do so!



WARNING

Numerous land mines await novice as well as experienced home buyers. This explosive symbol marks those mines, and then we tell you how to sidestep them.



INVESTIGATE

Occasionally, we suggest that you do more research or homework. Don't worry: We tell you exactly what you need to do.



REMEMBER

"If I've told you once, I've told you a thousand times. . . ." Remember good old Mom and Dad? From time to time, we tell you something quite important and perhaps repeat ourselves. Just so you don't forget the point, this icon serves as a little nag to bring back those childhood memories.



TECHNICAL
STUFF

Some of you are curious and have time to spare. Others are busy and just want to know the essentials. This geeky icon points out tidbits and information that you don't really have to know, but understanding this stuff can make you more self-confident and proud!



CHECK IT
OUT

Want to calculate your monthly expenses? Or have a handy-dandy list available when you interview Realtors and home inspectors? Wanna see what your bank may include on a mortgage application? These along with lots of other important stuff can be found online at www.dummies.com/go/homebuyingkit7e.

Beyond the Book

In addition to the material in the print or e-book you're reading right now, this product also comes with some access-anywhere goodies on the web. Check out the free Cheat Sheet at www.dummies.com/cheatsheet/homebuyingkit for 20 home-buying tips and a monthly mortgage payment calculator.

Also, go online to www.dummies.com/go/homebuyingkit7e to access the "kit" part of this book. You'll find a variety of useful forms, including many of the lists and applications that we show in the book. You can print out the application forms and fill them in, just to ensure you have all the information you need. And you can also print out the lists of questions for potential Realtors and property inspectors so you're prepared when interviewing them.

Here's a list of what you'll find at www.dummies.com/go/homebuyingkit7e:

Table 1-1	Figuring future rent
Table 2-1	Your spending, now and after purchasing a home
Table 3-1	Monthly mortgage payment calculator
Chapter 3	Estimated homeownership expenses
Chapter 3	1040 Schedule A

Chapter 7	Request for Copy of Tax Return (Form 4506)
Chapter 7	Tax Information Authorization (Form 8821)
Chapter 7	Release of Authorization grants permission to your mortgage lender or broker to verify and document the financial facts of your life
Chapter 7	Good faith estimate form
Chapter 7	The Uniform Residential Loan Application, Parts I through X
Chapter 7	Right to receive appraisal form
Chapter 9	Agent activity list
Chapter 9	Agent references
Chapter 9	Interviewing agents
Chapter 12	Sample counteroffer form
Chapter 13	Interviewing property inspectors
Chapter 14	TRID Loan Estimate
Appendix A	California Association of Realtors' Purchase Contract
Appendix B	Short-Sale Addendum
Appendix B	Short-Sale Addendum and Advisory
Appendix C	Sample Inspection Report
Appendix C	Buyer's Inspection Advisory

Where to Go from Here

Odds are you're not quite ready to bolt over to the nearest bank and take out a mortgage — and we don't suggest that you blindly call the first Realtor you find online. It's up to you where you go from here, but if you're just beginning to think about buying your first home, we recommend that you read this book straight through, cover to cover, to maximize your home-buying savvy. But the A-to-Z approach isn't necessary — if you feel pretty confident in your knowledge of certain areas, pick other ones that you're most interested in by either skimming this book's table of contents or by relying on the well-crafted index at the back of the book.

1

Getting Started with Buying a Home

IN THIS PART . . .

Compare the pros and cons as well as the economics of renting versus buying and owning your own home.

Get your personal finances in order before buying.

Determine how much you can afford to spend on a home.

Understand the drivers of home prices in your local market.

- » Considering the pros and cons of owning and renting
- » Avoiding common mistakes when deciding to buy or rent

Chapter **1**

Deciding Whether to Buy

Every month, week, and day, we buy things large and small: lunch, a new pair of shoes, and every now and then, a car.

Most people buy things without doing much comparison shopping, but instead draw upon their past experiences. When the counter help at the nearby coffee-house is friendly and you like the brew, you go back for more.

Sometimes purchases lead you by association to related purchases. You get a pet cat or dog, for instance, and buying a collar and pet toys may naturally follow. By the same token, you buy a home, and before long you have a new sofa and dining table.

You end up being really happy with some items you purchase. Others fall short of your expectations . . . or worse. When the items in question don't cost you much, it's no big deal. Perhaps you return them or simply don't buy more in the future. But when it comes to buying a home, that kind of sloppy shopping can lead to financial and emotional disaster.

If you're not willing to invest time, and if you don't work with and heed the advice of the best people, you can end up overpaying for a home you hate. Our goals in this book are simple: to ensure that you're happy with the home you buy, that you get the best deal you can, and that owning the home helps you accomplish your financial goals.

Weighing the Advantages of Owning versus Renting

Nearly everyone seems to have an opinion about buying a home. People in the real estate business — including agents, lenders, property inspectors, and other related people — endorse homeownership. Of course, why wouldn't they? Their livelihoods depend upon it! Therein lies one fundamental problem of nearly all home-buying books written by people who have a vested interest in convincing their readers to buy a home.



REMEMBER

Homeownership isn't for everyone. One of our objectives in this chapter is to help you determine whether home buying is right for you.

Consider the case of Peter, who thought that owning a home was the best financial move he could make. What with tax write-offs and living in a place while it made money for him, he thought how could he lose? Peter envied his colleagues at work who'd seemingly made piles of money with property they bought years ago. Peter was a busy man and didn't have time to research other ways to invest his money.

Unfortunately, Peter bought a place that stretched his budget and required lots of attention and maintenance. Adding insult to injury, Peter went to graduate school clear across the country (something he knew he was likely to do at the time he bought) three years after he purchased. During these three years of his ownership, home prices dropped 10 percent in Peter's neighborhood. So after paying the expenses of sale and closing costs, Peter ended up losing his entire down payment when he sold.

Conversely, some people who continue to rent should buy. In her late 20s, Melody didn't want to buy a home, because she didn't like the idea of settling down. Her monthly rent seemed so cheap compared with the sticker prices on homes for sale.

As it always does, time passed. Melody's 20s turned into 30s, which melted into 40s and then 50s, and she was still renting. Her rent skyrocketed to eight times what it was when she first started renting. She fearfully looked ahead to escalating rental rates in the decades when she hoped to be retired.

Ownership advantages

Most people should eventually buy homes, but not everyone and not at every point in their lives. To decide whether now's the time for you to buy, consider the advantages of buying and whether they apply to you.

Owning should be less expensive than renting

You probably didn't appreciate it growing up, but in addition to the diaper changes, patience during potty training, help with homework, bandaging of bruised knees, and countless meals, your folks made sure that you had a roof over your head. Most of us take shelter for granted, unless we don't have it or are confronted for the first time with paying for it ourselves.

Remember your first apartment when you graduated from college or when your folks finally booted you out? That place probably made you appreciate the good deal you had before — even those cramped college dormitories may have seemed more attractive!

But even if you pay several hundred to a thousand dollars or more per month in rent, that expense may not seem so steep if you happen to peek at a home for sale. In most parts of the United States, we're talking about a big number — \$150,000, \$225,000, \$350,000, or more for the sticker price. (Of course, if you're a higher-income earner, you may think that you can't find a habitable place to live for less than a half-million dollars, especially if you live in costly places such as New York City, Boston, Chicago, Los Angeles, or San Francisco.)



TIP

Here's a guideline that may change the way you view your seemingly cheap monthly rent. To figure out the price of a home you can buy for approximately the same monthly cost as your current rent, simply do the following calculation:

Take your monthly rent and multiply by 200, and you come up with the purchase price of a home.

\$ _____ per month \times 200 = \$ _____

Example: $\$1,000 \times 200 = \$200,000$

So, in the preceding example, if you were paying rent of \$1,000 per month, you would pay approximately the same amount per month to own a \$200,000 home (factoring in modest tax savings). Now your monthly rent doesn't sound quite so cheap compared with the cost of buying a home, does it? (Note that in Chapter 3 we show you how to accurately calculate the total costs of owning a home.)



WARNING

Even more important than the cost *today* of buying versus renting is the cost in the *future*. As a renter, your rent is fully exposed to increases in the cost of living, also known as *inflation*. A reasonable expectation for annual increases in your rent is 4 percent per year. Figure 1-1 shows what happens to a \$1,000 monthly rent at just 4 percent annual rental inflation.

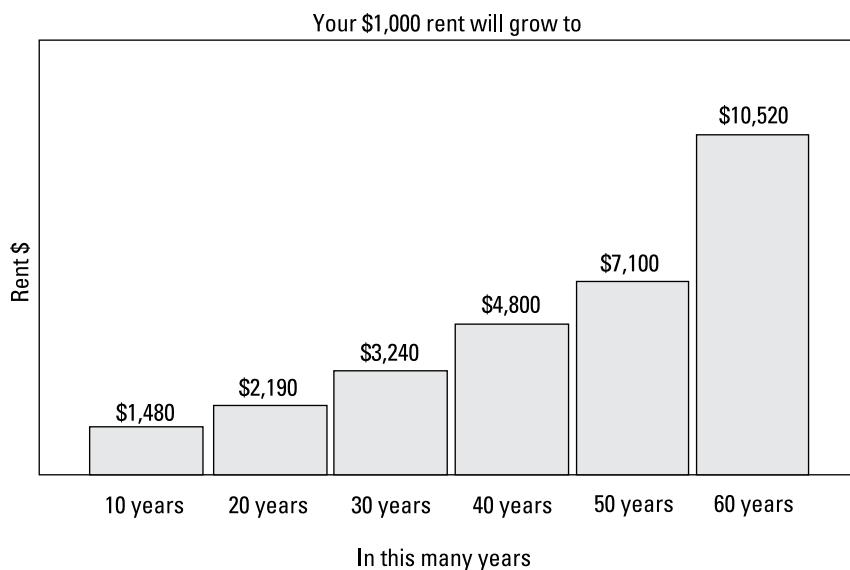


FIGURE 1-1:
The skyrocketing
cost of renting.

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When you're in your 20s or 30s, you may not be thinking or caring about your golden years, but look what happens to your rent over the decades ahead with just modest inflation! Then remember that paying \$1,000 rent per month now is the equivalent of buying a home for \$200,000. Well, in 40 years, with 4 percent inflation per year, your \$1,000-per-month rent will balloon to \$4,800 per month. That's like buying a house for \$960,000!



CHECK IT
OUT

In our example, we picked \$1,000 for rent to show you what happens to that rent with a modest 4 percent annual rate of inflation. To see what may happen to your current rent at that rate of inflation (as well as at a slightly higher one), simply complete Table 1-1. (You can also access Table 1-1 online at www.dummies.com/go/homebuyingkit7e.)



REMEMBER

If you're middle-aged or retired, you may not plan on having 40 to 60 years ahead of you. On the other hand, don't underestimate how many more years of housing you'll need. U.S. health statistics indicate that at age 50, you have a life expectancy of 30+ more years, and at age 65, 20+ more years (women on average tend to live a few years longer).

TABLE 1-1 **Figuring Future Rent**

Your Current Monthly Rent	Multiplication Factor to Determine Rent in Future Years at 4 Percent Annual Inflation Rate	Projected Future Rent
\$ _____	× 1.48	= \$ _____ in 10 years
\$ _____	× 2.19	= \$ _____ in 20 years
\$ _____	× 3.24	= \$ _____ in 30 years
\$ _____	× 4.80	= \$ _____ in 40 years
\$ _____	× 7.11	= \$ _____ in 50 years
\$ _____	× 10.52	= \$ _____ in 60 years

Your Current Monthly Rent	Multiplication Factor to Determine Rent in Future Years at 6 Percent Annual Inflation Rate	Projected Future Rent
\$ _____	× 1.79	= \$ _____ in 10 years
\$ _____	× 3.21	= \$ _____ in 20 years
\$ _____	× 5.74	= \$ _____ in 30 years
\$ _____	× 10.29	= \$ _____ in 40 years
\$ _____	× 18.42	= \$ _____ in 50 years
\$ _____	× 32.99	= \$ _____ in 60 years

Although the cost of purchasing a home generally increases over the years, after you purchase a home, the bulk of your housing costs aren't exposed to inflation if you use a fixed-rate mortgage to finance the purchase. As we explain in Chapter 6, a *fixed-rate mortgage* locks your mortgage payment in at a fixed amount (as opposed to an adjustable-rate mortgage payment that fluctuates in value with changes in interest rates). Therefore, only the comparatively smaller property taxes, insurance, and maintenance expenses will increase over time with inflation. (In Chapter 3, we cover in excruciating detail what buying and owning a home costs.)

**REMEMBER**

You're always going to need a place to live. And over the long term, inflation has almost always been around. Even if you must stretch a little to buy a home today, in the decades ahead, you'll be glad you did. The financial danger with renting long term is that *all* your housing costs (rent) increase over time. We're not saying that everyone should buy because of inflation, but we do think that if you're not going to buy, you should be careful to plan your finances accordingly. We discuss the pros and cons of renting later in this chapter.

USES FOR THE WEALTH YOU BUILD UP IN YOUR HOME

Over the many years that you're likely to own it, your home should become an important part of your financial *net worth* — that is, the difference between your *assets* (financial things of value that you own, such as bank accounts, retirement accounts, stocks, bonds, mutual funds, and so on) and your *liabilities* (debts). Why? Because homes generally increase in value over the decades while you're paying down the loan used to buy the home. Remember, we're talking about the long term here — decades, not just a few years. The housing market goes through downturns — the late 2000s being the most recent down period — but the long-term trend has always been higher.

Even if you're one of those rare people who own a home but don't see much *appreciation* (increase in the home's value) over the decades of your adult ownership, you still benefit from the monthly forced savings that result from paying down the remaining balance due on your mortgage. Older folks can tell you that owning a home free and clear of a mortgage is a joy.

All that home *equity* (the difference between the market value of a home and the outstanding loan on the home) can help your personal and financial situation in a number of ways. If, like most people, you hope to someday retire but (also like most people) saving doesn't come easily, your home's equity can help supplement your other sources of retirement income.

How can you tap into your home's equity? Here are three main ways:

- Some people choose to *trade down* — that is, to move to a less costly home in retirement. Sell your home for \$500,000, replace it with one that costs \$300,000, and you've freed up \$200,000. Subject to certain requirements, you can sell your home and realize up to \$250,000 in tax-free profits if you're single, or \$500,000 if married. (See Chapter 17 to find out more about this homeownership tax break.)
- Another way to tap your home's equity is through borrowing. Your home's equity may be an easily tapped and low-cost source of cash (the interest you pay is generally tax-deductible — see Chapter 3).
- Some retirees also consider what's called a *reverse mortgage*. Under this arrangement, the lender sends you a monthly check that you can spend however you want. Meanwhile, a debt balance (that will be paid off when the property is finally sold) is built up against the property.

What can you do with all this home equity? Help pay for your children's college education, start your own business, remodel your home, use it toward your retirement, or whatever!

You can make your house your own

Think back to all the places you ever rented, including the rental in which you may currently be living. For each unit, make a list of the things you really didn't like that you would have changed if the property were yours: ugly carpeting, yucky exterior paint job, outdated appliances that didn't work well, and so on.

Although we know some tenants who actually do some work on their own apartments, we don't generally endorse this approach because it takes your money and time but financially benefits the building's owner. If, through persistence and nagging, you can get your landlord to make the improvements and repairs at her expense, great! Otherwise, you're out of luck or cash!

When you own your own place, however, you can do whatever you want to it. Want hardwood floors instead of ugly, green shag carpeting? Tear it out. Love neon-orange carpeting and pink exterior paint? You can add it!



WARNING

In your zest and enthusiasm to buy a place and make it your own, be careful of two things:

- » **Don't make the place too weird.** You'll probably want or need to sell your home someday, and the more outrageous you make it, the fewer buyers it will appeal to — and the lower the price it will likely fetch. If you don't mind throwing money away or are convinced that you can find a buyer with similarly (ahem) sophisticated tastes, be as unusual as you want. If you do make improvements, focus on those that add value: a deck addition for an outdoor living area, updated kitchens and bathrooms, and so on.
- » **Beware of running yourself into financial ruin.** Changing, improving, remodeling, or whatever you want to call it costs money. We know many home buyers who neglect other important financial goals (such as saving for retirement and their kids' college costs) in order to endlessly renovate their homes. Others rack up significant debts that hang like financial weights over their heads. In the worst cases, homes become money pits that cause owners to build up high-interest consumer debt as a prelude to bankruptcy or foreclosure.

You avoid unpleasant landlords

A final (and not inconsequential) benefit of owning your own home is that you don't have to subject yourself to the whims of an evil landlord. Much is made among real estate investors of the challenges of finding good tenants. As a tenant, perhaps you've already discovered that finding a good landlord isn't easy, either.



REMEMBER

The fundamental problem with some landlords is that they're slow to fix problems and make improvements. The best (and smartest) landlords realize that keeping the building shipshape helps attract and keep good tenants and maximizes rents and profits. But to some landlords, maximizing profits means being stingy with repairs and improvements.

When you own your home, the good news is that you're generally in control — you can get your stopped-up toilet fixed or your ugly walls painted whenever and however you like. No more hassling with unresponsive, obnoxious landlords. The bad news is that you're responsible for paying for and ensuring completion of the work. Even if you hire someone else to do it, you still must find competent contractors and oversee their work, neither of which is an easy responsibility.

Another risk of renting is that landlords may decide to sell the building and put you out on the street. You should ask your prospective landlords whether they have plans to sell. Some landlords won't give you a truthful answer, but the question is worth asking if this issue is a concern to you.



TIP

One way to avoid being jilted by a wayward landlord is to request that the lease contract guarantee you the right to renew your annual lease for a certain number of years, even with a change in building ownership. Unless landlords are planning on selling, and perhaps want to be able to boot you out, they should be delighted with a request that shows you're interested in staying a while. Also, by knowing if and when a landlord desires to sell, you may be able to be the buyer!

Renting advantages

Buying and owning a home throughout most of your adult life makes good financial and personal sense for most people — but not all people and not at all times. Renting works better for some people. The benefits of renting are many:

- » **Simplicity:** Yes, searching for a rental unit that meets your needs can take more than a few days (especially if you're in a tight rental market), but it should be a heck of a lot easier than finding a place to buy. When you buy, you must line up financing, conduct inspections, and deal with myriad other issues that renters never have to face. When you do it right, finding and buying a good home can be a time-consuming pain in the posterior.
- » **Convenience:** After you find and move into your rental, your landlord is responsible for the never-ending task of property maintenance and upkeep. Buildings and appliances age, and bad stuff happens: Fuses blow, plumbing backs up, heaters break in the middle of winter, roofs spring leaks during record-breaking rainfalls, trees come crashing down during windstorms. The list goes on and on and on. As a renter, you can kick back in the old recliner

with your feet up, a glass of wine in one hand and the remote control in the other, and say, “Ahhhhh, the joys of *not* being part of the landed gentry!”

- » **Flexibility:** If you're the footloose and fancy-free type, you dislike feeling tied down. With a rental, as long as your lease allows (and most leases don't run longer than a year), you can move on. As a homeowner, if you want to move, you must deal with the significant chores of selling your home or finding a tenant to rent it.
- » **Increased liquidity:** Unless you're the beneficiary of a large inheritance or work at a high-paying job, you'll probably be financially stretched when you buy your first home. Coming up with the down payment and closing costs usually cleans out most people's financial reserves. In addition, when you buy a home, you must meet your monthly mortgage payments, property taxes, insurance, and maintenance and repair expenses. As a renter, you can keep your extra cash to yourself, and budgeting is also easier without the upkeep-expense surprises that homeowners enjoy, such as the sudden urge to replace a leaking roof or old furnace.



TIP

You don't need to buy a home to cut your taxes. Should you have access to a retirement account such as a 401(k), 403(b), or SEP-IRA plan (see Chapter 2), you can slash your taxes while you save and invest your extra cash *as a renter*. So saving on taxes shouldn't be the sole motivation for you to buy a home.

- » **Better diversification:** Many homeowners who are financially stretched have the bulk of their wealth tied up in their homes. As a renter, you can invest your money in a variety of sound investments, such as stocks, bonds, and perhaps your own small business. You can even invest a small amount of money in real estate through stocks or mutual funds if you want (see Chapter 16). Over the long term, the stock market has produced comparable rates of return to investing in the real estate market.
- » **Maybe lower cost:** If you live in an area where home prices have rocketed ahead much faster than rental rates, real estate may be overpriced and not a good buy. In Chapter 4, we explain how to compare the cost of owning to the cost of renting in your area and how to spot a potentially overpriced real estate market.



REMEMBER

Renting should also be cheaper than buying if you expect to move soon. Buying and selling property costs big bucks. With real estate agent commissions, loan fees, title insurance, inspections, and all sorts of other costs, your property must appreciate approximately 15 percent just for you to break even and recoup these costs. Therefore, buying property that you don't expect to hold onto for at least three (and preferably five or more) years doesn't make much economic sense. Although you may sometimes experience appreciation in excess of 15 percent over a year or two, most of the time, you won't. If you're counting on such high appreciation, you're setting yourself up for disappointment.

The Pitfalls of the Rent-versus-Buy Decision

When you're considering purchasing a home, you can do lots of reflecting, crunch plenty of numbers, and conduct copious research to help you with your decision. We encourage these activities and show you how to do them in later chapters.

In reality, we know that many people are tempted to jump into making a decision about buying or continuing to rent without setting all their ducks in a row. At a minimum, we want to keep you from making common costly mistakes, so in the following sections, we go over the biggies to avoid.

Renting because it seems cheaper

When you go out to look at homes on the market *today*, the sticker prices are typically in the hundreds of thousands of dollars. Your monthly rent seems dirt-cheap by comparison.



REMEMBER

You must compare the *monthly* cost of homeownership with the monthly cost of renting. And you must factor in the tax savings you'll realize from homeownership tax deductions. (We show you how to make these calculations in Chapter 3.) But you must also think about the future. Just as your educational training affects your career prospects and income-earning ability for years to come, your rent-versus-buy decision affects your housing costs — not just this year, but also for years and decades to come.

Fretting too much over job security

Being insecure about your job is natural. Most people are — even corporate executives, superstar athletes, and movie stars. And buying a home seems like such a permanent thing to do. Job-loss fears can easily make you feel a financial noose tightening around your neck when you sit down to sign a contract to purchase a home.

Although a few people have real reasons to worry about losing their jobs, the reality is that the vast majority of people shouldn't worry about job loss. We don't mean to say that you *can't* lose your job — almost anyone can, in reality. Just remember that within a reasonable time, your skills and abilities will allow you to land back on your feet in a new, comparable position. We're not career experts, but we've witnessed many folks bounce back in just this way.