

Lesson 1: Buying a House

Part 1

Student Guide Pages: 165-173

Lesson Objectives: By the end of this lesson, your students should be able to:

- explain the Five-Year Rule
- name six questions they should ask before they buy a home

Lesson Summary:

The Five-Year Rule states that if you're in the same place for more than five years, buying typically makes sense over renting. This number comes from historical data on home ownership. It's possible but unlikely that you will lose money on a home if you can hold on to it for at least five years. Thus, the first of the six questions to ask yourself is: "Am I reasonably certain I will stay in this home for at least five years?" This alone, however, is not gospel. There are five other ways to ensure that your home will be a good investment:

- **Put at least 10 percent down.** When you borrow money to buy a home, banks will not typically lend you 100 percent of the home price, so you must put in some money of your own. If

you cannot afford at least 10 percent, you cannot afford to buy a house. (10% is typically for first-time home buyers. Otherwise the down payment required is now 20%.)

- **Do not buy a home with an adjustable-rate mortgage.** Remember, whether we're talking cars or houses, *always* go with a fixed-rate loan.
- **The size of the loan cannot be more than three times your annual income.** Banks usually force this rule, but they sometimes ease up on it. Even if they do, it is a good rule of thumb to obey.
- **Plan on putting 5 percent of the mortgage payment into savings for home repairs.** Now that you are the owner, you have to fix everything, so create a house emergency fund.
- **Do all the other stuff.** Pay off your credit card debt and get adequate insurance.

At this point, most people realize they *cannot* afford to buy a home. For some, such as those who live in urban areas, home buying is absolutely out of the question, but that's okay. As long as you are saving, investing, paying off debt, focusing on your goals, and properly insuring yourself, you're doing just fine with your financial life.

Review Questions:

- Kathy is looking at a condo with an adjustable rate, locked for five years. She knows she will move out and sell the place before that. So what's wrong with getting an adjustable rate?

Answer: Sometimes things change. Kathy might stay where she is, or she may want to rent out her place. She might not be able to sell it for the price she wants, so she'll keep it longer. Remember, if you cannot afford the house with a fixed rate, you cannot afford the house.

- Jim bought a house with a fixed-rate loan. He usually sends the bank \$1,200 a month, but he got a statement in the mail last month that says he owes \$1,260. What happened?

Answer: Remember that while your loan payment is the same, taxes and insurance costs can go up. Jim's taxes and insurance are rolled into his loan bill (aka *escrowed*), so when those numbers go up, so does his bill.

Homework Assignment:

This is a two-day assignment. Students should pretend they are buying a home, and they should follow the steps they've learned. Randomly assign them artificial incomes ranging from \$25,000 to \$250,000, then instruct them to search the newspapers and online

for area homes for sale. They should visit lendingtree.com and use the mortgage calculator to determine how much they can afford. Remind them that their monthly mortgage payments should not exceed 30 percent of their monthly income, and you should assume a 6 percent interest rate and a 10 percent down payment. They can even call realtors and inquire about specific houses or look up home prices online. They can call the Police Department for crime statistics. Ask them to research local homebuyer programs in their area.

Students should present a written report of their findings. What house did they buy? How much did they borrow? What are their monthly payments? What other factors did they consider? Which ones did they overlook?

Class Activity:

Before students undertake the above exercise, have the class review the steps that should be taken in buying a home. Encourage them to brainstorm. What should they consider before they buy? Location? Schools? Public transportation?

Additional Information:

www.realtor.org: Find a local real estate agent here.

www.hud.gov: Housing and Urban Development is the government agency that helps homeowners and communities.

www.ncsha.org: This is the website of the National Council of State Housing Authorities. Here, you can find first-time homebuyer programs available in your state. Your state Housing Authority can tell you all about grants as well.

Fun Facts:

Most towns now post the property tax database online. Google your town name and “tax assessor.” Look up a property that is currently for sale. Is there a difference between the *assessed price*, which is what the tax collector thinks it’s worth, and the for-sale price? A house that is selling for *less* than its assessed price is usually a good deal!

Notes: _____

Homebuyer's Checklist

Review and answer the following questions. Do not make an offer until you have answered yes to all nine questions.

1. *Have you seen at least five homes?* YES NO

2. *Are you preapproved for a mortgage?* YES NO

Preapproved means you're already locked in for a rate. It makes you look like a more serious buyer and avoids the all-too-common snag of making an offer, then failing to get proper financing. Get preapproved before making an offer. If you cannot get preapproved, at least get *prequalified*, which is a slightly easier step.

3. *Have you examined your:*

a. *Finances* YES NO

b. *Mortgage Payments* YES NO

c. *Closing Costs* YES NO

d. *Moving Costs* YES NO

e. *New Commuting Costs* YES NO

f. *Taxes* YES NO

g. *Insurance Costs* YES NO

4. *Have you called the local Police Department for crime statistics?*
YES NO

5. *Are you reasonably certain you will be in the area for at least five years?*
YES NO

6. *Have you visited the schools in the area?*
YES NO

7. *Have you chatted with neighbors, especially if it is a condo?*
YES NO

8. *Are you comfortable buying this house after all these considerations?*
YES NO

9. *Have you thought about the hidden costs, like curtains, new furniture, etc.?*
YES NO

10 Frequently Asked Home Inspection Questions

1. **How do I find a home inspector?**

Don't go with the home inspector recommended by your real estate agent. Instead, ask your friends who they use, or look in the phone book or online. If you do ask your agent, ask for multiple names.

2. **Should I write a home inspection into the offer?**

When making an offer to purchase, you can write that the offer is subject to a home inspection, but you can also write in contingency numbers. In other words, if the home inspector finds more than \$400 of flaws, you can back out of the deal and get all your money back. Obviously, the lower this contingency number, the better for you and the worse for the seller.

3. **What does a home inspector do?**

The home inspector walks through the house with a flashlight and clipboard and looks for flaws, like cracks in the foundation, water damage, etc. After the inspection, he gives you a detailed report of his findings.

4. **If the inspector says the house is okay and I move in, but the place falls apart two months later, can I sue him?**

In this day and age, you can sue anyone. There are a number of people you can sue in a botched real estate transaction. If the seller or seller's agent didn't disclose or incorrectly disclosed something, you may be able to sue. You may be able to sue the builder, especially if it's new construction. While the home inspector does a thorough job, he's going through with a clipboard and a flashlight, not an X-ray machine. He is reasonably priced, likely just a few hundred bucks, depending on the size of your house, and he adds that extra level of comfort, even if it's just psychological, on a big transaction. Typically, it is hard to sue a home inspector for these reasons.

5. **How much will an inspection set me back?**

The cost is usually from \$300 to \$500, depending on the size of the house, but it's also usually worth it.

6. **If all the inspector uses is a flashlight and clipboard, can't I just do the inspection on my own?**

You can turn on faucets, flush toilets, and examine closet ceilings for water damage, but an inspector is still highly recommended, because the inspector will know what to look for. You, as a secretary, accountant, teacher, truck driver, or vascular surgeon, do not.

7. **If the inspector finds something wrong, will he fix it for me?**

No! Beware of the contractor posing as a home inspector, the one who takes

your \$300 for the inspection and then tells you he can repair the foundation for \$3,000. Home inspectors *inspect*, and that's it. Let someone else do the repairs, and never take a referral for an inspector's friend. It is best to find your own contractor if repairs must be made.

8. How can you be sure they are qualified in residential home inspection?

Typically, home inspectors need to be licensed. Ask for a copy of their qualifications. Also ask if they are a card-carrying member of the American Society of Home Inspectors (www.ashi.org) or the National Association of Home Inspectors (www.nahi.org).

9. How long will a home inspection take?

It typically takes two to three hours, depending on the size of the home.

10. Should I join the inspector?

You should absolutely attend. Since you will pay for the inspection yourself, you might as well squeeze an educational session out of it.

6 Frequently Asked Real Estate Agent Questions

1. Who do you represent?

There are four types of real estate agents:

- *listing or sub-agent*: represents the seller
- *buyer's agent*: represents the buyer
- *dual agent*: represents buyer and seller
- *non-agent or facilitator*: represents neither

By law, the agent must disclose whom they are working for. It's important to keep in mind who your agent actually represents. While you must sign a disclosure form stating that you understand this, it can be confusing, especially when you just want to see the house. The nice lady driving you around, telling you about the great restaurants in your area, might work for the seller of the property, so when you casually mention, "I could go as high as \$230,000," she is allowed to tell that to the seller.

Dual agents, which are not allowed in every state, arise in the middle of a transaction when the agent has found both the buyer and seller and is equally responsible to both. A non-agent, also not allowed in every state, is someone you can work with without signing any long-term agreements. Non-agency allows business to continue without legal interruptions, a test-the-waters kind of agency. It's usually best for you to work with a buyer's agent, someone who represents you and only you.

2. If you work on commission, don't you want me to buy the most expensive property?

Actually, no. Because real estate agents do earn commission, many believe they are motivated to get people to spend more. In truth, agents make their money with a *quick* sale, not an overpriced one. Imagine a real estate agent earns a 5 percent commission for selling a \$200,000 house. That's \$10,000. However, that agent has to split that \$10,000 with the agent working with the seller. That's still \$5,000, but the agent must split that again with their managing broker, so on a \$200,000 home, the agent really only earns \$2,500. Even if the agent talks you into paying \$210,000, they earn only an extra \$125. In most cases, it's not worth the effort, so don't be afraid of an agent beating you up on price. If anything, they'll try to convince you to act quickly so they can move on to the next sale.

3. Will you show me every house on the market?

That depends. Agents won't show you a house unless they will be paid for it. They may not show you for sale by owner properties because they often do not pay commissions. They may also steer clear of properties with a discount listing,

those that only pay reduced commissions. Buyer brokers often write into their contract a minimum commission of X percent of the price of the house. They credit you any money they get from the selling broker, but ultimately, you are responsible for their fee. While this can mean cash out of your pocket, it does ensure that you will see *every* property. All commission issues should be discussed before you sign any agreements with the agent.

4. How are you paid?

Nearly all real estate agents work on commission and are only paid if you buy a property. Normally, the commission comes out of the selling price of the house. However, buyer's agents often ask for a minimum commission, in the case of for sale by owner. So, if they show you a property sold by the owner, someone who refuses to pay commission, you, the buyer, are responsible for making up any shortfall, if you agreed to that. This will ensure you see all properties and not just those that offer commissions, but it can mean cash out of your pocket. If you ask this up front, you will know what you're getting into.

5. Can you recommend a real estate attorney, mortgage broker, and home inspector?

Sure, but be careful. Real estate agents will recommend those they feel will push the deal along and make it happen, not necessarily the person with your best interests at heart. Just be skeptical of their suggestions and feel free to find your own resources.

6. Will you put what you say you're going to do in writing?

This must be a yes; if it's not in writing, it might not happen.

3 Things to Consider When Making an Offer

1. How long has the property been on the market?

This varies in every market. Ten days could be a long time, and three months could be short. If the property you're looking at is above average, you might have a bargain opportunity. Ask your broker for the days on market (DOM) number. Then ask what the average is in your area.

2. Why is the seller selling?

In any negotiation, the more you know about the other party and the less they know about you, the better. If the seller is motivated, maybe because they divorced, have to move to Florida ASAP, or have gone bankrupt, they may be looking for fast cash. You may want to ask the seller if there are any special circumstances that would lower the price. Perhaps they don't want to move during the holidays. Perhaps they want to take their prize-winning rose bushes with them. You never know unless you ask. Remember, every deal has a price and terms, and you can negotiate both. Be sure to make use of the Negotiation Checklist in Part 5, Lesson 5.

3. You also want your offer to be subject to:

- a home inspection
- a pest inspection, if it is common in your area
- property to be delivered vacant and broom clean
- a walkthrough with the broker before you exchange the final funds
- your attorney's review of the condominium documents, if applicable
- financing, as not acquiring financing will weaken your offer

Most local realtor organizations have standard forms, but you can always write in anything you want. If you have any questions, just ask your real estate agent.