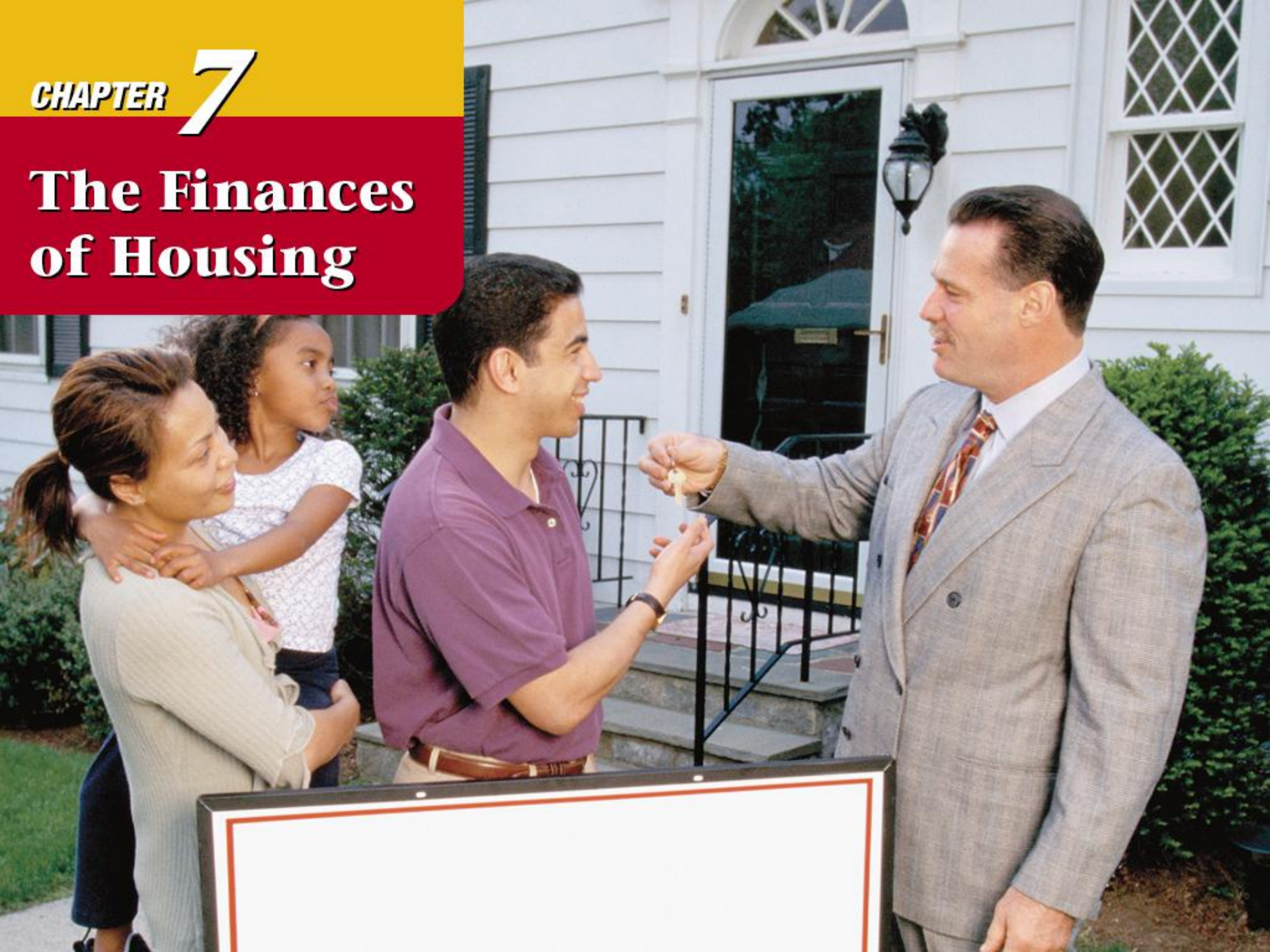


CHAPTER 7

**The Finances
of Housing**



Chapter 7

The Finances of Housing

What You'll Learn

- **Section 7.1**
 - Evaluate various housing alternatives.
- **Section 7.2**
 - Assess the advantages and disadvantages of renting.
 - Identify the costs of renting.
- **Section 7.3**
 - Identify the advantages and disadvantages of owning a residence.
 - Explain how to evaluate a property.
 - Discuss the financing involved in purchasing a home.
 - Describe a plan for selling a home.

Housing Options

- **Q:** My older sister loves her new job and has decided that she would like to work for her company at least five years. Is this a good time for her to buy a house, or should she continue renting?
- **A:** A home can be an excellent investment, but your sister will need to take some things into consideration before she makes this decision. For example, she will need to assess her finances to determine if she can afford to buy a house. She must also consider whether she wants to spend time maintaining a house; if not, it may be best for her to continue renting.

Go to finance07.glencoe.com to complete the Standard & Poor's Financial Focus activity.

Section 7.1

Housing Options

*Before
You Read*



PREDICT

Do you plan to own or rent a residence?
Explain your choice.

Main Idea

Knowing about housing options will help you spend your money wisely now and in the future.

Section 7.1

Housing Options

Your Lifestyle and Choice of Housing

Finances play an important role in housing decisions.

One major factor you will need to consider when making housing decisions is your lifestyle. Your lifestyle will determine:

- How close to work you want to live
- How long you plan to stay in one place
- How much privacy you would like to have

Section 7.1

Housing Options

mobility

the ability to move easily from place to place

Opportunity Costs of Housing Choices

When you make choices about housing, you have to consider what you will be giving up in terms of:

- Time
- Effort
- Money

Renting an apartment, for example, may give you more **mobility**, but you will give up the tax advantages that homeowners enjoy.

Section 7.1

Housing Options

Renting versus Buying

One of the most basic considerations about housing is whether to rent or buy. Your decision will depend on:

- Your lifestyle
- Financial factors

Section 7.1

Housing Options

Renting

Renting is a good choice for:

- Young adults who are beginning their careers
- People who want or need mobility
- People who do not want to devote time or money to maintenance

Because renting is often—though not always—cheaper than owning a home, it appeals to people whose funds are limited.

Section 7.1

Housing Options

Buying

Owning property is a wise choice for people who want:

- A certain amount of stability in their lives
- Privacy and some freedoms that may not be available to a renter

While ownership can be costly, it offers financial benefits, such as:

- Tax advantages
- Potential for a good long-term investment if the value of the house increases

Section 7.1

Housing Options

Housing Information Sources

Housing information is plentiful and often free. You can begin researching on your own, using a variety of sources:

- Libraries
- Newspapers
- Internet
- Friends and family
- Real estate agents
- Government agencies

Section 7.2

Renting a Residence

*Before
You Read*



PREDICT

How would you begin a search for an apartment?

Main Idea

Knowing more about the advantages, disadvantages, and costs of renting will help you make the right choice.

Section 7.2

Renting a Residence

tenant

a person who pays for the right to live in a residence owned by someone else

landlord

the person who owns the property that you rent

Selecting a Rental Unit

When you rent the place where you live, you become a **tenant** with a **landlord**.

When making a selection, you should consider the differences in the rental units':

- Size
- Cost
- Location

Section 7.2

Renting a Residence

Size and Cost

Most people who rent live in apartments. These units may be located in:

- A two-story house
- A high-rise building
- An apartment complex

Some apartments are located in complexes with on-site conveniences such as:

- Swimming pools
- Laundry facilities

Section 7.2

Renting a Residence

Renting a House or Private Room

A family or individual who needs more space than an apartment provides may prefer to rent a house.

A single person with very few possessions might choose to rent a private room in a house. In this case, the person may have to share common areas, such as the:

- Kitchen
- Bathroom

Section 7.2

Renting a Residence

Sources of Information

To find a rental unit, you can:

- Check the classified section of the local newspaper.
- Ask friends and coworkers for suggestions.
- Check with real estate and rental offices.

Section 7.2

Renting a Residence

Advantages of Renting

The three main advantages of renting over buying a home are:

- Greater mobility
- Fewer responsibilities
- Lower initial costs

Section 7.2

Renting a Residence

Mobility

For many people, the appeal of renting is the mobility it offers. For example, you may wish to move if:

- You are offered a job in another town.
- You decide that you want to live in a different community.
- Your family is growing and needs more space.

Section 7.2

Renting a Residence

Fewer Responsibilities

Tenants do not have many of the responsibilities that homeowners have, including:

- Making major repairs and maintaining the property
- Worrying about property taxes or property insurance

Section 7.2

Renting a Residence

Low Initial Costs

A third advantage to renting is cost. Buying a house typically requires many thousands of dollars for:

- The down payment
- Other costs

In contrast, you usually pay the equivalent of only one or two months' rent to move into a rental unit.

Section 7.2

Renting a Residence

Disadvantages of Renting

Renting is a good option for many people, but it has some disadvantages.

For example, renting:

- Offers few financial benefits
- Can contribute to a more restrictive lifestyle
- May involve various legal issues for tenants

Section 7.2

Renting a Residence

Financial and Lifestyle Restrictions

Certain financial benefits are available to homeowners but not to tenants. For example, homeowners:

- Are eligible for various tax deductions
- Benefit as the value of their property increases
- Gradually pay back the money they borrowed to buy their home, eventually eliminating their monthly housing payments

Tenants must also accept certain limitations regarding their activities in the places they rent.

Section 7.2

Renting a Residence

lease

a legal document that defines the conditions of the rental agreement between the tenant and the landlord

Legal Issues

If you decide to rent, you will probably have to sign a **lease**. When you sign a lease:

- Make sure you understand and agree with what it says.
- Pay special attention to the amount and due date of the monthly rent and the length of the rental period.
- Check to see whether you have the right to sublet the property if you want to move out before the lease expires.

A lease is designed to protect the rights of both the landlord and the tenant.

Section 7.2

Renting a Residence

The Cost of Renting

Some of the factors that affect and determine the price of renting a home include:

- Location
- Living space
- Utilities
- Security deposit
- Insurance

Section 7.2

Renting a Residence

Location

The amount of your monthly rent will depend on the location, or neighborhood, where you choose to live.

You will need to decide whether you are willing to pay more for an apartment that is, for example, close to:

- A park
- Work

Section 7.2

Renting a Residence

Living Space

The price of a rental unit will also depend on the amount of living space that you require.

Your choices, from least to most expensive, are:

- A private room in a house
- An apartment
- A townhouse or single-family house

You might consider living with one or more roommates to share expenses.

Figure 7.5

Finding and Living in Rental Housing

Step 1: The Search

- Choose a location and a price that fits your needs.
- Compare costs and features among possible rental units.
- Talk to people who live in the apartment complex or the neighborhood where the units are located.

Step 3: Living in Rental Property

- Notify the owner of any necessary repairs.
- Respect the rights of neighbors.
- Obtain renters insurance to protect personal belongings.

Step 2: Before Signing a Lease

- Be sure that you understand and agree with all aspects of the lease.
- Note the condition of the rental unit in writing; have the unit's owner sign it.

Step 4: At the End of the Lease

- Leave the unit in good condition.
- Tell your landlord where to send your refunded security deposit.
- Ask that any deductions from your deposit be explained in writing.

Seeing Eye to Eye

Renting involves more than just finding a desirable apartment.

How do these steps protect the rights of both tenant and landlord?



Common CENTS

On Your Own

Sharing an apartment or a house with a roommate is a great way to cut costs and can be fun. It is a good idea to have a trial period to make sure you get along before making a long-term commitment.

Why do you think sharing an apartment or a house will help you cut costs?

Section 7.2

Renting a Residence

Utilities

You may also have to pay for utilities, such as:

- Electricity
- Gas
- Water
- Trash

Before you sign a lease, be sure to ask your landlord if the rent payment includes any utilities.

Section 7.2

Renting a Residence

security deposit

an amount of money paid to the owner of the property by a tenant to guard against any financial loss or damage that the tenant might cause

Security Deposits

When you sign a lease, you may have to pay a **security deposit**.

When you move out, your landlord must return the security deposit, minus any charges for:

- Damage you may have caused
- Any unpaid rent

Security deposits usually equal one or two months' rent.

Section 7.2

Renting a Residence

renters insurance

a type of insurance that covers the loss of a tenant's personal property as a result of damage or theft

Renters Insurance

Another expense is **renters insurance**. Many tenants neglect to buy renters insurance, wrongly assuming that their possessions are covered by their landlord's insurance.

Most tenants who buy it find the cost worth the peace of mind it brings.

Section 7.3

Buying and Selling a Home

*Before
You Read*



PREDICT

If you plan to own a house one day, how do you think you begin the process?

Main Idea

Understanding the processes involved with homeownership is necessary when you buy or sell a home.

Section 7.3

Buying and Selling a Home

The Home-Buying Process

Buying a home is a huge financial commitment.

In order to purchase a home, you will need to:

- Determine your home ownership needs.
- Find and evaluate a property to purchase.
- Price the property.
- Obtain financing.
- Close the transaction.

Section 7.3

Buying and Selling a Home

Step 1: Determine Your Home Ownership Needs

To make an informed decision about whether to buy a home, you will need to consider:

- The benefits and drawbacks of ownership
- The types of homes that are available
- How much you can afford to spend

Section 7.3

Buying and Selling a Home

equity

the value of the home less the amount still owed on the money borrowed to purchase it

Owning Your Residence: Benefits

As a homeowner, you can enjoy benefits such as:

- A sense of stability and permanence
- Freedom to decorate, change your own home, and have pets
- Tax deductions

Homeowners can usually sell their homes for a profit, depending on their **equity**.

Section 7.3

Buying and Selling a Home

Owning Your Residence: Drawbacks

Some drawbacks of being a homeowner include:

- Financial risk
- Limited mobility
- High expenses

The cost of taking good care of a home can be quite high, even if homeowners do most of the work themselves.

Section 7.3

Buying and Selling a Home

Types of Housing

Homes come in all shapes and sizes, providing housing alternatives for a range of budgets and lifestyles. You can choose between:

- Single-family dwellings
- Multiunit dwellings
- Condominiums
- Cooperative housing
- Prefabricated homes
- Mobile homes

Section 7.3

Buying and Selling a Home

Affordability and Your Needs

Selecting a type of dwelling is only one part of determining your home ownership needs. You will also need to consider:

- The price of a home and the required down payment
- Its size
- Its quality

As you advance in your career and your income increases, you may be able to “trade up” and purchase a home with some extra comforts.

Section 7.3

Buying and Selling a Home

Step 2: Find and Evaluate a Property to Purchase

You will be able to start searching for a property to purchase when you know:

- What type of residence you would prefer
- What you can afford

Section 7.3

Buying and Selling a Home

Selecting a Location

Some factors that can help you determine where you want to live are:

- The distance between home and work
- The quality of the local school system
- Your interests and lifestyle

The existence of local zoning laws can also affect your housing decisions.

Section 7.3

Buying and Selling a Home

Hiring a Real Estate Agent

Real estate agents can help you:

- Find housing
- Negotiate the purchase price between buyer and seller
- Arrange financing for the purchase
- Find lawyers, insurance agents, and home inspectors

Real estate services are usually hired by a seller and are free to the buyer.

Section 7.3

Buying and Selling a Home

Conducting a Home Inspection

Before you make a final decision to buy property, it is important to get an evaluation of the house and land by a qualified home inspector.

A home inspection costs money, but it can save you from problems and unplanned expenses in the future.

Section 7.3

Buying and Selling a Home

Step 3: Price the Property

After you have checked out the property as thoroughly as possible, it is time to consider making an offer to the current owner.

This is usually done through a real estate agent, unless the owner is acting as his or her own agent.

Section 7.3

Buying and Selling a Home

Determining the Price of the Home

Every home that is for sale has a listing price, but that is not necessarily the price you will pay. Here are some questions to consider when making an offer:

- How long has the home been on the market?
- What have similar homes in the neighborhood sold for recently?
- Do the current owners need to sell in a hurry?
- How well does the home meet your needs?
- How easily can you arrange financing?

Section 7.3

Buying and Selling a Home

escrow account

an account where money is held in trust until it can be delivered to a designated party

Negotiating the Purchase Price

When the buyer and seller agree on a price, they must sign a purchase agreement that states their intention to complete the sale.

At this point in the process, the buyer sometimes must pay the seller a portion of the purchase price. This earnest money is:

- Held in an **escrow account** until the sale is completed
- Applied toward the down payment

Section 7.3

Buying and Selling a Home

Step 4: Obtain Financing

After you have decided to purchase a specific home and have agreed on a price, you will have to:

- Have money for the down payment.
- Get a loan to help pay for the remainder of the purchase price.
- Be responsible for fees and other expenses related to the settlement of the real estate transaction.

Section 7.3

Buying and Selling a Home

private mortgage insurance (PMI)

a special policy that protects the lender in case the buyer cannot make payments or cannot make them on time

Determining Amount of Down Payment

The most common sources of funds for down payments are:

- Personal savings accounts
- Sales of investments or other assets
- Gifts or loans from relatives

If your down payment is less than 20 percent of the purchase price, some lenders will require you to obtain **private mortgage insurance**.

Section 7.3

Buying and Selling a Home

mortgage

a long-term loan extended to someone who buys property

Qualifying for a Mortgage

You will need to meet certain criteria to take out a mortgage. To decide whether you are a good risk, lenders look at your:

- Income
- Debts
- Savings

If you fail to repay the **mortgage** or make regular payments, the lender can foreclose, or take possession of the property.

Section 7.3

Buying and Selling a Home

points

extra charges that must be paid by the buyer to the lender in order to get a lower interest rate

Paying Points

The size of your mortgage will also depend on the current interest rate. If you want a lower interest rate, you may have to pay:

- A higher down payment
- **Points**

A lower interest rate results in a lower monthly payment, but you might pay more money up front.

Section 7.3

Buying and Selling a Home

The Loan Application Process

To apply for a mortgage, the buyer must fill out forms, giving details of his or her:

- Income
- Employment
- Debts

If the application is approved, the purchase contract between seller and buyer becomes legally binding.

Section 7.3

Buying and Selling a Home

amortization

the reduction of a loan balance through payments made over a period of time

Types of Mortgages

Depending on the terms of the loan, a homeowner will have to make monthly mortgage payments for many years.

The monthly payments on a mortgage are set at a level that allows **amortization** of the loan.

Section 7.3

Buying and Selling a Home

fixed-rate mortgage

a mortgage with a fixed interest rate and a fixed schedule of payments

Fixed-Rate Mortgages

Fixed-rate mortgages:

- Typically run for a period of 15, 20, or 30 years
- Offer peace of mind because monthly payments always remain the same
- Guarantee a particular interest rate

Section 7.3

Buying and Selling a Home

adjustable-rate mortgage (ARM)

a mortgage with an interest rate that increases or decreases during the life of the loan

Adjustable-Rate Mortgages

With an **adjustable-rate mortgage (ARM)**, the rate changes according to economic indicators, such as:

- Rates on U.S. Treasury securities
- The Federal Home Loan Bank Board's mortgage rate index
- The lender's own cost-of-funds index

Your rates will change according to the terms of your agreement with the lender.

Section 7.3

Buying and Selling a Home

Evaluating Adjustable-Rate Mortgages

You should consider the following factors when you evaluate adjustable-rate mortgages:

- Determine the frequency of and restrictions on allowed changes in interest rates and in the monthly payment.
- Find out what index the lender will use to set the mortgage interest rate over the term of the loan.

Most adjustable-rate mortgages have a rate cap, which limits the amount the interest rate can rise or fall.

Section 7.3

Buying and Selling a Home

Government Financing Programs

Some government agencies that help qualified buyers arrange for loans from regular lenders are:

- The Federal Housing Administration (FHA)
- The Veterans Administration (VA)

Although extra insurance fees may be added on to government-guaranteed loans, government-backed mortgages are a good deal for those who qualify for them.

Section 7.3

Buying and Selling a Home

home equity loan

a loan based on the difference between the current market value of a home and the amount the borrower owes on the mortgage

Home Equity Loans

A second mortgage is also called a **home equity loan**. To determine the amount of this type of loan, the financial institution will find out:

- The current market value of a home
- How much equity is in the property

Section 7.3

Buying and Selling a Home

Dangers of a Second Mortgage

Carefully consider taking out a second mortgage. Taking out this type of loan can:

- Keep a homeowner continually in debt
- Cause a homeowner to lose the house if he/she is unable to make the second mortgage payments

Section 7.3

Buying and Selling a Home

refinance

obtaining a new mortgage to replace an existing one

Refinancing

Many homeowners need extra money or want to reduce their monthly payments. These options are possible when they **refinance**.

Remember that if you refinance, you may:

- Pay extra fees
- Extend the life of a loan

Section 7.3

Buying and Selling a Home

closing

a meeting of the seller, the buyer, and the lender of funds, or representatives of each party, to complete the transaction

Step 5: Close the Transaction

The final step in the home-buying process is the **closing**, when:

- Documents are signed.
- Last-minute details are settled.
- Money is paid.

The seller and buyer must also pay a number of fees and charges, which are closing costs.

Section 7.3

Buying and Selling a Home

title insurance

a type of insurance that protects the buyer if problems with the title are found later

deed

the official document transferring ownership from seller to buyer

Closing Costs

Most closing costs involve the legal details related to purchasing a home. Some common closing costs include:

- Title insurance
- A fee for recording the deed
- Private mortgage insurance to protect the lender from any loss resulting from default on the loan

Section 7.3

Buying and Selling a Home

Escrow Account

After the closing, your lender might require that you deposit money into an escrow account. The money, usually held by the lender, is set aside to pay for:

- Property taxes
- Homeowners insurance

Section 7.3

Buying and Selling a Home

Selling a Home

As your needs change, you may decide to sell your home. You will have to:

- Get it ready for the market.
- Set a price.
- Decide whether to sell it on your own or with professional help.

Section 7.3

Buying and Selling a Home

Preparing a Home for Selling

When preparing a home for selling, real estate salespeople recommend that homeowners:

- Make needed repairs.
- Paint worn exterior and interior areas.

The nicer your home looks, the faster it will sell at the price you want.

Section 7.3

Buying and Selling a Home

appraisal

an estimate of the current value of the property

Determining the Selling Price

Setting a price on a home can be difficult. You may want to pay for an **appraisal** and use that as a basis for a listing price.

If you ever sell a home:

- Find out whether the current market and demand for housing favors buyers or sellers.
- Decide how quickly you need to sell your home.
- Evaluate any improvements you have made to the property.

Section 7.3

Buying and Selling a Home

Choosing a Real Estate Agent

Real estate agents can:

- Help determine a selling price
- Attract potential buyers and show them your home
- Handle the financial aspects of the sale

When choosing a real estate agent, pick someone who knows your neighborhood and is eager to sell your home.

Section 7.3

Buying and Selling a Home

Sale by Owner

Selling your home yourself can save you thousands of dollars, but it will cost you time and energy. You will need to:

- Advertise the home.
- Show the home to prospective buyers.

Be sure to use the services of a lawyer or a title company to help you with the contract, closing, and other legal matters.

Section 7.3

Buying and Selling a Home

Making Choices

Your housing decisions will be affected by many factors, including:

- Your lifestyle
- Your financial situation

You will make the best housing choice to suit your needs if you:

- Carefully review your options.
- Make educated decisions.
- Follow the appropriate process.

Chapter 7

The Finances of Housing

Key Term Review

- mobility
- tenant
- landlord
- lease
- security deposit
- renters insurance
- equity
- escrow account
- private mortgage insurance (PMI)
- mortgage
- points
- amortization
- fixed-rate mortgage
- adjustable-rate mortgage (ARM)
- home equity loan
- refinance
- closing
- title insurance
- deed
- appraisal

Chapter 7

The Finances of Housing

Reviewing Key Concepts

1. Evaluate the various housing alternatives that are available.

Renting a home:

- Tends to be less expensive than buying
- Offers more flexibility than buying

Home ownership offers:

- Stability
- Financial benefits
- Increased value over time

Chapter 7

The Finances of Housing

Reviewing Key Concepts

2. List the advantages and disadvantages of renting.

Renting a residence has the advantages of:

- Mobility
- Few maintenance responsibilities
- Relatively low initial costs

Disadvantages include:

- Rent increases
- Few tax benefits
- Restricted activities

Chapter 7

The Finances of Housing

Reviewing Key Concepts

3. Identify the costs of renting.

The cost of renting is affected by the:

- Neighborhood
- Space
- Monthly rent
- Security deposit
- Renters insurance

Chapter 7

The Finances of Housing

Reviewing Key Concepts

4. List the advantages and disadvantages of owning a residence.

Advantages of owning a residence include:

- Stability
- Individual expression
- Tax benefits
- Increased value

Disadvantages include:

- Financial risk
- The possibility of value not increasing
- Limited mobility
- High expenses

Chapter 7

The Finances of Housing

Reviewing Key Concepts

5. Explain how to evaluate a property.

When evaluating a property:

- Walk through the neighborhood.
- Check the home exterior and interior.
- Get a home inspection.

Chapter 7

The Finances of Housing

Reviewing Key Concepts

6. Discuss the financing involved in purchasing a home.

When you purchase a home, you will need to:

- Pay a down payment.
- Get a long-term loan, or mortgage, to pay for the remaining purchase price.
- Pay closing costs.

Chapter 7

The Finances of Housing

Reviewing Key Concepts

7. Describe a plan for selling a home.

To sell a home:

- Decide whether to use a real estate agent.
- Prepare the home.
- Set a fair price.
- Keep the home neat and clean.

Newsclip: Low Interest Rates

Home prices have been on the rise since 2000, driven by low interest rates that make mortgages affordable.

Log On Go to finance07.glencoe.com and open Chapter 7. Learn more about the different types of mortgages available. How is buying a home different today? Write a list of answers.