Greetings!

My name is Rea Sonable, and I have drafted this letter to help provide you with a voice of reason ☺ in your home purchase quest.

So you want to buy a home and you've heard that buying a home…

Is a great investment!

Will give you the freedom to make your home yours!

Is better than renting because you are throwing away money now!

Will make you money.

Well, let me tell you what is buying a home can also be:

> "*Buying a home can be a* ***TERRIBLE*** *investment that causes you to lose a significant amount of money while putting in jeopardy your entire financial world, not to mention possibly ruining your credit.*"

And you say, "What?" or "Nonsense?" or even "What is this Nonsense?"

Great questions. I will tell you, but take good notes because there will be a test at the end of this session.

In this first letter, we're going to take a look at what it means to buy a home and what it means to pay lots of money with a very small, very slow return.

Guide developed by the Winnebago Homebuyer Program Coordinator for informational purposes to assist potential homebuyers with thinking through the home purchase process.

Welcome. I am T. E. Latruth and I will be helping Rea with the in-class session. My goal is to help you think hard and honestly about your quest to buy a home, and to make smart choices if you decide to move forward.

Our first topic in the sessions is…: **<u>What You Are Paying When You Buy</u>**

Envision this scenario: You find a beautiful home that you fall in love with, the neat yard, beautiful features like great wood floors, and even new appliances! You've seen quite a few homes that didn't compare, and this one fits with your lender pre-approval. They are asking $92,000, and your Realtor thinks that this is about what the property is worth. You feel uneasy because you don't want to lose this once-in-a-lifetime opportunity, and you want to move fast. You agree to offer $91,500 because you don't want to risk a refused offer that makes room for another buyer.

(I bet you have been there recently if you're reading this, right?)

They agree!!!!! Woohoo for you! …and for everyone else that gets paid by you and the seller. Now, don't get me wrong, these "others" are professionals and play a highly valuable role. In fact, I recommend against skipping any of their services. But it all costs money, much of which you pay.

You pay the lender for the application fee and related charges to qualify for the loan. Let's say $600. They require you to pay for your credit report, and because they want to make sure the property is worth what you are offering, they make you pay for an appraisal. Add on another $600 for the two.

But before you actually finalize your offer, you include a provision for a home inspection to ensure that there aren't issues with the home. I'd say this is extremely important and recommend not skipping this. It will cost you around $300.

You want to have protection in case something goes wrong at your home (and your lender will require this) so you purchase home owners insurance for $600.

You will also have miscellaneous fees for recording, title work, etc, so let's tack on one final chunk of change in the amount of $600.

So where are we at? $600+$600+$300+$600+$600 = **$2,800.00** in purchase costs. Add this to your purchase offer of $91,500 and we get at total of $94,300 that you agree to pay for the total purchase of the home.

Now, you needed to bring some cash to the table to make the deal work, right? Let's say that you have 20% down – that is almost $19,000 that you can hand over to the bank.

Don't have $19,000? Watch out for the dreaded PMI, a monster believed to have arisen one Halloween night out of Milwaukee, WI. PMI, or private mortgage insurance, is often a fee you as the buyer are required to pay until you reach 20% ownership in your home (the part you "own" is also called equity). This might be an extra $75 a month, and if you need to pay if for 4 years, we're talking over $3,500 you pay without any asset gain.

Let's get back to the actual loan amounts you need from your lender, assuming you had an extra $19,000 sitting around. Your final purchase price of $94,300 minus your $19,000 downpayment/closing cost payment leaves a needed loan amount of $75,300. Your loan terms that you secured from the lender were average, with a 4% fixed interest rate and a 30-year payback term requiring monthly payments.

But along with these payments comes the reality of owning your home: property taxes. Now, taxes aren't all bad. They do pay for your police and fire protection, for your city services, parks and other important things. But they do add costs. Together, your taxes and mortgage payment requirements for this purchase will be about $575 per month. Because we need to continue our insurance coverage, we also pay an additional $50 each month, bringing our costs to $625.

Pay Attention Here! How much of that $625 each month is actually building an asset for you? Not much!

	Monthly Payment	Amount per payment that is building an asset	Total Equity from payments	Total amount paid to date	Total amount still owed on $75,300 loan
After 1 year:	$625	$110	$1300	$7500	$74,000
After 2 years:	$625	$115	$2700	$15,000	$72,600
*After two years of payments totaling $15,000, you haven't even recouped your closing costs of $2800!					
After 4 years:	$625	$125	$5600	$30,000	$69,700

After 4 years of ownership and paying $625 every month (48 times!), you will have paid $30,000. Out of that, you will have developed only $5,600 in equity (the amount you own). If you consider that you paid $2,300 more than the property was worth due to the extra fees, this lowers the amount that you have actually "earned" on the property to only $3,300?

This $3,300 further gets reduced by any money you have to pay for home repairs and modifications. These costs can be devastating to your finances and your overall investment. Make sure you are being smart with the property you purchase. If you do buy, you need **need** <u>**need**</u> to put at least $50/month aside for repairs.

THE SEVEN YEAR RULE

What this all means is that owning a home is not instant wealth, and requires significant time to actually develop any financial value for you. In general, if you can't commit to living at your home for SEVEN years, you are likely to lose several thousand dollars (we haven't talked about paying to sell your home yet…). Around the seven year mark, many homebuyers will start to be at an area where they can break even. Stay for 10 years and you might even make a few dollars. **If you can't commit to seven years at your home, you need to really think hard if homeownership is right for you at this time.**

Oh, there isn't really a test…but you've completed pt 1 of Why Not to Buy!