

Getting A Place To Live

- A basic need
- A major financial decision
 - Budget: Typically your largest expense
 - Saving: The need for up-front cash
 - Investing: Often your largest investment (*if you own*)
 - Debt: Often your largest source of debt (*if you own*)
 - Pricing: Subject to negotiation
- Significant commitment
 - Which involves risk
 - And a need for care when contracting
- Many options
 - Buying/renting/roommates/parents

Renting: What Can You Afford?

Assuming you are OK with the lease - TBD

- Can you handle the rent?
 - Affordability and the 30% rule of thumb
 - Will be hard to satisfy this rule in high cost areas like NYC
 - Need to budget carefully in these cases
 - And utilities?
- Do you have the security deposit?
 - Typically 1-3 months rent
- Do you trust your roommates?
 - You are on the hook if:
 - Your name is the only one on the lease
 - And your roommates leave/don't pay/trash the place
 - Can you:
 - Get their names on the lease?
 - Get them to sign a contract?

Buying: What Can You Afford? - 1

Can you afford the “running costs” of owning the home?

Can you assemble the funds needed to buy the home?

“Running costs” include

- Mortgage payment
- Property Taxes
 - Typically 1-2% annually (but can be as high as 4%)
- Insurance:
 - General: Homeowners
 - Special: Earthquake, Flood, Hurricane, etc.
 - *Both are getting increasingly expensive and in some cases hard to get*
- Utilities
- Repairs & maintenance
 - Budget: 1-4% annually for home
(depending on age, style and construction of home)
 - Issue: Can you handle chunky costs?

Mortgage Payments & Interest Rates

On A \$100,000 30-Year Fixed Rate Mortgage

Interest Rate	Monthly Payment	Total Payments
3%	\$421	\$152,000
4%	\$477	\$172,000
5%	\$536	\$193,000
6%	\$599	\$216,000
7%	\$665	\$239,000
8%	\$733	\$264,000
9%	\$804	\$289,000
13%	\$1,106	\$398,000
18%	\$1,507	\$543,000

Source: BankRate Mortgage Calculator

Getting A Lower-Cost Mortgage

- Comparison shop
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 - Can do internet-based checks if you know your credit score
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- **Become a more attractive borrower (*to the lender*)**
 - **High credit score (*credit record, credit utilization, etc.*)**
 - Remember last 2 years count the most
 - **Good income coverage (*PITI ratio, DTI ratio*)**
 - **Stable job record (*3 years*)**
 - **High down payment**
 - **Be prepared (*see Kobliner for the documents you need to bring*)**

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 - Be prepared (*see Kobliner for the documents you need to bring*)
- ***But be wary of mortgages with lower interest rates like ARMs and Balloons***

Types of Mortgages

- Fixed-rate mortgage
 - Level payments over life of mortgage based on quoted interest rate
 - Usually have the ability to “lock in” this rate up to 30 days prior to taking out loan
 - Can prepay without penalty (if you move or if interest rates fall)
- Adjustable rate mortgage (ARM)
 - Interest rate tied to an index (*which goes up and down*)
 - Usually linked to shorter rates (*often with a cap and perhaps a floor*)
 - Key risk: Interest rate risk
 - Teaser rate vs. eventual rate
 - Expectations if long rates are much higher than short-rates?
- Balloon mortgage
 - Usually shorter-term (say 3-5 years)
 - Only pay interest
 - Owe entire principal at end of period
 - Key risks: Interest rate risk and refinancing risk
 - Can be very dangerous: No caps on interest rate and may be unable to refinance loan when it comes do.

Buying: What Can You Afford? - 2

Can you assemble the funds needed to buy the home?

- Do you have the needed cash?
 - Banks usually look for a 20% down payment
 - And you need to cover closing costs
 - Your share of transfer taxes (*typically 1-2% of house price but may be higher*)
 - Mortgage points (*typically 1-2% of mortgage*)
 - Doc prep fees, escrow fees
 - Inspection & survey costs
 - Prorated property taxes etc.
 - Lower down payment possible, but usually need to take out PMI
- Can you get the mortgage you need?
 - Higher down payment may be needed if you face borrowing constraints
- Do you have the funds needed for upfront renovations/repairs?

Assembling The Down Payment

- Big savings challenge
- Parental help with down payment
 - Banks will require that any such help be in the form of a gift
- Increasing savings by living at home
 - Huge boost in discretionary income
 - No rent, utilities, food, cleaning costs, etc.
 - Big issue: what are you doing with that extra discretionary income?
 - Don't forget issue of parental patience
- Taking out a mortgage with a lower down payment
 - No PMI needed if down payment \geq 20% of house value
 - Otherwise expect banks to require PMI
 - Which can add 1% or more to interest rate
 - Just remember
 - You can get bank to stop charging PMI once mortgage balance has fallen to 22% of original purchase price.
 - Potential benefit to refi strategy if house has appreciated in value

Borrowing Limits

- Limit 1: Home's appraised value
- Limit 2: Your Debt capacity
 - Banks often focus on two key ratios when deciding how much they will lend to you – your PITI ratio and your DTI (*debt to income*) ratio .
 - PITI ratio =
$$\frac{\text{Principal} + \text{Interest} + \text{Property Taxes} + \text{Insurance}}{\text{Gross Monthly Income}}$$
 - DTI ratio =
$$\frac{\text{All Monthly Debt Payments}^*}{\text{Gross Monthly Income}}$$
 - Generally banks want PITI < 28% and DTI < 36%
 - The max DTI on which they will provide mortgage funding is generally 43%

- *Includes mortgage, student loans, credit card, car payments, and other debt payments*

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 - Generally banks want $\text{PITI} < 28\%$ and $\text{DTI} < 36\%$
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 - **Implications: Higher interest rates will reduce how much you can borrow**
High debts elsewhere will reduce how much you can borrow
What happens if someone co-signs the loan?

Protecting Yourself If You Rent

- Read the lease carefully before you sign
 - It is a legal document
 - Which sets out rent, occupancy dates, payments dates, landlord & tenant rights and responsibilities, etc.

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- **Examples of lease terms**
 - **Responsibilities** (utilities, cleaning, maintenance, repairs, painting...)
 - **Restrictions** (noise, decorating, ...)
 - **Prohibitions** (smoking, pets, roommates, subletting, Airbnb...)
 - **Penalties** (late rent, apartment condition on leaving, etc.)
 - **Landlord's ability to enter your apartment** (unlimited, showings only, ...)
 - **Renewal or early termination clauses, if any**
 - **Security deposit**
 - Usually 1-3 months rent
 - Protect yourself by
 - Getting a receipt
 - Taking lots of pictures showing apartment condition when you occupy it.

What Can You Negotiate?

- **Rent** *(check Zillow, Craigs List, etc. for comps)*
 - **Lease terms** *(check NoLo.com)*
 - **Broker fees** *(if any)*
-
- Just remember to:
 - Put yourself in landlord's shoes when negotiating/competing for a lease
 - Good credit record?
 - Good tenant?
 - Care for property?
 - Good neighbor (indicate you won't be using Airbnb if you want the ability to sublet, but not in that way)
 - Time horizon
 - But also remember that a landlord may be looking for something different in cases of rent controlled or rent stabilized apartments

Protecting Yourself If You Buy

Basic steps in buying a home

- Negotiating/signing the purchase and sale contract
- Conducting inspections, arranging financing & insurance, etc.
- Escrow
- Closing the sale/recording the deed

Purchase & Sale Contract

- Offer: key features
 - Sale price, deposit, closing date
 - Financing (*& qualifications*)
 - Requirements/contingencies
 - Response deadline

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- Implications of a house being under contract
 - Buyer has the right to purchase home at the agreed price (even if seller gets a better offer later on)
 - Buyer can walk away from deal without penalty if a contingency is triggered.
 - Seller keeps deposit if buyer walks away from deal without triggering a contingency
 - About 4-10% of homes sales fall through
 - This number varies over time, and has been larger.
 - Which is one reason a seller may decide to keep showing a house even after a contract has been signed

Purchase & Sale Contract - 2

- Some key requirements/contingencies
 - Certificate of occupancy
 - Legal protections (lawsuits, pre-sale disaster, etc.)
 - Clean title + title insurance (examples of driveway, power-line easements)
 - Inspection contingencies
 - Examples: termite, building, sewer, chimney, seismic, geological, radon, etc.
 - \$ triggers, mitigation clauses, etc.
 - Mortgage contingency, Home sale contingency
 - Mortgage: Financials vs. pre-qualified vs. pre-approved)
 - Insurability?
 - Survey contingency?
 - *Note on contracts supplied by real estate agents*
 - *Note on disclosure requirements (personal sale vs. estate sale)*
 - *Note on neighborhood, city restrictions (example: historical status)*

Escrow and Closing

- Escrow, a third party
 - Holds the money
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- Closing Statement
 - **KEEP THIS FOR TAX PURPOSES**
 - Purchase price
 - Adjustments
 - Prorations & adjustments (property tax, condo fees, etc.)
 - Gov't recording charge and transfer taxes
 - Title insurance (usually paid by the seller)
 - Escrow charges
 - Mortgage (loan, document preparation, points)
 - Broker charges (usually paid by the seller)
 - Net to you. (Note: Purchaser will have likely paid in advance.)

What Can You Negotiate?

- Price
- Repairs
- Contingencies
- Closing date, etc.

- *But put yourself in the shoes of the seller*
 - Can they be confident this deal is going to close?
 - Home sale contingency in bad markets
 - Mortgage contingency
 - Financials vs. qualified vs. approved

The “Rent vs. Buy” Decision

- **Common claims made in favor of buying a home**
 - **Building equity**
 - **Tax deductions (TBD)**
 - **Great investment**

*Can well be true, but don't
accept these claims uncritically*

The “Rent vs. Buy” Decision

- Common claims made in favor of buying a home
 - Building equity
 - Tax deductions (TBD)
 - Great investment
- **Issue rarely brought up**
 - **Taxation of imputed rent**

Can well be true, but don't accept these claims uncritically

This is a big deal!

Tax Treatment Of Imputed Rent

- Consider the following simplified situation
 - We both have \$2 million
 - Have located identical homes next to each other
 - We each want to live in a different home.
 - The homes cost \$2 million or can be rented for \$100,000/year
- Alternatives
 - A1: Each of us buys one home and lives in it
 - A2: We each buy one home and rents it to the other person
 - i.e. We each spend \$2 million on a house
 - Earn \$100,000 rent on the house we buy
 - And pay \$100,000 rent on the house we live in
- Result:
 - A1: No reportable rental income, so no taxes.
 - A2: We pay income taxes on \$100,000 in rental income, so don't have enough after-tax income to pay the \$100,000 rent we owe

“Rent vs. Buy” – Other Considerations

- Control over the property
- Transaction costs if you stay for a limited period
 - Original closing costs to buyer
 - Plus closing costs paid when you sell
 - Plus broker costs (often 4-6% of sale price)
 - Need to be in home for a period of time for numbers to work after deducting these costs
- But what about
 - The “building equity” argument?
 - The “great investment” argument?

“Building Equity” And Interest Rates

First Payment On A \$100,000 Mortgage

Interest Rate	Monthly Payment	Of Which		% Interest
		Interest	Principal	
3%	\$421	\$250	\$171	59%
4%	\$477	\$333	\$144	70%
5%	\$536	\$417	\$119	78%
6%	\$599	\$500	\$99	83%
7%	\$665	\$583	\$82	88%
8%	\$733	\$667	\$66	91%
9%	\$804	\$750	\$54	93%
13%	\$1,106	\$1,083	\$23	98%
18%	\$1,507	\$1,500	\$7	> 99%

“Building Equity” And Interest Rates - 2

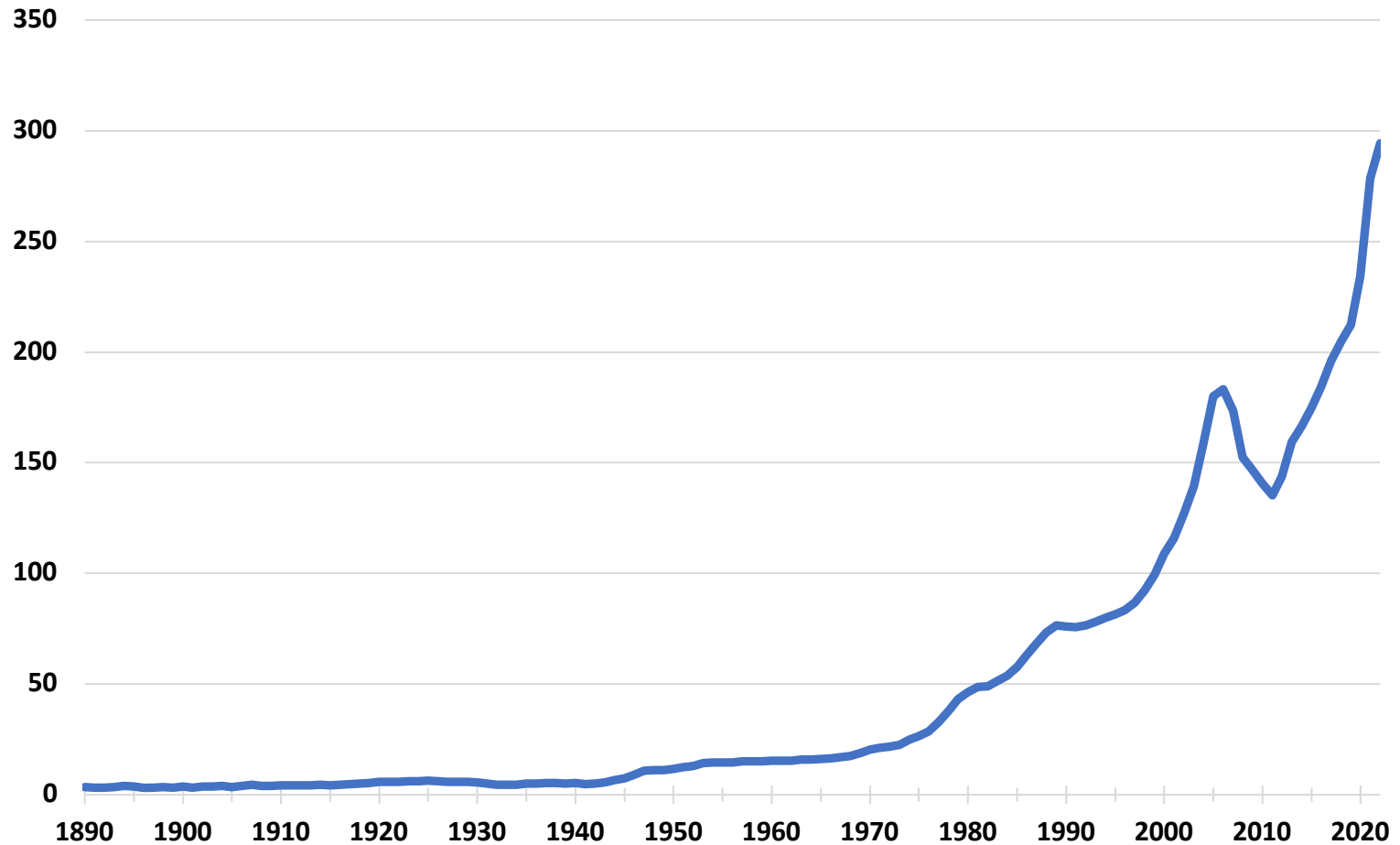
Amount Owed On A \$100,000 Mortgage After 10 Years

Interest Rate	Monthly Payment	Payments (10 Years)	Amt. Paid Off	% Principal	% Interest
3%	\$422	\$50,592	\$23,980	47%	53%
4%	\$477	\$57,290	\$21,216	37%	63%
5%	\$537	\$71,946	\$18,658	26%	74%
6%	\$600	\$79,836	\$16,314	20%	80%
7%	\$665	\$80,644	\$14,188	18%	82%
8%	\$734	\$88,052	\$12,275	14%	86%
9%	\$805	\$96,555	\$10,570	11%	89%
13%	\$1,106	\$132,744	\$5,580	4%	96%
18%	\$1,507	\$180,850	\$2,347	1%	99%

So in what way are you “building equity” by buying a home if interest rates are high?

Housing As An Investment

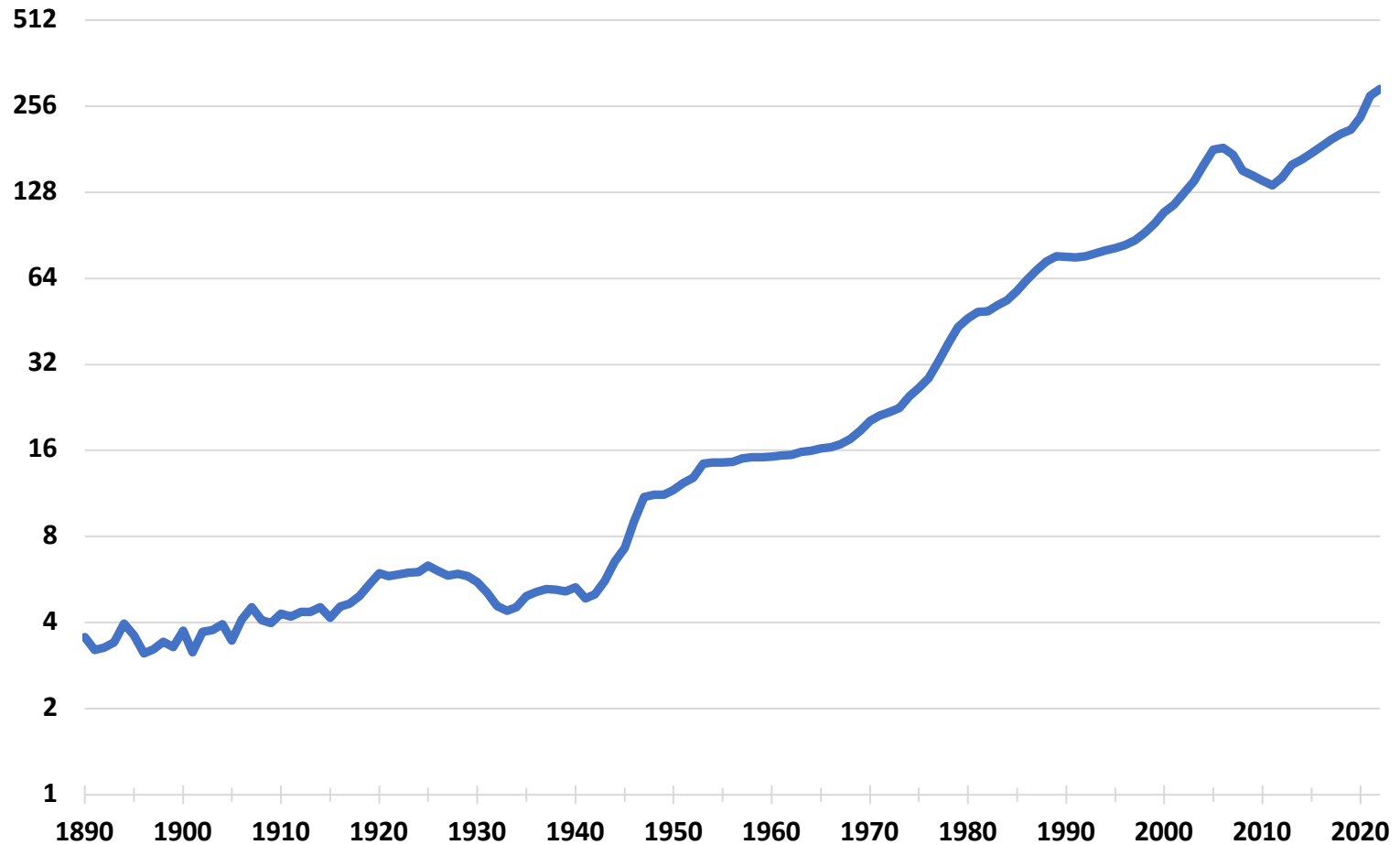
Case-Shiller Nominal House Price Index: 1809-2022



Source: Robert Shiller Online Data Base

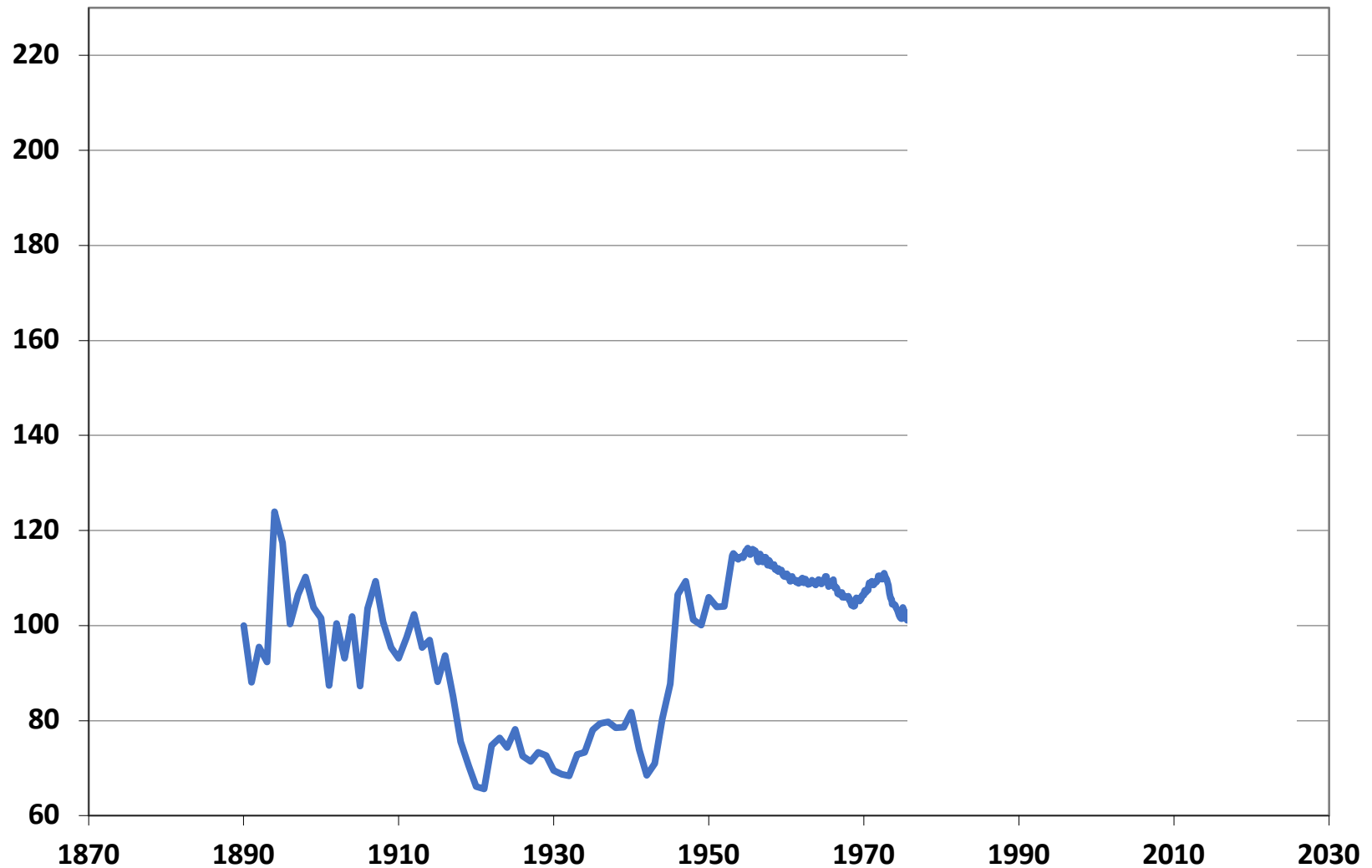
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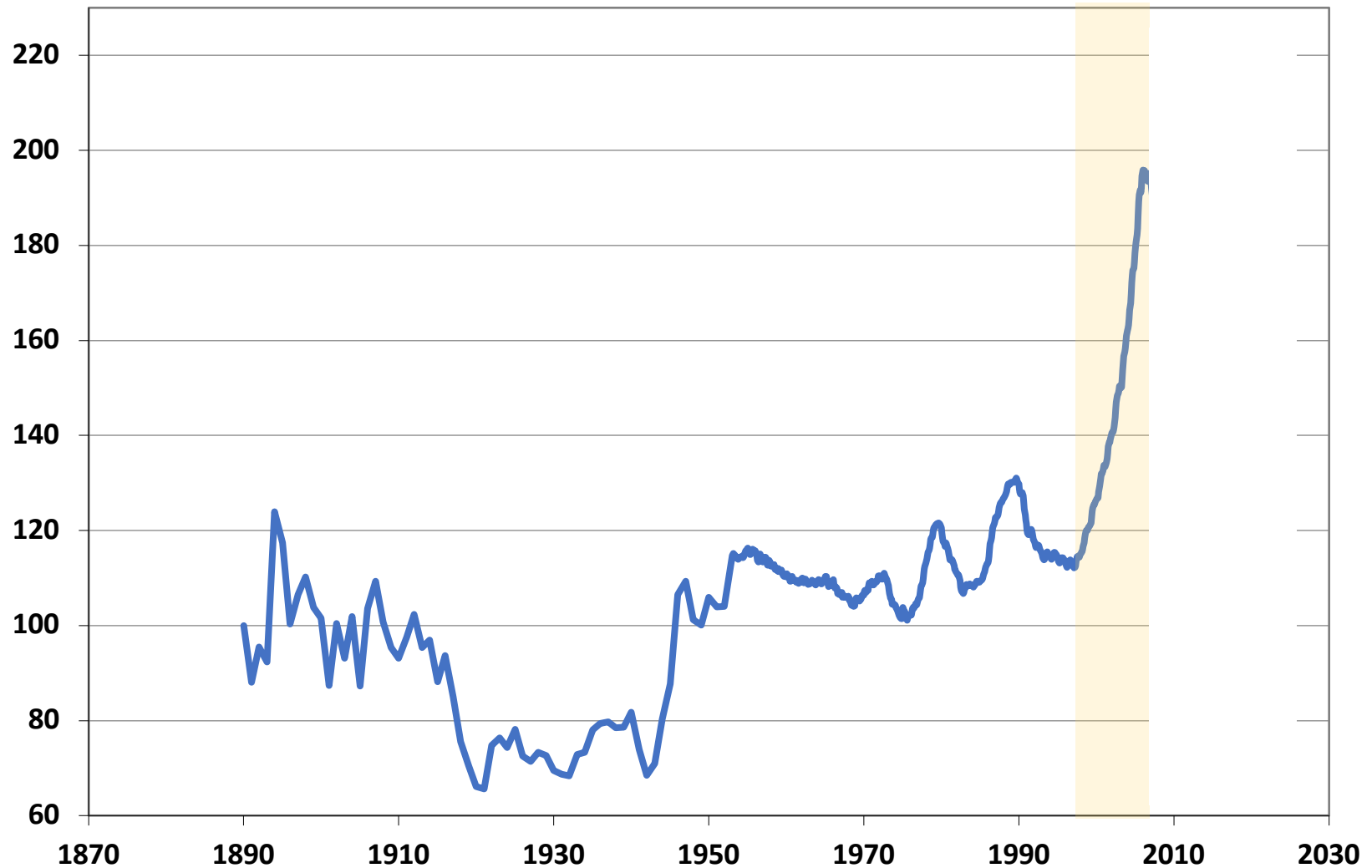
Source: Robert Shiller Online Data Base

Case-Shiller Real Home Price Index



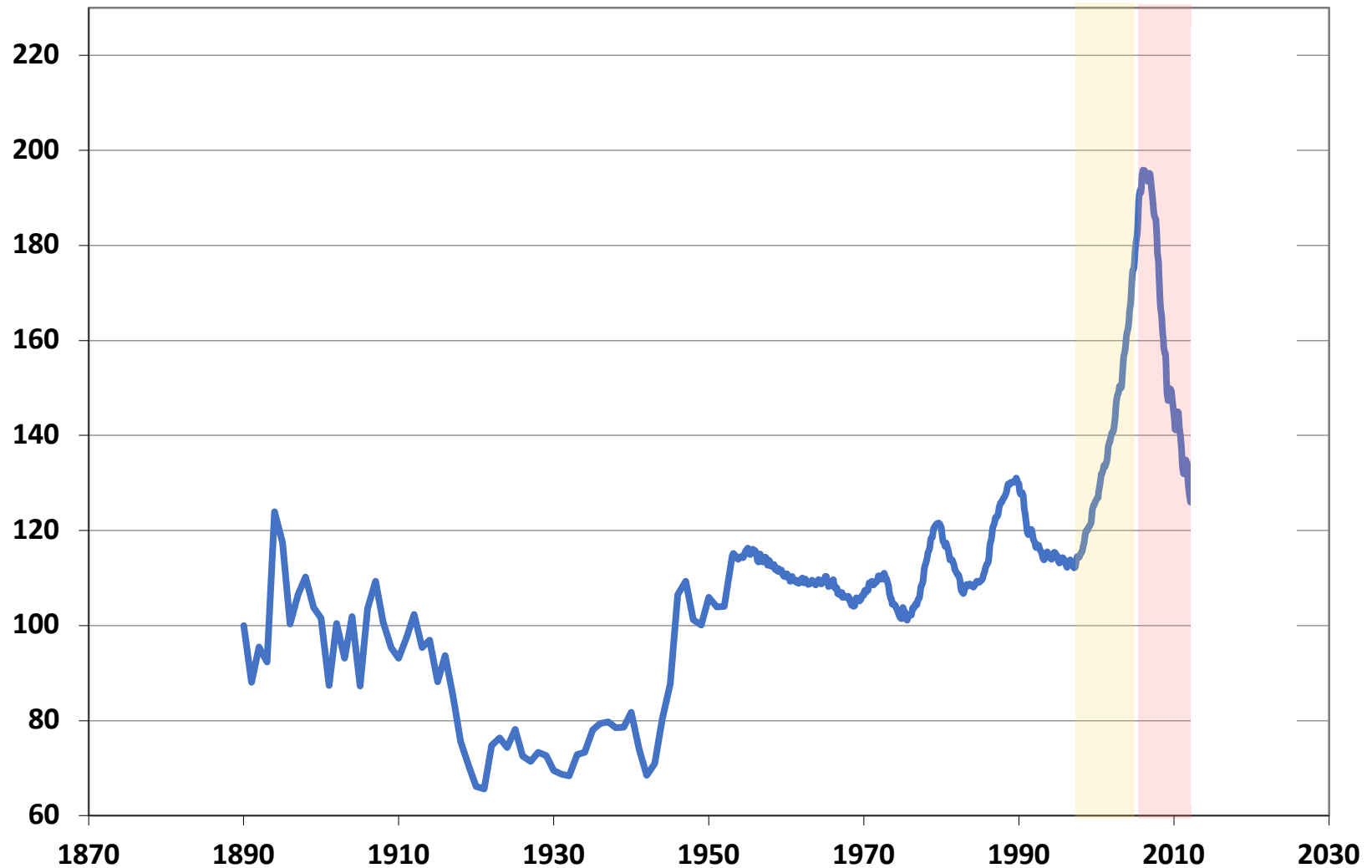
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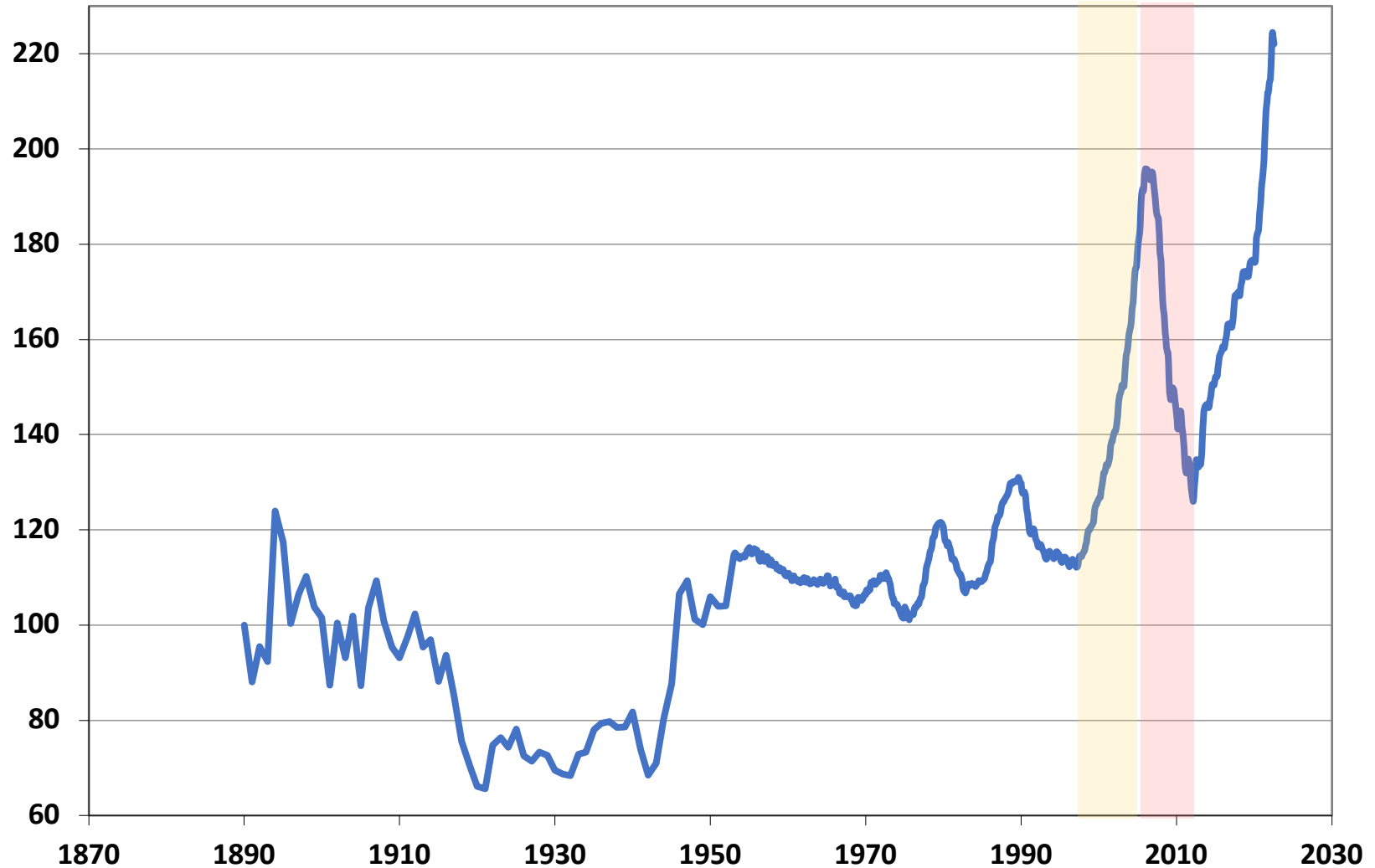
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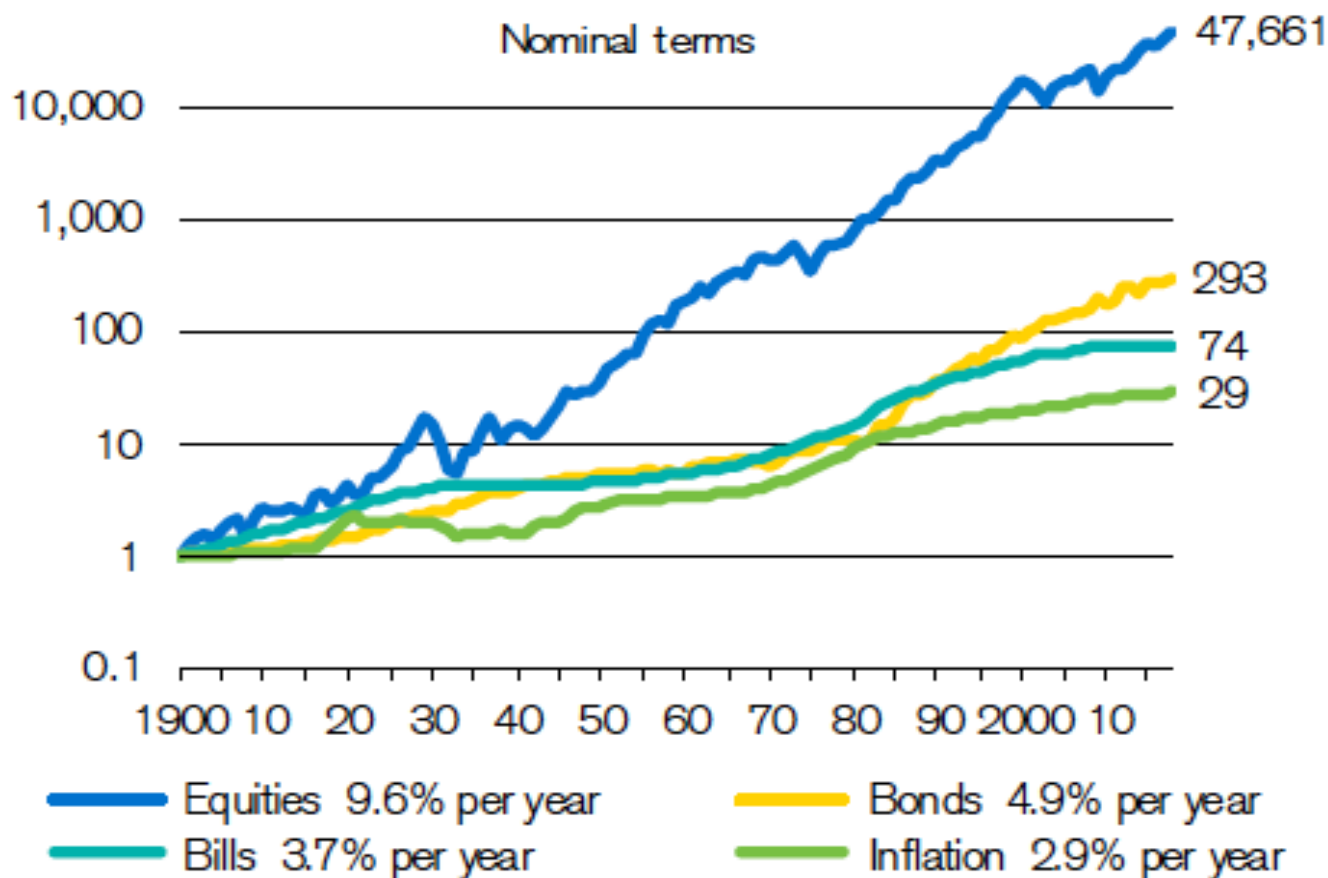
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Through December 2022



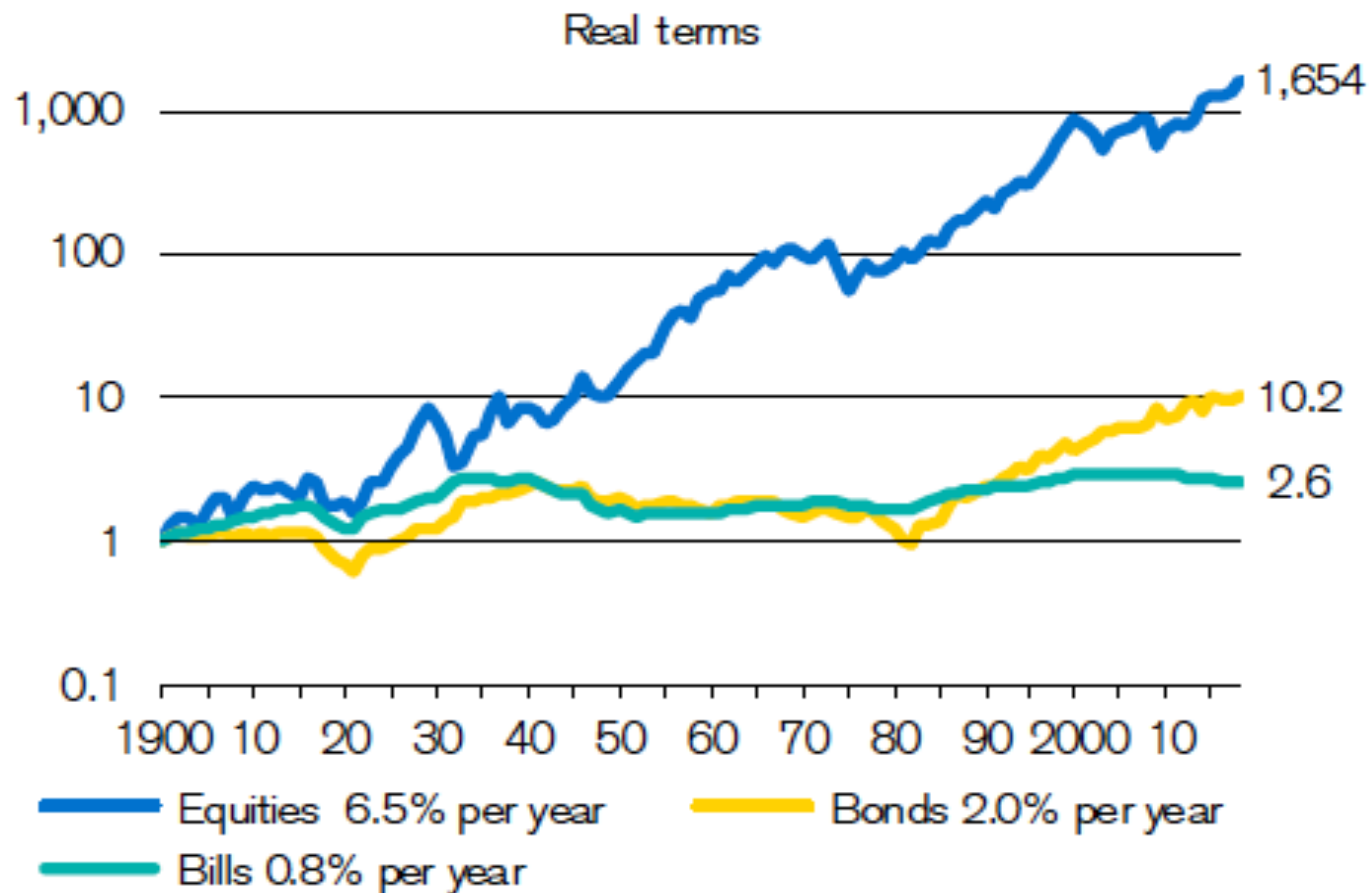
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Cumulative Returns on US Assets (1900-2017)



Source: Dimson, Marsh & Staunton, Credit Suisse

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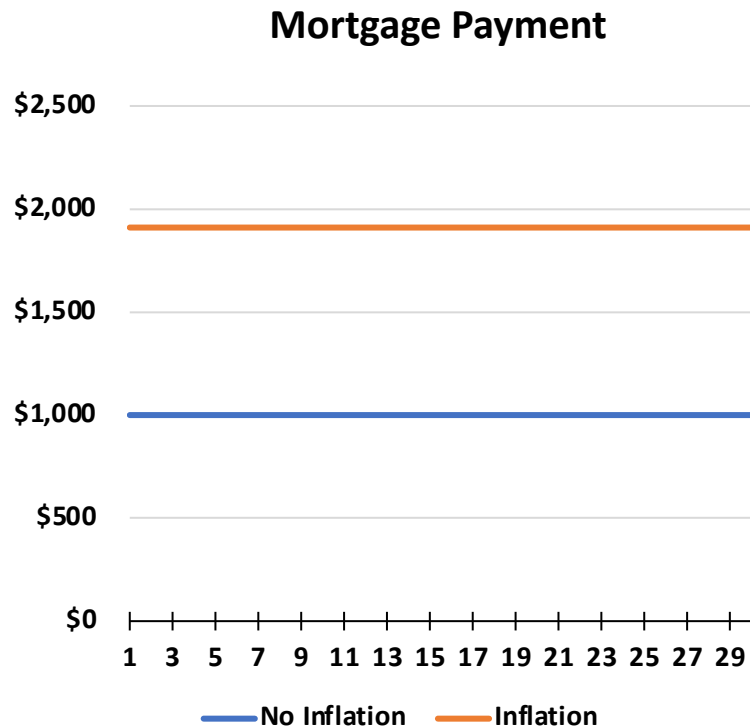
Inflation, Mortgage Payments and Mortgage Limits

- Definition:
 - Real interest rate \approx nominal interest rate - inflation
- Fisher Equation
 - Suppose economy determines real interest rate
 - Then nominal interest rate = real interest rate + inflation
 - Idea: Higher inflation eventually means higher interest rates
- Implications
 - On your monthly budget
 - On your ability to purchase a home

Housing Costs And Inflation

Assumptions:

- Mortgage Rate = 3% if no inflation; 9% if 6% inflation

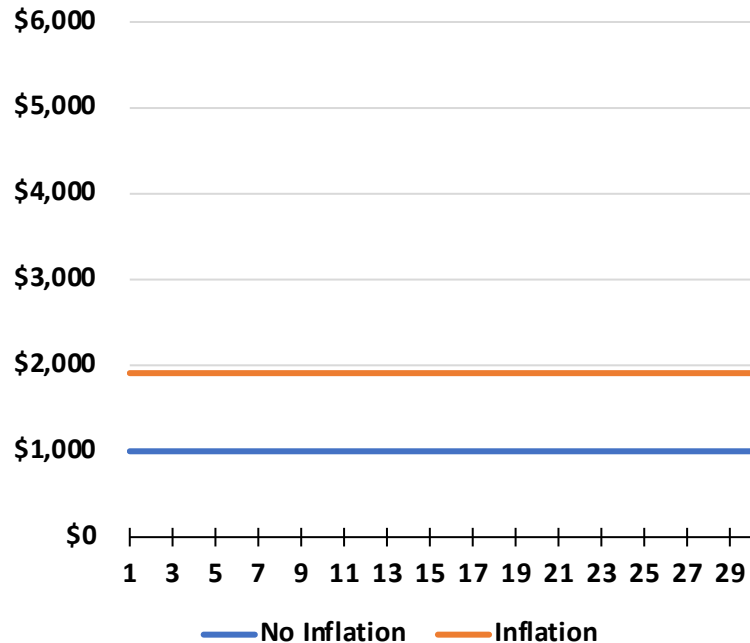


Housing Costs And Inflation

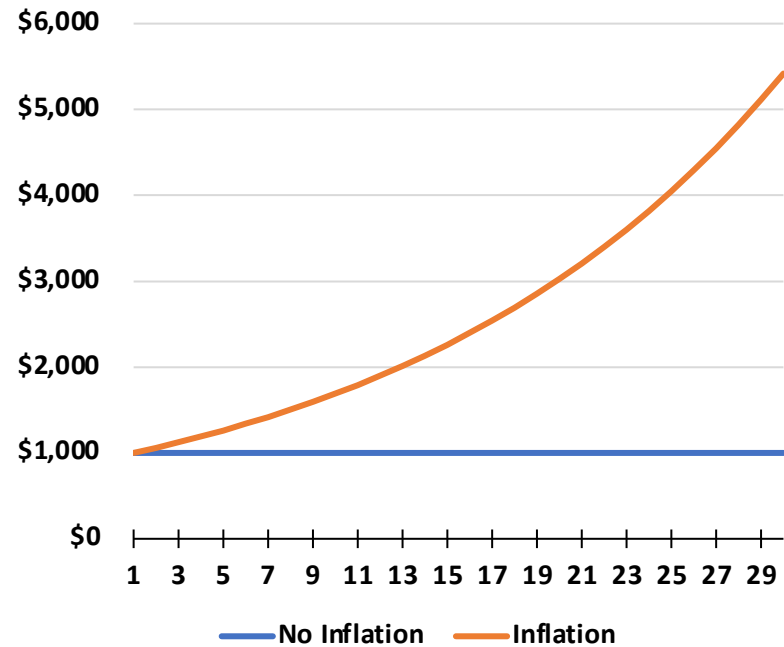
Assumptions:

- Mortgage Rate = 3% if no inflation; 9% if 6% inflation
- Rent flat if no inflation, grows 6%/year if 6% inflation

Mortgage Payment



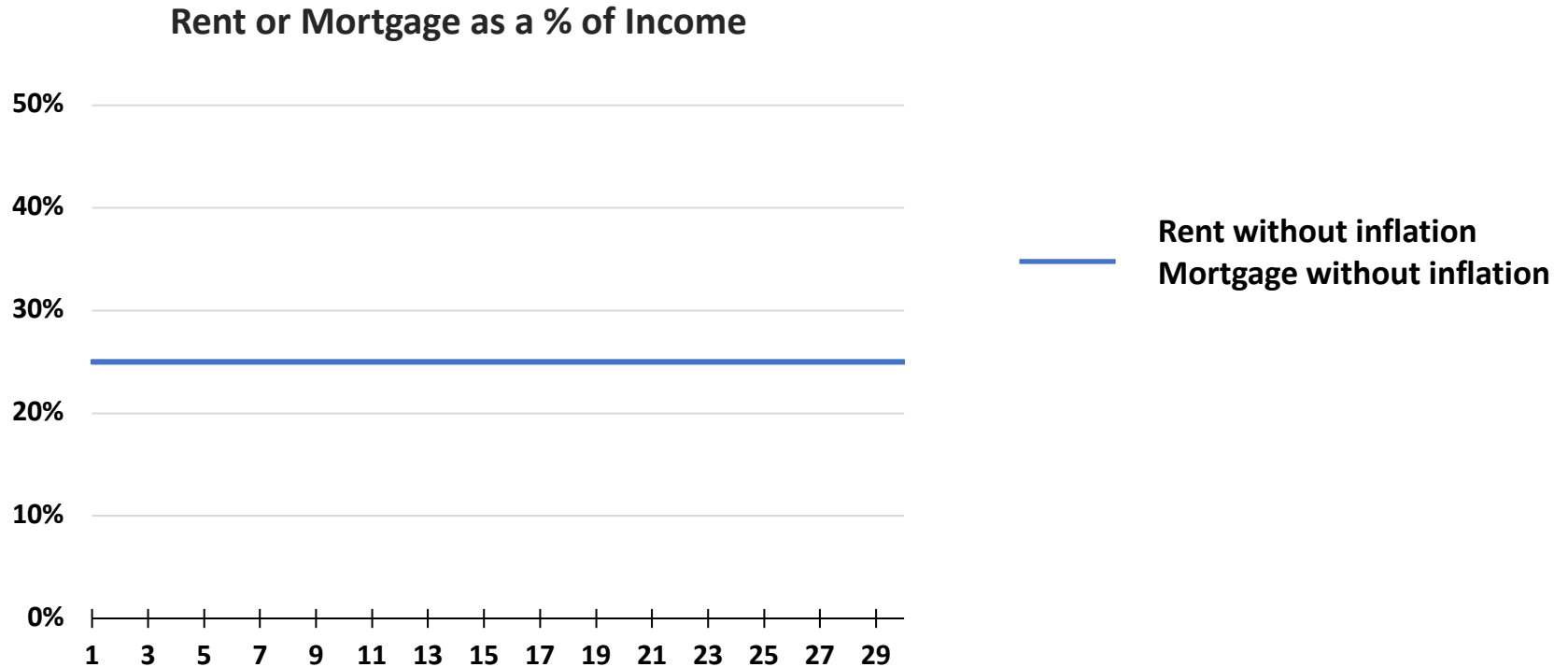
Expected Rent



Housing Costs And Inflation

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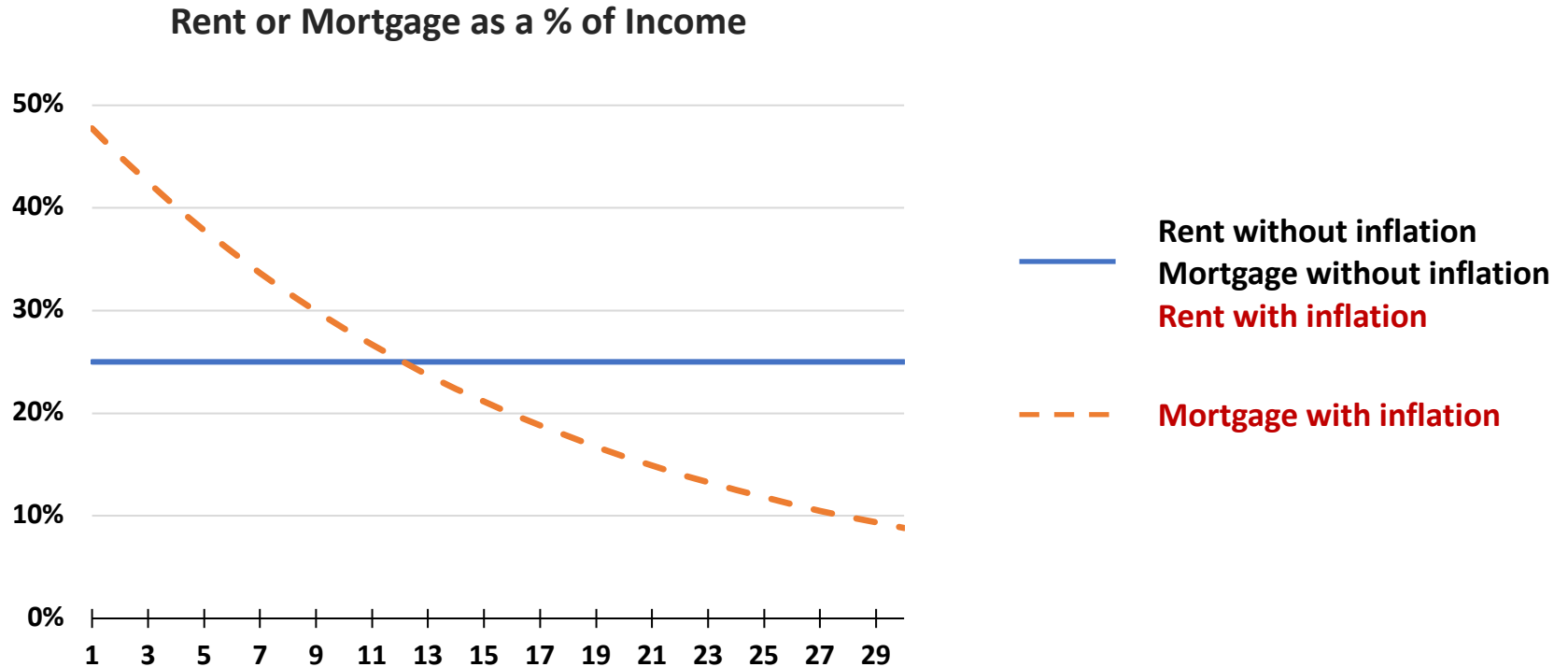
- *No inflation: Rent flat, Income flat, mortgage rate = 3%*



Housing Costs And Inflation

Assumptions:

- *No inflation: Rent flat, Income flat, mortgage rate = 3%*
- *6% inflation: Rent grows 6%/year, income grows 6% year, and mortgage rate = 9%*



Digression: Risk Of Too Much House

- In terms of lifestyle choice and running costs
- In terms of wealth allocation
- In terms of your actual needs
(and your ability to stay in home as you age)