Ep74: What Issues Should Be Considered When Buying A Home?

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PATTI BRENNAN: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

For those of you who are tuning in today, you probably know that at the end of every podcast, I encourage everybody to just go to our website. If you have any questions, just send us your questions because from time to time, I will record the answers. That's what we're going to do today. It's called the "Ask Patti Brennan" series.

The first question that I'm going to tackle today...By the way, these are shorter, direct. Here's the bottom line. The first question is "What are some of the issues that I should consider when I'm buying a home?" A lot of times, people just focus and, I will say, hyper focus almost on the mortgage.

First question I have is "How are you going to come up with a down payment? Where's that money going to come from?"

If it's coming from a gift, you're going to need a gift letter from the person who is giving you that money because there's no lender in the world that's going to lend you even 80 percent of the value of the purchase of the home without a really good understanding of where's the other 20 percent coming from. That's first and foremost.

Also, when you think about where we are today, you've probably seen it. It's a mania out there when it comes to real estate. There are a lot of people who want to buy but not a lot of people who want to sell. What's happening? The prices are going up. People who are putting their homes on the market are not just getting their asking price. They're getting 10, 20 percent above.

If you're looking for a home, whether it be a primary or even a vacation home, you've got to go into that whole situation understanding what tippy top really is. Once you get into that mode, emotions take over. I'm finding that a lot of people are going way, way over budget.

The fact of the matter is the cost of a home is not just the monthly mortgage payment. It is the monthly mortgage payment plus some real estate taxes plus the insurance. I think you probably already know that.

What about some of the other stuff? For example, utilities, renovations that you might want to do. If it's a vacation home, where is it located? If we're in Pennsylvania and you go buy a place in Florida, how are you going to get there? You've got to add that into the cost of the home ownership in terms of what's the all in package and then model that based on your personal situation.

Let's fast forward and say, "OK, we've got the number. We're looking for the mortgage. What are some of the considerations?" There are two ratios that are really important when you go into something like that. The underwriters for any lender, they're going to be looking at basically 28 percent and 38, 30, 28…Scratch that.

Now, we're going to go into the mortgage situation. You've got your boundaries. You understand what your limits are. What about the mortgage? What are the lenders going to be looking at? There are two ratios that are critical to keep in mind. The first is 28 percent. The second is 36 percent.

A lender is going to be looking at your sources of income. They don't want you to be spending more than 28 percent of your gross, which means pre tax, your gross monthly income, on your mortgage payment, which includes real estate taxes and insurance. 28 percent for that.

The 36 percent, for those of you who may have car loans and student loans, they're not going to lend you more than 30 percent of the total of all that combined with the mortgage payment. Those are the two ratios to keep in mind.

Really, that's a pretty good rule of thumb. That, again, would be tippy top. Again, we're talking gross, pre tax. You're not keeping all of your income. Figure out what your tax bracket is. Let's say 25 percent is coming right off the top. You're only living on 75 percent of your income in that case. Again, you want to understand the impact of this new property on your personal situation.

As you go into this, if it's a new home, if this is your first home, you've got to remember you're going to want some furniture. There's going to be some big ticket items that come along with that. Even something as, I mean, not dumb but putting in cable, cable TV, the Internet cost, things of that nature, that stuff really adds up.

Some of it is going to be one time costs, but if you're putting absolutely everything, everything into your down payment, how are you going to pay for that? I will tell you, you don't want to be doing that on credit cards. Don't get yourself into that situation.

Understand, up front, the total, all in cost of purchasing either a primary or a secondary residence.

What's it like applying for a mortgage today? If you know anybody that's done it, it is not fun. It's just gathering all the stuff, two years worth of tax returns, pay stubs, a statement from absolutely every account. It is a painful process. That has not changed since the financial crisis, so just be prepared.

I think that as you go into this also, this is not the time to be adding a credit card. It's also not the time to be closing a credit card because that has a negative impact on your FICO score. That's another thing that the lenders are going to be looking at.

I think about different ways to fund your down payment. You're looking at the situation. You really want to get this real estate. Let's say that your employer said, "Hey. Guess what? You don't have to come back to the office anymore." You want to go to a different place and get a nice house way out in the suburbs, etc. How are you going to fund the down payment?

First, understand the rules as it relates to IRAs. If you've had a Roth IRA for five years or longer, you can take up to $10,000 out of that Roth even though you're under 59 and a half and not pay a 10 percent penalty. Because it's a Roth, you're not paying tax on the gain either.

Option number two would be to go to a regular IRA. Again, first time home buyer, no 10 percent penalty, but you will pay income tax on your gain.

Scratch that Roth thing because you do have to pay tax on the gain on the Roth, I think. There's just no...Let me go back to that. I forget what the rule is.

Oh, your contributions. Got it. Fast forward. You've been approved for the mortgage. Where are you going to come up with a down payment? Assuming that your great aunt is not gifting you a significant amount of money, you may have different buckets that you can pull from.

If you have a Roth IRA, understand what the rules are. As long as you've had that Roth for longer than five years, you can take out your contributions completely tax free. There is no 10 percent penalty even though you're under 59 and a half.

If you have a regular IRA, same deal applies. You can take out up to $10,000 for your first home purchase. There is no 10 percent penalty, but you do have to pay income taxes on the amount that you're pulling out of the IRA, the $10,000.

If you have a 401K, many employers provide for borrowing privileges. You can take a loan against your 401K. That gives me a little bit of a heebie jeebie. I'm not a real big fan of that. I'm not a big fan of actually pulling out of the IRAs either. It's really if you absolutely have to pull money from somewhere. I'm just giving you the rules.

I would much rather you wait. Understand that you need to fund this down payment and save for it outside of your retirement plans. Real estate is going to go through different cycles. Right now, we're going through a crazy cycle where everybody is just out there looking to buy anything.

That's going to calm down. There actually may be better opportunities going forward when things calm down a little bit. I understand that you're worried, probably, of rising interest rates, that the mortgage rates are going to go up.

I'm not as concerned about that. Yes, they may go up a little bit. I don't see them going up to six or seven percent, so it may make sense for you to take your time.

By the way, if you don't see yourself being in this property for five years or longer, you're going to find, or at least I'm going to tell you, renting is usually a better deal. Really think long and hard, especially in this environment.

From a tax planning perspective, recognize and understand that mortgage interest over $750,000 of debt is no longer tax deductible. Again, don't want to let the tax tail wag the dog. That's not why you're buying the real estate. Especially if you're buying an expensive home or vacation home, 750 is your limit in terms of what you're able to write off.

If you are working from home, if you are self employed, just make sure that your office space in this new home is literally separate. You don't necessarily have to have a separate entrance, although that always looks and feels better from the IRS' perspective, but it does need to be used exclusively for business use.

I guess the only other thing that I'd like to bring up are some of the insurance issues. Keep in mind that you've got this new, beautiful home. Please consider an umbrella liability policy that umbrellas both your car insurance, your auto insurance, as well as your home, to cover those unfortunate things that can happen.

Even as wonderful as you are in taking care of your property, people trip. They fall. Unfortunately, they'll sue too. An umbrella liability protects your other assets and is really important as you consider this.

Actually, I have one more thing, guys. You know me. I've always got something I'm pulling out. The other thing to think about is the titling of the property. If you're married, is it jointly held, etc.?

Then also, it's really also going to be important to update your will, your powers of attorney, things of that nature, because now you've got a real asset that needs to be considered in your estate plan.

I think that pretty much covers it. If you have questions, again, go to the website. Send me an email. I'm happy to help, any way I can. In the meantime, thank you so much for tuning in today, and I hope you have a terrific day.