The following is a very interesting story about three individuals and their ambition, or lack there of, to be home owners…

All three individuals, Chris Couldcareless, Johnny Goodintention, and Mary Wealthbuilder, all lived in the same rental area, and paid the same rent. All three had the dream of owning a home, and making money. All three individuals happened upon the same open house, offered for sale @ $150,000. All three people reviewed an example financial flyer explaining costs and payments if they were to purchase this home. The following summarizes their respective decisions and ending results.

Chris Couldcareless – Took a look at the 80/20 loan example with 0% down. The total house payment was $1,150. Chris exclaimed, "My rent is $875 a month. Houses are just too darned expensive. I'll be better off with lower rent", and he left.

Johnny Goodintention – Looked at the same example, and was also a little surprised by the payment. But, Johnny had done a little research and had been talking to a co-worker who purchased a home the previous year. This co-worker told him how much money his tax refund was, because of his new deductions as a home owner, and Johnny got very excited. Johnny called his accountant and figured out that based on his tax bracket (30%), his net deduction would be $3,304.8, or $275.40 a month. That would reduce his effective house payment from $1,150 to $874.60, "CHEAPER THAN RENT" he cheered! Johnny also had $1,000 in his savings, but this was not enough for the closing costs. For the closing costs, he could have received asked for seller paid costs, a gift from a family member, refinanced his car, or used funds from his 401K. Johnny did not see a need to tap into any of these funds and did not understand that a seller can pay for a buyer's closing costs, as he felt he could save the rest over the next year. Johnny made the decision that he would simply take the difference between his rent of $875 and the house payment of $1,150 and save $290 a month for the next year. He figured with the $1,000 he had now, and the money he would save over the next year ($3,480), he would have the $4,500 needed to close.

Mary Wealthbuilder – Knew what Chris didn't know, she knew what Johnny did know, and was also informed about the potential for the property value to increase through appreciation. Mary researched average appreciation figures and assumed over time that 5% appreciation was a fair expectation. Mary felt comfortable with the price of $150,000 and made an offer. She used funds from her 401K for the down, and moved in a month later.

1 Year Later

Chris had spent $10,500 in rent, had $0 equity, but did purchase a new jet ski with the money "saved" by renting.

Johnny also spent $10,500 in rent, had $0 equity, but unlike most buyers who intend to save for closing costs, he actually saved $280 every month just like he planned. Johnny went back to the same neighborhood of homes, excited and ready to buy. Unfortunately, the homes had appreciated 5%. The asking price was now $157,500. Johnny had saved $3,360 in the last year only to lose $7,500 in appreciation. Although Johnny was a little disgruntled about working so hard to save, and still losing ground, he decided to buy anyway. He knew the house payment of $1,150 was still going to be better than renting at $875, and he definitely did not want to miss out on any more appreciation. Unfortunately, Johnny got hit with another bit of bad news. Even though interest rates were the same as the previous year, because the home had appreciated, his payment was now based on a higher loan amount. Instead of a loan payment of $1,150, his payment was now $1,207.50.

Mary spent $13,800 in house payments, got a refund of $3,844.80 (her property taxes were a write-off as well), effectively spending $9,955.20, (which is less than Chris or Johnny). Mary gained $7,500 in equity through appreciation as well.

5 Years Later

Chris experienced three rent increases and was now paying $1,100 a month for the same place and still had $0 equity. (Though there was a brand new 4X4 in the driveway)

Johnny was on the right track but would always be trying to catch up to Mary. His payments were still $1,207.50. Interest rates dropped ½%, but that didn't make enough difference in savings for Johnny to refinance.

Mary's home was now worth $191,442.23 after appreciating 5% a year for 5 years. Her equity position was $41,442.23 than 5 year prior. Because Mary had nearly accrued 20% equity, she was now in a position to refinance and consolidate both loans into one product, or even pull out equity to pay off the remainder of her consumer debt and student loans-she was now debt free other than her mortgage payment, and she paid cash for a new car.

In year 6

Mary took out an equity line on her home and bought a second house. She offered her previous home as a rental to Chris for $1,050 a month. Chris jumped at the chance to be in a bigger place with lower rent. Besides, now that he would have a garage, he could get a boat to match his jet ski.

KNIGHT FINANCIAL

Brooke Knight, President
503.496.1802
www.knightfinancial1.com

"Your Dreams. Our Passion."