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CHAPTER 7 The Finances of Housing

Reviewing Key Terms: Complete the Sentence

DIRECTIONS: *Using terms from the following list, complete the sentences below. Write the letter of the term you have chosen in the space provided.*

A. mobility	D. equity	G. adjustable-rate mortgage (ARM)
B. lease	E. escrow account	H. refinance
C. security deposit	F. points	I. title insurance
		J. appraisal

1. ______ is the value of a home less the amount still owed on the money borrowed to purchase it.
2. A(n) ______ has an interest rate that increases or decreases during the life of the loan.
3. A(n) ______ is an estimate of the current value of a property.
4. The ability to move easily from place to place is called ______.
5. Money in a(n) ______ is held in trust until it can be delivered to a designated party.
6. An amount of money paid to the owner of a property by a tenant to guard against any financial loss or damage that the tenant might cause is called a(n) ______.
7. Extra charges that a home buyer must pay in order to get a lower interest rate on a mortgage is called ______.
8. ______ protects the home buyer in case problems with the title are found later.
9. A(n) ______ is a legal document that defines the conditions of a rental agreement between a tenant and a landlord.
10. When homeowners ______, they take out a new mortgage at a lower interest rate.

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Understanding Key Concepts

DIRECTIONS: On a separate sheet of paper, answer the following questions.

1. Noemi is an apprentice carpenter who would like to live the rest of her life in the neighborhood where she grew up. She plans to host frequent parties for her many family members and friends but cannot afford the large, elegant houses in the real estate agent's listings. What kind of housing would you recommend for Noemi? Explain your answer.
2. Martin is an actor who travels to different locations to perform in plays and in movies. He spends much of his time auditioning; learning scripts; and networking with directors, agents, and other actors. Sometimes the run of his play is cut short, and he scrapes by without a paycheck for weeks. Is Martin more likely to rent or buy a home? Explain your answer.
3. How does a lease usually protect the tenant in most states?
4. Catherine and Jim have finally paid off their home mortgage. What house-related financial obligations do they still have?
5. List three factors that will help working parents Claudia and Steve decide where to buy a house.
6. When might a buyer consider offering more than the listing price for a house?
7. What serves as collateral when a home buyer takes out a mortgage loan, and what happens if he or she fails to repay the loan?
8. Mary has paid two years on a 20-year mortgage at 8 percent interest. Since taking out the loan, she received a raise and would like to pay off her loan more quickly. Mary has found a bank that will refinance her mortgage for 15 years at the same rate of 8 percent interest plus $2,000 in fees. What would you advise Mary to do? Why?
9. Who qualifies for home loans from the Federal Housing Administration (FHA)?
10. Name three typical closing costs.

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Activity 1: *Examine a Rental Lease*

SKILLS ACHIEVED

Reading, Writing, Reasoning, Problem solving, Acquiring and evaluating information, Self-management

OBJECTIVE: *Obtain and evaluate a rental lease.*

In this activity, you will examine a lease to get a sense of what they typically include. This knowledge will make you better prepared if and when you rent your first apartment. Obtain a rental lease from an apartment complex rental office near you, from a housing agency, or from someone you know who is a landlord. Then answer the following questions.

1. How long does the lease run?

____

2. How much is the rent and on what day of the month is it due?

____

3. How much notice do you need to give before you move out?

____

4. Who pays for water, heat, electricity, and other utilities?

____

5. Can you have pets? If so, how many and what kinds?

____

6. Is there a restriction on how many people can live in the apartment? If so, what is the limit?

____

7. Can you make changes to the apartment? If so, what kinds?

____

8. Are there any restrictions on your activities, such as playing your stereo? Describe them.

____

9. What is the procedure for settling disputes with the landlord?

____

10. After evaluating the lease, would you rent this apartment? Why or why not?

____

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Activity 2: *Comparing Housing Options*

SKILLS ACHIEVED

Reading, Writing, Teaching others, Problem solving, Decision making, Reasoning, Seeing things in the mind's eye

OBJECTIVE: *Determine which kind of housing is best for you by assessing your attitudes.*

Some people like houses in the suburbs for the sense of stability they offer, while others prefer the flexibility of an apartment in the city. Some want to own; others want the freedom of renting. In this activity you will use a scale to determine your housing preferences.

On the next page, you will find some statements. For each statement, circle the number on the scale that corresponds to the way you feel about it. Then, exchange completed exercises, including this page, with a partner. Read his or her rankings on the scales. Then write a recommendation in the space below about what kind of housing seems most suitable for your partner.

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Circle the number that best matches how you feel about the statement.

1. I want the security that comes from owning my own home.

5 Strongly agree	4	3	2	1 Strongly disagree

2. The freedom to easily change my living situation is important.

5 Strongly agree	4	3	2	1 Strongly disagree

3. I want to live near movies, clubs, and other types of entertainment.

5 Strongly agree	4	3	2	1 Strongly disagree

4. Living around a lot of other people like me would be a lot of fun.

5 Strongly agree	4	3	2	1 Strongly disagree

5. The type of home that I grew up in will always be the ideal for me.

5 Strongly agree	4	3	2	1 Strongly disagree

6. It would be hard for me to live without pets.

5 Strongly agree	4	3	2	1 Strongly disagree

7. I need to put my own stamp on any place I live.

5 Strongly agree	4	3	2	1 Strongly disagree

8. Yard work and home maintenance chores are my idea of drudgery.

5 Strongly agree	4	3	2	1 Strongly disagree

9. It would be nice to live near work so I would not have to commute a long distance.

5 Strongly agree	4	3	2	1 Strongly disagree

10. The idea of taking on a mortgage frightens me.

5 Strongly agree	4	3	2	1 Strongly disagree

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CHAPTER 7 The Finances of Housing

Math-Building Skills: Nate and Lindsay Buy a House

Choosing the best mortgage would be easy if all you had to do was look at the interest rate. Of course, with points, closing costs, and other charges, you have to make sure you are comparing apples to apples. The only way to find out the real cost of each mortgage package is to do the math.

DIRECTIONS: *Read the scenario. Then answer the questions below.*

Nate and Lindsay have found a house they like in a neighborhood they want to live in. The price of the house is $120,000. They plan to make a down payment of $24,000 or 20 percent. They have received quotes for 30-year fixed mortgages from three lenders:

- **Washington Federal** offered a rate of 8.38 percent with 1.25 points and additional closing costs to the buyer of $2,000.
- **Adams National Bank** offered a rate of 8.63 percent with no points and additional closing costs to the buyer of $3,300.
- **Jefferson Savings** offered a rate of 8.5 percent with 1 point and additional closing costs to the buyer of $2,500.

1. How much money will Nate and Lindsay need to borrow? _______________

2. How much will Nate and Lindsay pay at closing with each loan package?

   a. Washington Federal _______________

   b. Adams National Bank _______________

   c. Jefferson Savings _______________

3. Which package will give them the lowest monthly payment?

   ____

4. Based on your answers, which mortgage loan would you recommend they choose? Why?

   ____

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Finance Online: The Finances of Housing

What kind of house would you like to buy someday? How many rooms will it have? Do you want a patio? A garden? An attached garage? What will a house like this cost you each month in mortgage payments?

For this activity, use an Internet search engine to find out about available houses. Choose the house closest to your ideal. Note the house's listing price. Then check the Internet for available interest rates on 30-year conventional mortgages. Next, find an amortization table or loan calculator to help you determine the size of monthly mortgage payments at different rates.

Keywords Used	Site Names	Web-Site Addresses	Information Offered

1. Describe your choice of house. What was the price listed for this house?

____

____

2. Imagine you can make a 10 percent down payment on the house. What would be the amount of your mortgage loan? What interest rate did you find for a 30-year mortgage?

____

____

3. At the lowest available interest rate, what would be the monthly payment on your mortgage loan?

____

____

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Your Financial Portfolio Worksheet

Renting or Buying Your Home

Check a newspaper for a typical rental price for a two-bedroom apartment and a typical selling price for a two-bedroom house. Use those figures to complete your comparison. How do your figures compare?

Rental Costs	
Annual rent payments (monthly rent $_____ × 12)	
Renter's insurance	250
Total annual cost of renting	

Buying Costs	
Down payment (10%) **Purchase price × .10 = down payment**	
Annual mortgage payment (use interest factor 0.0878) **Purchase price − down payment = loan amount** **Loan amount × 0.0878 = annual mortgage payment**	
Annual property taxes (1.5% of purchase price)	
Annual mortgage insurance premium (.007 × loan amount)	
Homeowner's insurance (annual premium)	400
Estimated annual maintenance and repairs (1% of purchase price)	

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Financial Benefits of Home Ownership:	
Less: Tax savings for mortgage interest (estimate)	– $2,866
Less: Tax savings for property taxes (annual property taxes times 27% tax rate)	
Total cost of buying first year	
Less: One-time down payment (from above)	
Less: Estimated annual appreciation (average 4% increase on the purchase price)	
Total long-term annual cost of buying	

Using the figures in your comparison, will it be less expensive the first year to rent or buy? In the long term, will it be less expensive to rent or buy?

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Software Activity (Optional)

Spreadsheet Application

Comparing Housing Alternatives

OBJECTIVE: *Effectively compare and analyze the financial implications involved in a buy-versus-rent decision.*

Practice Situation

The following data represents two housing alternatives. Alternative 1 presents the costs associated with renting an apartment. Alternative 2 offers data related to the purchase of a home. Calculate the annual total expenses required for each option, then answer the questions on the next page.

Alternative 1: An apartment is available at a monthly rent of $750. Renters insurance will cost $75 per quarter. A $1,000 security deposit is required on the apartment.

Alternative 2: The cost of a home is $95,000. You are considering a 30-year conventional fixed-rate mortgage. The mortgage interest rate is 8 percent and you plan to pay a down payment of $9,500. The monthly payment will be $627. You will pay approximately $6,800 in mortgage interest for the first year. You anticipate that closing costs will be $2,000. The annual property taxes are estimated to be $2,500, and homeowners insurance has been computed to be $500. You anticipate spending approximately 1.5 percent of the cost of the home per year for its maintenance. Assume that homes in your geographic area appreciate at approximately 3 percent of their cost annually.

For both alternatives, assume an after-tax savings interest rate of 5 percent and a tax rate of 30 percent.

Spreadsheet Directions

1. Start your spreadsheet software program and open problem **SA07.xls.** Use the information presented for each alternative and enter the data into the spreadsheet. Remember to use formulas to calculate annual amounts. *Note: Format all dollar amounts to Currency, 2 decimals.*
2. Insert the formulas to compute tax savings for mortgage interest and property taxes by multiplying the payments by the tax rate.
3. Insert the formulas to compute the Total Annual Cost of Renting and the Total Annual Cost of Buying.
4. Perform your calculations and complete the spreadsheet, then save your work to a new file labeled **SA07***.xls.** (Replace *** with your initials.)
5. Print out a copy of your work if your teacher has instructed you to do so.

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Interpreting Results

1. What is the total annual cost associated with each housing alternative?

2. Based on your calculations for alternative 2, what actual total cash outlay would be required in the first year of the purchase?

Drawing Conclusions

1. Based upon your computations, which scenario would be the favorable decision based on financial considerations? Explain.

2. What other nonfinancial advantages and disadvantages should be considered for each alternative?

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SELF-ASSESSMENT QUIZ

DIRECTIONS: *Circle the letter of the choice that best completes the statement or best answers the question.*

1. An advantage of owning a house instead of renting is that you (A) do maintenance yourself (B) can move easily (C) may have tax advantages (D) need less money.
2. If a tenant fails to pay rent or damages the property, the lease gives the landlord the right to (A) increase the rent (B) take legal action (C) throw the tenant out (D) lock out the tenant.
3. The most popular type of housing in the United States is (A) single-family dwellings (B) multi-unit dwellings (C) condominiums (D) mobile homes.
4. A real estate agent provides all the following services *except* (A) supplying locations of available houses (B) evaluating a house's soundness (C) negotiating a purchase price (D) recommending lawyers and insurance agents.
5. Owners might accept less than they think their house is worth when (A) homes are in high demand (B) the house fits the buyer's ideal of a home (C) the interest rates are low (D) they need to move in a hurry.
6. The portion of the purchase price that a buyer pays the seller when signing a purchase agreement is called the (A) earnest money (B) escrow (C) application fee (D) down payment.
7. Generally mortgage insurance is required when the buyer's down payment is (A) 10% (B) 20% (C) 25% (D) 30%.
8. In the first years of a mortgage, most of the monthly payment goes toward paying off the (A) points (B) property taxes (C) principal (D) interest.
9. What might a homeowner do to get a lower interest rate? (A) default (B) take out a second mortgage (C) refinance (D) amortize.
10. An example of a closing cost is the fee for (A) garbage removal (B) title insurance (C) homeowner's insurance (D) an appraisal.