

# Personal Finance

Class 5: Making your purchasing decisions

Consumer purchasing strategies.

The housing decisions.

# Consumer Buying Activities

- FINANCIAL IMPLICATIONS OF CONSUMER DECISIONS

Commonly overlooked trade-offs when buying include...

- Paying a higher price over time by using credit to buy items you need now

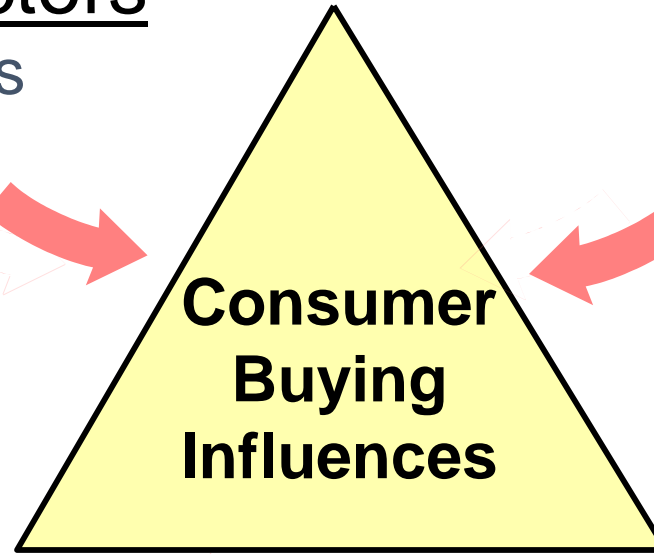
# Consumer Buying Activities

## Economic Factors

- ◆ Consumer prices
- ◆ Interest rates
- ◆ Supply/demand
- ◆ Brand name
- ◆ Warranty
- ◆ Product Quality
- ◆ Tax rates
- ◆ Govt. regs.

## Social Factors

- ◆ Lifestyle
- ◆ Culture
- ◆ Attitudes
- ◆ Ads
- ◆ Media/Internet
- ◆ Hobbies
- ◆ Peer group



## Personal Factors

- ◆ Sex and age
- ◆ Marital status
- ◆ Occupation
- ◆ Income
- ◆ Education
- ◆ Family size
- ◆ Housing type
- ◆ Ethnic group
- ◆ Religion

# Consumer Buying Activities

- Buying unknown, possibly poor-quality brands, that are less expensive
- Selecting brands that may be difficult to service or repair
- Ordering online to save time and money, but return or repair may be difficult
- Taking time and effort to comparison shop

# Consumer Buying Activities

- PRACTICAL PURCHASING STRATEGIES
  - Timing purchases
    - Be aware if the price varies with the time of the year
  - Purchase Location
    - Choice of retailer depends on location, price, product selection
    - Cooperatives: a non-profit organization; members save money

# Consumer Buying Activities

- Brand Comparison
  - Comparison shopping of store and national brands; avoid impulse buying (unplanned purchasing)
- Label information
  - Look for information on label; open dating describes the freshness or shelf life of perishable products

# Consumer Buying Activities

- Price comparison

- Unit pricing provides a standard of measurement
- Coupons (online: [coolsavings.com](http://coolsavings.com); [centsoff.com](http://centsoff.com); [couponsurfer.com](http://couponsurfer.com)) and rebates (partial refund)
- Convenience & ready-to-use products may mean higher prices. Large is not always the best buy, and “Sale” prices vary among stores

# Consumer Buying Activities

- **WARRANTIES**

- Full or limited express warranties, usually written
- Implied warranty of Title indicates the seller has the right to sell the product
- Implied warranty of merchantability guarantees the produce is fit for normal use
- Used-car Warranties disclosures must describe warranty if any (otherwise car sold “as is”)
- New-car Warranties include basic parts, power train, and corrosion coverage
- Service contracts known as extended “warranties” but are not warranties; more of an insurance policy for a fee

# Consumer Buying Activities

- WISE ONLINE BUYING ACTIVITIES



# Major Consumer Purchases: Buying Motor Vehicles

- PHASE 1: PRESHOPPING ACTIVITIES

- Problem identification

- Information gathering

- Personal contacts

- Business organizations

- Media sources (television, Websites)

- Independent testing organizations (Consumer Reports)

- Government agencies.

- Online Sources ([www.edmunds.com](http://www.edmunds.com),  
[www.caranddriver.com](http://www.caranddriver.com), [www.autotrader.com](http://www.autotrader.com) )

# Major Consumer Purchases: Buying Motor Vehicles



# Major Consumer Purchases: Buying Motor Vehicles

- PHASE 2: EVALUATING ALTERNATIVES
  - Comparison shopping
  - Selecting vehicle options (mechanical devices, convenience and aesthetic options)
  - Comparing used vehicles ( [www.carmax.com](http://www.carmax.com) [www.dealernet.com](http://www.dealernet.com), [www.autotrader.com](http://www.autotrader.com) )



# Major Consumer Purchases: Buying Motor Vehicles



- Leasing an automobile
  - lower payments, smaller initial cash outlay
  - no ownership in vehicle
  - maximum # of miles/year; charged for extra miles
  - know the capitalized cost of the lease, the money factor, the monthly payment, number of payments, and the residual value

# Major Consumer Purchases: Buying Motor Vehicles

- PHASE 3: DETERMINING PURCHASE PRICE
  - Negotiation for New and Used cars
  - Know necessary information about the product
  - Deal with a person of authority to give you a lower price or additional features
  - Used-cars: Check newspaper ads, Kelly Blue Book ([www.kbb.com](http://www.kbb.com)) or Edmund's Used Car Prices ([www.edmunds.com](http://www.edmunds.com) )
  - New cars: Set-price dealers, car-buying services

# Major Consumer Purchases: Buying Motor Vehicles

## - Compare financing alternatives

- Variety of lenders and some lenders may pre-approve you
- Avoid being upside-down or having negative equity in your car
- Look for rebates or low-interest financing
- Consider the APR (true cost of credit)
  - Check out [www.bankrate.com](http://www.bankrate.com)

# Major Consumer Purchases: Buying Motor Vehicles

- Comparing rebates and special financing

	<b>AUTO MANUFACTURER FINANCING</b>	<b>FINANCIAL INSTITUTION FINANCING (BANK, CREDIT UNION)</b>
ANNUAL PERCENTAGE RATE	2.9%	6.0%
VEHICLE PRICE	\$17,500	\$17,500
DOWN PAYMENT	\$ 2,500	\$ 2,500
MANUFACTURER'S REBATE	\$ 1,500	\$ 1,500
LOAN AMOUNT	\$13,500	\$13,500
TERM OF LOAN	60 MONTHS	60 MONTHS
MONTHLY PAYMENT	\$ 242.00	\$ 262.00
TOTAL PAYMENT (NOT INCLUDING DOWN PAYMENT)	\$14,520	\$15,720
TOTAL SAVINGS USING AUTO MANUFACTURER: \$1,200		

# Major Consumer Purchases: Buying Motor Vehicles

- PHASE 4: POSTPURCHASE ACTIVITIES
  - Lemon Laws ([www.lemonlawamerica.com](http://www.lemonlawamerica.com) )
  - Automobile operation costs
    - Use the item correctly to have improved performance and fewer repairs
    - Investigate, evaluate, and negotiate a variety of servicing options
  - Motor Vehicle Maintenance
    - Operation costs; fixed and variable expenses
  - Automobile servicing sources
    - Car dealers, service stations, auto repair shops, Wal-Mart, specialty shops...

# Resolving Consumer Complaints And Legal Options for Consumers

## Step 1 - Initial Communication

- Return to place of purchase or contact online retailer.
- Provide a detailed explanation and the action you desire.
- Be pleasant yet persistent in your efforts to obtain a resolution.



## Step 2 - Communication with the Company

- Send an e-mail with the details of the situation (Exhibit 8-9).
- Post your concerns on the company's online social media sites.
- Comment on a blog or a consumer review website.



## Step 3 - Consumer Agency Assistance

- Seek guidance from a local, state, or federal consumer agency.
- Determine if any laws have been violated in the situation.
- Consider the use of mediation or arbitration.



## Step 4 - Legal Action

- Consider bringing your case to small claims court.
- Determine if a class action suit is appropriate.
- Seek assistance from a lawyer or legal aid organization.

# Legal Options for Consumers

- Step 4: Take Legal Action
  - Small claims court
  - Class action suits
  - Using a lawyer
  - Other legal alternatives
    - Legal aid society
    - Prepaid legal services
  - Personal Consumer Protection
    - Follow common sense guidelines on dealing with reputable companies, signing contracts, exaggerated advertising, credit vs. cash purchase and rushing to get a deal



# Housing Alternatives

- YOUR LIFESTYLE AND YOUR CHOICE OF HOUSING
  - How you spend your time and money affects your housing choice
  - Personal preferences for housing are modified by financial factors
    - Traditional financial guidelines suggest you spend no more than 25-33% of take-home pay on housing, or no more than 2 1/2 times your annual income

# Housing Alternatives

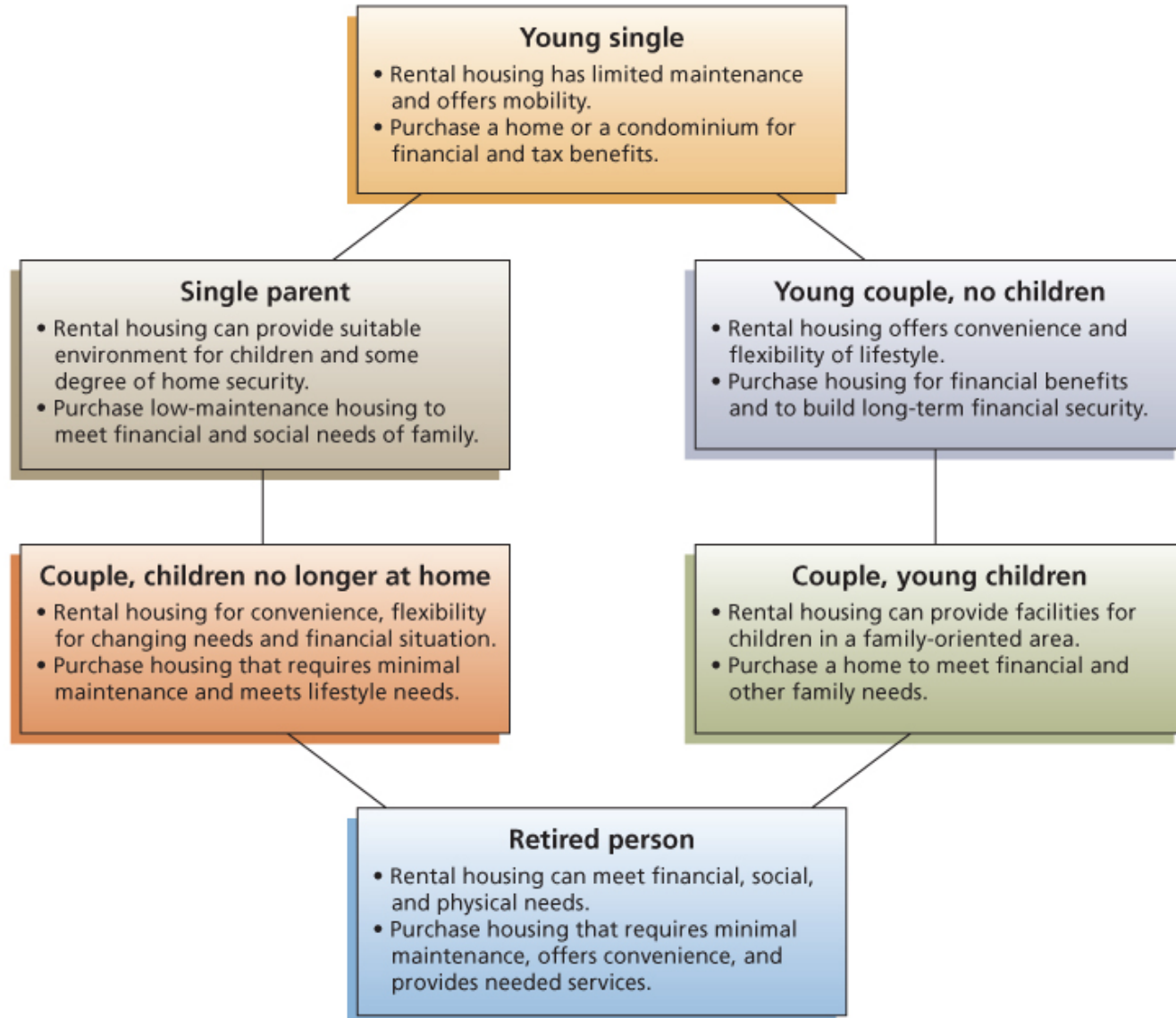
- OPPORTUNITY COSTS OF HOUSING CHOICES
  - Interest earnings lost on money used for a down payment on a home or the interest on a security deposit for an apartment
  - Time and cost of commuting to live in an area that offers less costly housing or more space

# Housing Alternatives

- Renters lose tax advantages and equity growth
- Time and money you spend to repair and improve a lower-priced home
- Time and effort when you have a home built to your personal specifications



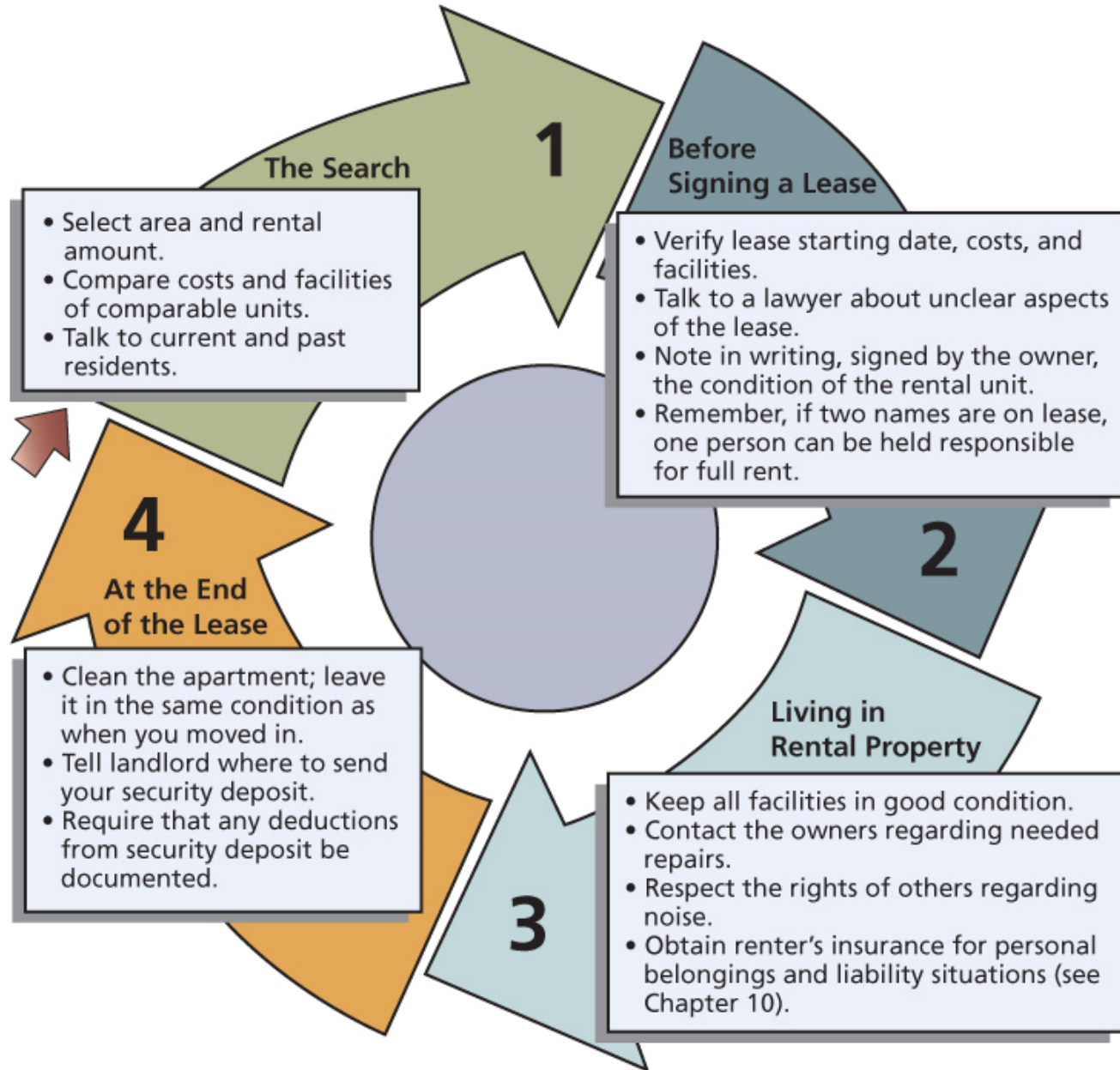
# Housing Alternatives for Different Life Situations



# Renting Your Residence

- THE SEARCH
  - Select an area and rental cost for your needs
  - Compare costs and facilities between units
  - Talk to current and past residents

# Housing Rental Activities



# Renting Your Residence

- ADVANTAGES OF RENTING
  - Easier to move (mobility)
  - Fewer maintenance and repair responsibilities
  - Lower initial costs



# Renting Your Residence

- DISADVANTAGES OF RENTING

- No tax benefits
- Limits regarding remodeling
- Restrictions regarding pets and decorating
- Costs including a security deposit, utilities, and renter's insurance



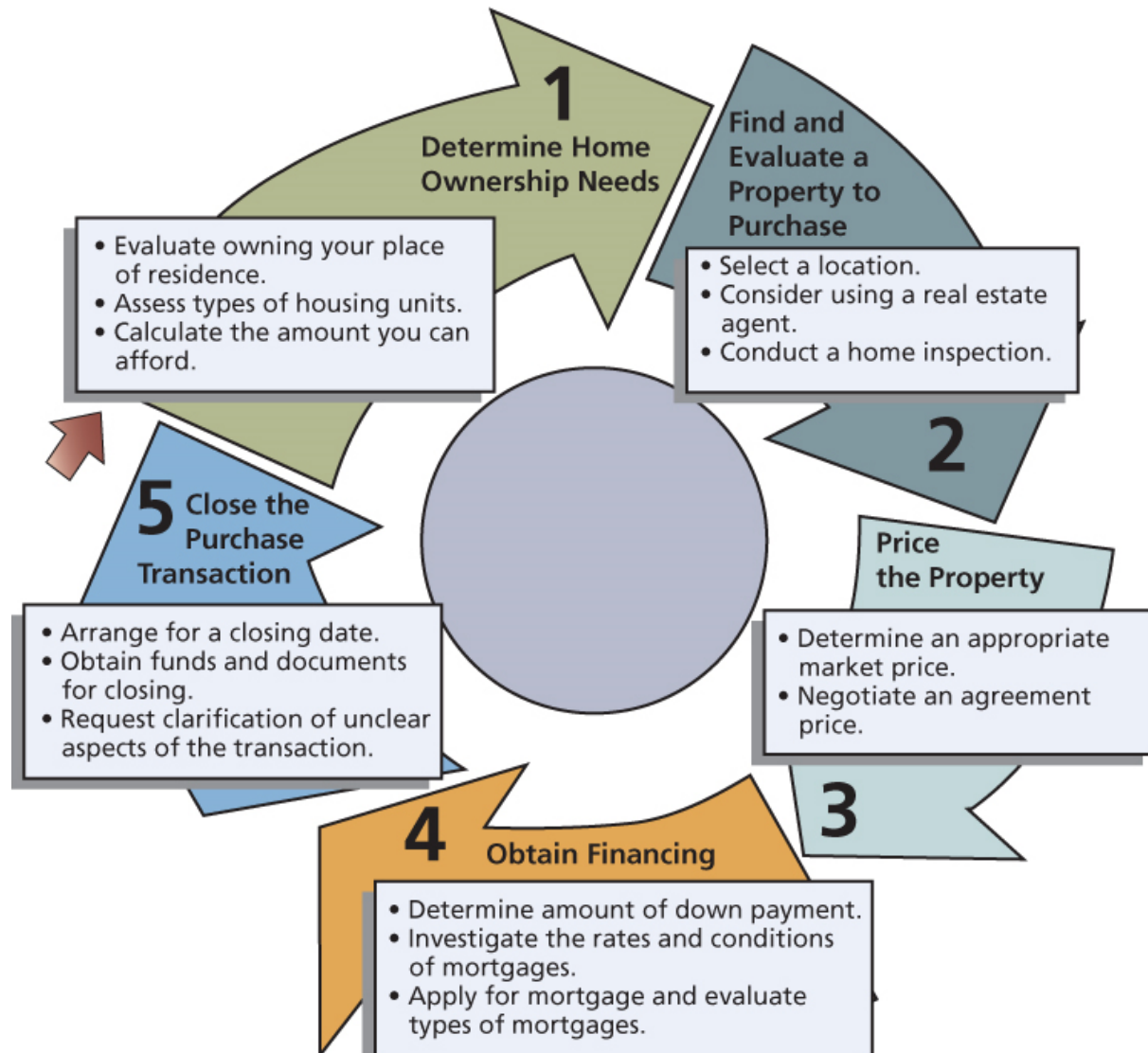
# Renting Your Residence

- Legal Details Of A Lease
  - Description and address of property
  - Name and address of the owner/landlord (lessor)
  - Name of tenant (lessee)
  - Effective date and length of the lease
  - Amount of security deposit
  - Amount and due date of rent

# Renting Your Residence

- Location where rent is due
- Date and amount for late rent payments
- List of included utilities and appliances
- Restrictions on certain activities (pets, remodeling)
- Tenant's right to sublet the rental unit
- Charges for damages or for moving out later (or earlier) than lease expiration date
- Conditions where landlord may enter rental unit

# Home Buying Process



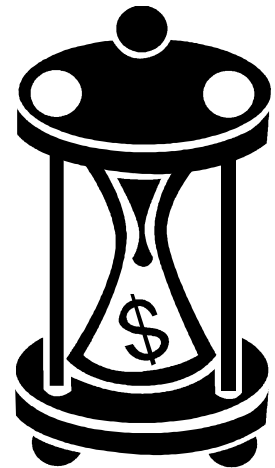
# Home Buying Process

## STEP 1: DETERMINE HOME OWNERSHIP NEEDS

- *Benefits* of Home Ownership
  - Pride of ownership (“American dream”)
    - Stability of location
  - Financial benefits
    - Deduct property taxes and mortgage interest
    - Potential increase in value of your home
    - Building equity in your home
  - Lifestyle flexibility
    - express your individuality (decorating)

# Home Buying Process

- *Drawbacks* of Home Ownership
  - Financial uncertainty
    - Obtaining money for the down payment
    - Obtaining mortgage financing
    - Home values could drop
  - Limited mobility
    - Can take time to sell your home
  - Higher living costs
    - Home improvements
    - Rising real estate taxes



# Home Buying Process

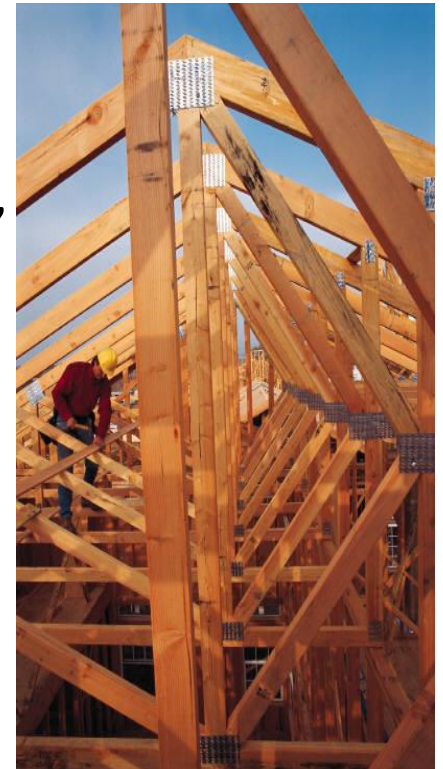
- Assess Types of Housing Available
  - Single-family dwelling
  - Multiunit dwelling
    - Duplex, townhouse
  - Condominium
    - You own your individual unit in a building of units
    - It is not a type of building structure but rather a legal form of home ownership
  - Cooperative housing
    - Non-profit organization - members own shares and rent a unit in a building with multiple units

# Home Buying Process

- **Manufactured homes**
  - Fully or partially assembled in a factory, and then moved to the housing site
  - Prefabricated type has components built in the factory and assembled at the housing site
  - Mass production under factory conditions keeps costs lower than site built homes
- **Mobile homes**
  - A type of manufactured home; often has less than 1,000 square feet
  - Offers same features as a conventional house
  - Safety is debated and they tend to depreciate

# Home Buying Process

- Building a home
  - Does the contractor have needed experience?
  - Does contractor have a good working relationship with architect, suppliers, electricians, plumbers, carpenters and others?
  - What assurance do you have about quality of materials?
  - What are the payment arrangements during construction?



# Home Buying Process

- What delays in the construction process will be considered legitimate?
- Is the contractor licensed and insured?
- Is the contractor willing to provide names, addresses, and phone numbers of satisfied customers?
- Are there any complaints about this contractor?
- Written contract should have a time schedule, cost estimates, description of work, and a payment schedule.

# Home Buying Process

## STEP 2: FIND AND EVALUATE A PROPERTY TO PURCHASE

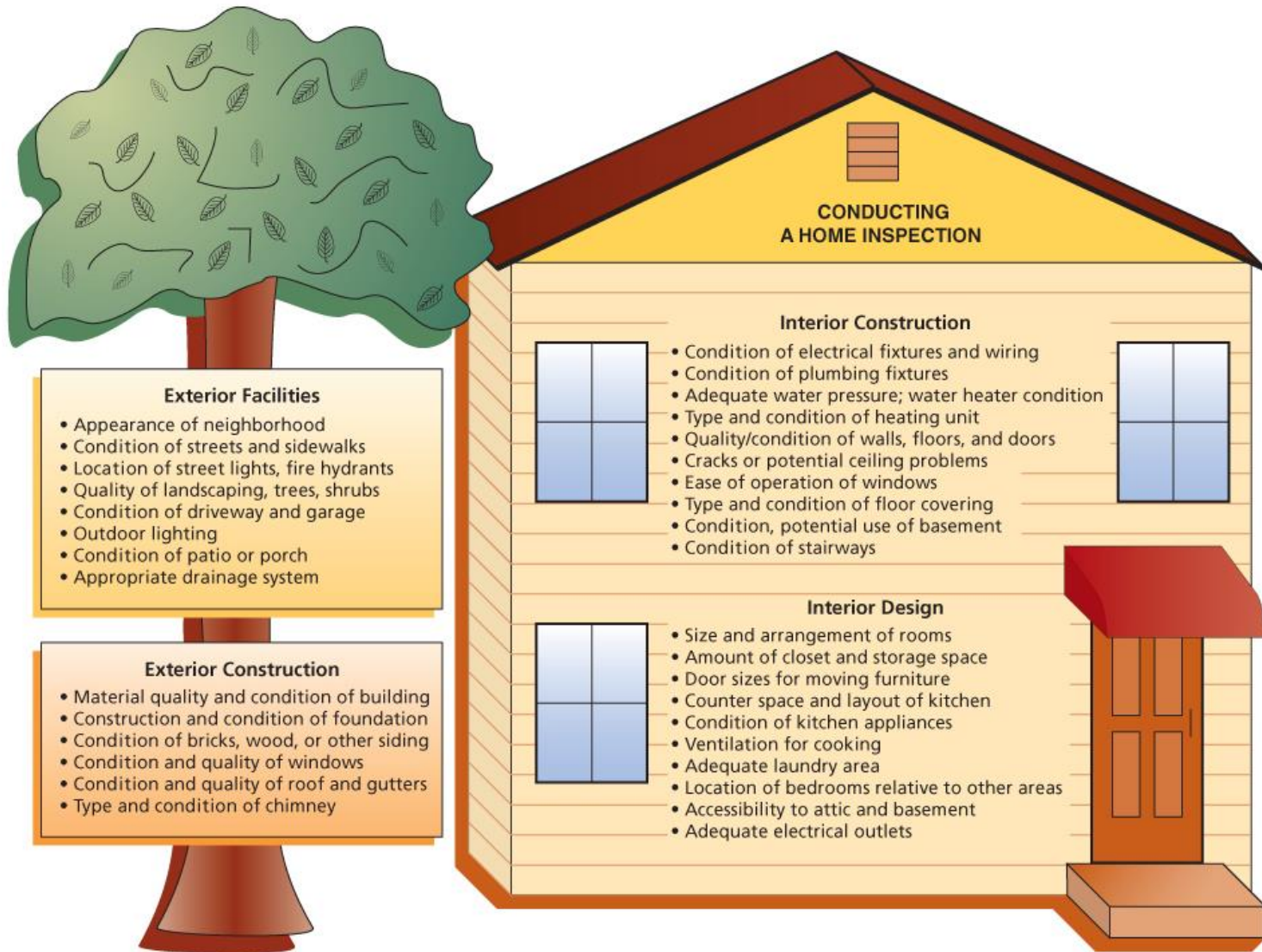
- Selecting a Location
  - Be aware of zoning laws
  - Assess the school system if you have children

# Home Buying Process

- Using a real estate agent
  - They present your offer, negotiate the price, assist you in obtaining financing, and represent you at the closing
- Conduct a home inspection or hire an inspector
- Mortgage company will want an appraisal



# Home Buying Process



# Home Buying Process

## STEP 3: PRICE THE PROPERTY

- Determining the Home Price
  - Consider recent selling prices in the area, current demand for housing, the length of time the home has been on the market, the owner's need to sell, financing options, and features of the home
- Negotiating the Purchase Price
  - Counteroffers are common
  - Earnest money
  - Contingency clauses, such as...
    - Buyer must be able to obtain financing
    - Sale contingent on the sale of the buyer's current home

# The Finances of Home Buying

## STEP 4: OBTAIN FINANCING

- Determine the amount of the down payment
  - Private Mortgage Insurance (PMI) is required if down payment is less than 20%
- Investigate the rates, types, & terms of mortgages
- Apply for a mortgage and evaluate types of mortgages. Guidelines for affordability of housing costs are 33% to 38% of gross income

# The Finances of Home Buying

- Qualifying and Applying for a Mortgage
  - includes your income, debts, credit history, down payment amount, length of the loan, and current mortgage rates
    - Prequalification
    - Finding a property including appraisal
    - Fee Payment and commitment
- Points are prepaid interest as a % of the loan amount and represent the premium you pay to obtain a lower mortgage rate



# The Finances of Home Buying

- **FIXED-RATE, FIXED-PAYMENT MORTGAGES**
  - **Conventional**
    - Fixed rate, fixed payment home loan
    - Equal payments over 10, 15, 20, 25, or 30 years
    - Loan is amortized which means balance owed is reduced with each payment

# The Finances of Home Buying

- Government financing programs
  - Loans insured by Veterans Administration
  - Loans insured by Federal Housing Authority
  - Lower down payment and lower interest

# The Finances of Home Buying

- ADJUSTABLE-RATE, VARIABLE-PAYMENT MORTGAGES
  - Adjustable rate mortgages
    - During the life of the loan the interest rate varies with the prime rate, but has a rate cap
    - A payment cap may limit the payment but, extend the loan



# The Finances of Home Buying

- INTEREST-ONLY MORTGAGE
  - Allows a homebuyer to have lower payments for the first few years of a loan
  - None of the mortgage payment goes toward the loan principal amount
  - Higher payments will occur later in the loan
  - Can be especially dangerous if the value of the property declines

# The Finances of Home Buying

- Comparison of 30 and 15 Year Fixed Mortgages
  - Loan Amount= \$100,000
  - Interest Rate=6%

Loan Term (years)	# of payments	Payment amount	Total cost
30	360	\$600	\$216,000
15	180	\$843	\$151,740

***Total Savings=\$64,260***

# The Finances of Home Buying

- Comparison of Different Rates
  - Loan Amount= \$100,000
  - Loan term= 30 years (360 payments)

Interest rate	# of payments	Payment amount	Total cost
7%	360	\$665	\$239,400
6%	360	\$600	\$216,000

***Total Savings=\$23,400***

# The Finances of Home Buying

- OTHER FINANCING METHODS
  - Buy-Downs
    - Interest rate subsidy from a home builder or a real estate developer that reduces the mortgage payments for the first few years
  - Second mortgage
    - Home is collateral and interest may be tax deductible; known as a Home equity loan

# The Finances of Home Buying

- Reverse mortgages
  - Provides elderly (>62 years old) with tax-free income based on their home equity in the form of a loan that is paid back (with interest) when the home is sold or the homeowner dies
  - Known as Home Equity Conversion Mortgages
- Refinance if interest rate drops at least 1%

# The Finances of Home Buying

## STEP 5: CLOSE THE PURCHASE TRANSACTION

- Documents signed; meeting of buyer, seller, and lender
- Closing costs (Settlement costs) include...
  - Title insurance and Title search fee
  - Attorney's and Appraisers fees
  - Property survey; Termite inspection
  - Deed recording fees; Transfer taxes
  - Credit report; Lender's origination fee
  - Escrow account for tax and insurance reserve
  - Pre-paid interest; Real estate commission

# The Finances of Home Buying

- The Main Elements of Buying a Home

- **Location.** Consider the community and geographic region. A \$250,000 home in one area may be an average-priced house, while in another part of the country it may be fairly expensive real estate. The demand for homes is largely affected by the economy and the availability of jobs.
- **Down payment.** While making a large down payment reduces your mortgage payments, you will also need the funds for closing costs, moving expenses, repairs, or furniture.
- **Mortgage application.** When applying for a home loan, you will usually be required to provide copies of recent tax returns, pay stubs, w-2 forms, a residence and employment history, information about bank and investment accounts, a listing of debts, and evidence of auto and any real estate ownership.
- **Points.** You may need to select between a higher rate with no discount points and a lower rate requiring points paid at closing.
- **Closing costs.** Settlement costs can range from 2 to 6 percent of the loan amount. This means you could need as much as \$6,000 to finalize a \$100,000 mortgage; this amount is in addition to your down payment.\*
- **PITI.** Your monthly payment for principal, interest, taxes, and insurance is an important budget item. Beware of buying "too much house" and not having enough for other living expenses.
- **Maintenance costs.** As any homeowner will tell you, owning a home can be expensive. Set aside funds for repair and remodeling expenses.

(\*some states limit the amount of closing costs.)

# Selling Your Home

- PREPARING YOUR HOME

- Repair, repaint, and clean
- Clear the garage
- Keep the lawn cut
- When showing home, turn on lights and open drapes
- Bake bread or make coffee for a welcoming smell



# Selling Your Home

- DETERMINING THE SELLING PRICE
  - Appraiser estimates the current value
  - Real estate agent markets your home
- If “FOR SALE BY OWNER,” use a lawyer or title company to assist with contract and closing
- LISTING WITH A REAL ESTATE AGENT