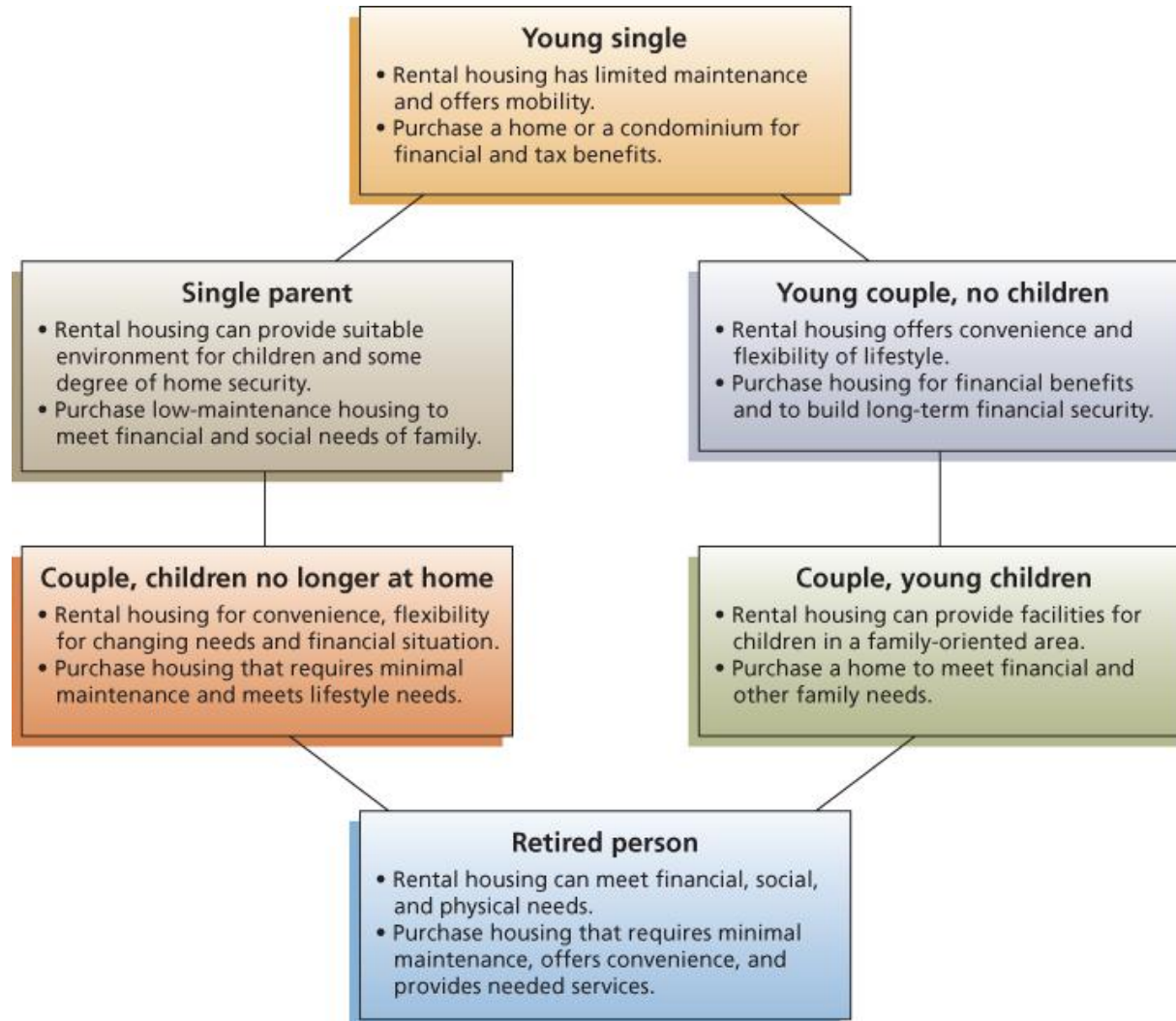


Section 5: Housing decisions

By Watcharida Boonthaveepat

Housing alternatives by life stages



Housing alternatives

- ▶ Your lifestyle and your choice of housing
 - How you spend your time and money, affects your housing choice.
 - Personal preferences 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.
- ▶ Opportunity costs of housing choices
 - ▶ Interest earnings lost on money used for a down payment 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

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

Renting your residence (2)

- ▶ Advantages of renting
 - ▶ Easier to move
 - ▶ Fewer maintenance and repair responsibilities
 - ▶ Lower initial costs

Renting your residence (3)

- ▶ Disadvantages of renting
 - ▶ No tax benefits
 - ▶ Limitations regarding remodeling
 - ▶ Restrictions regarding pets and other activities
 - ▶ Legal concerns of a lease
 - ▶ Costs including a security deposit, utilities and renter's insurance

Home buying process

Step I: DETERMINE THE HOMEOWNERSHIP NEEDS

- ▶ *Benefits of Home Ownership*
 - ▶ 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

Home buying process (2)

- ▶ *Drawbacks of Homeownership*
 - ▶ 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 (3)

- ▶ Assess Types of Housing Available
 - ▶ Single-family dwelling
 - ▶ Multi-unit dwelling
 - ▶ Duplex, townhomes
 - ▶ Condominium
 - ▶ You own your unit in a building of units
 - ▶ It is not a type of building structure, but rather a form of homeownership

Home buying process (4)

▶ 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?
- ▶ What are the payment arrangements?

Home buying process (5)

- ▶ **Building a home (continued)**
 - ▶ What delays will be considered legitimate?
 - ▶ Is the contractor licensed and insured?
 - ▶ Are there any complaints about this contractor?
 - ▶ Contract should have a time schedule, cost estimates, description of work, and a payment schedule.

Home buying process (6)

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.
- ▶ **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**

Home buying process (7)

Step 3: PRICING THE PROPERTY

- ▶ **Determine the Home Price**
 - ▶ Price is affected by whether it is a seller's or a buyer's market.
- ▶ **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

Factors affecting the monthly payment

- ▶ The amount borrowed
- ▶ The interest rate
- ▶ Length of maturity of the loan

The finance of home buying

Step 4: OBTAIN FINANCING

- ▶ Determine the amount of the down payment
 - ▶ Mortgage insurance (PMI) if less than 20% down
- ▶ 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 finance of home buying (2)

▶ Qualifying for a mortgage

- ▶ includes your income, debts, credit history, down payment amount, length of the loan, and current mortgage rates
- ▶ Step 1: Prequalification
- ▶ Step 2: Finding a property, including appraisal
- ▶ Step 3: Fee Payment and commitment

Fixed-rate, fixed-payment mortgages

▶ Conventional

- ▶ Fixed rate, fixed payment, amortized
- ▶ 5%, 10% or 20% down
- ▶ 15, 20 or 30 years of fixed payments

▶ Balloon

- ▶ Fixed monthly payments plus one large payment, usually after 3, 5 or 7 years

The mathematics of mortgage loans

- ▶ Mortgage loans are available from depository institutions and mortgage finance companies.
- ▶ In exchange for the loan, the lender (mortgagee) has a lien on the real estate, that is, the legal right to take and hold property or to sell it in the event the borrower (mortgagor) defaults on the loan.
- ▶ Foreclosure is a process in which the lender sues the borrower to prove default and asks the court to order the sale of property to pay the debt.

The mathematics of mortgage loans (2)

- ▶ Amortization = the process of gradually paying off a loan through a series of periodic payments to a lender.
- ▶ Each payment is allocated in two ways:
 - ▶ A portion goes to pay the simple interest on outstanding debt for that month multiplied by the periodic (monthly) interest rate
 - ▶ The remainder goes to repay a portion of the principal, which is the debt remaining from the original amount borrowed.

The mathematics of mortgage loans (3)

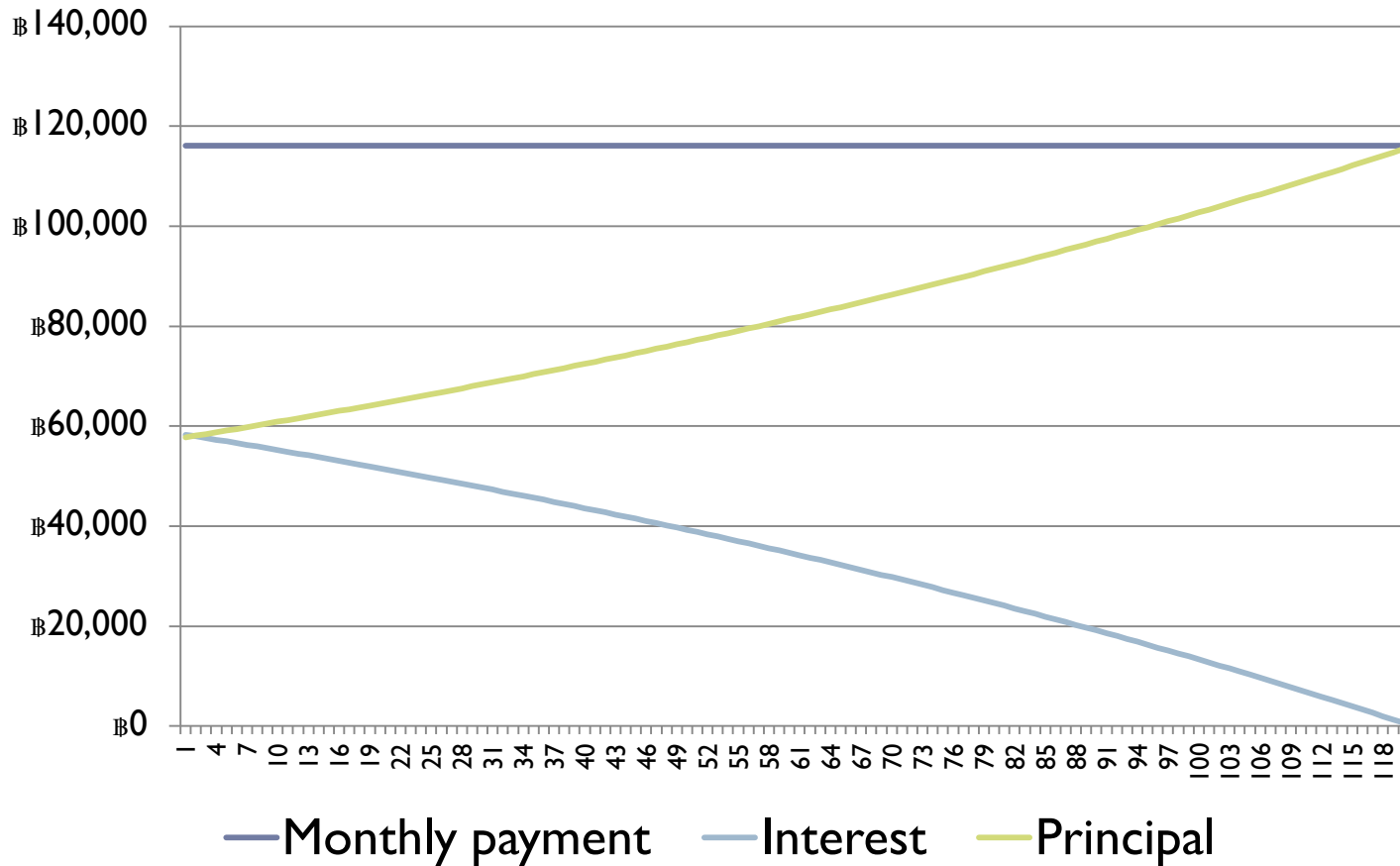
- ▶ As the principal is paid down, increasingly smaller portions of the payments will be required to pay interest while the portion of the payments devoted to the principal will grow faster.
- ▶ The slow decline in the amount of each monthly payment going toward interest.

An illustration

Summary information	
Loan amount (bt)	10,000,000
APR	7.00%
Life of loan (in years)	10
Number of payments per year	12
total number of payments	120
Payment per period	฿116,108.48
Sum of payments (total cost of loan)	13,933,018
Interest Cost	3,933,018

Calculate for each
monthly payment

An illustration (2)



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

Other financial methods

▶ Buy-Downs

- ▶ Interest 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. Home equity loans are an example

▶ Reverse mortgages

- ▶ Provides elderly (>62 years old) with tax-free income based on the home equity

▶ Refinance if interest rate drops at least 1%

U.S. subprime case study

- ▶ **Objective:**
 - ▶ Understand the structure of mortgage linked products
 - ▶ Understand the terminology of mortgage loans
 - ▶ Understand the potential causes of subprime crisis and lesson learned from the crisis

- ▶ **15-minute group discussion**

- ▶ **Class discussion**