SUMMARY

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Buying Your First Home

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Summary of Buying Your First Home by Ilona Bray, Alayna Schroeder, Marcia Stewart

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What you need to know if you’re buying your first home.

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Introduction

There's no doubt about it: buying your first home is one of the biggest, scariest steps you can take! For many people, this decision is considered a major milestone of adulthood. Society has taught us that being successful and buying your own home are two core signs that you've "made it" as an adult-- and thus, it's something that most people aspire to.

But although there's no shortage of pressure to buy a home, advice on how to do so is often a little more scarce. That's why the authors aim to demystify this process and cut through the many confusing messages that first-time home buyers receive. So, think of this book as your clear-cut, no nonsense guide to everything you've ever wanted to know about buying your first home!

The Basics of Buying Your First Home

If you're a young person in your twenties or thirties, you've probably noticed that this is not your grandma's economy. Your parents and grandparents likely enjoy giving frequent lectures about how, "Back in my day, I bought a house right out of college!" or "I worked hard to support myself through school-- what are you kids whining about?" and these lectures clearly communicate that younger generations are just lazy. But the truth is that the struggles of our current economic climate cannot be blamed on the old excuse of "kids these days are lazy."

In fact, young people today are actually living in a radically different economic landscape from that of their parents and grandparents. And that's why you need economic advice that's tailored to the financial difficulties of today. So, the authors aim to begin by unpacking some of the most common concepts in real estate. In their own words, the authors break down the first-time house-buying process by explaining:

"You've probably heard people talk about real estate as a great investment. But what exactly do you get out of the deal? Well, a few things: You'll build equity instead of spending cash on rent, you gain immediate benefits (a place to live!), and you'll eventually have full ownership of an asset that—at least over the long term—has a good chance of appreciating in value.

Buying a home is one of those rare instances where you can control a very large and potentially appreciating asset with a comparatively small initial cash investment (your down payment). Better yet, notes adviser Daniel Stea, "You're using the proverbial 'OPM' (other people's money) for the balance of the investment, and that money is being lent to you at comparatively low cost given the historically low interest rates we've experienced these past few years. Yet you get to enjoy the appreciation on the full value of the investment, not just your cash component. It almost doesn't seem right!"

Over time, as you patiently pay your mortgage, two things might start happening—your principal loan balance will go down, and the house's market value may go up. Both of these mean that you're accruing equity. Equity is the difference between the market value of a house (what it's currently worth) and the claims against it (what you have left to pay on any mortgages or loans you've taken out against it).

You'd be hard-pressed to find another investment where you can borrow a large amount of money, pay a modest interest rate, and reap every bit of the gain yourself. For example, let's say that Hugo buys a home for $300,000 with a $60,000 down payment (20%) and a $240,000 mortgage. If the market value of the house is $300,000, Hugo's current equity in the home is $60,000 (market value minus mortgage debt). A few years later, Hugo has reduced the principal on the mortgage by $5,000, to $235,000. Meanwhile, the house's value has risen to $310,000. Hugo now has $75,000 in equity ($310,000 minus $235,000).

That's $15,000 more than he originally invested. Of course, the value of a property doesn't always increase: It can also decrease, sometimes dramatically. Fortunately, houses rarely drop in value permanently. And after some precipitous value drops in the early 2000s, home appreciation in 2019 averages around 4–5%, according to the S&P/CoreLogic Case-Shiller U.S. National Home Price indexes.

A good chunk of the money you'll use to finance your home is money you're already spending on rent. When you buy a house, your rent money becomes investment money. Some people like to call a mortgage a forced savings plan, because it makes you sock a little cash away every month in the form of a mortgage payment—money you will, with any luck, get back when you sell the place. On the other hand, you might call it a smart investment plan, because it gives you both a roof over your head and a way to convert your cash into a potentially appreciating asset.

Eventually, as your equity in your home builds, you can borrow against it at relatively low interest rates, using a home equity loan or a HELOC (home equity line of credit). These are also commonly referred to as "second mortgages." The interest rates on these tend to be higher than on primary mortgages, but lower than on the typical credit card. The money borrowed can be used for any number of purposes, such as home improvements, college tuition, or a car.

How Your Credit Score Impacts Your Purchase of a Home

We hear so much about people who ruined their credit score by getting foreclosed on that it's hard to remember the reverse side of the picture: the fact that a mortgage is seen as "good debt." When you successfully pay it down, credit-reporting companies view that as a sign that you're responsible and able to handle a large loan. "This can do wonders for your credit rating," says adviser Daniel Stea. "It makes you a much better credit risk (statistically speaking), which becomes especially useful if you decide to apply for an auto loan, a small-business loan, a student loan for your kid's college tuition, and so on."

One other benefit to buying a house is kind of obvious . . . you're becoming a homeowner, and when the loan is paid off, you won't have to pay for a place to live. You could keep renting the same place you're in now for 50 years, and at the end of that time you'll still have to pay monthly rent checks to your landlord. You'll also get to claim various federal tax deductions and credits for home-related expenses. For some, these can add up to some serious savings.

However, you should be careful not to confuse a tax deduction with a tax credit. A tax deduction is an amount that taxpayers who don't take the standard deduction, but instead "itemize" their deductions, subtract from their gross income (all the money earned during the year) to figure out how much of their income is subject to tax. For example, if your gross income is $80,000, and you have a $2,000 tax deduction, and you don't take the standard deduction, your taxable income is reduced to $78,000.

As a new homeowner, you might be entitled to certain tax credits:

● Tax credit for first-time homebuyers.

At the time this book went to print, all the tax credits for first-time homebuyers had expired—but keep an eye on the news and www.irs.gov for anything new that might come along!

● Tax credits for energy efficiency.

Homeowners who install solar, geothermal, fuel cell, or wind systems to generate electricity, or in some cases hot water, are eligible for a tax credit if the system is placed in service before January 1, 2022. There is no dollar limit on solar, geothermal, or wind system credits, but fuel cell system credits are capped at $500 per half kilowatt (kW) of power capacity.

The credit value decreases over the next few years. It's 30% of the cost of the systems placed in service through December 31, 2019; then goes down to 26% for systems placed in service after December 31, 2019 and before January 1, 2021; then reduces to 22% for systems placed in service after December 31, 2020 and before January 1, 2022. It officially expires on December 31, 2021. Taxpayers can claim such credits using IRS Form 5695 Residential Energy Credits. For more about the credit, as well as the latest information on eligibility and expiration dates, see the Energy Star website at EnergyStar.gov.

To take advantage of house-related tax deductions, you'll need to itemize your tax deductions, rather than take the standard deduction (for 2019 tax returns $12,200 for individuals and $24,400 for married people filing jointly). For most people, homeowners included, taking the standard deduction is the more beneficial approach under the latest iteration of the U.S. Tax Code. You'll want to run the numbers to see whether your itemized deductions exceed the standard deduction amount. If you do end up itemizing, you'll find that it involves a step up from the good old 1040EZ, but it's not all that complicated.

For more information about this, you can check out IRS Publication 530, Tax Information for Homeowners, available at www.irs.gov. This publication will give you more detailed information about the tax benefits of buying a home.

And if itemizing deductions is the right approach for you, be prepared to prove them to the IRS—all of them, not just the house-related ones.

Keep a file of receipts for the more common deductions, such as unreimbursed business expenses (office equipment and travel); educational expenses (tuition and books); charitable contributions; and unreimbursed medical expenses. Consider getting help—even the cost of meeting with a tax professional might be tax deductible! One of the biggest potential deductions from your taxable income, if you itemize, will be the interest you pay on your home mortgage (available for mortgages of up to $750,000 for individuals and married couples filing jointly and $375,000 for married people filing separately).

This one can be particularly advantageous during the first few years of a fixed rate mortgage, when most of your payment will be put toward interest. Until the end of 2017, home-owning families with an adjusted gross income of $100,000 or less were able to fully deduct the cost of their mortgage insurance premiums (PMI). (PMI protects the lender's investment if it needs to foreclose—lenders require borrowers to purchase PMI if their down payment is less than 20% of the purchase price.)

Although the PMI deduction has since expired, a bill to create a permanent PMI deduction was introduced in early 2019 (H.R. 284—116th Congress: Mortgage Insurance Tax Deduction Act of 2019), so it's possible that homeowners who itemize might be able to again use this deduction in the future. Check IRS.gov/Schedule A for the latest information before you file your taxes.

Taxpayers who itemize can also deduct certain other expenses from their taxable income, such as:

- Property taxes

While the amount varies between states and localities, most people pay around 1% of the home's value each year in state property tax. You can deduct from your federal taxable income up to $10,000 of what you pay collectively for state, local, and property taxes.

● Points

Points are additional one-time (and usually optional) fees you pay to reduce your mortgage's interest rate. They're tax deductible in the year you pay them. •Interest on a home improvement loan. If you take out a loan to make improvements that increase your home's value, prolong its life, or adapt its use—for example, by adding a deck or a new bathroom—you can deduct the interest on loans up to $750,000.

But you can't deduct interest on loans used to make normal repairs, such as repainting the kitchen or fixing a broken window, and definitely not if you take out a loan secured by your home for some unrelated purpose, such as medical bills.

● Home office expenses

If you use part of your home exclusively and regularly for a home-based business, you might be able to deduct a portion of the related expenses—including the costs of some home repairs, or even things like landscaping if your home's appearance will be important to visiting clients.

Final Summary

When you're thinking about buying your first home, there's a lot you need to know! So much, in fact, that it's impossible to cram it all into a single summary of a book. Fortunately, however, the authors are willing to share and simplify their experience so that the first-time home buying process can be a little more accessible.

You can always check out the full, unabridged version of this book for more detailed advice from the authors that covers even more information. But thanks to this summary, you can unpack a few basics, like why buying a house is considered such a smart investment. You can also see what a mortgage is and why it's important, along with some helpful information about tax breaks for homeowners that may save you a buck or two!