JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And / Or Sponsoring Organization Is Missing

6. Real Estate Finance/Mortgage Banking/Mortgage Guaranty Insurance

z. "Discussions in Family Finance and Home Ownership", no date

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DISCUSSIONS IN FAMILY FINANCE
AND HOME OWNERSHIP

I. Revision of organization of three topics

A. Karl Hall has suggested

1. Financing home ownership in this period
2. Renting vs. home ownershiplater this morning
3. Housing and the family budget next week at this time. For these topics are not easily separated from one another so we will interrelate these subjects over the next several class periods.

B. There is no clear dichotomy any longer between the home owner and the renter for there is an almost continual spectrum of housing ownership in the legal sense. This rainbow of color of title ownership might first be listed:

1. Lease an apartment
2. Subsidized lease with purchase option
3. Proprietary lease of a cooperative apartment
4. Purchase of a condominium apartment
5. Purchase of a town house or row house
6. Purchase of a detached duplex
7. Purchase of a detached home in a cooperative subdivision
8. Purchase of an old single-family home
9. Purchase of a new songle-family home

C. The degree of ownership could also be characterized by the amount of financing required to carry the home in light of the responsibility to make good on the mortgage.

1. For example a low down payment FHA mortgage exposes the borrower to the threat of collection by judgment far more than a higher down payment, privately guarenteed loan which is required by law to waive its rights against the resident owner in event of default.
2. The risk of legal liability for the object, its use, and unexpected expenses can be a measure of ownership.
3. The law recoggizes that any lease for more than three years will create an equitable interest in real estate which must be foreclosed and Lord Coke created a ladgend in our common law that a lease for one hundred years or more was tantamount to outright ownership.

D. Ownership in the psychological and emotional sense will also reflect the emotional identification of a family with its home and neighborhood.

1. Perpetual house payments like perpetual car payments can be akin to rent regardless of the legal form it takes.
2. The power of a proprietor interest imagined by a long term tanant as a force in the economic life of a building and a neighborhood.

II. The financial decisions of selecting a form of housing are basically defensive--a means of balancing risks taken against desired amenities, either real or imagined.

A. The owner assumes the uncertain future in regard to operating costs, real estate taxes, or neighborhood values (These may be shifted to the tenant by contract, by rent formula, or requiring tenant to supply his own.)

B. The owner assumes the risk of continued income with which to meet the payments, excepting higher payments with more stable payments, and shifts these risks and obligations by means of life and accident insurance.

C. The lender faces the risk of non-payment and erosion of the pledged property value which may be his only recourse to recover his capital. He may shift the risk by means of the FHA or MGIC.

D. Each form of housing strikes a different compromise between present and future risk for the lender, the buyer, and often the builder.

E. Rational decision making is a careful balancing of the risks a family will assume and the benefits they expect to receive.

III.

By way of introduction to the question of rent or buy, consider the relative financial costs of a home versus an apartment for a family with an annual net, uncommited income of $6500.

A. Assume the family has a choice of purchasing a home for $15,955 or renting it on a one year lease for $125 per month.

B. Assume further that they obtain a 25 year 5 1/2% mortgage for 90% of this price, at 5 1/4% interest.

C. Assume further that the sale value of the home can inflate an average of 2% per year , remain constant, or deflate about 2% per year.

D. At constant prices the renter would pay a total of $37,500. The downpayment he would have made might have been invested at 4% compounded -- amounting to $4292 at the end of 25 years, of which $2697 was interest earnings, reducing his net housing cost to $34,803 or about or $166 per month.

E. If he bought the house and prices were constant, his payments would be $94.20 for the mortgage, $36.00 for insurance, and $220.00 a year for real estat taxes, it would cost him about $115.53 out of pocket, however, some of this cost might be recovered on sale of the house at the end of 25 years.

F. In 25 years he will have paid $28,260 of which $13,900 is interest. $900 -- insurance, $1750 -- maintainence, $5,500 -- taxes, and $2,697 -- for interest lost on his sown payment--- total cost $40,802. Assuming 32% depreciation, the house would be worth $11,649 minus a sales commission of $700. However, income tax savings over 25 years for taxes and interest paid would be $662 so this would also be charged against housing cost, and we would arrive at an unrecovered housing cost of $27,791. Housing cost would be $92 per month, and the home buyer will have saved $5,417 over the renter during the 25 year period.

G. If prices had declined during the 25 years, annual rent would have fallen but not the purchasing cost, so that even a small annual decline in prices will eliminate the advantage of the buyer in favor of the renter.

H. More likely, however, is the inflation at a straight rate of 2% a year, so that price level would increase 50% in 25 years. Over time $125 rental would reach $187.50 for a total of $46,800 for 300 months minus the savings account or $42,508 or about $147.

I. If the pruchase assumptions for taxes, etc. were modified to reflect 2% increase per annum, gross cost would be $42,027. If the house was sold to represent 68% of replacement cost, sale wouldnnet after commission about $17,000, reducing net cost for 25 years to $25,027 or about $84 per month.

Of course the investor for use has many non-financial benefits but he soould never purchase a house unless he expects to live in it for a considerable number of years. There are social advantages to ownership too. Said one writer of the 1800's:

"Give a man ownership of a bleak rock and he will turn it into a garden: give him a 9 year's lease of a garden and he will convert it into a desert."

J. In real life you can't choose between equivalent dwellings nor compare equal amenities or costs. The depreciation cost for home ownership is never known except in retrospect after the house is sold. Moreover, the demand-supply factor is price changes at different times for homes and apartments.

K. The real issue of ownership is whether the family can meet the financial obligations and housekeeping responsibilities and whether these sacrifices are intended to gain intangible luxuries or given investment objectives

IV. Before you go house hunting know how much you can spend. Know the nature of your assets as well as the amount, know your earning capacity, and know your obelagations including prospective family expences.

A. Determine free cash avelable for a down payment after alowing at least two months pay as an emergancy acount at the bank or S&L.

B. The next step is to determine monthly net effective income. FHA calls this qualificating income.(refer toFHA 201)

C. Analysis should determine racial of effective income to allowable housing expese. Rules of thumb such as 25% of income for housing expense. Or two and a half times income income to determine the price are unrealible.

D. Housing expense includes the following:
1. Mortgage principal and interest
2. Mortgage insurance premium
3. Hazard insurance premium
4. Taxes and any special assessments
5. Maintenance and repairs
6. Utilities (light, heat, water and air conditioning)
7. Fuel for cooking

E. If housing expence exceeds present rental costs, and the home buyer hasn't saved any money at the present price of shelter, it is doubtful that he should be a home owner.

F. The FHA uses the following guied:

Percentage of Expense to Income

Net effective income	Typical to maximum housing expense	Ratio in percentage
$250	$93-$107	37-43
300	97- 115	32-38
350	101- 112	29-35
400	114- 128	28-32
450	120- 137	27-30
500	127- 143	25-29
550	135- 150	24-27
600	142- 157	24-26

G. About one half or 60% of this housing expense can be spent on debt service. For example net effective income of $550 would mean a maximum housing expense of $150, of which $90 a month could be spent on the mortgage repayment of principle and interest. Now how much money can you buy for $90 a month?

H. The size of the mortgage you can afford for $90 depends on the interest rate, a loan guarantee charge, and the term of the loan in years.

6.5% = 7.46/mo.

1. A conventional loan would probably have a twenty-year term, require a 20% downpayment, and cost 5 3/4% interest. It would cost you $7.03 per month per thousand. You could borrow $12,500 - or a $15,500 house.

2. If you borrowed with an S&L, privately insured mortgage, you would need a 10% downpayment and at least 6% interest, possibly 6¼%. You could probably borrow for 25 years. At 6¼% including insurance fee for ten years, it would cost you $6.60 a month so you could borrow about $13,800, and still buy a $15,000 house.

3. If you borrowed FHA, interest would be 5 3/4% and there would be an additional ½% insurance charge. At 6¼% for 30 years it would cost you $6.15 a month so you could borrow $14,400 with about 5% down or $750 - or a $15,500 house at best.

4. Note you cannot buy a bigger house by seeking more liberal financing, but you can reduce your downpayment substantially.

5. The VA plan is a better deal than FHA in terms of downpayment, or it may require as little as nothing down while the minimum FHA payment would be 3%. BUT be wary of builders who offer VA terms because of the hidden financing charge in the price of the house.

6. FHA money also requires payment of a loan discount fee of two or three percent, but this varies among lenders depending on how anxious they are to have FHA paper. For example, I understand in Madison FHA money costs 1½% from advance mortgage and 2½% from Mortgage Associates.

7. To maximize qualifying income and hence the amount you can borrow, get rid of installment financing on the car, furniture, or loans from University before you buy a house, and postpone furniture, etc., for purchase after you get your financing and move into the house, since the lender is concerned only with your obligations at the time you buy and you are not under contractural obligation to avoid future debt. Financial responsibility is whatever you define it to be.

8. One should shop for financing just as you shop for the home.

V. There are different degrees of home ownership today depending on how you value the urban-rural atmosphere, city and cabin secondary residence, apartment vs. single family structure.

A. Degrees of ownership range from:

1. High rise apartment	1. Used
2. Garden apartment	2. Do-it-yourself
3. Trailer court	3. New-turnkey
4. Cooperative apartment	4. New-custom
5. Condominium apartment	
6. Townhouse	
7. Cluster plan subdivision	
8. Single family conventional	