NEVER SELL YOUR FIRST HOME

The 12 Questions Your Client Will Ask You About Real Estate and Real Estate Finance

(And the Answers You Need to Know)

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"Brendan's approach is spot on."
—Art Laffer

The 12 questions your clients will ask you about real estate and real estate finance

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Q1	Can you explain Renting vs Owning - What is the benefit of owning?
Q2	We want to save up for a down payment. Isn't 20% the best amount to put down?
Q3	When we apply for a mortgage, what does the bank or lender look at to approve us?
Q4	We don't understand our credit and credit report? What can we do to improve our scores? And why do scores matter?
Q5	What is PMI, and how much do I need to put down to avoid PMI? Can a higher down payment really result in a HIGHER interest rate?
Q6	How do underwriters look at my income if Self employed? How does claiming less income affect my ability to borrow more?
Q7	What are the Best Routes to invest in real estate?
Q8	What are the different types of investment properties I should look for?
Q9	I want to keep my current home and turn it into a rental and buy a new one. Is that possible?
Q10	If I own my home, when should I refinance or look at refinancing?
Q11	What are the most efficient ways to consolidate debt? Should I do that with a HELOC or by refinancing my mortgage?
Q12	We want to buy a lot and build our dream home. What do we need to know?

Question 1

Can you explain Renting vs Owning – What is the benefit of owning?

Most online calculators or websites that talk about renting versus owning are always going to steer you towards owning. This has bothered me for years, so I created an Excel spreadsheet that outlines all the details of renting versus owning. I want to give people a genuinely honest answer. Shocking, right? The rent versus own analysis is actually very simple; it shows the annual household cost of renting, and compares it to potential mortgage equity payments. With renting, you multiply your rent by 12 to get your yearly cost. And you have to add in your insurance policies for your belongings. This is called a renters policy/ renters insurance. None of these items are deductible. So for example if you rent for 2500 a month, that's $30,000 a year in annual shelter cost. We use that term because everyone has a shelter cost. In this example, you might also have a $300 a year insurance policy for your belongings. **So your total shelter cost with insurance is $30,300.** You cannot claim this on your tax return as a deduction.

On the owning side the examples we always use are very simple. We use 5% down and a $500,000 home. So this would be 25,000 down (plus closing cost and prepaids and escrow, which are normally about 2% of the purchase price – so another 10,000) and a mortgage of $475,000.

The real magic happens next as we break down the entire payment. Most people, including some mortgage professionals, don't analyze this in detail.

Principal and interest on a $475k loan at 5.5% is **$2,697.**

The principal portion of this payment goes up a little each month as the loan interest portion decreases. This is called **amortization.** In the beginning of a 30 year loan, interest is higher than principal. In this example, in the first year, the principal portion of the payment is around $533 per month on average.

Real estate taxes on a $500,000 home would be around $5,000 per year or 1% of the home's value. **$416 per month.**

Home insurance would cost about $1500 per year or **$125 per month.**

Mortgage Insurance would depend on your credit score, but it is

required when you put less than 20 % down. The typical factor is between .25% and .75% of your loan annually. In this example we could use .50%, which would equate to $2,375 per year, or **$197 per month.**

Here's the math.

$2,697 ($533 principal + $2164 interest)

+ $416 (real estate taxes)

+ $125 (home insurance)

+ $197 (mortgage insurance)

= $3,435 total. Or $41,220 annual shelter cost.

But this is where the math is important. The 533 you pay per month towards principal is **$6396 annualized**. Because you are paying down the principle on an asset, when we analyze this **it is not a cost, rather it is an investment.** So we subtract this from the annual shelter cost.

$41,220

– $6,396

= $34,824 net cost.

After this, the detail becomes even more important when it comes to taxation. This is complicated, so bear with me. The federal government allows you to deduct the interest that you pay, the real estate tax that you pay, and the mortgage insurance that you pay (up to income of $110,000 annually for PMI) as an itemized deduction on your federal tax return. So if you're single and this scenario above applies to you, your standard deduction would be $12,800 on your tax return if you were renting. Your annual cost was the $30,300 number, and you would not be able to deduct any of that. So if your itemized deductions (such as charitable donations and other items) did not exceed 12,800, you would file a standard deduction return.

However, in this scenario the interest and the real estate tax monthly is $2,580 or $30,960 annually. When you're filing your tax return you would use the $30,960 as an itemized deduction over and above