



UNIT 1 – 1

Why Home Ownership Is Important

Without doubt, home ownership—along with good jobs, good pay and good health—is a major part of the American dream.

Moreover, federal statistics confirm that many people in America are reaching that dream, with rates of home ownership ranging from 64% to 69% from about 1995 to the present. These are among the highest home ownership rates in the world among highly developed countries.

The high rates of home ownership in America are all the more remarkable given the fact that the cost of a home is one of the largest ones that people will ever face, so there must be more than a few good reasons for this phenomena.

Case Study Application

In this and the units that follow, we'll begin with a relatively short case study that will illustrate the main points being made. You will probably see reflections of yourself or others in these studies, but this is intentional because the case studies are meant to reflect situations that you could easily run into.

We should also point out that none of the answers are intended to be definitive. For example, we might ask whether it is better to buy or to rent, or we might ask whether it is better to have a fixed-rate mortgage or a variable rate one. In either case there is no clear answer that applies to everyone, because everyone is different. Instead, we want you to think about the issues that are important, along with the possible choices that can be made.

In the end, what is better for one person might not be good for another, but only you can make the choice. We can tell you some of the things to think about, and we can tell you how some things work, but the choices that you make are up to you, so make an effort to make the best ones.



CASE STUDY: BILL AND RHONDA'S CHOICE

When Bill and Rhonda were first married, they rented a small apartment while they got established in their careers. They had a lot of tasks ahead of them as they had to learn how to set their financial goals and learn the basics of budgeting so that they could accomplish what they actually set out to do, but a nagging question remained – whether or not they should even think about becoming homeowners.

They had heard arguments both ways, so they thought they would start out by looking at the advantages of home ownership. Then they would tackle the issue of renting vs. buying so that they would have a much better idea of what to do.

They would be first time home buyers and perhaps because of that they have had a lot of advice from friends and family – especially their parents. Even so, it was important to them that this be their decision, not one that was forced on them by someone else.

Advantages to the First-Time Buyer

Bill and Rhonda realized, of course, that it was going to cost them something to stay somewhere, so thinking about the advantages of buying a house seemed like a reasonable step to take. For example, they were paying rent where they were currently staying, and they would have to pay on a mortgage if they decided to buy. The only way they could avoid paying anything at all would be if they moved back in with one of their parents, but that would be a burden on everyone and for a number of reasons; they'd rather be on their own and make their own decisions.

After some research, the following items seemed to summarize the advantages.

- **Have pride of ownership**—Home ownership would give them a certain sense of accomplishment because a new home would be something that would actually belong to them, not to someone else.
- **Gain freedom of control**—if they owned the property themselves, they wouldn't have to get anyone's permission if they wanted to paint any of the rooms, redecorate, or make any other changes.



- **Get more privacy**—most homes offer far more space and much more privacy than do most apartments.
- **Establish strong credit**—By keeping their mortgage payments current, they could demonstrate to other lenders that they were worthy borrowers. This could come in handy if they ever had large, unexpected expenses in the future and needed to borrow. They thought that a strong credit rating would allow them to get a loan with a lower interest rate that could even save them money in the future.
- **Achieve financial stability**—If they did decide to buy a home, and if they decided to get a 30-year mortgage with a fixed payment, they would know *exactly* how much they would have to pay for housing for the 30 years. They would have no similar guarantee if they continued to rent. In fact, they had no guarantee that they could even stay where they were currently renting for an extended period of time.
- **Gain tax advantages**—They had heard that there were tax advantages to home ownership. For example, they discovered that if they made monthly payments of \$800, and if \$750 of that was in the form of interest during the first year, they would get $(\$750)(.28) = \210 per month back in taxes at the end of the year. This effectively lowered the monthly payment after tax cost of the mortgage to $\$800 - \$210 = \$590$ per month. And, it turned out that the \$800 per month on the mortgage was more than they were currently paying for rent, but the \$590 was actually less.
- **Invest in an appreciating asset**—The value of a home, unlike the value of an automobile, would appreciate or get larger over time, rather than depreciate. They knew that a brand new car could lose up to one-third of its value the minute it was driven off the lot, and they heard that a study by an economist found the long-term home values grew by an average of about 1% per year after adjusting for inflation. This meant that the value of the house would grow over time, even as someone was using it to live in.
- **Build home equity**—As your home rises in value, and as the amount you borrowed gets smaller, the resulting equity becomes larger. **Equity** is the difference between what the home is worth and what is owed, and it is very important for the homeowner for several reasons:
 - First, you could always sell your home and then use the equity as a down payment on a larger one if you should ever decide to “move up” to a larger home.
 - Second, you could always use your equity as **collateral**, or as backing, against a loan you might need to take out.



- Third, you could always refinance your loan and take the equity out either in the form of cash now, or in the form of lower payments on another mortgage.

Overall they were impressed with the list, but they also thought that they should look at the disadvantages as well.

- Before we consider the disadvantages, does it seem as if any of the advantages in the above list are more important than others?
- Can you add any more advantages to the above?

Disadvantages to the First-Time Buyer

The biggest disadvantage they could think of was the responsibility of having a relatively large fixed monthly payment that they would have to make regularly for the next 360 months (or 30 years). They had never had this kind of responsibility before, and it was intimidating.

Having a home also meant that you had to have insurance, and that you had to pay annual taxes on it, and so these would also seem burdensome to a potential new homebuyer. However, they also knew that their landlord had to pay the same insurance and taxes, so they suspected that some of their monthly rent went to pay those fees.

Aside from these payments, the homeowner would be completely responsible for the upkeep and maintenance on the property. This means things like mowing the lawn, keeping the building painted, repairing furnaces and toilets when they broke, to mention only a few of the many repairs that a homeowner will have to face. Right now all they did was to call the landlord whenever something went wrong. As homeowners, however, they would have to do all of these things themselves.

Finally, the home could limit the owner's mobility. For example, someone who rents an apartment can move from one city to another much easier, and with much less cost, than can a homeowner. The homeowner will even have to pay someone to sell the home, and the cost of selling the home may eat up much of the homeowner's net value in the house.

- Can you add to the list of disadvantages of owning a home?
- Given the list of advantages and disadvantages, what do you think Bill and Rhonda should do?



Bill and Rhonda Evaluate Their Options

Whenever you make a decision, it always helps to have a way to go about making it, or having some useful model to follow. We like to use the **PACED** (short for state the **P**roblem, list the **A**lternatives, list the **C**riteria, **E**valuate the criteria, and then make your **D**ecision) model to help us with a variety of decisions.

In order to use the model (see the next page), simply place the criteria that are most important to you (the advantages such as “financial stability” and “pride of ownership”) in the columns, and then the alternatives (rent or buy) in the rows. Then, evaluate each alternative with either a “+” or a “-“ to make your decision.

We can help explain how things are and how they work, and we can give you a process for evaluating the things that are most important to you, but the choices that you make are up to you, so give it some careful thought and you’ll find that you’ll be able to make good ones.



The PACED Decision-Making Model

Directions: Use the PACED Decision-Making Model below to contrast the advantages and disadvantages of your problem. After you have evaluated the issue, discuss the choice you would make. Complete the analysis by using these five steps in the decision making model:

Step 1: State the **P**roblem: _____.

Step 2: List the **A**lternatives in the first column.

Step 3: List the **C**riteria in the first row.

Step 4: Evaluate each alternative by placing a “+” or a “-” in the box below each criterion.

Step 5: Make your **D**ecision: _____
_____.

Criteria ↓ → Alternatives	1.	2.	3.	4.
1.				
2.				
3.				
4.				
5.				

Using the space below, explain why the alternative in step 5 above is the best solution to your problem:

