

## YOUR HOME IS YOUR CASTLE

One of the major tenets of the American Dream is that everyone is entitled to home ownership. It is amazing the number of mortgage companies that exist and are trying to get your business. The media constantly reinforces the idea that pursuant to the American Dream, you too can have your own home. The US Government has special agencies that they subsidize to help people purchase their first home. Essentially, when new home construction is good, the economy is good.

It is wonderful for you to own your own home but home ownership is not for everyone. Your home is going to be the biggest investment you will ever make so you don't want to purchase a home that is going to put you into a life of debt.

Naturally, you want to live in a nice home in a good neighborhood with quality schools for your children. How do you realistically decide which home you can afford? Some mortgage companies use a magical twenty per cent down payment. However, I have seen clients put a couple of thousand dollars down and have mortgages way over their head.

Unfortunately, too many people listen to mortgage companies who will qualify you for mortgages that are from the start ready to put you in a free fall towards foreclosure. It is in the broker's interest to approve you for a mortgage. Also, your realtor wants you to buy the home no matter what the cost since they get their commission if the home is sold. Remember, the mortgage broker doesn't pay your mortgage nor does your realtor; you are the one who is ultimately responsible for making this payment. Many people I see who "qualified" for a mortgage live pay check to pay check and have absolutely no savings. In the case of a job loss, illness or accident, the Sheriff will be knocking on the door.

Why shouldn't you accept a bank's representation that you qualify for a mortgage? Isn't the bank in the business of making these decisions for you? My response is that in life there are many intangibles and emergencies that occur that are not anticipated when you are initially screened for a mortgage.

Take the example of Jack and Jill. Jack is a 30-year-old professional who earns \$40,000 per year and Jill is 28 years old and earns \$40,000 per year. Based on the fact that they earned a sizable income they easily qualified for a \$150,000 mortgage. Since they put \$30,000 down they purchased a home

for \$180,000 and had a thirty-year mortgage with payments of \$998 monthly for 30 years. This only included principal and interest. Jack and Jill were responsible for taxes and homeowners insurance.

Everything was fine for Jack and Jill financially. However, within 6 months of the home purchase Jack's old car fell apart, so he decided to lease a new vehicle for \$399 per month. A year later, Jill felt it was time for her to get a vehicle so she financed a car at \$350 a month for 5 years. It was a little tighter with the car payments but they were both doing well on their jobs and each got modest raises. Then, Jill got pregnant. This was a new challenge. If Jill stopped working there would be a substantial drop in the family income, but if she continued her job, childcare expenses would be outrageous which would put a dent in Jack and Jill's pocketbook.

Jill eventually quit her job and credit cards became a necessity since the once "prosperous" childless couple that earned \$80,000 was now barely making ends meet, using 80% of their income to pay their mortgage and 2 car payments. Why didn't the bank tell them this could happen?

When you apply for a mortgage, the people who process your application are only concerned with your *present* paycheck. They don't anticipate your future. They don't anticipate that you may need a new car or you may have additional children. The only thing constant about life is change, and relying on your present circumstances can have devastating effects, as in the case of Jack and Jill. It is also possible that Jack's income can double or triple as he improves in his profession, which is phenomenal. But one must consider all *projected* expenses with a substantial raise plus the costs of raising a family.

It is amazing the cost of raising children. It has been estimated that the cost of raising a child until he or she is seventeen can range from \$151,170 - \$293,400 depending on whether you qualify as a low income family earning under \$29,000, to high income families earning over \$48,300.<sup>1</sup>

In order to plan for your home, you should rely on one breadwinner's income to make sure you qualify for the mortgage and your mortgage payment should be absolutely no more than 20% of your weekly take home pay. Most people never truly do a thorough budget analysis. They are so taken with the prospect of purchasing a home that they assume that if they qualify then everything is fine. Remember that over 1 million people filed for bankruptcy in 1998<sup>2</sup> and all those people who owned their homes initially qualified for their mortgage.

I see people whose mortgage payments constitute over 75% of their take home pay. How can they possibly avoid debt when they don't have enough money to pay for necessities? Before you purchase any home you should keep track of your expenses for one full year. If you have never lived in a house before, you are not going to be able to know how much home maintenance is. A lot of expenses can be controlled by simplification. However, if you're caught up with keeping up with the Jones, you will pay for landscapers and several home improvements, pools, cleaning services and other expenses that could be avoided.

You must be aware of your regular expenses since if you don't properly anticipate you will be debt ridden. Remember, even though you get a tax deduction for a mortgage payment, you have to be able to pay it. What good is a major tax deduction if you can't meet the monthly obligation?

If you never lived in a home before, it would be advisable to check with future neighbors or the utility companies regarding how much your normal monthly obligation is. One expense that can clearly be within your control is the phone. It is amazing how much people can run up their phone bill. Also, cable TV is another expense that can be controlled. Some people who have run up thousands of dollar in credit card debts spend over \$100 per month for cable TV.

What about maintenance and repairs? How do you anticipate that? If you buy a handyman's special you better expect to spend a lot for repairs. Even if you have had a thorough inspection any home eventually needs work. Even if you are fortunate to be able to do the work yourself, there are still costs for parts.

One problem is that people use every penny for their deposit and closing costs and they have no emergency funds left over. Eventually, you are going to need repairs for roofs, heating, air conditioning, plumbing, plus a host of other contingencies that you have to anticipate. How do you prepare for home maintenance? You put away a few thousand dollars for an emergency if you are buying your own home.

Every family has to eat and you should have a good idea how much you spend on food. The cost of food is tied in with the size of your family. If you purchase a home while childless and suddenly have three children over the course of your home ownership, the cost of your monthly food expenses will substantially increase. Also, once the children become teenagers the food bill will be even larger. A major problem is that many clients I've met over the years have no idea how much they spend on food. It is true that you can use coupons and go to special clubs or discount stores; however, I have a hard time comprehending how a family of four can have a grocery bill of \$300 per month.

Let's assume that you live moderately. You can control certain expenses for food if you buy bulk or use coupons. However, even if you brown bag and don't eat out all the time, you have to anticipate groceries for a 2 person household a minimum of \$300 per month, and it would be a lot higher if you eat out or buy a lot of processed foods. Please note that if you have any additional children, food expenses will go up substantially. It has always been my experience that you can't skimp on food. However, think about your eating habits. Do you stop in you local convenience store everyday and get your coffee and pastry? This could cost an extra \$50 a month just for breakfast. Do you brown bag you lunch or order out everyday? People who order out can spend an additional \$100 per month if they eat out for lunch everyday. Finally, eating out for dinner can substantially raise your food budget.

Before determining your food budget what I want you to do is get a notebook and actually write out what you spend on necessities before you even think about a mortgage. How much do you spend on food each month? Make sure you consider paper products, diapers, “special” foods and anything else. Also, consider the size of your family; if you have one or two children and plan to have additional kids, no matter how frugal you are, the food budget is going to go up. This is the case regardless of the fact that you use coupons or go to the discount food store. People have to eat.

Clothing is another necessity that we all need. I am not talking about designer clothing, although that is a realistic expense for certain families. In larger families children can wear hand me downs. However, if clothes are torn or shoes are without soles it is necessary to purchase new clothes.

Again, if you have teenagers who don’t stop growing and eating, you will have to allocate more money for clothing. It is not always easy to anticipate your clothing budget if your family is growing. However, use a budget of the past year’s clothing budget to give you a start. Unfortunately, many people I come into contact with don’t realize how much they spend on clothing since they just run it up on their credit cards.

Besides a larger family, do you have a job that requires you to purchase work clothing or do you have to dress the part? You may spend a substantial amount on clothing under these circumstances. If you spend a few hundred dollars per month on clothing and don’t have enough money to make ends meet, you better be very careful about what type of mortgage commitment you get.

Before you consider expenses you have to anticipate utilities which are a crucial part of your budget. It is extremely difficult to anticipate certain utilities based on the size of the home. However, if you simplify you can eliminate certain unnecessary costs such as cable TV, satellite TV and large electric, gas and phone bills that are not necessary.

Another expense that you must take into consideration is association fees if you purchase a townhouse and Condo Association fees if you purchase a condominium. Please note that these expenses are also subject to change based on the whims of an Association. Thus, before you get locked into a condominium or townhouse be aware of these expenses.

Finally, home maintenance, car repairs and medical expenses cannot be anticipated with a certainty, but they have to be made part of the planning process before you commit yourself to a mortgage.

This is a very monumental decision. Before you commit yourself to this decision, plan out all the contingencies so that you won’t find yourself in debt.

Another expense, which is overlooked often, is laundry and dry cleaning. If you have a washing machine at home that expense will usually be incorporated into electric and gas. However, some occupations require dry cleaning on a regular basis which could easily run over \$100 per month. People just refuse to contemplate all these monthly expenses before they purchase a home.

Medical expenses are crucial and are one expense that is extremely hard to anticipate. Most young persons who purchase their first home do not even contemplate any type of medical emergency. Unfortunately, this is something that is difficult to anticipate. The only thing that I can advise you, which will be discussed later, is to protect yourself with insurance. Also, I am not a physician but you can certainly help create health if you eat right, exercise moderately, eliminate toxins from your life and try to avoid stress. (One way to avoid stress is to have your finances under control). Again, as with repairs, I would try to establish some type of nest egg to protect against normal expenses for doctors, dentists and prescriptions that are not covered by insurance.

Another important budgeting item is transportation. First you have to consider whether you have a car payment. As I will explain later, car payments and especially leases, are not recommended since there can be substantial ramifications that create debt. It is important to understand this perspective if you must finance a vehicle. Remember that a vehicle doesn't make you sexier, younger, faster or cooler ... it is a means of transportation.

You want to have a reliable car that will last and not be a fortune to operate. In considering the costs of transportation, the initial cost will be gasoline. In 1979 with the height of the energy crisis and long lines at the gas pumps, mileage per gallon was a major advertising scheme. However, fuel economy doesn't seem to be a major selling point any longer but with gasoline prices escalating in 2001, this may change soon. The key issue is safety, which it should be. However, fuel economy shouldn't be totally disregarded since there is a correlation between maintaining and repairing a luxury vehicle and an economy vehicle. Naturally, the overall costs of owning a Mercedes will be substantially higher than a Ford Escort. You will pay more for gasoline, parts, maintenance and insurance. However, with the major increase in gas prices in 2001 and a US Economy that relies more and more on foreign oil supplies, gasoline prices should not be disregarded. If you need a SUV for your family, you have every right as an American to have that vehicle. Just remember that the SUV will be a lot more expensive to run than the economy vehicle.

We live in a free country where you can have any material object you desire. But a car is your second largest investment. If you spend too much on the vehicle, it may reduce your opportunity to purchase the right home. Even if the Mercedes is paid in full, you have to factor in the costs tied with owning the more expensive vehicle.

Have you ever really analyzed and written down how much you spend a year on recreation, clubs, entertainment, newspapers and magazines? It is amazing how minor variations in these expenses can save hundreds of dollars per month. The reason I suggest you figure out *yearly* expenses is that you want to calculate how much you spend on holidays, birthdays, parties and activities for your kids. You would be amazed how many people don't want to deprive their kids Christmas gifts, but

in the process let their mortgage fall behind and were in the process of depriving their family of their home, neighborhood, school and friends, based on these choices. However, even a budget analysis is not going to be 100% accurate, since you may have 1 year with minimal “emergency” expenses while the next year, you have \$4,000 in home maintenance, \$3,000 in car repairs and develop a medical condition that also incurs more expenses.

For readers who have children, how much do you spend a month on gifts for parties, entertainment or just snacks? I can say that a lot of people on fixed paychecks spend \$5.00 every morning on breakfast and coffee at the local convenience store and \$5.00 *every* day on lunch. These are not self-employed persons who have certain tax write offs. If you add in another \$25.00 per week on cigarettes, they spend over \$300.00 per month on items that are clearly not necessities. This isn’t even counting eating out, shows, games and vacations. Recreation is very necessary since constant work will eventually have negative implications on your health. However, unless you are truly financially independent or are single with no responsibility, these expenses are totally out of control. They could be used to prepay your mortgage or car loan or to put money away into investments. If you plan that you will allocate \$2,000 for a vacation, you can save that money by cutting back on the aforementioned expenses for seven months.

Charitable Contributions are important since people have to learn to give to receive. There are several wonderful charities. The only thing that I caution is what percentage of your contribution goes to the charity? Are you really giving to the charity or are you paying John Doe’s \$80,000 per year salary as administrator? Several clients of mine tithe their income. I think it is truly wonderful if you tithe your income to your church or synagogue. Again, if you barely can afford necessities and tithe your income at the expense of your other bills, then you have to rethink your priorities.

A major expense that most people don’t anticipate is costs of insurance. In order to avoid major medical problems, you must have health insurance. This could run anywhere from \$150 per month for a single person to over \$700 per family. These rates can change substantially depending on what company you use. This is another factor that can cut down on your take home pay substantially. As this book is being written, health insurance costs are continuing to escalate.

In addition to the expenses for medical insurance, you also have to include life insurance if you have a family and disability insurance if you are self-employed. Insurance doesn’t create wealth but it is totally necessary to protect you from financial disaster. For example, if you don’t have automobile insurance besides facing civil and quasi-criminal penalties, you can face financial consequences and lose everything you own. Also, liability insurance is necessary for any business and homeowners insurance is necessary to protect you from burglary, fire and several other types of unforeseen problems. You should know what insurance is necessary and the costs involved, otherwise you will be on the road to debt and may lose everything you ever worked for.

Does your mortgage include taxes and insurance or are you responsible for taxes and homeowners insurance? Most people feel it is easier to have the Mortgage Company be responsible for everything. I don't. If your mortgage company is responsible for these costs they can put forced place insurance on the property, which can cost substantially more than if you get insurance yourself. With regard to taxes, it is much better to take responsibility and set aside money for real estate taxes. The alternative is that your mortgage company will then escrow the funds and your mortgage payment can drastically change.

It is my position to try to create as much stability with your mortgage payments since so many other monthly expenses are not predictable. In order to maintain a life without debt then you should try to have as much certainty as possible in a world full of change.

Do you have substantial amount of installment payments on consumer items? This is a very dangerous situation you are in since these are added expenses to all your necessities and the unexpected expenses. This is a sure sign that you are in debt if you have installment payments before you purchase your home.

Another major expense, which most people fail to consider in their budgeting, is gifts and expenses for parties, weddings, bar mitzvahs and other celebrations. Life cycle events are very important, but people should never mortgage their homes or take a loan to pay for such events. People are so concerned with impressing other friends and family members that they lose all perspective in what they spend for parties and celebrations.

So many of my clients get into debt by spending substantial sums of money for Christmas and they never calculate that into their budget. There is absolutely nothing wrong if you spend a large sum for family and friends but not at the expense of your mortgage. You must consider these expenses in analyzing your initial budget to see how much of a mortgage you can afford.

You also have to anticipate for normal expenses for children, i.e. sports, lessons, dancing, parties and other incidental expenses. As evidenced from statistics, costs of raising children is substantial and most of my clients have failed to budget for the dollar here and there; the class trips, the uniforms and any other miscellaneous expenses tied with children. This is why if you purchase your home and that doesn't constitute the entire family, there could be substantial additional expenses later.

Lets say the basis for your qualification was both or your paychecks. As with Jack and Jill, they were both single and earning substantial salaries. But two years later with the birth of their child, they had to incur full time daycare for Jill to keep her job. This is a major unanticipated expense that people never anticipate. People have to not only know their budget when they are looking to purchase a home; they have to anticipate the costs of children, balance whether both spouses should

work and the resulting costs of child care if one spouse does work. Therefore, you should never rely on both spouses' income when determining what type of mortgage is best for you.

Another major point is that you should never let your mortgage company pay your taxes and homeowners insurance. This is a sure way of having your mortgage increase with escrow adjustments. You must take responsibility for paying your own taxes and homeowners insurance. Maybe this will encourage you to own your home free and clear in less than thirty years.

Also, never get an adjustable rate mortgage. Others would disagree with me stating that if you are not planning to live in the home for more than a few years the numbers can work in your favor. However, the key to living a life without debt is to have a regular mortgage payment that will not alter and which you can payoff quicker than 30 years or 15 years depending on your mortgage payment. If you take a 30 year mortgage at 8.25% for \$60,000 at \$451 per month over 30 years you will be paying close to \$240,000 back. Think of how much interest you would save if you prepaid your mortgage. Also, another way to save interest is by having a 15 rather than 30 year mortgage.

Another folk tale, you always seem to hear, is that in order to cut taxes you should have a large mortgage since you get a tax deduction; however, incurring debt is a very dangerous proposition since it does not build net worth. Also, if your circumstances change as in the case of Jack and Jill, you are stuck with a substantial debt load. I have seen too many people who got tied up in investment properties who are now tied up with bankruptcies, since their income has changed. They can't rent out the properties or just aren't receiving the rent, which they rely upon to pay the mortgage.

Even assuming you only have 1 property, if you don't have the income to afford the mortgage, the tax deduction won't mean a damn thing since tax deductions are only useful when you have the income; it does no good to have a tax deduction if you have no income to support it. In order to follow my rule that the mortgage payment equals 20% of the breadwinner's net monthly pay, you are going to have to save a substantial amount of money to buy a home. Why don't I use two spouse's incomes to qualify? First let's assume the female breadwinner has to go on maternity leave. If you rely on both salaries, this may cause an extreme drop in income. Also, if children come into the picture, you may have to consider substantial child-care expenses, which offset the income even if both spouses are employed.

The second reason for you to rely on one spouse's income is that it is much more important that one spouse use his or her salary for savings. People just have to realize that the only way to avoid being set up for financial problems is to have one spouse's income pay the expenses and the other spouse save and eventually work on investments. This will force people to have the discipline and learn to live within their means rather than letting their wants get them into debt. If you are single and want to purchase a home, you can still follow the formula since a condo or townhouse is a lot

less expensive. Also, a condo or townhouse may be a starter home so you want to have the flexibility of being able to purchase a larger home when you start a family.

The other practical reason is that the only constant in life is change. Thus, if you rely on both breadwinners what will you do in case of an accident, disability, illness, loss of job, maternity or a number of factors that can alter your initial budget when you decided to purchase that home years ago? This would be an automatic safety net since if one spouse had used their income solely for savings and investments, you can temporarily switch that to paying the household bills. Also, you have the reserve as savings. No matter how hard you try to plan, you may still get in debt due to circumstances outside of your control. However, if you plan for these contingencies then you have a much better chance of avoiding the debt trap. Another reason to purchase a home within your means is that you have to anticipate major repairs, loss of income or other contingencies outside of your control.

Try to establish as much certainty in a world full of changes. Be responsible for your own real estate taxes and homeowners insurance so your mortgage company won't dramatically raise your mortgage. If real estate taxes go up, you can budget the increase over the year; but if your mortgage company has to absorb this increase, the escrow adjustment may be substantially higher than the tax increase. Also, I have seen numerous cases where when mortgage companies put forced place insurance which is higher than what you can negotiate on the open market. It may *appear* easier to let the Mortgage Company handle everything. However, you will pay a price for letting them handle taxes and insurance. Take responsibility.

Based on the 1 breadwinner theory, the second breadwinner's income can be used to prepay principal. As previously illustrated, prepaying principal can save thousands of dollars. Isn't it better to use that money towards earning net worth than getting a tax deduction?

Be extremely cautious about refinancing. Understand all costs involved. Also, try to find a mortgage company that won't assign its interest. I have seen disaster stories about people who thought they were dealing with "A" mortgage company and in 2 years "A" assigned it's interest to "B", "B" assigned it's interest to "C", and "C" assigned it's interest to "D". Pay your mortgage before any other debts.

Remember, get a home where the mortgage payment is within your means. You are the one who is contractually obligated to pay that mortgage. The mortgage broker doesn't pay your mortgage; neither does the real estate broker. If the bank's assessments of who qualifies were always correct then nobody would ever lose their home in a foreclosure. You have to use your common sense when you get approved for a mortgage. If your mortgage payments constitute 50% of your net monthly income that should raise a big red flag since you know with all the other expenses that it just won't

work. If a second mortgage raises that ratio then you have to really wonder. If you don't plan for emergencies then emergencies will find you.

Even though there is no tax benefit or equity in renting, it is only a short- term endeavor. It is beneficial to sacrifice to save before you commit to a home. You must work out the numbers. Follow the 20% rule or you will open yourself to a life of scarcity rather than abundance. We all want a nice home in a nice neighborhood with quality schools; however, make sure you're comfortable and can sustain these payments before you sign the dotted line.

This is the biggest investment you will ever have. If you misanticipate, this can have incredible consequences on all aspects of your life. You have worked too hard. Use your common sense. Later you can always buy up when you develop the equity.

Do your homework and this will keep you free from debt.