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Homeownership



Homeownership

What is it?

If you're like most consumers, homeownership involves the largest financial transaction you'll participate in during your lifetime. As such, it's no wonder that the process of buying or selling a home can be so stressful, frustrating, and, at times, totally confusing. If you want to ensure that you make sound financial decisions and survive the process with your sanity intact, you should first educate yourself about real estate transactions and then engage in careful planning. Your first step should be to ask yourself: "Do I really want to own a home?"

Isn't it always smarter to buy rather than rent?

Many people feel that renting is like throwing your money away, and that you should buy a house as soon as you can. However, this isn't necessarily true. Although there can be many benefits to homeownership, many people find renting more advantageous than buying. Which is better for you? To find out, you'll need to evaluate many nonfinancial and financial factors.

Nonfinancial advantages of renting

The nonfinancial advantages of renting include:

- Moving is easier: Simply find a new home to rent, give the required notice, pack up, and move (although there may be some complications if you break a lease). This is particularly attractive to individuals who are often relocated by their employers.
- You don't need to hire someone to do repairs: Is your faucet leaking, air conditioner blowing hot air, heater blowing cold air? No worries--just call the landlord.
- You don't need to maintain the property: Need the driveway shoveled, the grass mown, or the leaves raked? Don't get up--most landlords include these services in the lease.

Financial considerations

Is renting really a better financial option than buying? Certainly you'll save some costs associated only with buying, such as a down payment (though if you rent you generally must pay two months up front plus a security deposit), closing costs, and property taxes. You may even save on other expenses of owning, like purchasing new furniture/appliances, landscaping, or remodeling. And, you can generally rent an apartment, house, or condo for less than the monthly cost of buying the same space.

The answer seems easy, doesn't it? But this is deceiving. Rent payments are not deductible on your federal income tax return (although some of it may be deductible on your state return), but mortgage interest and property taxes are if you itemize. As a result, the effective cost of owning a home may be lower than it appears compared to renting. To get an accurate comparison, you need to calculate after-tax costs. Further, there are other financial benefits of buying (e.g., equity) that you must consider. For more information on the financial benefits of homeownership, see below.

Tip: The rent vs. buy calculation is complicated and many factors come into play, such as the price of the home, the amount of your down payment, current interest rates, the current property tax rate, your income tax bracket, how long you intend to live in the home, and the amount of rent you're currently paying. You may want to seek the help of a financial advisor to determine whether renting or buying makes better sense for you.

What are the benefits of homeownership?

For many, owning a home represents the American dream--a back yard, privacy, a place to call your own. If you're committed to fulfilling that dream, you'll never be happy renting regardless of any advantages doing so may hold. Other advantages of homeownership include:

Stability and flexibility

Owning your own home can provide a certain sense of security. You won't be faced with the prospect of finding yourself without a place to live if your landlord dies suddenly or decides to sell the building, and you won't have to deal with increases in rent.

Caution: *The price of this stability is a certain amount of risk. If you become delinquent in your house payments, your mortgagor may foreclose and pursue a forced sale of your home--and you may lose money on the sale. Renters are not faced with this possibility because they do not own the property in which they live.*

As a homeowner, you'll also have almost unlimited flexibility to personalize your home. From painting and wallpapering to landscaping to putting in a skylight or even adding a room, the possibilities are endless. Renters typically don't have this freedom.

Financial benefits

Income tax deductions: As you're probably aware, federal tax laws strongly favor homeowners. Mortgage interest and property taxes are tax deductible, provided you itemize your deductions.

Gain on sale exclusion: If you sell your home and qualify, you may exclude up to \$250,000 of your capital gain from tax. For married couples, the exclusion is \$500,000.

Equity: As a homeowner, you can borrow against the equity in your home, using either a second mortgage or a home equity line of credit. The interest on a home equity loan of up to \$100,000 is also tax deductible, regardless of how you use the money. Many homeowners use home equity loans to consolidate other high-interest loans, make repairs and improvements, and even fund a child's education. Lenders will generally allow you to borrow up to 80 to 90 percent of the value of your home.

Asset appreciation: You may buy a home with a little of your own money (your down payment) and a lot of someone else's (your mortgage). However, if the value of your home increases, the profit is all yours when you sell it. You benefit from the increased value of the entire property, even though originally you used only a small portion of your own money to finance it.

Tip: *Amounts paid for qualified mortgage insurance in 2015 may be tax deductible.*

What should you think about when choosing a home?

When choosing a home, focus on determining what you need and how much you can afford. Your lifestyle and the size of your family will certainly influence your choice. So will the size of your income.

What you need

What you need in a home is, to a large extent, a personal matter. You may decide that you need that 16-room colonial, or you may find you can get what you need from a condominium, a co-op, or some other residential arrangement. Or, you might decide to build the home of your dreams. Whatever you decide, you must be able to afford it.

What you can afford

How much do you have for a down payment, and what size mortgage will fit your budget? Determining what you can afford is always a matter of running the numbers. When doing so, be sure to consider tax issues, such as the home mortgage interest deduction and real estate taxes. You should also include other considerations, such as the price of homeowners insurance. Once you've determined that the home you need is attainable at a price you can afford, you're ready to take the next step.

How do you find and buy a home?

Finding a home

Brokers and real estate agents can help you find a home. Since the seller of the property typically pays the broker, you may want to hire a buyer's broker to work for you.

Sometimes you'll find a home that is listed as "for sale by owner." While such arrangements can eliminate brokers and broker's fees from the transaction, be wary. If you don't have a broker to help you navigate through the home-buying process, hiring an attorney to protect your interests is especially important. An attorney should make sure that your deal is properly documented and that you are obtaining a good and clear title to the property.

Occasionally, a home is auctioned or foreclosed by a mortgage holder. You can get a good deal at such a public sale, but you can also buy yourself a big headache. Be cautious: The condition of the house, outstanding real estate taxes, and undisclosed liens can all turn your good deal into a bad one.

Buying a home

Once a buyer and seller come together, the buyer typically submits a written offer to purchase the property. If the seller accepts the offer, additional terms of the sale are hammered out in a purchase and sale agreement and a closing is scheduled. Prior to the closing, a home inspection is advisable to determine whether there are any problems with the home that may not have been detected by a normal examination. At the closing, money and title instruments are transferred, and mortgage documents, title insurance documents, and other instruments required by the various parties are signed.

Forms of ownership

There are many ways to own a home. The way that you own real estate is specified in the deed of title and determines what rights and protections you may or may not have with respect to the property.

How are vacation homes different?

In addition to the above issues, you'll have a few special considerations when thinking about buying a second/vacation home. For starters, vacation homes are typically considered a luxury. Accordingly, they receive different tax treatment, especially if you rent yours out to others during the time that you own it.

Many buyers choose timeshare arrangements as an alternative to purchasing a traditional vacation home. A timeshare is a special type of real estate ownership for vacation homes.

What about selling a home?

First, consider all of your alternatives, such as making home improvements and/or converting your residence to rental property. If you decide to sell, the most important considerations will involve preparation, timing, and pricing. You need to decide whether to use a real estate broker and whether you are willing to extend a private mortgage to a potential buyer. If you need the proceeds from the sale of your old home to fund the purchase of a new home and the sale is delayed, you might need to think about a bridge loan to cover your shortfall until your old home is sold. Finally, you also must consider the tax consequences of selling your principal residence. The most important of these involves your ability to exclude certain capital gains from your income in the year that you sell the home. There are also special capital gains rules to consider when selling second/vacation homes.

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