Cynthia Dawkins: And now I’d like to have Sarah Miller introduce our second speaker. Sarah…

Sarah Miller: Thank you, Cynthia. It’s my pleasure to introduce Nate Wenner. Nate is a Certified Public Accountant, Personal Financial Specialist, Certified Financial Planner, and an investment consultant for Wipfli Hewins Investment Advisors, the fee-only money management division of Wipfli LLP.

He has over 14 years of financial services experience. His personal financial planning services include financial independence planning, net worth management, tax planning, investment advisory services, insurance planning, education funding, and retirement income planning.

Nate and his ideas have been featured or quoted in publications such as the Journal of Financial Planning, USA Today, Minneapolis Star Tribune and Financial Planning Magazine. He also had financial planning ideas included in the personal finance book Tips from the Top by Edie Milligan.

Nate is a part-time adjunct instructor for Minnesota State University-Mankato, teaching financial planning in the university’s Financial Planning Certificate Program. Nate also serves on the Personal Financial Specialist Committee of the American Institute of Certified Public Accountants.

Welcome, Nate.

Nate Wenner: Well, thank you very much, Sarah. I’m very happy to be participating today on this very important topic. And my section today is going to be figuring out
whether and how buying a home fits into your personal financial plan and some related tax considerations and other related issues.

Now many of you might say that you don’t have a formal personal financial plan. But I think, frankly, a prospective home buyer needs to do some level of assessment and planning in order to reach this goal and to keep yourself on the straight and narrow [path], if you will.

What you qualify for in terms of a mortgage--which is something that Mary is going to talk about later--is not necessarily the amount of house one should purchase, if you have decided that “Yes, I do want to buy a home.”

By the way--just going back briefly to something Pam mentioned--she mentioned some great [calculators] out there at dinkytown. I’d like to mention one other website that is hosted by the American Institute of CPA’s, and it’s a Web site that has a lot of articles, tools and frequently asked questions, not only on this whole area of buying and selling a home, financing, insurance for a home, but also on a whole related area of personal finance topics.

That website--if I can quickly [mention it]--is www.360--the numbers 3-6-0--and then financialliteracy.org. So it’s www360financialliteracy.org, and again, it’s a great website. It has a lot of very useful articles and tools.

So home ownership and viewing this as part of your comprehensive financial plan - how does this fit in with your personal cash flow if you’re going to go ahead and do this? How this fits in with the rest of your asset or debt picture is also very important.

You may be aware of a common threshold, that it is generally advised that housing costs for a person or family should remain below a certain level of
your income. And this very quickly again. Mary might be covering this in more detail.

Very quickly, generally said, your mortgage payments, including your principal and interest on your mortgage, as well your real estate tax payments and your home owner’s insurance, all together should not exceed 28% of your gross monthly income.

So if your gross income, for instance, is $3,000 a month or $36,000 a year, that means that $840 a month should be the maximum amount that you would spend not only again going to pay your mortgage payment, but including the monthly homeowner’s insurance and property taxes.

If your monthly income is $5,000 a month, then $1,400 a month would be the maximum amount. And again, that is just really the capacity that the lenders generally are going to use - one of the tools that they’re going to use--[to decide whether you qualify for a mortgage]. But that doesn’t necessarily mean that you really have the capacity in your own personal financial area to really afford that.

We’ll also talk a little bit about tax implications. You may be aware that there are some tax benefits [to owning a home] and that’s one thing that’s frequently cited in the benefits of buying a home.

And again, keep in mind that there are some great tax benefits if you itemize your tax return. And what that means is everybody gets--on your Form 1040--you add up all your income items and then different adjustments on the front and if you’re familiar with your tax form, then on the second page you go into your deductions and exemptions and other things. And your deduction, if you’re single [the standard deduction] is $5,150, and if you’re married filing
jointly, it’s $10,300. At least that’s what the figures were for last year—for 2006.

If your mortgage interest that you paid on your mortgage payments throughout the year and your property taxes and other possible deductible items such as charitable giving and possibly medical expenses, if all those together are greater than your standard deduction—again either $5,000 or $10,000—then there is a tax benefit to you of having a mortgage that you can write off for tax purposes.

But not everybody does itemize their taxes, and so it’s not always the case that that is a benefit. And people need to be aware of that and really do your own little bit of tax planning as part of your financial planning to figure out really what your benefits might be.

But if it is a tax deductible item, that means that if you have let’s say it’s a 6.5% [interest rate] mortgage, maybe in effect it’s only costing you say 5% because again you’re going to have… you’re getting some [tax] benefits from those mortgage payments.

There are other, also other costs of home ownership and other benefits of home ownership, and certainly Pam went through some of those. I want to encourage people to start with asking yourself some questions. She talked about some great questions of how much can you afford and your time horizon and, regardless again of your…of what you qualify for, so to speak, you need to ask yourself how much would you be comfortable putting at risk and how much of a home do you want to manage frankly and buy furniture for and clean and all those kinds of questions. How much growth in your family are you anticipating over a time period? And again, time period, as Pam
mentioned, is a very important concept here in buying a home and in deciding what size of home to get into.

You know, some people find a condo or a “starter home,” a smaller home perhaps, are great options and do have some of the benefits and tax breaks of buying a home, of owning a home but without feeling that this has to be your ideal home or your dream home or final home.

Other people may find that if this is the case--that you can’t afford your dream home--then they’d rather just rent and stay flexible until such time as they’re, you know, financially ready to buy their ideal home.

But often times people find when they’re, you know, starting or growing a family or, you know, until they’re advancing in their career, [they purchase a starter home and] then you buy a bigger home, more expensive home, when you really have the need for it and perhaps the capacity to support that.

And in fact, you know, I’d like to even just share a little personal story, you know, which is probably not unlike a lot of people, but perhaps it is, you know, constructive and instructive for those considering buying a home.

I tell you, myself, I've been married for about ten years now next month, and my wife and I rented for two years when we were first married. And we wanted to be in a certain location, a certain neighborhood when we were young and we didn’t have the parental responsibilities.

We had a simple… simpler life. We had more free time. Maybe we didn’t think we had much free time, but believe me, now that we have three kids, [we realize that] things were simpler then. And our income was a lot lower at the time.
So in addition to the flexibility and ease of renting, we knew that we could afford a home, but it really didn’t fit into our financial plans at the time. We were interested in saving, putting aside some money for a potential down payment later.

We didn’t have a ton of money, and plus my wife was in grad school and we wanted to fund other long-term goals, like retirement goals. So I think we both agree at this point that if we could have gotten into sort of a dream house at the time and afforded it and been able to do all of the other things, maybe we would have bought a house then and a larger house.

But we waited, and we were able to save and get our feet more solidly on the ground financially. And then two years later, we decided to buy a house that was actually well below what we could qualify for.

So we still were able to save for those other goals and invest elsewhere and actually just now we’re at a point where we just had our third child last fall. And now we’re really feeling, “You know what? We need more space.” And we believe we can afford it. And we’re already trying to figure out how much of a home we want and how much we can afford.

And we’re looking right now next year when we are probably going to sort of upgrade to a different size house. So again a lot of us would agree that you don’t want to stretch yourself so tight that you become “house poor.”

This is a concept that maybe some of you have heard about, which is a way of saying that so much of your income and your cash flow goes towards your home cost that you really feel poor because you don’t have enough money for other things in your life that you desire, like going on vacation or saving for retirement--excuse me--or saving for kids’ education or buying toys or other items that you really find important.
Or having an emergency fund to cover unforeseen expenses in case, you know, you lose your job or something. And if this is what happens--that you overextend yourself--believe me, as a financial planner, I've seen it. Then you might end up having to give up the home, move back into a smaller home, make some serious cutbacks elsewhere.

So it’s much better to identify what your means are now. And don’t let people tell you that, you know, you’re throwing money away down the drain by renting. You’re paying for a service, and don’t let them – don’t let someone – tell you that you shouldn’t… should not buy a home.

You’re going to need to take the responsibility, as a prospective homeowner, to really figure out whether you can afford something, whether this is something that you can commit to that fits into the rest of your financial picture.

And if you don’t think you can do that yourself, then I really encourage you to use some of these tools or ask, you know, your financial or tax adviser. So how do you figure out if this fits into your personal financial plan?

Well, it’s sort of a boring and a four-letter word for a lot of people, but it’s really budgeting. Understanding where your own cash flows are going, where your own spending money is going right now, is a great idea to determine what is your ability to buy a home and what size of home, what sort of payments you can afford, you know, again not only is there is a mortgage payment and there’s, you know, insurance and property taxes.

But there’s other costs. Again, you’re going to have to come up with the down payment. There’s closing costs, there’s maintenance, you know, home improvement, other operating expenses. And it’s really those sort of one time
up front expenses that people often don’t plan for, but are a very important part of buying a home.

And one thing that I really recommend people do is sort of practice ahead of time while you’re still renting. What I mean by practice is a lot of people will maybe sort of pretend that they’re making additional payments while renting.

Pam mentioned… maybe, you know, a renter spends X amount and by buying a home you’re going to spend this much more. Well, if it’s $500 a month more that you have to pay in buying a home, well, practice by setting that amount aside every month and putting it into a very safe account.

If you can’t actually keep this up month upon month over the course of several months, you know, whatever the excuse is or reason is, then you’re probably not ready for that size of house that you thought you were able to buy.

And again, that’s not even including some up front costs. Again, people often find that they need to buy all new furniture or other new things when they move into a new home. You may have found that, you know, in your current situation you’re fine having older or your current furniture, but people generally--when they move into a home-- now all of a sudden want to, feel they need to buy a lot of additional things, not to mention, you know, lawn mowers and outdoor things and all that kind of stuff.

So, a lot of additional costs that you assumedly anticipate when you’re going to buy a [first] home or for some people a second or a vacation home as well.

Another just quick topic is “Should you view your house as an investment or as a place to live?” And frankly I am of the mind that you should primarily view it as a place to live.
If you rent, you’re going to be paying rent for a long time. There’s no doubt about it. If you buy, eventually you hopefully pay off your mortgage, and your residence costs would decrease substantially. Of course, you also have some costs, always have some costs, like homeowner’s insurance and property taxes and maintenance.

But for many people, again, this is going to be your biggest asset. And some do view it as an investment. And many of us have seen our parents or our grandparents have their home appreciate so much over time that it really can become a source of funds during retirement.

And that could be the case. You know, for a lot of people that has been the case in the recent market and going back the last few decades for sure. But you also have to remember that these people could have also invested in other assets, in more traditional investments and also had sort of a lot of growth.

And the truth is we really don’t know how quickly and at what rate the real estate market will appreciate, not to mention how your actual neighborhood or your single property will appreciate.

And in fact, in doing financial planning, we often assume, over the long term, that maybe a home or a real estate item will grow at maybe 4% annually. That’s been less than what it’s been for the last couple of decades. But maybe more than what it’s been in a lot of markets in the last year, two years.

So you need to kind of build that expectation again into your long-term financial planning. Some people will think about buying a fixer upper, and that could be a great way to get into the housing market if you think you have the appropriate skills and are handy or you have the time to really devote to this.
Some people find out they thought that was the case for them, but they really don’t have the time and the skills and then they’re unhappy. So be very careful. Of course this is not a bad time perhaps for buying a first home or upsizing into a bigger home right now in this current market. If things are a little bit less hot than they were a few years ago.

Of course the flip side is true for those selling right now. And this is the other thing to think about in terms of your own financial plan.

You need to think to yourself, “What if I had to sell in a market like this? What would I do? Would I be okay selling this home, this investment, so to speak, at a loss?”

Many people are not. And in fact, in this environment, sometimes we’re seeing people who have negative home equity, [which is] when their home value is actually less than the mortgage that they owe and they’re actually having to deal or negotiate with their bank or lender to maybe accept a lower payoff because otherwise they couldn’t come up with the cash to pay off the mortgage even if they did sell their home right now. So again this is, you know, somewhat risky and it needs to be anticipated as part of your financial plan.

Lastly, I just want to talk about people who view real estate again as an investment to diversify their current asset holdings. And again, this will likely become the biggest asset you own, and that’s okay, and it may diversify you if you already have a lot of money in bank accounts or CDs or if you have money in retirement plans that are invested in stocks or bonds and mutual funds.
And this can be a very good way to diversify because often different asset classes—again such as stocks or bonds or real estate—can act as a cushion against each other. Because we can’t really predict ahead of time how any asset class will perform over a short period of time or which will appreciate in value most.

It really helps to own holdings in a lot of different types of assets. But if you’re not already sitting there with a lot of money in the bank or other investments, then by buying a home you are putting a lot of your eggs into a single basket, and that can be risky.

So you need to again think about this in view of all the other assets that you own, things that you own and other things that you owe, and look… understand your own cash flows—the ins and outs. And again this can be a boring thing to do. This can be a difficult thing to do. But if you need help, there are tools out there. There are people who can help you do that.

You really need to spend a little bit of time to understand what it is that you can afford. Get advice from family and friends. And use those kinds of tools that are out there to figure out what is the right route for you in terms of size of home.

In terms of size of home—and what I really mean by that is how much you’re going to pay—one question people ask sometimes is what percent of your financial net worth [the value of your assets, including cash, less your total liabilities] is appropriate [for you to spend] for your home? And there’s really no one right answer.

If you’re building your retirement nest egg still and you’re also anticipating and planning to pay for other financial goals, then it’s okay to have your home
be your largest and primary asset. But if not, if you’re not able to maintain
and build those other additional assets, then you need to be very careful.

Thank you very much for your time.

Cynthia Dawkins: Thank you, Nate, for the great information.