FIRST-TIME HOME BUYER

The COMPLETE PLAYBOOK *to* AVOIDING ROOKIE MISTAKES

SCOTT TRENCH, CEO of BiggerPockets
MINDY JENSEN, co-host of *The BiggerPockets Money Podcast*

BiggerPockets® PUBLISHING

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to AVOIDING ROOKIE MISTAKES

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BiggerPockets®
PUBLISHING
Denver, Colorado

Praise for *Set for Life* by Scott Trench

Winner—2018 National Indie Excellence Award
Honorable Mention—2018 Foreword INDIES Business Book of the Year
Honorable Mention—2018 CIPA EVVY Awards, Business Category
Distinguished Favorite—2019 Indie Press Awards, Business & Entrepreneurship

"[This] personally narrated audiobook is geared toward those of us at the start of our career journey for whom the end feels unimaginable. If you're worried about how you'll ever save enough to retire, settle down with Trench's calming voice and sage advice in *Set for Life*."

—from Audible's "20 Best Finance Audiobooks for Amateurs and Masters Alike"

"Cogently written and ideal for those beginning their careers who are not averse to risk; some may find this fiscal plan too audacious, but others will likely embrace its spirit and pursue it with fervor."

—Kirkus Reviews

"*Set for Life* provides a plan for your money in a no-nonsense way... If you take these ideas to heart, then you could completely transform the trajectory of your life."

—Robert Farrington, Founder of The College Investor

Praise for *How to Sell Your Home* by Mindy Jensen

***Honorable Mention*—2018 CIPA EVVY Awards, Business Category**

"There is so much that goes into this process and it can be very overwhelming for homeowners. Mindy does a phenomenal job of providing a comprehensive yet easy to digest A-to-Z guide for homeowners so that time and money can be saved. I enjoyed learning new strategies and I am looking forward to using these strategies on my next sale!"

—Liz Faircloth, Co-founder of The Real Estate InvestHER Community

"A great read for both real estate investors and homeowners... It's critical to know the ins and outs of selling your home fast and at a high price, and Mindy does just that in *How to Sell Your Home*."

—Andrew Syrios, BiggerPockets blog author and real estate investor

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Scott Trench and Mindy Jensen

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INTRODUCTION

It all starts with a simple concept: You want your dog to have a yard.

As you picture little Fido rolling around in green grass with ample space to roam, your thoughts wander further, and the simple concept turns into a dream. Maybe you don't want a roommate or to share walls with anyone else. Your upstairs neighbors stomp around like clumsy baby elephants. You want to paint the bedroom walls lime green and listen to Nickelback without fear of being overheard. Your landlord is, quite frankly, a bridge troll. You're throwing your money away on renting this place, anyway.

Suddenly, you're thinking of buying a house.

It's a no-brainer, right? Tax breaks! Long-term appreciation! Fixing up the outdated kitchen and adding hundreds of thousands of dollars in value! Just think of the possibilities!

Though the potential benefits are endless, we're here to give you some bad news—the potential problems are also endless. On the other end of the spectrum, you have broken toilets, wire fraud, and financial disaster that could spiral into endless debt and the possibility of foreclosure.

No pressure.

If you're reading this book, you are probably about to make what is the most significant financial decision of your life so far. Let's say that again: Buying a home is, first and foremost, a *financial decision*. Forget about your forbidden love of Nickelback, and forget all the people who have shouted from the rooftops that renting an apartment is worse than shoving all your cash down the garbage disposal (and then needing to call your landlord to fix your sink).

You've seen the workings of this financial decision before. Countless people buy their dream home right out of the gate—the huge, beautiful house on a hill, right in the middle of a winning school district and a charming neighborhood. They believe they are making a smart investment by finally breaking the renter's cycle. They throw their entire life savings at the painfully large down payment, but it doesn't stop there. The monthly mortgage payment sucks away a significant portion of each paycheck. With no cash left and an inability to save any more, they realize they walked right into a financial booby trap. They can't leave their job, start a business, move to Seattle, or travel the world like they always wanted.

Instead, they're stuck with their "smart investment" and all its broken toilets. That's the American dream, right?

Now, don't get us wrong. Buying a home really can be a smart investment that fast-tracks you to financial success, all while supporting a great quality of life. You can opt for a smaller home with a smaller mortgage and really rake in those tax benefits and long-term appreciation. You can even boogie your way into homeownership with the intention of turning your home into a *real* investment—that is, a rental property, a fix and flip, a basement Airbnb, or any other cash-generating asset. It's all about the things you know, the choices you make, and your willingness to see past the tempting house on a hill that exceeds your practical budget.

THE STANDARD AMERICAN HOME PURCHASE

We're passionate about the power of real estate to build long-term wealth—but only if you make smart decisions when you purchase. What do those smart decisions look like?

Let's kick things off with a breakdown of the standard American home purchase, in all its ordinary glory.

Alex and Shelby have been hopping from apartment to apartment, and they're sick of the endless rules, security deposits, and pet rent. After getting married and settling into their newly wedded bliss, they decide it's time to buy a house—hooray for freedom!

Collectively, they make $85,000 per year and have $40,000 in lifetime savings outside of their retirement accounts. While shopping around for their first home, they move into a sublet apartment with a lease that ends in three months. They need to find a home before then to avoid signing a one-year extension.

To get started on their journey, they call a local lender to find out just how much house they can afford. Their lender tells them that their collective income and credit qualifies for a maximum mortgage loan of about $400,000. The monthly payment would be about $2,500, which is significantly higher than their current rent—but with the countless benefits of homeownership.

Here's a quick peek behind the scenes: Though Alex and Shelby are ecstatic that they qualify for a $400,000 home, their lender isn't totally unbiased. While the loan qualification is based on hard numbers, the lender's goal is to calculate the *largest* possible loan—because the larger the loan, the more money the lender makes in commission.

What does the happy couple do with this information? Well, they call up Joy, a local real estate agent whose face and phone number they saw on a bench ("These signs really work!"), and tell her they're shopping for their dream home with an all-in budget of $440,000—the $400,000 loan plus their $40,000 in cash.

Another look behind the scenes: Though Joy really wants her customers to be happy with their homes, she also earns a commission of 3 percent of each property's purchase price. The bigger the home, the bigger her commission. The faster she transacts, the more commissions she receives. Simply put, she helps local home buyers buy the most expensive homes possible in the shortest amount of time.

Joy asks the couple about their preferences—big yard, quiet street, newer build, close to amenities—and she takes them to neighborhoods where properties just so happen to be priced at $425,000 to $450,000 each. After a few showings, Joy presents them with a beautiful three-bedroom home that just came on the market in a darling neighborhood.

Alex and Shelby fall in love with the property. It's perfect. There are extra bedrooms for their future children, an unfinished basement that could be completed with a possible fourth bedroom, a huge garage, and a brand-new kitchen.

The problem? The home is listed at $485,000—just beyond their price range. But, hey, Alex and Shelby have fallen in love. This is their forever home, and they simply *have* to have it. Being the totally unbiased party that she is, Joy lets it slip that their lender will probably go for it if the couple can come up with a slightly larger down payment. Luckily, Alex's father is willing to lend them the remaining $40,000, as long as they pay him back gradually over time.

Because the property was just listed and is getting a lot of interest, Joy encourages the couple to submit a "competitive bid" at a few thousand dollars higher than the asking price. Alex and Shelby breathe a sigh of relief when their bid is accepted, and they go under contract on their dream home.

After a few tense weeks of negotiating with the seller, getting a home inspection, and signing endless contracts, Alex and Shelby close on their home. Their expert real estate agent, Joy, helped them navigate a few tricky situations, and she even negotiated $10,000 in concessions from the seller! Joy is a top agent, after all. (And she'll be making close to $15,000 on this transaction—talk about an incentive.)

The couple used the $40,000 they'd saved as a down payment, they have a $2,500 monthly mortgage payment, and they will pay back an additional $500 per month to Alex's dad for the next several years. They move into their dream home, and after settling in, they can't believe how responsible and mature they feel for finally moving forward on such a big milestone.

Life is bliss. (Or is it?)

SO...WHAT'S THE PROBLEM?

Alex and Shelby's first-time home buyer situation seems par for the course. Little do they know, they're setting themselves up for a decades-long slog of financial struggle and worry. They've walked into an unseen financial booby trap that will consume the best part of their lives—that is, unless they win the lottery or receive a mysterious inheritance from Great Aunt Linda.

It took them five years to save up $40,000, build their credit, and get to $85,000 in joint income. Basically, all their cash savings and income (plus a little help from Dad) will now go toward the down payment and mortgage payments on their house. Their monthly expenses jump from $1,800 in rent to $2,500 toward their new mortgage (plus $500 per month to Alex's dad for the generous loan—which will take nearly seven years to pay back). On top of that, they assume all the *awesome* maintenance expenses that come with being a homeowner.

Alex and Shelby might have been saving money for years, but you can bet your bottom dollar they aren't saving much now. The mere concept of investing their money anywhere else (like in retirement accounts, stocks, or real estate) went right out the window when they closed on their house. The only "wealth" that Alex and Shelby have is the slowly building equity in their home.

As a result of this choice, Alex and Shelby are stuck. They can't change careers, and they can't change location. If an opportunity with a huge pay raise in another city comes up for Shelby, she can't take it—at least not in the near future. She has "invested" far too much in her new home to up and move. Because they are already taking the highest-paying jobs they can find in their local city, Alex and Shelby are unlikely to receive massive raises in the next few years.

Alex and Shelby are now "house poor." They spend everything they earn on their living expenses, massive monthly mortgage payment, and unexpected home maintenance costs. They must work their current high-paying jobs indefinitely, fighting to climb the corporate ladder. It'll take years, if not decades, of promotions and raises to finally return to a cash-flow-positive lifestyle, and only then do they have a shot at starting to save money again.

They're in a weak position if they want to start a business. They're in a tough spot if one parent wants to quit their job to raise their children. They can't do anything more than take a few low-cost vacations per year—they certainly can't take six months off and travel the world like they always dreamed of doing.

Alex and Shelby will slowly slip into the middle-class trap. They will passively accept the next phase of their careers to move up the corporate ladder one rung at a time. They will forget their dreams of being leaders in the community or spending significant time with their children during the formative years of their lives. They will basically live paycheck to paycheck, even if they build "home equity" on paper by paying down their mortgage and eventually benefiting from appreciation.

This struggle will continue for decades, but it will get better someday. Maybe ten or twenty years down the road, Alex and Shelby will reassess their financial position. They'll see a large increase in the value of their home, just like they knew would happen all those years ago. They're now sitting on several hundred thousand dollars of equity, driven by slowly paying down their mortgage and the long-term appreciation of their beautiful neighborhood.

They'll look back and talk about how their forever home was the best "investment" they ever made.

Well, of course it was! It was the *only* large investment they ever made.

By allowing the lure of the dream home to pull at their heartstrings (and their purse strings), they made a decision that will negatively impact their lives for decades. And guess what? It would be no surprise if they build those hundreds of thousands of dollars of equity just to sell their home to buy a bigger, better, nicer home down the street.

WHY YOU SHOULD CARE

Alex and Shelby may have struggled for a while, but it all worked out in the end. And besides, your great-great-grandpa bought his house when it was only $300, and now it's worth $300,000—so why not follow in his footsteps?

Well, the times they are a-changing, and the American dream just won't cut it anymore.

Not only is the current financial situation wildly different than in great-great-grandpa's day—high rental costs make it difficult to save for a down payment, and an increase in education debt makes it difficult to apply for a mortgage[1]—but the concept of retirement isn't what it used to be. Younger generations have recognized the change and are rolling with the punches: They're cutting frivolous spending and handling their future retirement with a much more self-sufficient approach. The concept of "financial freedom" allows folks to retire early, evade the corporate rat race, and follow their dreams.

The same changes apply to homes and mortgages: Millennials are, on average, delaying getting married, having fewer children, and buying smaller houses.[2] Why try to keep up with an outdated standard? Buying a home that stretches your financial limits is a socially accepted practice that has gone unchallenged for far too long, but that's starting to change.

It's time for a new kind of homeownership, one that does a lot more than just put a roof over your head. A smart home-buying decision will not only give you a place to live but also offer flexibility, financial stability,

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1 Jung Choi, Bhargavi Ganesh, Laurie Goodman, Sarah Strochak, and Jun Zhu, "Millennial Homeownership: Why Is It So Low, and How Can We Increase It?" Housing Finance Policy Center, July 2018, accessed at https://www.urban.org/sites/default/files/publication/98729/millennial_homeownership_0.pdf.

2 Sheri Koones, "Why Millennials Are Buying Smaller, More Efficient Houses," Forbes, October 18, 2019, https://www.forbes.com/sites/sherikoones/2019/10/18/why-millennials-are-buying-smaller-more-efficient-houses/#7e8887524558.

and the chance to recognize an increase in that home's value over time. By following all the steps outlined in this book, you will set yourself up for a smart home purchase at a great price, with as few snags as possible in the process.

STRANGER DANGER

Since you're about to make a whopper of a financial choice and you're going to follow our advice while doing it, allow us to introduce ourselves (and toot our own horns).

We're both experts on finance, home buying, and real estate investing, and we have more than thirty years of experience between us. We're cohosts of *The BiggerPockets Money Podcast*, which has been around since 2018 and (as of now) has more than 10 million downloads, 1,500 five-star reviews, and countless corny dad jokes. The show covers everything you can and should do to get your finances in order so you can save, invest, and ultimately win at life. After hundreds of interviews with brilliant financial experts, we have absorbed quite a bit of knowledge.

On the home-buying side, Mindy knows best. She's been buying and selling homes as an investor for more than twenty years, and she's been a licensed real estate agent for more than six. Mindy is currently occupying her eleventh live-in flip—which means she buys wonderfully hideous houses, moves in, makes them beautiful while living there, and sells them for a killer profit.

On the finance side, Scott knows his stuff—he's the CEO of BiggerPockets.com and author of the best-selling finance book *Set for Life*. Not to mention that he achieved financial freedom and built a successful real estate business just three years after graduating college. (Yes, seriously.)

All horn tooting aside, we're here to help you make the best decision possible when it comes to buying your first home. We've seen both ends of the spectrum—the crash-and-burns and the wild success stories—and are happy to pass this knowledge along to you. Buying your first house can be intimidating, and it can sometimes seem like no one will give you a straight answer to all your questions.

Well, buckle up, buttercup: straight answers ahead.

WHAT YOU'LL FIND IN THIS BOOK

Dad jokes and puns? Most likely.

But other than that, this book encourages new (and improved) frameworks about the home-buying process. If you're looking to justify your dream home as an "investment," you'll find no help here.

The first part of this book will cover the critical financial concepts behind buying a house, plus the different strategies you can use to upgrade your first home to a real, cash-positive investment. Before diving into a home purchase, you should fully understand what's at stake so you can make a focused decision. Part One will educate you on the financial benefits (and consequences) of a home purchase and demonstrate a range of possible home purchase decisions.

Buh-bye, American dream—hello, financial freedom!

The second part of this book is all about preparation. Now that you know you're *ready* to buy a house, it's time to make some real-life decisions. We'll show you how to figure out exactly what you want from a home, define what a "good" deal really means to you, and organize your finances. We'll also touch on how to understand your loan, choose a stellar lender, and find a real estate agent with your best interests in mind.

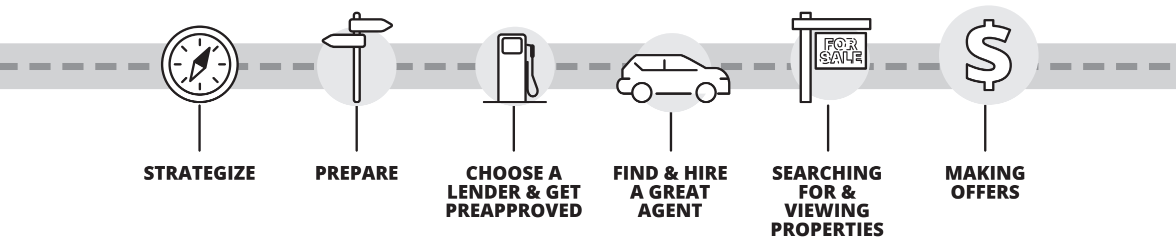
Getting that first set of house keys is a milestone, a rite of passage, a feel-good moment. But getting to that point, not so much. The home-buying process is like digging through an unorganized box of holiday decorations—it's full of chaos and unpleasant surprises, and no one in the world seems to know what you'll encounter. (What's title insurance, you ask? You're about to find out.) That's why Part Three will focus on the nitty-gritty process behind home buying.

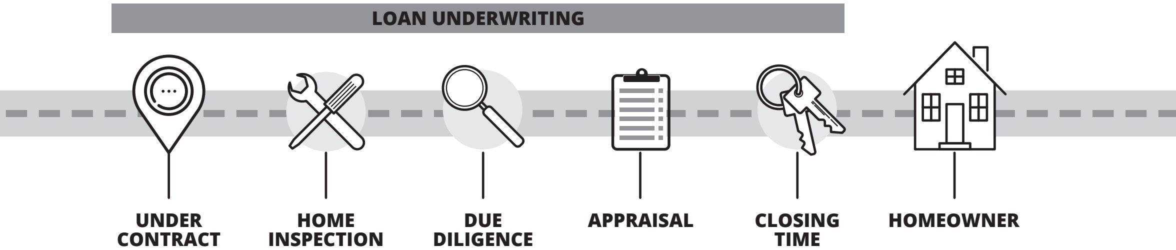
By the end of it all, not only will you see homeownership in a new light, but you'll be armed with the tips, tricks, and tactics you need to really go for it. And, done correctly, your first home purchase should give you better odds of fulfilling your dreams, achieving your potential, and building a strong financial foundation. Fido gets a yard, you get to travel the world, everyone is happy.

You might even get to have uncomfortable conversations with your friends and family who just don't get it. Why not buy the house on a hill if you can afford it (at least on paper)? Why subject yourself to hard work and hustle when you've spent all this time saving money for a down payment already? You're going to do *what* with your detached garage?

We're not sorry. Let's dive in!

FIRST-TIME HOME BUYER ROADMAP



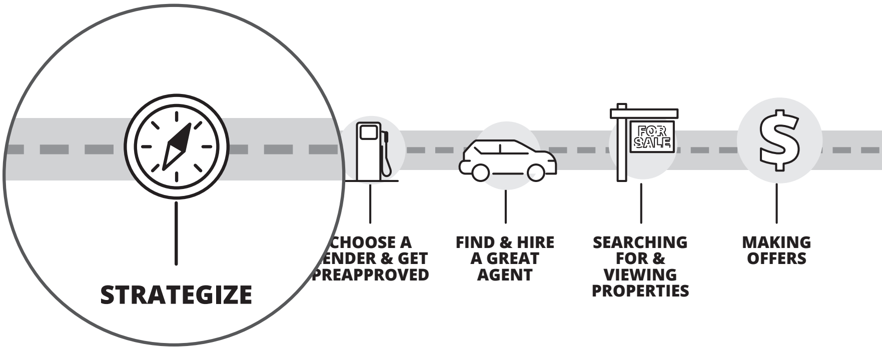

LOAN UNDERWRITING
UNDER CONTRACT
HOME INSPECTION
DUE DILIGENCE
APPRAISAL
CLOSING TIME
HOMEOWNER

PART ONE

HOME-BUYING STRATEGY

"You do not find the happy life. You make it."

—CAMILLA EYRING KIMBALL



CHAPTER ONE

IS BUYING A HOUSE A GOOD INVESTMENT?

So, is it?

Answer the question. Don't hold back. Say your answer out loud, especially if you're in a public place.

Chances are your gut reaction stems from years of social conditioning—and that answer is *yes*. Most of the adults you know own a house. Some might be an utterly practical three-bed two-bath, while some others are a second vacation home on a lake in rural Vermont. Houses are cozy, private, wonderful little structures that give us shelter.

Is there anything wrong with buying a house? Of course not. But is it a good *investment*?

The easiest way to demonstrate the lack of clarity here is to take a look at the financial impact of buying versus renting over the long term. For the sake of this example and to keep things simple, we'll assume some specific numbers, but these are subject to change depending on where you live and when you're reading this. The main point, however, applies across many of the major markets in the country.

RENTING VERSUS BUYING

In the left corner, weighing in at $2,300 per month...

Renting a lovely apartment! The original listing included words like "sun-soaked" and "pet-friendly," and you have everything you need, give or take a few overdue maintenance requests.

Your $2,300 rent includes all expenses, utilities, and routine fixes. Over the course of a year, that monthly payment adds up to a total of $27,600. (Yeah, just let that number sink in for a minute.) You can also assume your rent will increase annually in line with inflation at an average of 3.4 percent per year. Next year, that $2,300 per month becomes $2,378 per month, then $2,459 the year after that.

Of course, you won't build any equity in the property you live in, but you only have to pay that simple $2,300 per month to enjoy your sun-soaked paradise.

And in the right corner, current world heavyweight champion...

Buying a house! Though buying a home means owning a slice of property, homeownership is not nearly as straightforward as sending off a monthly rent payment.

Let's start with the hard numbers. This house is listed at $400,000. The buyer makes a 10 percent down payment and pays 3 percent of the property's value in closing costs: an all-in total of $52,000 cash to close on the property. The buyer then assumes a loan of $360,000 (the purchase price minus the down payment), and with all interest, taxes, and insurance included, the buyer's monthly mortgage payment is $2,917 per month. Because broken windows and running water aren't free, let's tack on an extra $250 per month for maintenance and utilities. This comes to a total cost of $3,167 per month, or $38,000 per year.

Simple enough, right? The home buyer obviously pays more per year than the renter.

That's true, but it's not so easy. We also need to take into consideration all those wonderful benefits of homeownership. The first and most obvious would be building equity—part of that $2,917 monthly payment will pay off the total loan balance. The property will also appreciate (that is, increase in value) at an average rate of 3.4 percent per year. Appreciation is complicated, but for the sake of this example, let's say the $400,000 home will be worth $413,600 this time next year, then $427,662 the year after that.

Though this sounds wonderful, you can't forget that this daring home buyer brought $52,000 in hard cash to close on the house. (And by *hard* *cash*, we don't mean stowed in a sketchy briefcase—we mean real money, not credit, from a bank account.) Because the buyer's mortgage payments come out to $38,000 per year, that means the buyer spends a total of $90,000 just in the first year.

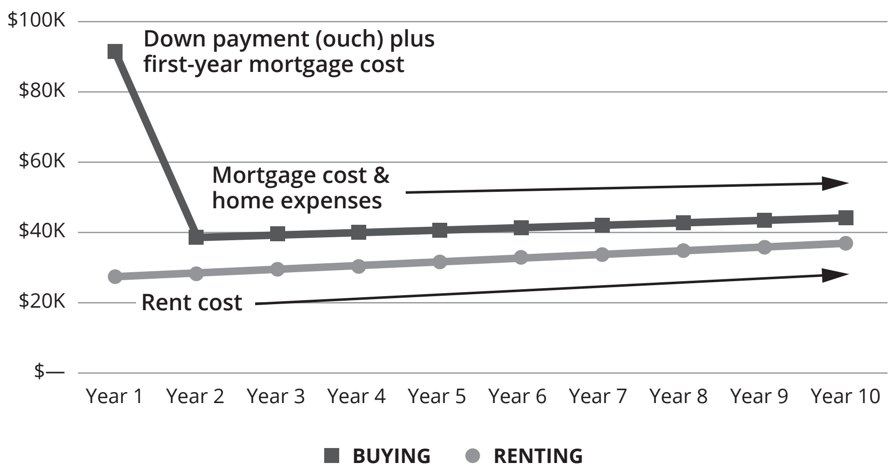
That $27,600 per year to live in an apartment is starting to sound really good, isn't it?

To clarify, the two main comparisons we're looking at are:

- **Up-front cost.** In this example, the apartment renter has no up-front cost, while the home buyer has $52,000. Both will vary based on the specific situation—sometimes, you have to put down a deposit before renting an apartment, and sometimes you can buy a home with a lower down payment—but no matter what, you're bound to pay more up front to own a home.
- **Total net worth created or destroyed.** Your net worth is the whole kit and caboodle of your financial health. Squander all your savings on a porcelain doll collection? That's a loss in your net worth. Invent America's first pizza vending machine? Cha-ching. Spend all your savings on a down payment but then slowly build equity in a property? That's a big initial hit that eventually regains value over time.

Let's look at a visual of our two competitors in both these categories.

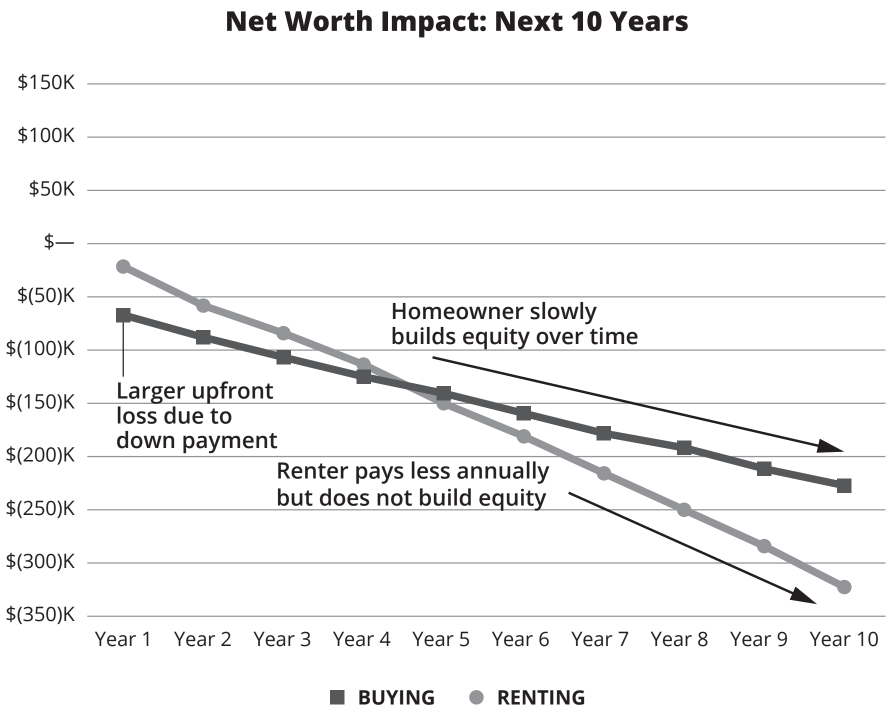
Cash Outlays: Next 10 Years



Starting with that up-front cost, you can see how financially painful that first year of owning a home can really be. Even by year ten, the homeowner is still paying more each year than the renter. (Remember, the cost of rent is increasing by 3.4% every year, while the cost of the monthly mortgage payment is locked in place.) You can imagine that around year fifteen, the homeowner will be paying less each year—but who really has a robust fifteen-year plan?

But in the meantime, here's the important thing: The homeowner is going to be shelling out more cash over the next ten years. They'll have less disposable income for fun things like road trips and karaoke bar nights, and it'll be harder for them to invest in stocks, real estate, or retirement accounts.

Now, this is where the fun begins:



Right out of the gate, our homeowner line is looking a little droopy. That large up-front down payment plus closing costs takes a toll on the homeowner's net worth, but around year five, things start to change.

Because the homeowner has been paying down their mortgage (and not tossing their money at a landlord "make it rain" style), they're building equity in their home. That, combined with the gradually increasing value of their property, starts to counteract the costs, and by year five, their net worth is less impacted by housing than the renter's.

Is it better to buy or rent in this scenario? All other financial factors like cash savings and credit score aside, buying might be better for someone who plans to stay in the property for longer than five years or so. The break-even point can vary considerably depending on the numbers; you can conduct your own analysis with the rent-versus-buy spreadsheet at www.biggerpockets.com/homebuyerbonus.

Still, if the buyer decides to hit the road in year two, they can't simply sell the house and get back all the money they put into it. Let's say this buyer's plans change, and they need to relocate for a new job after two years of owning their home. The $400,000 home is worth about $425,000 after two years of average appreciation, and we can assume that the loan balance would be about $349,000 after the down payment and regular monthly mortgage payments. The $25,000 gain in property value, $40,000 down payment, and $11,000 in loan paydown seems like a lot of money that they will "get back" when they sell, but that's not necessarily the case.

Including the initial $12,000 they paid in closing costs when they bought the house plus an overall mortgage cost of $38,000 per year, they will have spent a total of $88,000 in two years—and that doesn't even account for the cost of any property maintenance. Also, if they want someone to take the house off their hands, they'll have to pay seller's closing costs, usually around 7.5 percent of the home's value, just to close that transaction. If they sell the property at $425,000, that's another $32,000 out of pocket.

While they built a total of $76,000 in home equity—a combination of the $40,000 down payment, $25,000 of appreciation, and $11,000 of loan paydown—they spent a total of $120,000 over the course of their two-year housing venture. Ouch.

Long story short, buying a house costs money—a *lot* of it—but will help you build equity and wealth over long time periods relative to renting. The transaction costs associated with buying and selling property often make renting a better choice if you don't intend to own long term. The math skews even more in favor of renting instead of buying in