

The Rules

WHEN GREG WAS TRANSFERRED TO WASHINGTON, D.C., HIS WIFE, STACEY, knew immediately she wanted to move to Fairfax County, Virginia. Her family had lived in the area for years and the commute into Washington was a breeze. Unfortunately, the couple had to start their search right in the middle of the spring buyers' frenzy and were competing with other families eager to get into a new home before the school year started. Soon after their search began, they discovered a neighborhood that boasted a pool and tennis club that residents automatically belonged to. And, days later, the couple walked into an open house for a cozy ranch with skylights and new carpeting in every room. The only downside was a strange mildewy odor—but the sellers assured them they had taken care of the problem. The pressure to move quickly was high. Seven other couples at the open house were eager to buy. Greg and Stacey decided they would have to put together a strong offer quickly to compete. They bid the asking price of \$669,000. Stacey even wrote a thank-you note to the owners to improve the chances of their bid being accepted. The price tag was a little more than they had anticipated spending, but the

two agreed they could afford their prize if they kept their spending on extras to a minimum. They won the bidding war, but just a month after they moved in, they discovered that the mildewy odor was a symptom of a much bigger water problem: water soaked the basement carpet. They gutted the room down to its studs and installed a new drainage system, as well as a new carpet, wainscoting, and furniture. But that was only a prelude to the problems created a year later by a massive rainstorm.

“At five o’clock on a Sunday morning I heard water running,” Stacey recalls. “I went downstairs, and it was like a levee had broken—there was water coming through the wall, up from under the floorboards, everything.” Greg and Stacey worked like a bucket brigade emptying the house of water. More renovations ensued.

In the first two years of owning the house, they had to replace several skylights, fix leaky soffits, and excavate the backyard to install French drains. The price tag—a total of nearly \$36,000—was sizeable and unexpected. Because the two were stretching to buy the house in the first place, they had little room in their budget to finance the repairs. Greg tapped his retirement fund to pay for the biggest repairs, but the problems left the family strapped. Had the two been in less of a rush and hired an inspector, they would have been spared the setback.

Compare their situation with that of Ted and Barbara. At the time the two decided they had outgrown their Queens, New York, condo, the market couldn’t have been more hostile to buyers. Prices were on the rise in Westchester County, where they had decided to move. Attractive homes were drawing multiple bids and bidding wars. If ever there were a time for buyers to hold up and wait, this was it. But the couple came up with a strategy that allowed them to find a home that fit their needs yet didn’t break their budget.

They started by investigating neighborhoods. They quickly ruled out the most expensive ones, such as Scarsdale and Bronxville, where competition was the most heated and the potential for overbidding high. And they knew they didn’t want to move too far away from their jobs—Ted worked in Queens, while Barbara worked in Manhattan. When Ted’s boss suggested they check out his commuter town, Sleepy

Hollow, they liked what they saw. Prices in the town were high but not stratospheric. When they found a quaint bungalow with some maintenance issues, they pounced. Exterior paint was peeling and interior hardwood floors had been badly damaged by renters. The kitchen hadn't been updated in years. Rhododendrons had been allowed to grow nearly to the eaves, and the overall appearance from the outside caused many potential buyers to drive past without even seeing the interior. After confirming the house had no structural issues, the two decided to buy—driven mostly by the idea that the house was well priced for the neighborhood at \$475,000. Because the two were able to purchase the house at such an attractive price, they could spend money on upgrades. They had the cramped kitchen stripped out and updated with roomy oak cabinets and stainless-steel appliances. They repainted the house, warming up rooms with rich colors to replace the faded creams and whites. The floors were refinished. The exterior was painted a sophisticated gray-green and the shrubs trimmed or removed altogether. Within a few short months of buying, the house was transformed. “We were enthusiastically welcomed by our neighbors,” said Ted. “Most commented they really had never been able to see just how beautiful the house was beneath all those overgrown shrubs. One neighbor even said she would have bought the house long ago had she known what was hidden beneath. That’s a great feeling.”

After the two had completed the transformation of their home, they set their sights on a real eyesore house in the neighborhood to buy, fix up, and sell—an investment they never would have been able to even consider had they not bought so advantageously in the first place.

Greg and Stacey’s failure to investigate the musty odors they smelled during their initial visit ultimately cost them tens of thousands of dollars, stealing any money they might have used for upgrades, while Ted and Barbara’s careful investment will likely reap strong returns. Most of the pair’s gains will come from sweat equity, but it’s no small part of the equation that they also simply bought right, hedging their risks by buying well within their budget and carefully choosing both their neighborhood and their house.

Over the years, Americans have discovered that home ownership is

one of the most reliable methods for building wealth in this country. You may have seen this firsthand in your own family. Did your grandparents retire on the proceeds of selling their house? Did Mom and Dad finance a second home or your education by tapping their home equity? A consumer survey regularly conducted by the Federal Reserve reveals that the biggest nest egg owned by people entering their retirement years isn't a 401(k) or IRA, it's their house. And it's little wonder that our homes are the single most valuable thing we own. A mortgage is an enforced savings plan. Unlike investing in your 401(k), for example, you can't stop paying your mortgage because there's another, more pressing bill on hand. But it's not just the consistency with which we pay for our homes that ultimately makes them an attractive investment.

Home values have increased an average of 6.6 percent each year since 1968, according to the National Association of Realtors. That's less than the returns on stocks and bonds during the same period. But to make a true comparison, you need to take into account all the financial benefits you get from home ownership. The mortgage interest deduction is the fattest tax break most households enjoy. Plus, Uncle Sam also lets you exclude as much as \$500,000 in gains when you sell. The point isn't that you shouldn't invest in stocks or bonds—you should be well diversified, and that means investing in all three: stocks, bonds, and real estate—but you need to think of your home not just as the place you live but as an investment you can use to your advantage.

To be sure, real estate can experience negative price appreciation. Prices can and do go down as well as up. Still, housing returns over the long haul compare favorably with anything else you're likely to put your money into, plus there is also a unique advantage to investing in real estate: personal control. For most of us, mutual fund managers or brokers decide when to buy and sell our stock and bond investments, but with real estate, you decide when to get into a market or leave it. Likewise, you decide when to make upgrades to your home and how much to spend. You determine how much money goes into maintenance. It's these decisions that will make the difference between a poor investment and a great one.

We live differently than our parents did—we move more often, we don't buy and hold for decades. For that reason, we have to be much savvier, whether we are buyers or sellers. The stakes in managing your investment intelligently are higher than ever because people stay in their homes an average of just nine years, according to the American Housing Survey for the United States: 2005. In other words, these days homes are more of a medium-term investment than a long-term one. That means if you make a mistake, time isn't on your side. Covering up mistakes becomes difficult because you won't have thirty years of appreciation to make up for a misstep. What's more, the homes you're likely to encounter when you buy may have few, if any, of the features on your wish list. The average home in this country was built thirty years ago, and its architects could hardly anticipate our desires for open floor plans and light-filled rooms, or the fact that many of our homes now accommodate multiple generations. This book will show you how to make smart decisions about your home, from buying it to living in it, changing it, and selling it. *Home Rich* presents a plan you can follow whether the market is rising relentlessly or falling fast. In the end, if you follow the rules of this book and manage your investment wisely, your home will become the best investment you ever make.

To use this book effectively, you can either follow its advice through the entire process of home ownership or dip into it when you need help. It helps, though, to make the right choices from the beginning. Nothing is more important to becoming home rich than choosing the right home to buy in the first place. Price, of course, is critical. Pay too much and you may never get back even your original investment. The condition of the house matters greatly, too. Pick a house with problems and you may be forced to blow your entire renovation budget on repairs you never anticipated. In Chapters 2 through 8, you'll learn the steps to picking the right house: understanding how much house you can afford, choosing a real estate agent to work with, researching the neighborhoods, zeroing in on the best property, and negotiating for that house. And, most important, you'll learn the importance of thinking of a house as an investment even as you shop for a home, getting beyond your ini-

tial, emotional reaction to a property to think about deeper issues, such as its broad appeal, the investments that are likely to pay off, and the health of the neighborhood.

Buying right is important, but it's not the only step in transforming your home into the best investment it can be. The mortgage you choose and the financing that you use at every turn to upgrade and maintain your home are critical. The lending options these days are various and confusing. Thirty-year fixed-rate mortgages are old hat. Bankers have devised all kinds of products to fit every imaginable consumer need. In this book you'll see detailed analysis of mortgages from conventional thirty-year fixed-rate loans to some of the industry's wackier innovations that you'll want to steer clear of, such as interest-only and nothing-down loans. Some of these newer loan products have fallen out of favor but could resurface again to tempt borrowers. In Chapter 9, you'll learn how to navigate this complicated area and when to seek professional advice. Plus, you'll learn how to calculate your equity—what you actually own—and the best ways to grow that investment.

Few of us can afford to buy the home of our dreams. In fact, it can even be difficult just to find a home that works well for our needs. Modifying your home to suit the needs of your family and potential buyers down the road is up to you. We start in Chapter 16 with a discussion of the projects that really pay off and how you can decide which is right for you. From there, you'll learn about small upgrades that make a difference. In Chapter 18, you learn about hiring contractors and what to expect from them. Next, you'll focus on what makes for successful home improvements, the range of design options, and where you can save when accomplishing the most popular upgrades. We'll consider in detail improvements to kitchens and baths for any wallet.

One investment that appeals to buyers more than ever these days is upgrades that reduce your energy bill. In Chapter 13, I'll take you on a tour of the improvements, from insulation to solar panels, that are most likely to make a difference where you live. You'll also learn about other popular green solutions, such as products that produce no or low emissions and architectural salvage.

If it's the exterior of your home you're concerned about, turn to

Chapter 14 to find out about landscaping and garden improvements that can enhance any home's appeal. Whether you live in an urban area with a tiny lot or a sprawling suburban neighborhood, we'll look at solutions that can make your property stand out from the rest. You'll also find a buyer's guide to shrubs and trees for your part of the country. Once again, our focus will be on upgrades with broad appeal that will add to your home's value.

Even if you buy the best-built house in the neighborhood, your investment will still suffer if you don't manage the house over time. Taking care of a home's systems is no easy prospect, but a well-maintained home is something home buyers can sniff out in only a few minutes. Turn to Chapter 15 for details.

Eventually you'll want to sell your castle, and when that time arrives, you'll want to do it with an eye to maximizing your investment gain. Chapters 20 through 23 will guide you through the decision-making process that will get you the best return for your biggest investment. When should you sell on your own? How much should you invest in fixing up the place before putting your home on the market? In Chapter 22, you'll learn the best strategies for selling your biggest asset at the best price.

As you read along, you'll find step-by-step advice on how to make the decisions that will make your home a solid investment. What you won't find is advice for people who want to flip homes—buy and sell them quickly—for a quick gain. That's because this book is no get-rich-quick manual. In fact, I believe that building real wealth results from carefully monitoring and investing in your home over time. You can start by understanding a few essential rules.

KNOW YOUR WALLET

It seems everybody has heard the banker's rule of thumb that you shouldn't spend more than 33 percent of your gross income on housing. But few people seem to abide by it. The ratio of mortgage debt to disposable income has doubled to 18 percent from 8.1 percent in 1980. And while you used to be able to count on lenders to make sure you weren't overspending, the truth is that they aren't taking the rule too se-

riously either. The way bankers these days determine whether you're good for your loan is by using sophisticated new computer programs. Developed by credit bureaus, these programs tell bankers whether you're conscientious about paying your bills on time. The more timely you are with payments, the more likely they are to be willing to lend to you. In other words, if you are a conscientious bill payer, it's up to you to know what to spend. Trouble is, if you make a bad decision—that is, if you choose to overspend—it's a decision that will haunt you for the entire time you own the house and jeopardize your ability to make a solid investment. To get a handle on the numbers, check out Chapter 2 to determine how much you should spend, what loan is right for you, and the costs associated with getting a mortgage. Even if you already have a mortgage, analyzing your budget is critical to making your home a good investment.

PICK A WINNING TEAM OF ADVISORS

Like having children, buying, selling, and managing a home will require backup. You'll need the best real estate agent, lawyer, and mortgage banker (or broker) possible. Many of us will also choose a contractor to make home improvements. And remember, once you identify a team of knowledgeable experts, not only will they help you find a quality home and structure a smart, favorable deal, they will also guide you through the entire process of purchasing and closing on your home. As you begin to decide how to improve and update your abode, these are also the people who will help you figure out the best moves to make. Chapters 4, 5, 18, and 20 provide a detailed guide to getting the perfect home buying, managing, and selling team for you.

LOCATION, LOCATION, LOCATION

That old saying is true. And while it sounds simple, the idea is more complicated than simply targeting your town's most expensive or prestigious neighborhood. Let's face it, most of us can't afford the old-line neighborhoods with the top amenities. For many of us the problem isn't a choice between the most expensive zip code in town and any other, it's

affording any neighborhood at all. In fact, after doing the *Home Rich* analysis, you may find that the expensive neighborhood is ripe for a tumble in prices and you may decide to avoid buying there altogether. The first step in deciding which location is right for you is doing your homework. While the temptation is to search on the Web and to focus your attentions on just the attractiveness of individual properties, in Chapter 7 you'll find out how to analyze neighborhoods' long-term attractiveness on a variety of criteria and to find the one that fits your needs.

PLAY HOUSE DETECTIVE

For some, shopping for a home is like going back to high school. You develop crushes on attractive candidates, but you can't seem to figure out which are the true trophies. Forget sentiment when you shop. Stop searching for a kitchen that resembles your grandmother's and start thinking analytically. After all, you can always remodel to make your kitchen look like Grandma's. You're better off spending your time determining two things: whether the house has "good bones," that is, whether the home's basic design and structure are sound and pleasing to the eye, and whether the fundamental systems of the house—the heating and cooling, plumbing, and electrical systems—are solid. It's up to you to uncover the truth and ferret out the homes that offer the greatest value given their qualities and flaws. Turn to Chapter 8 for tips on vetting homes and uncovering problems while they still belong to someone else. Find out how to hire a professional inspector who can do all the heavy lifting for you. And don't forget that all the skills you develop inspecting potential purchases should be applied to your own home once you buy it. The investigation shouldn't stop once you buy because you'll want to be sure new problems aren't being created on your watch.

BE A LOAN SHARK

Banks have created a myriad of different types of mortgages to satisfy every need—some offering terrific innovations on the thirty-year fixed-rate mortgage, others that are poor substitutes. There's the no-doc loan

and the 3-1, 5-1, or 7-1 ARM. You can pay interest only or—get this— even less than interest. What about a forty-year loan? No matter what your needs, it is critical to choose your financing vehicle wisely, navigating this complex arena to obtain a loan that is ideally suited to your situation. Still, not all innovation has been bad. The Web can help you shop for mortgages, understand the terminology, and even compare terms. Chapters 9 and 11 will show you how to choose the right loan and even survive the closing. Plus, you'll learn how to navigate the world of equity loans and lines of credit if you need to tap the equity you are steadily building.

BEGIN AT THE END

Before you buy, you'll want to think seriously about what improvements you plan to make, what they will cost, and how you'll pay for them. Sounds like a tall order, but unless you have a vision for developing the house in a way to improve its value, chances are you could make poor early decisions that could make it impossible to wring the best possible return out of your house. Starting early can pay big dividends. While the initial analysis that you do won't be conclusive, it should be a fairly reliable guide. In Chapter 8, you'll learn to gauge whether the home you want to buy is the most improved or the least. You'll learn the importance of how long you plan to be in that home. The goal: determining the sorts of upgrades that will make your home outshine neighbors' houses while not burning up too much equity. Using that information plus the details of your situation, you can carve out the best plan for bringing a home to its potential. In Chapter 19, we'll guide you through this analysis, including small-scale improvements that can make a difference.

RENOVATE LIKE A POPULIST, NOT AN ELITIST

When you renovate or restyle a home, it's best to temper your creativity with a little practicality. Ask yourself what it is that the next buyers are most likely to want. Is it a Jacuzzi or simply an updated kitchen? Pool or expanded deck? Sure, you want the ultimate master bedroom with over-the-top master bath fixtures, but spending \$250,000 can be a disaster.

Overspending can push your home beyond the reach of the kinds of buyers you will likely attract. The reality is that most money gets spent on kitchens and bathrooms because that's where people spend most of their time, and it's where investment dollars can really shine. Chapter 19 will show you how to choose materials and designs that are sensible and have broad appeal. Plus, you'll learn the importance of making design choices that fit the tastes and predilections of the people most likely to buy a home in your neighborhood.

CRUNCH, CRUNCH, CRUNCH

People everywhere want to know whether home prices are poised to go up or down. Undoubtedly, there are few things more worrying than the idea that the sky-high price you paid for your modest bungalow will become a laughable suggestion when you are ready to sell. Truth is, appreciation is just one part of your return when you sell a house. The other part, and what many people lately have ignored, is their contribution in the form of mortgage payments and renovations. Equity includes all of that plus appreciation. If you've just bought your home in the last few years, chances are you haven't built up much of this good stuff. Equity can serve many purposes: it can be a store of emergency cash in the event that something truly awful happens, or it can be tapped to help improve the value of your property. Of course you eventually have to pay it back. But the key to doing the latter well is analyzing your local market trends and then spending that money judiciously. Go to Chapter 12 to find out how to manage your equity over time and Chapters 3 and 22 to learn about tracking price trends.

GET LUXURY FOR LESS

These days, luxury doesn't simply mean more space. Let's face it, those sprawling McMansions once may have seemed like exclusive retreats. But now with energy prices on the rise, they're criticized as expensive Sheetrock palaces. The real way to boost your luxury quotient is with high-end finishes and carefully chosen design elements. The idea of extending taste and style throughout your home is a trend that is hard to

ignore. Think of it as luxury living without the mansion. As a smart homeowner focused on the value of your home, you're better off concentrating on features and fit rather than square footage. Chapter 17 shows you how to increase the elegance of the interior of your home without incurring a high price tag. Chapter 14 will help you find the luxury finishes that won't break the bank for your garden and yard.

PRIORITIZE YOUR IMPROVEMENTS

It's all well and good to add an outdoor Jacuzzi to the deck off your master bedroom, but you might be better off making simpler improvements first, such as updating the baths and kitchens. Understanding the improvements that will add the most value to your home is key while keeping in mind how long you plan to live there and when exactly you plan to sell. The tendency is to become obsessed with the renovation that gets the most ink in home design magazines, such as the outdoor kitchen with all the bells and whistles. You're far better off evaluating your specific property and what would make it more appealing to potential buyers. See Chapter 19 to get details on picking the right renovation.

CONSIDER GOING GREEN

Forget Earth shoes and composting. While getting off the grid is a worthy goal, the truth is that for homeowners who've bought an older house, the price of producing enough energy to make their home self-sustaining is too high to be cost-effective, especially in the short run. Those photovoltaic solar panels and thermosiphon water heating systems are pricey. However, you can do your bit for the universe and see a return on your investment by picking up on some green trends. Go to Chapter 13 for tips on going green.

CASH IN WITH CARE

Getting the most for your carefully managed investment requires you to be smart about how you put your home on the market and manage the selling process. If, like most of us, you own your home for just nine years,

you could own five to six homes over your lifetime. That means you'll want to manage your home carefully. Selling with an eye toward getting the best return on your investment is handled in Chapters 20 to 23.

To be sure, buying and managing a home is a complicated process. But it doesn't have to be impossible, and it certainly should have a financial reward. *Home Rich* is here to help you achieve those goals and enjoy your investment at the same time. Good luck as you start your journey.