Chapter 1

Deciding to Sell

In This Chapter

- Making the choice: To sell or not to sell
- Selling in weak and strong housing markets

Selling your house and moving can be an enjoyable (not to mention profitable) experience. Unfortunately, for most people, it isn't. Selling a house not only introduces financial turmoil into most people's lives but also causes them stress.

One goal of this book is to help you make the right decision about whether to sell your house. If you do decide to sell, we want to make sure that you get as many dollars and as few upset stomachs from the sale as possible.

The reasons people want to sell their houses are almost as varied as the houses themselves. Here are some of the common, not-so common, and downright bizarre reasons:

- Additional debt burden because of layoff, medical expenses, disability, or overspending
- Bad vibes or bad luck associated with house
- Better job opportunities elsewhere
- Diminished space requirements now that children are grown
- House located in a flood, earthquake, or other disaster zone
- Increased space requirements for expanding family
- Lack of garage
- Neighborhood conditions incompatible with socioeconomic status
- Noisy neighborhood
- Noisy/messy/obnoxious family or business moved next door
- Recent death of spouse
- Recent marriage or divorce

- Serious house defects (such as radon or termites) that owners don't want to fix
- Unfriendly neighbors
- Unsafe neighborhood
- Unsatisfactory neighborhood shopping
- Unsatisfactory school district
- Unsuitable climate

As you can see from this partial list, most of the reasons why people have a desire to sell their houses are based on *wants,* not *needs*. In the United States, we sometimes take for granted how economically fortunate we are.

You don't *need* to move because your neighborhood is too noisy or because your house seems too small. You don't *need* to move because the weather in your area isn't nice enough. You don't *need* to live on quieter, tree-lined streets.

All these features are things people *want,* not things they *need.* And people who think that they can afford to pay for such things usually get more of what they *want.* Sometimes, however, people spend money moving and, ironically, still don't get what they want. The weather in the new locale may not be terrific, the neighbors may not be friendly and quiet, and the schools may not turn children into stellar students. You may move to get away from particular problems and then find yourself facing a new set of different problems.

We're certainly not going to tell you how and where to spend your money — that's your choice. However, we definitely want you to make the most of your money. Unless you're one of the few who has far more money than you can ever possibly spend, we suggest that you prioritize the demands on your money to accomplish your most important financial goals.

Nothing's wrong with spending money to trade in one house for another, but *before* you set those wheels in motion, think about the impact of that kind of spending on other aspects of your life. The more that you spend on housing, the less you'll have for your other goals, such as saving for retirement, taking annual vacations, and spending less time working and more time with your family and friends.

Figuring Out if You Really Need to Sell

Although spending your entire life in the first home you buy is an unlikely prospect, some people do end up living in the same home for 10, 20, even 30 or more years. Ray (humble coauthor of this book), for example, lived in his home nearly 30 years. Ray's no fool; staying put must have its advantages.

If, like most prospective house sellers, you have a choice between staying put and selling, *not* selling has clear advantages. Selling your house and then buying another one takes a great deal of legwork and research time on your part. Whether you sell your house yourself or hire an agent, you're going to be heavily involved in getting your house ready for sale and keeping it pristine while it's on the market.

In addition to time, selling your house and buying another one can cost serious money. Between real estate commissions, loan fees, title insurance, transfer tax, and myriad other costs of selling your house and then buying another one, you can easily spend 15 percent or more of the value of the property that you're selling (see bar on the left in Figure 1-1).

Fifteen percent sounds like a lot, doesn't it? Well, consider this: Unless you own your house free and clear of any mortgage debt, your transaction costs are going to gobble up an even larger percentage of the money you've invested in your home.

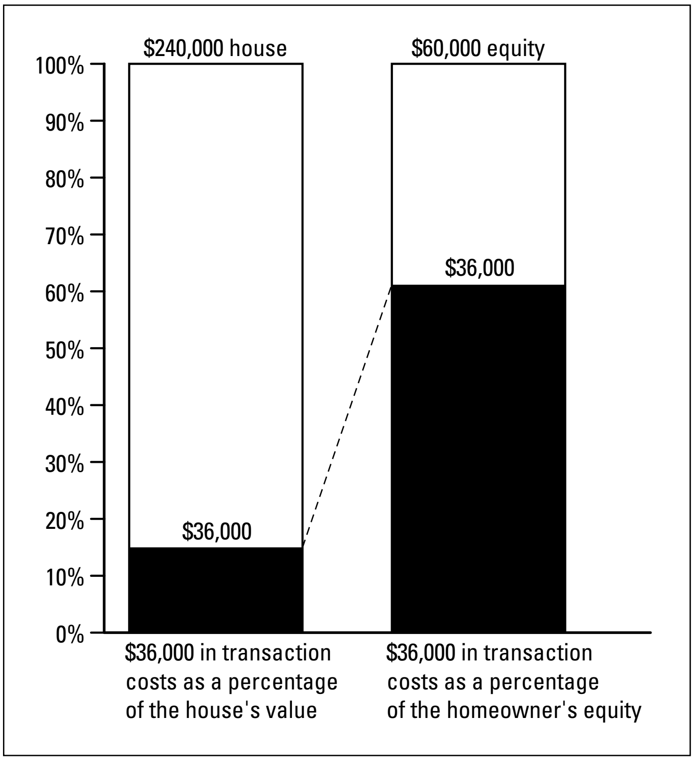

Figure 1-1: Trading homes can cost you big bucks.

Check out this scenario: You're thinking about selling your $240,000 house. If selling your house and buying another one costs you 15 percent of the first house's value, then you're taking $36,000 out of your sale proceeds. However, if you happen to owe $180,000 on your mortgage, your *equity* in the home — the difference between the amount the house is worth ($240,000) and the amount you owe ($180,000) — is $60,000. Therefore, the $36,000 in transaction costs devours a huge 60 percent of your equity (see bar on the right in Figure 1-1). Ouch!

Before spending that much of your hard-earned money, make sure that you give careful thought and consideration to why you want to sell, the financial consequences of selling, and the alternatives to selling. In Chapters 2 and 3, we walk you through the personal financial issues that you need to weigh when contemplating the sale of your current house. But before we get to the numbers, consider the qualitative issues.

Good reasons to stay

Whereas some people have clear and compelling reasons for selling their homes, others do so for the wrong reasons. You don't want to make the financially painful mistake of selling if you don't have to or can't afford to.

The following sections offer reasons why you may be better off staying right where you are.

You're already having trouble living within your means

If you're having difficulty making ends meet, and you use high-interest consumer credit, such as credit cards or auto loans, to maintain your desired standard of living, you shouldn't spend more money on housing. Even if you're planning to trade your current house for one of comparable value, you may not be able to afford all the transaction costs of selling and buying.

Even if you aren't a consumer-debt user and you're saving a comfortable portion (10 percent or more) of your current earnings, *don't* assume that you can afford to trade up to a more expensive home. In addition to a higher mortgage payment, you may also face increased property taxes, insurance rates, and home maintenance costs.

A mortgage lender may be willing to finance a loan that enables you to trade up to a more expensive home, but qualifying for a loan doesn't mean that you can *afford* that home. Mortgage lenders use simplistic formulas, based primarily on your income, to determine the amount they're willing to lend you. Mortgage lenders don't know (or care) how far behind you are in saving for your retirement or how many children you must help with college costs or how much assistance you want or need to give to elderly parents.

Mortgage lenders are concerned about protecting their interests in the event that you default on your mortgage. As long as you meet a few minimal financial requirements (you make a sufficient down payment, and your housing expenses are less than a certain percentage of your income), the mortgage lenders can sell your loan with the backing of a government mortgage agency, effectively wiping their hands clean of you and your problems.

If you're thinking about trading in your current house for another one, especially for a more expensive one, you absolutely, positively must consider the financial repercussions of changed housing expenses in addition to the costs of buying and selling. We cover these important issues in Chapters 2 and 3.

The problems are more in your perceptions

Everybody, at some point, leaps to conclusions based on faulty assumptions or incomplete research in virtually all aspects their lives. Peter, for example, was a single parent living with his son in a nice neighborhood in an urban environment. When his son started junior high school, Peter grew increasingly concerned with the possibility that his son would become involved with drugs, which seemed to be so prevalent in their city.

Despite working in the city, Peter decided to move to an easygoing, suburban community about 45 minutes outside the city. Shortly after the move, Peter's son got mixed up with drugs anyway — perhaps, in part, because the long daily commute meant that Peter was around even less.

In addition to ignoring lifestyle issues (such as the length of his commute), Peter made a common human mistake — he assumed that things were a particular way without getting the facts. The reality was that the suburban community to which Peter moved had as many problems with teenagers on drugs as the good neighborhoods in his former city.

Crime and safety make up another common realm where people have misconceptions. Some communities often make the evening news with graphic stories and film footage of crimes. Statistically, however, most crimes committed in a given city or town occur in fairly small geographic areas. Local police departments tabulate neighborhood crime rates. If you're concerned about crime and safety, don't guess; get the facts by calling your local police department and asking them how to obtain the data.

Schools are another hot-button issue. In some areas, people make blanket statements condemning all public schools. They also insist that if you live in such-and-such town or city, you must send your children to private school if you want them to get a good education. The reality, as education experts (and good old-fashioned common sense) suggest, is that you can find good and bad public schools and good and bad private schools. You also need to evaluate if you're spending too many hours working and commuting just so you can make expensive school payments. If that's the case, you may not be able to spend adequate time with your children. The best possible teacher for your children is you.

Selling won't solve the problem(s)

Avoiding problems is another human tendency. That's what Fred and Ethel tried to do. Much to their chagrin, Fred and Ethel discovered that their home had two not-so-visible but, unfortunately, costly-to-fix problems. The new roof they needed was going to cost big bucks, because local ordinances required the removal of several layers of existing roofing material when a new roof was installed. Fred and Ethel also had recently found out that their house contained asbestos, a known carcinogen.

Rather than research and deal with these problems, Fred and Ethel decided that the easiest solution was to sell their house and buy another one in a nearby town where they thought they'd be happy. They then attempted to sell their home without disclosing these known defects — a major legal no-no, as we point out in Chapter 8 — but were tripped up by smart buyers who found out about the problems from inspectors they hired to check out the property.

Actually, the prospective buyers did Fred and Ethel two big favors:

- By uncovering the problems early, the buyers saved Fred and Ethel from a costly lawsuit that could easily have resulted if the flaws were discovered after the house was sold.
- By ultimately deciding to hold onto their home, which they otherwise were content with, Fred and Ethel saved themselves thousands of dollars in selling and buying transaction costs. Those savings more than paid for the cost of a new roof. And Fred and Ethel discovered that, because the asbestos was in good condition and properly contained, it was best left alone.

You can fix some or all the problems

When they realized that they couldn't run from their home's problems, Fred and Ethel, discussed in the preceding section, discovered how to get those problems fixed. You can address quite a number of possible shortcomings in your home less expensively than buying a new home.

If you think that home improvement projects are going to be too expensive, do some rough calculations to determine the cost of selling your current house and then buying another. Remember, you can easily spend 15 percent of the house's value on all the transaction costs of selling and then buying again.

Instead of trading houses, why not spend those transaction dollars on improving the home you currently own? Do you hate the carpeting and paint job? Get new carpets and repaint. If your home is a tad too small, consider adding on a room or two. Just be careful not to turn your home into a castle if all the surrounding houses are shacks. Overimproving your property can be an expensive mistake. By overimproving, we mean that after the improvements to your house, you'll own the most expensive house on the block, and you'll have difficulty recouping the cost of the improvements in the form of a higher house sale price.

Some people are seduced by the seeming better attributes of other houses on the market. If your house is small, larger ones seem more appealing. If you don't like your carpeting, houses that have hardwood floors may attract you. However, as is true of long-term friends or spouses, you know your current home's defects all too well because you've probably lived with them for years. Unless you're incredibly observant, you surely didn't know half your home's faults and shortcomings before you moved in. The same is true of new homes you may be lusting after.

Some problems and defects are more easily fixed and more worth fixing than others. When you're deciding whether to fix problems or move away from them, consider these important issues:

- **What's the payback?** Some home remodeling projects may actually pay for or come close to paying for themselves. We're not suggesting that you can have the work done for free. However, certain remodeling projects do increase your home's value by enough to make up for most or even all the cost of the improvement(s).

  Generally speaking, projects that increase the cosmetic appeal or usability of living space tend to be more financially worthwhile than projects that don't. For example, consider painting and recarpeting a home versus fixing its foundation. The former projects are visible and, if done well, enhance a home's value; the latter project doesn't add to the visible appeal of the home or usability of living space. If, however, you *must* do foundation repairs or the house will collapse, spend your money on the foundation.

  If you decide to stay put and renovate or improve your current home, you're going to need to find a way to pay for all that work. In Chapter 4, we discuss the way to figure out the amount you can afford to spend improving and how to actually finance your improvements. If you head down the renovation path, don't forget that contracting work often ends up costing more than you (and your contractor) originally expected.

- **How intrusive will the work be?** As you surely know, money isn't everything. Six months into a home remodeling project that moves you out of your bedroom, spreads sawdust all over your kitchen table, and has you wanting to flee the country, the "payback" on the project doesn't seem so important anymore. In addition to costing more than most parties expect, contracting work almost always takes longer than everyone expects.

  Ask yourself and others who've endured similar projects: How much will this project disrupt my life? Your contract with the contractor should include financial penalties for not finishing on time.

Some problems or shortcomings of your current house simply can't be fixed. If you're tired of shoveling snow in the winter and dripping sweat in the summer, you're not going to be able to change your local weather. If crime is indeed a big problem, you yourself aren't going to be able to cut area crime anytime soon. Moving may be the best solution.

Reasons to consider selling

If you're in a situation where you really *need* to sell, as opposed to wanting to sell, by all means put your house on the market. And if you *want* to sell, and can *afford* to do so, you should go for it, as well. The following sections offer some solid reasons for selling.

You can afford to trade homes

Your desire to sell your current house and buy another one may be driven by a force as frivolous as sheer boredom. But if you can afford to sell and buy again, and you know what you're getting into, why not?

Now, defining *afford* is important. By *afford,* we mean that you've identified your personal and financial goals and you've calculated that the cost of trading houses won't compromise those goals.

Everyone has unique goals, but if you're like most people, you probably don't want to spend the rest of your life working full-time. To retire or semi-retire, you're going to need to save quite a bit of money during your working years. If you haven't yet crunched any numbers to see where you stand in terms of retirement saving, postpone major real estate decisions until you explore your financial future. In Chapter 2, we walk you through the important retirement planning considerations in selling your house, and in Chapter 3, we show you how to calculate the economics of selling and moving.

You need to move for your job

Some people find that at particular points in their lives they need to move to take advantage of a career opportunity. For example, if you want to be involved with technology companies, certain regions of the country offer far greater opportunities than others.

When you lack employment, paying bills is difficult, especially the costs involved in home ownership. If you've lost your job or your employer demands that you relocate to keep your job, you may feel a real need to move, especially in a sluggish economy.

Moving for a better job (or simply for *a* job) is a fine thing to do. However, some people fool themselves into believing that a higher-paying job or a move to an area with lower housing costs will put them on an easier financial street. As we discuss in Chapter 3, you must consider all the costs of living in a new area versus your current area before deciding that moving to a new community is financially wise.

And, although we don't pretend to be career counselors, we want you to consider that you may be overlooking opportunities right in your own backyard. Just because your employer offers you a better job to get you to relocate doesn't mean that you can't bargain for a promotion and stay put

Patience — not money — solves some problems

Some problems may solve themselves if you're patient and willing to wait things out. For example, Eric (humble coauthor of this book) once lived a block away from a busy California freeway. Although adequate fencing and safety barriers separated the speeding cars on the highway from the neighborhood, the noise was a bit of a nuisance, especially during peak commute hours.

The longer Eric, who was raised in a quiet nonurban environment, lived in the home, the more the noise bugged him. Within several years of having bought the home, however, the problem was solved. Expansion of the freeway forced the state to add sound walls, which greatly dampened the noise and enhanced home values in the area.

geographically. Likewise, during an economic slowdown, if your employer says you must relocate or face downsizing, explore other employment options in your area, especially if you want to stay put.

You're having (or will have) financial trouble

Sometimes, people fall on difficult financial times because of an unexpected event. Check out these two scenarios:

- After Ryan graduated from college, he landed a good marketing job and seemed financially secure. So he bought a home. After a few years in the home, Ryan discovered that he had a chronic medical problem.

  Ultimately, Ryan decided to go into a lower-stress job and work part time. As a result, his income significantly decreased while his medical expenses increased. He no longer could afford his home. It made sense for Ryan to sell his house and move into lower-cost housing that better addressed his reduced mobility.
- When Teri and her husband bought a home, they were both holding down high-paying jobs. Unfortunately, two years later, Teri discovered that her husband had an affair. After much marital counseling and many attempts to get their marriage on a better track, Teri and her husband divorced. Because neither of them alone could afford the costs of the house, Teri and her husband needed to sell.

In addition to unexpected events, some people simply live beyond their means and can't keep their heads above the financial water of large mortgage payments and associated housing costs. Sometimes, people get bogged down with additional consumer debt because they stretched themselves too much when buying their home.

Selling your house and moving to a lower-cost housing option may be just what the financial doctor ordered. On the other hand, if you can bring your spending under control and pay off those consumer debts, maybe you can afford to remain in your present home. Be sure that you're being honest with yourself and realistic about your ability to accomplish your goals given your continuing housing expenses (see Chapter 2 for more information).

You're retiring

If you decide to call it quits on the full-time working life, you may find yourself with more house than you need, or you may wish to move to a less costly area. Instead of trading up, you may consider trading down.

You can free up some of the cash you've tied up in your current house and use that money to help finance your retirement by moving to a less expensive home. If you're otherwise happy with where you're currently living, don't think that you must trade down to a less expensive home simply to tap the equity in your current property. As we discuss in Chapter 2, you can tap your home's equity through other methods, such as taking out a reverse mortgage.

Your house is associated with bad feelings

As with other financial decisions, choosing to sell or buy a home isn't only about money. Human emotions and memories can be just as powerful and just as real factors to consider.

If your spouse or child has passed away, you divorced, or your house was burglarized, the property may be a constant source of bad feelings. Although selling your house and moving won't make your troubles go away, being in a new home in a different area or neighborhood may help you get on with your life and not dwell excessively on your recent unpleasant experiences. Just be sure to temper your emotions with a realistic look at your financial situation.

Knowing the Health of Your Housing Market

Your personal financial situation clearly is an important factor in deciding whether and when to sell your house, but the state of your local housing market may also influence your decision. Check out the following sections for the lowdown on the housing market and how it affects your sale.

Selling in a depressed housing market

No one likes to lose money. If you scraped and saved for years for the down payment to buy a home, finding out that your house is worth less than the amount you paid for it can be quite a blow. Between the decline in the market value of your home and the selling costs, you may possibly even lose your entire invested down payment. And you thought the stock market was risky!

In the worst cases we've seen, some homeowners find themselves *upside down,* which simply means that the mortgage on the house exceeds the amount for which the house can be sold. In other words, upside-down homeowners literally have to pay money to sell their houses because they've lost more than their original down payment. Ouch!

When deciding whether to sell in a depressed market, consider the factors discussed in the following sections.

If you still have adequate equity

Although your local real estate market may have recently declined, if you've owned your house long enough or made a large enough down payment, you still may be able to net a good deal of cash by selling. If you can make enough money to enable yourself to buy another home, we say don't sweat the fact that your local real estate market may currently be depressed. As long as the sale fits in with your overall financial situation, sell your house and get on with your life!

REMEMBER

All real estate markets go through up cycles and down cycles. Over the long term, however, housing prices tend to increase. So, if you sell a house or two during a down market, odds are you'll also sell a house or two during better market conditions. And if you're staying in the same area or moving to another depressed housing market, you're simply trading one reduced-price house for another. If you're moving to a more expensive market or a market currently doing better than the one you're leaving, be sure that spending more on housing doesn't compromise your long-term personal and financial goals (see Chapter 2).

If you lack enough money to buy your next home

Sometimes, homeowners find themselves in a situation where, if they sell, they won't have enough money to buy their next home. If you find yourself in such a circumstance, first clarify whether you *want* or *need* to sell:

- If you *want* to sell but don't *need* to and can avoid selling for a while, we say wait it out. Otherwise, if you sell and then don't have adequate money to buy your next home, you may find yourself in the unfortunate position of being a renter when the local real estate market turns the corner and starts improving again. So you'll have sold low and later be forced to buy high. You'll need to have an even greater down payment to get back into the market, or you'll be forced to buy a more modest house.
- If you *need* to sell, you have a tougher road ahead of you. You must hope that the real estate market where you buy won't rocket ahead while you're trying to accumulate a larger down payment. However, you may also want to look into methods for buying a home with a smaller down payment. For example, a benevolent family member may help you out, the person selling you your new home may lend you some money, or you may decide to take out one of the low-down-payment loans that some mortgage lenders offer. If prices do rise at a fast rate, you can either set your sights on a different market or lower your expectations for the kind of home you're going to buy.

  If you must move or relocate and don't want to sell in a depressed market, you can rent out your home until the market turns around. Be sure that you understand the tax consequences of this arrangement, which we cover in detail in Chapter 2. Before becoming a landlord, consider your ability to deal with the hassles that come with the territory. You must also educate yourself on local rent-control ordinances and compare your property's monthly expenses with the rental income that you'll collect. (We explain how to calculate the difference between a property's income and expenses in the sidebar, "Figuring the cash flow on rental property.") If you're going to lose money each month, the constant cash drain may handicap your future ability to save, in addition to increasing your total losses on the property.

Selling during a strong market

What could be better than selling your house during a time of rising or already-elevated home prices? If you can afford the transaction costs of selling your current house and buying another home, and if the costs of the new home fit within your budget and financial goals, go for it.

Just be careful of two things:

- Don't get greedy and grossly overprice your house. You may end up getting less from the sale than you expected, and the sale is likely to take much longer than if you'd priced the property fairly. If you price your house too high, when you finally drop the price to the right range, you may face lower offers because your house has the stigma of being old on the market. In Chapter 11, we detail how to price your house for a quick sale that gets you top dollar.

- If you're staying in your current strong market or moving to another strong market, be careful about timing the sale of your current house and the purchase of your next one. For example, you probably don't want to sell and then spend months bidding unsuccessfully on other homes. You may get stuck renting for a while and need to make an additional move; such costs can eat up the cash from your recent sale and interfere with your ability to afford your next home. In Chapter 5, we explain how to time the sale of your house and the subsequent purchase of your new home.

INVESTIGATE

Figuring the cash flow on rental property

Cash flow is the difference between the amount of money that a property brings in and the amount you have to pay out for expenses. Some homeowners-turned-rental-property-owners can't cover all the costs associated with rental property. In the worst cases, such property owners end up in personal bankruptcy from the drain of negative cash flow (that is, expenses exceed income). In other cases, the negative cash flow hampers property owners' ability to accomplish important financial goals such as saving for retirement or helping with their children's college expenses.

Before you consider becoming a landlord, make some projections about what you expect your property's monthly income and expenses to be.

Income

On the income side, determine the amount of rent you're able to charge:

- Take a look at what comparable properties currently are renting for in your local market.
- Check out the classified ads in your local paper(s).
- Speak with some leasing agents at real estate rental companies.

Be sure to allow for some portion (around 5 percent per year) of the time for your property to be vacant — finding good tenants takes time.

Expenses

On the expense side, you have your monthly mortgage payment (of which we're sure that you're already painfully aware). And, of course, you have property taxes. Because you probably pay them only once or twice yearly, divide the annual amount by 12 to arrive at your monthly property tax bill.

You may end up paying some or all your renter's utility bills, such as garbage, water, or gas. Estimate from your own usage what the monthly tab will be. Expect most utility bills to increase a bit because tenants will probably waste more when you're picking up the bill.

Be sure to ask your insurance company about how your property insurance premium changes if you convert the property into a rental. As is true with your property taxes, divide the annual total by 12 to get a monthly amount.

Don't forget repairs and maintenance. Expect to spend about 1 percent of the property's value per year on maintenance, repairs, and cleaning. Again, divide by 12 to get a monthly figure.

Finding good tenants takes time and promotion. If you choose to list through them, rental brokers normally take one month's rent as their cut. If you advertise, estimate at least $100 to $200 in advertising expenses, not to mention the cost of your time in showing the property to prospective tenants. You must also plan on running credit checks on prospective tenants.

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Estimated cash flow

Now, total all the monthly expenses and subtract that number from your estimated monthly income after allowing for some vacancy time. Voilà! You've just calculated your property's cash flow.

If you have a negative cash flow, you may actually be close to breaking even when you factor in a rental property tax write-off known as depreciation. You break down the purchase of your property between the building, which is depreciable, and land, which isn't depreciable. You can make this allocation based on the assessed value for the land and the building or on a real estate appraisal. Residential property is depreciated over 27½ years at a rate of 3.64 percent of the building value per year. For example, if you buy a residential rental property for $250,000, and $175,000 of that amount is allocated to the building, that allocation means that you can take $6,370 per year as a depreciation tax deduction ($175,000 × .0364).

After you've crunched all these numbers, if you find that you're still interested in renting your property, be sure to read Chapter 2, especially the section dealing with the tax consequences of converting your home into a rental property.