Your Broker:

Rob Cassam

December 2021

REAL ESTATE Update™

CAROLINA REALTY ADVISORS

The right real estate advice makes ALL the difference!

Can You Use Home Equity to Buy Another Property?

When you have equity in your home, you can tap into that and, if you're strategic, use it as a way to build long-term wealth. One question people commonly have is whether or not they can use their home's equity to purchase another property.

In short, yes. You can use a home equity loan to buy a house, but that doesn't mean it's always the right decision in every situation. Using home equity can be a way to buy a second home or an investment property with caveats.

A home equity loan is a second mortgage, giving you a way to access the equity you've built in your home. Home equity refers to the difference between what you owe and what your home is worth.

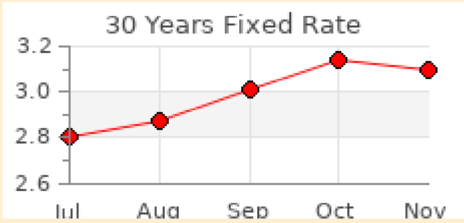
If you're thinking about using your home's equity to buy another house, there's a distinction you need to first make. Are you buying a second home or an investment?

If you're buying an investment property, using your home equity can be a good wealth-building strategy. If you're buying a second home, you have to consider that it's not going to bring in income like an investment. That means that you're going to be tying your home up in a loan and then taking on another loan, so you need to be in a solid financial position to make this work.

The big takeaway here is that, yes, using home equity to buy a second home is an option and sometimes a very good one. At the same time, there are risks and it's not always the right decision, so you need to go over the details in your specific situation carefully.

Mortgage Rates
U.S. averages as of December 2021:

30 yr. fixed: 3.1%
15 yr. fixed: 2.42%
5/1 yr. adj: 2.47%



Understanding Your Appraisal

Apraisals will compare the subject property with other similar type properties in the area. The sales prices of these 'comparable' homes are reviewed and then compared with the subject. Most loan programs ask for at least three such sales in the area within a six to twelve month period along with an active listing. One of the pieces of data the appraiser looks for is the 'Days on Market' number; how many days it took for a recent sale to close. A 60 day DOM indicates a decent real estate market while a 30 day DOM would indicate a very hot, sometimes overheated real estate market. Longer DOMs would suggest a relatively sluggish market.

Finally, the appraiser will then make certain adjustments to the comparable sales. One 'comp' might have an outdated kitchen compared to the subject property. Another property might have a pool in a neighborhood where pools are more prevalent whereas the subject does not. Lot size and the number of bedrooms are also adjustments. The age of the structure is also reviewed. All of this information is spelled out clearly in your appraisal. You just have to look for and understand it. All of these data bits are used to arrive at the number your lender uses when underwriting your loan file.

Deferred Maintenance: What You Need to Know

Deferred Maintenance is an observation the appraiser makes when performing an on-site property inspection and, if it's so noted on your appraisal report, it can stop your loan application dead in its tracks. What is it and why is it so important?

Technically it means there are things wrong with the house and in need of repair, but the owners have yet to fix them. These can include: cracked or broken windows, carpets that are severely stained, sidewalks with multiple cracks and sagging porch decks. The appraiser will note all these things on the report. The sellers can choose to adjust the sales price to reflect the needed repairs. While this can certainly be a strategy, a lender won't issue funds until those items are fixed.

Another option to address deferred maintenance issues is to establish an 'escrow holdback.' A holdback is an amount set aside that will go toward fixing the needed repairs during the approval process. An inspection is made of the problems and an estimate is made about how much those repairs will cost. In this fashion, the appraised value will be based upon those issues being repaired. It's an 'as repaired' notation made on the appraisal. Once the repairs are completed, an inspector will be sent back to the home to verify and the loan approval process will then proceed.

Minor repairs won't hold anything back other than perhaps some additional negotiations between the buyers and sellers, but if there are indeed bona fide deferred maintenance issues, know in advance there will be some bumps in the road to loan approval.

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How Lenders View Tip Income
By David Reed

When tips play a big part in someone's take-home pay, it can be used to help qualify for a mortgage. The kicker is that many don't report all of the tip income or simply lose track of the amount. Tips are issued to the recipient directly either in cash or added onto the credit slip. Either way, it must be accounted for.

It's the recipients' job to not only keep track of the daily amounts as well as report the income when filing income tax returns. And here is where things can sometimes get a little off track. Most such jobs pay a minimum wage and it's the tip income that really matters. But when it comes time to qualify for a home loan, that tip income must be accounted for. Accounting for tips means depositing the funds into a bank account on a regular basis. It also means keeping a personal, written record of tip income.

When someone gets paid from their employer, it's common for income to be paid out on the 1st and 15th. The bank account statements will then show these deposits from the employer using direct pay. But what the employer won't show is how much tip income was distributed. In fact, the employer might have a general idea but there isn't any way for the employer to get an exact number on the amount of tips. It's important to also deposit tips in a regular manner. Someone might deposit last week's tip income on a Monday, for example. Weekly, consistent deposits that are verified by bank statements and even deposit slips may be counted.

However, as we recently mentioned, all income must have a history and tip income is no different. Income in general must be documented to having been received for at least the last two years. This provides the lender with enough confidence the income will continue well into the future, typically for at least three years. Verifying a consistent, two year history helps lenders make this determination. Tip income must also be shown being received for at least two years. The income reported to the IRS is the amount of tip income lenders will use when qualifying. That's the final verification lenders need in order to use tip income when qualifying for a mortgage and probably the most important. If this income doesn't show up on your tax returns, that's going to be a problem. Even if you keep solid personal records.

If you're planning on buying a home in the future and your tips play an important part, make sure we speak together about how to document this important piece of your financial profile before you get too much further. In essence, it's just like any other income as it relates to how it can be verified. Your W2s from the last two years will be needed but they will only report your hourly wages from the employer. It's up to you to take the next step and report this income on your federal tax returns each year. If you've done all these things in advance, you can certainly use tip income to help qualify. It's a bit more paperwork to document these transactions but in reality it's not really that big of a deal. But it must be done.

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Despite Home Price Surge, Cooling May Be On the Horizon

By Ashley Sutphin

The median home price in the United States just surpassed $400,000 for the first time at the end of October, according to the St. Louis Federal Reserve. The median home price in the third quarter of this year went up to $404,700. That represented a 13% jump from the third quarter of 2020. At that time, the median sales price was $358,700.

Factors contributing to the eye-popping number include a lack of inventory and high demand. Goldman Sachs recently released an analysis indicating they see home prices rising another 16% by the end of next year. Economist Jan Hatzius said the housing shortage might last the longest compared to all other pandemic-related shortages. Hatzius said currently Goldman doesn't see a crash being very likely.

Housing Shortages

Throughout the pandemic, there have been low mortgage rates. Other factors are part of the mix, like people moving from urban areas to suburbs and younger people buying their first homes. The latest forecast from Fannie Mae indicates an expected rise of 7.9% in home prices between Q4 2021 and Q4 2022.

Morgan Stanley released a recent note saying they believe the U.S. needs as many as 1.5 million more homes to regain a sense of normalcy. The availability of real estate is three years behind based on their analysis.

Strategists at Morgan Stanley wrote the housing shortage is meaningfully contributing to the record real estate appreciation currently being seen. While it's unlikely based on current trends there will be an excess supply any time soon, the contraction pace of the supply does appear to be slowing.

Could the Housing Market Be Headed Toward a Cooldown?

While prices are likely going to keep going up, with inventory remaining behind, some signals that a slowdown at least in monthly price growth could be on the horizon. Many housing experts say they expect price growth to start to slow somewhat through the end of 2021. 2022 might see more significant pricing slowdowns. While housing inflation seems to be stalling a bit or plateauing, it remains five times higher than before the pandemic.

Supply Chain Bottlenecks

The limited supply of homes is complex, and another issue in the industry is the supply chain bottlenecks affecting builders. They're having a hard time keeping up with the items they need, which is also paired with a labor shortage.

Increasing Mortgage Rates

The average mortgage rate for a 30-year fixed-rate loan did go up ten basis points in August to 2.87%. There aren't signs that the trend is going to slow or reverse any time soon, and that does hamper buyers' ability to raise their offers in bidding wars.

Seeing what's going on in the market, many homeowners are holding onto their properties rather than selling, with the worry they wouldn't be able to buy something new. That's putting a further squeeze on inventory.

So, what does all this mean? Home prices are likely to remain elevated for the foreseeable future, and inventory will stay limited as well. However, there might be at least some slowdown in how quickly home prices are accelerating.

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How Does Inflation Affect Home Prices and Real Estate?
By Ashley Sutphin

If you've followed the news lately, you've probably seen quite a bit about inflation. In September, there was another surge in consumer prices, which matched a 13-year high. The price increase was the largest since 2008, up 5.4% from a year ago. Some of the categories seeing the most significant increases included new cars, gas, food and restaurants meals. Core inflation was up 0.2% in September and there was a 4% increase from last year.

COVID-19 has contributed to some of the issues because for example, the pandemic continues to close factories in Asia and slow operations at U.S. ports. There are significant bottlenecks in the supply chain and high demand, meaning inflation will stay up for a while. So, how does all of this affect the real estate market?

The Inventory Issue

Interest rates have been kept low for so long it's created a bubble for everything and not just the housing market. There's also inflationary pressure on the housing market because of limited inventory. Limited inventory stems from a myriad of problems in the industry.

First, many homeowners aren't putting their houses on the market. This is due to factors like lockdowns, but also the fear they won't be able to find a new one to buy.

There are construction delays due to supply chain bottlenecks as well.

Buyers are often having to put in bids well above ask to get properties, creating a frustrating situation, to say the least.

Other Inflationary Effects On Real Estate

Along with the situations above, there are some other ways inflation can influence how much you pay for a home. First, inflation is a reference to a rise in the price of everyday goods. Those everyday goods are used to build homes. If the price of things like lumber and appliances go up, then the builder will pass those additional costs onto the buyer in the form of higher prices.

In some cases, however, inflation can have oppositional effects on real estate. If inflation rises, then theoretically, money should become more expensive to borrow. People borrow less of it, so there are fewer home purchases and that can lead to lower economic growth. Right now, that's not happening however, because as mentioned, interest rates remain low.

When the Central Bank increases the money supply into the economy, which is a primary driver of inflation, home prices tend to automatically go up as a result.

Real Estate Can Protect You Against Inflation

While real estate can be negatively affected by inflation in the form of higher prices, it can also protect you from its effects. As home prices go up over time, you're lowering the loan-to-value of your debt. You're simultaneously increasing your equity, but your fixed-rate mortgage payments will stay the same.

If you're a real estate investor earning income from rental properties, then you're likely going to be able to charge higher rent when inflation is up. You can adjust the rent while the mortgage stays the same.

Finally, in general, home prices do also tend to go up steadily over time. The homes that hit bottom prices during the real estate bubble burst of 2008 were back up to pre-crash prices in less than ten years in most cases.

The relationship between housing and inflation can go in both directions. If you're a buyer right now, inflation isn't good news, but if you own a home, it can be one of the best ways to protect yourself against rising prices.

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Buying a Home as an Unmarried Couple: What to Know
By Ashley Sutphin

It's increasingly common for people to live together but not be married. For example, in the past 20 years, the number of unmarried couples living together has almost tripled. You might be planning to wait to get married, or maybe you're not going to at all, but what if you want to buy a home together?

It's possible to buy a home as an unmarried couple, but it can be a little more complex than it is for a married couple. The following are some considerations to proactively think about before you start the process.

Who's Going To Apply for the Mortgage?

When you aren't married, but you want to buy a home together, one of the first things you'll have to think about is who's applying for the mortgage. The person in the relationship who has the strongest financial history is the one who needs to do it in almost all cases.

When you aren't married, you have to apply as individuals typically.

Go over financial factors like credit scores, incomes, debt-to-income ratios, employment status, and assets to figure out who has the stronger financial standing. Not only will that person have a better likelihood of approval, but they'll also qualify for better terms like lower interest rates.

Some lenders may let you apply for a mortgage together, although it's not extremely common. If you apply together, it can help or hurt you. The benefit is that you may qualify for a larger mortgage since you have a combination of two incomes. The downside might be if your partner has a lower credit score, and the lender could base their decision on that.

How Will You Hold the Title?

The title of a home is proof of ownership. There are a few options here:

• Joint tenancy is one option in which both you and your partner will have equal shares of your property. This will include the right of survivorship, meaning that if one of you passes away, the survivor will receive the deceased's half of the property.

• Another way to deal with the title is called tenants in common. Under this arrangement, you're co-owners with equal rights to the property. It's different from joint tenancy because you hold titles individually for your share of the property. You can dispose of your individual ownership. There isn't a right of survivorship and the other partner doesn't receive the decedent's property share if they pass away. Instead, the property would go to the heirs of the person who passed away.

• A living trust of real property is a way to set up the arrangement also. The trustee holds the title for the beneficiary who has all of the management responsibilities and rights.

What About a Cohabitation Property Agreement?

Whether you're married or not, when you buy a property together, you're going to accumulate equity. However, you're not going to have the same level of property protection as a married couple, meaning you might want to go further to protect yourself. One way to do this is to have an attorney create what's called a cohabitation property agreement, outlining who owns what. This is something you'll fall back on if you separate.

A cohabitation agreement should outline how you'll share expenses related to the home you buy, buyout terms, an exit strategy if one of you wants to sell, and a process for how you'll resolve any disputes. Your cohabitation agreement will also include the type of ownership on the title and deed.

Other Considerations

There are a few other things to think about in addition to what's above. First, if your name is on a mortgage and your partner stops contributing to payments for any reason, you're both equally liable. If you can't make the payments without their financial contribution, you may be faced with foreclosure. If you get a joint loan, your name will stay on the mortgage unless you refinance.

Finally, only one of you is eligible for the mortgage interest tax deduction since unmarried couples file taxes separately. The best thing to do before buying a house as an unmarried couple is sit down and carefully go through your finances, and make sure you're on the same page before you proceed with anything.

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