Fidelity Viewpoints®: Your Home—Make the Right Money Moves

TRANSCRIPT

SPEAKERS:

Jim Armstrong   Meredith Stoddard

SEGMENT 1: Rent or Buy

Jim Armstrong: Hello and thank you for joining us. I'm Jim Armstrong with Fidelity.

The place you call home comes with a lot of financial questions associated with it, and it's not always clear that you're making the best financial decisions. So that's what this webcast is all about.

To help us have this conversation, we are joined by Meredith Stoddard. Meredith is a vice president here at Fidelity, and she leads up the team that tries to help our customers as they navigate what we call life events: big things like the decisions around homeownership. She is also a former real estate agent as well, so she's got some excellent firsthand experience there, too. Meredith, thanks so much for joining us today.

Meredith Stoddard: Thanks for having me on, Jim.

JIM: Yeah, of course. Let's start, if we could, with the idea of homeownership in general, right? I mean, I think for generations, the idea of owning your own place was sort of the cornerstone of someone's financial plan; but in recent years, a lot of people have been thinking more about whether or not it makes financial sense to rent long term rather than maybe ever buy a place. But the thing is, that's not an apples-to-apples comparison, right?

MEREDITH: Yeah. There is no one-size-fits-all here, Jim. There's a couple of key considerations around the complete cost of homeownership.

So, on one level there is the one-time cost, so, that up-front expense. Two, is there is the taxes. And then three, there is the ongoing monthly costs, insurance, fees, bills.

And there is a potential offset to consider: it's that equity that you may build in the home.

On the up-front category, you want to consider brokers fees, inspection costs, appraisal fees, title insurance, and mortgage origination fees.

In the tax category, property taxes can vary greatly by city and town, and even after a mortgage is paid off, you'll continue to pay those real estate taxes on the property. If you're in a higher income bracket, the tax deduction can be valuable; though, keep in mind that in 2018, the tax law changes capped that at $10,000.

On the monthly cash flow, you want to think about the mortgage and taxes as well as maintenance, utility, and repair costs that are important to prepare for. Repair costs do vary based on the age of the home and other factors, but in general, it's a good idea to put aside about 1% of your purchase price annually to build up a cushion.

And on the equity front, it's not necessarily all downside, as part of those monthly costs are going towards paying down your principal and building equity in the home, which can add up over the years—sometimes to a significant amount.

JIM: So it feels like, intuitively, renting probably makes more sense if you know you're only going to be in a place for a year or less. Is that fair?

MEREDITH: Yeah. In general, the longer you remain in the home, the long—more time you have to spread out those one-time costs, and the more buying may make sense. If you sell within a few years, the value of your house may not have appreciated enough to offset the fees of buying and selling. Nor will you pay down much of the principal on your mortgage. If you know you're going to be in a home for five years or more, then the scales really start to tip big-time in favor of buying because you can withstand any market fluctuations and build up equity.

JIM: Having those long-term—or that long-term—lens, I think, really does help a lot. What else would you say is a good financial consideration to have in mind?

MEREDITH: Yeah. So the finances are really the crux of your decision here. It's got to be grounded in that math. You do want to factor in some of the costs we discussed as well as the potential for resale value and ways you might enhance the value of your property. So, for example, renovations: putting on an addition can also further maximize your investment.

Location is key here. You can change wallpaper or appliances, but the location is set for the duration of your homeownership.

Consider things like if you want more walkability, for example. Or arts, culture, diversity, job opportunities in the area, and education also come into play.

JIM: Yeah, for sure. And I've also got to imagine—if you do the math, right?—you come up with renting costs X and buying costs Y. Maybe you go with the cheaper option, but you've got to be realistic about what you're going to do with that extra money, right?

MEREDITH: That's exactly right, Jim. At the end of the day, you've got to be self-aware enough to know if you're going to save let's say $300 a month between renting versus buying—what are you doing with that money? So if you're putting it into an investment account, putting it towards your retirement savings and getting a company match, that can actually be quite material over time. But if you're going to spend it on dinners out and it's money that's going to slip through your fingers, then that savings doesn't actually help you as much as you want it to and you've got to also factor in that longer term. So 20, 30 years from now, you'll still be renting, as opposed to having a paid-off home or condo.

JIM: Okay. So let's say I do make the decision to buy. You have to figure out how much house you can afford. I remember doing this with my wife before our first purchase. The bank came up with a very different number than she and I came up with.

MEREDITH: Yeah. So the banks' numbers are incredibly informative to your decision, but they are not the whole decision.

So using a factor of your household income, you can quickly gauge how much house you can afford. So the total house value, generally speaking, should be a maximum of three to five times your total household income, and that depends a lot on how much debt you currently have. So, for example, if more than 20% of your monthly income goes towards existing debt—such as student loans, car payments, or other recurring debts—a house that is 3X your total household income may make more sense. If you're completely debt-free, you may be able to consider houses that are up to that five times number.

Keep in mind that the banks look at the affordability against debt and they don't generally factor in things like childcare, savings, your retirement plan contributions. You don't have to borrow the full amount and you do want to make sure that you land on something that you're going to feel comfortable with.

JIM: Yeah, right. Absolutely. If we had bought a house worth what the bank told us we could afford, it would have been some lean months in there for quite a while, so that's good to keep in mind.

Talk to us, too, about down payments, as well. That's—there's a lot of questions around how to get a reasonable down payment.

MEREDITH: Yeah, I mean, the gold standard continues to be that 20% number. So it can be ideal in the sense that if you hit that 20% target, your actual monthly cost over the entire life of the loan will be lower.

But it's not realistic for some people to get to that number, and you don't want to spend your lifetime trying to get to a target that's just not attainable for you. There are options to buy with less than 20% down payment; however, keep in mind that you'll usually have to pay private mortgage insurance, otherwise known as PMI, which is an insurance paid by the buyer to protect the mortgage company until they have at least 20% equity.

There are also first-time homebuyer programs to consider, including some federal, state, veterans' programs, bank programs, and even local programs. We do have some tools, calculators, and a homebuying life events experience on our website that can help you with some of these savings goals and more.

It also is really helpful to automate your savings to make it easier to meet those goals.

JIM: Yeah. Tons of great resources there for sure, Meredith. And you just shared a lot as well, so can you recap sort of the highlights of what we just covered?

MEREDITH: Yeah, it can be a lot. So here are the things to remember: factor in the complete cost of homeownership, consider how long you're planning to stay in that location, calculate the affordability of a home using the 3 to 5X guideline, save up as much down payment as possible, and remember to factor in quality of life.

JIM: Tons to consider before you make the decision, Meredith. So thank you for helping us wrap our heads around where to get started. Really appreciate it.

MEREDITH: Thank you, Jim.

SEGMENT 2: Refinance or Tap into Equity

JIM: For a lot of people, housing is their biggest monthly expense. So when interest rates drop, a lot of homeowners start to consider refinancing, maybe as a way to lower their monthly payments, shorten the term of their loan, or perhaps both.

Other folks consider tapping into the equity in their homes, maybe to do some renovations. We certainly saw a lot of people doing that in 2020 during the pandemic when we were all stuck at home. We wanted to make those homes as perfect as possible.

Meredith, can you get us started just wrapping our heads around the idea of refinancing for maybe someone who's never done it before?

MEREDITH: Yeah. The good news is it's somewhat similar to the process that you went through when you bought the house in the first place. So it's going to be a good idea to check your credit score in advance and make sure that there's no surprises, and your mortgage company will ask for a lot of paperwork, just as they did before—so about two years of tax returns, usually, two months of paychecks, two months of bank statements, etc.

Do expect your credit to be pulled. It's what called a hard pull, which means that it will have a small impact on your credit score. Just don't be alarmed about it; it will come off your credit score within a couple of years and it's a slightly negative impact.

JIM: And I'll fess up here—I try to be a little less obsessive about interest rates, but I do always wonder if now is the time for me to refinance again. So what sort of rules or guidelines should I maybe be following instead?

MEREDITH: Yeah. Fear of missing out is real. Refinancing your mortgage can make sense to consider every time that interest rates are lower than when you first bought, but first, you want to look at your priorities. Is freeing up your cash flow now or shortening the term of your mortgage more important? Then run the numbers. What are the closing costs? What does the total interest cost add up to be? How much principal and interest will you be paying with each payment? While it's not a hard-and-fast rule, generally speaking, if you're getting more than a 1% difference in mortgage rates, it may make sense to refinance. And when we talk about closing costs, those include things like the cost of an appraisal, application fees, points, and origination fees, and attorney fees. I've seen the cost as low as 1%, but on average they can add up to between 3 and 6% of your outstanding principal, according to the Federal Reserve Board.

For example, if someone refinanced at a lower rate and saved $250 a month, but the refinancing costs were $5,000, it would take about 20 months to make back that closing cost. If you plan on staying in your home for a long time, this may be a case where it makes sense. There are a lot of online calculators that can help you with the math on this piece.

JIM: And I'm glad you brought up the math, Meredith, because there is such a thing as refinancing too much, right?

MEREDITH: Yeah. Individuals who constantly refinance and chase those lower rates may be extending the loan term and end up paying a lot more in interest over time. Every time you refinance, that clock resets at the beginning of the loan period when interest costs are much higher than the principal costs each month. So if you're 10 years into a 30-year loan, refinancing to another 30-year loan with a lower interest rate means that you're back to square one as far as that interest versus principal ratio, and you have 30 years of monthly payments ahead of you.

Your monthly payment may be lowered due to the lower interest rate and longer loan term, but your overall cost could go up as the net effect would be that you're adding 10 years to your loan.

It just depends on how big the difference in interest rates is, what you do or not with the monthly savings, and how long you plan to stay in your home, as well as your other financial priorities.

JIM: I know also that especially when interest rates are low, people think about if they're lucky enough to have equity in their homes, pulling out some of that equity when they refinance, taking cash out or maybe tapping into that with a home equity line of credit. What can you tell us about either of those options?

MEREDITH: Yeah, I'll start with the home equity line of credit, otherwise known as a HELOC. That's a secured line of credit you take against the principal in your home. They are often lower cost than some other forms of borrowing, such as credit cards, but like a credit card, you have a line of credit that you don't have to take out the full amount all at once, and you can use it as you need it. Similarly, your payments will vary based on how much of the credit line you're using at any given point. And just be aware that you're putting the house on the line. So if you get really behind on payments and aren't able to pay it back for some reason, the bank can take your home as collateral for that loan.

JIM: Yeah. Not a decision to make lightly, for sure. What other considerations would you suggest?

MEREDITH: Yeah, think through, "Why do you need the loan?" and "What are you going to use the money for?" For example, if using it for short-term consumables and continue to take money out of it versus adding to your home—the value of it with renovations—or paying off high interest debt once and for all, just be honest with yourself about your inclination to be disciplined about paying it back versus having an outstanding line of credit that you continue to tap into. For people who itemize their tax deductions, your home equity line of credit may be tax deductible if you stay below specified caps and use the money for home improvements. The tax laws on this were recently updated in 2018 and are slated to change again in 2026.

JIM: Yeah. We opened up a HELOC for this house to redo the kitchen a couple of years ago. I personally was just in a rush to get it paid off as quickly as possible. Not everybody is in that boat; I get that. What other options are there for someone other than HELOC?

MEREDITH: Yeah, some other options you could consider are a home improvement loan, which is a secured personal loan where you get the full amount up front and pay it back over a fixed period of time. There's also personal loans, which are unsecured loans against your income. And lastly, a cash-out refinance can be a way to combine that refinancing of your home with getting cash rolled into your regular monthly mortgage payments to fund renovations and other priorities.

Keep in mind that with all of these except for the personal loan, you're reducing the equity you have in your home, adding to your monthly costs, and the bank does have a right to take your home if you don't pay it back. However, they can be cost-effective ways to get needed money and take care of important priorities.

JIM: Yeah. Tons to consider, but definitely nice to know that you have options, right? Can you just recap what we—what you just covered?

MEREDITH: Yeah. So some things to consider include, "Run the numbers." Refinancing can make sense when rates are low, but make sure that that's truly the case for you. Assess your priorities and needs. Weigh the importance of cash flow in the short term versus the length of the loan and the long-term goals you have. Remember that closing costs can add up, but so can the long-term savings.

JIM: All right. Again, lots to consider, Meredith. So thank you, again, for taking the time to walk us through all this.

MEREDITH: Thank you, Jim.

SEGMENT 3: Downsize, Relocate, or Age in Place

JIM: When people think about what they've got saved up for retirement, they often forget to include what can be one of their biggest assets: their home. Home equity actually counts for about 70% of net worth, according to the U.S. Census Bureau, so Meredith, I want to throw a situation at you that I hope is familiar to a lot of our viewers. Let's say you've lived in your house for a decent amount of time and you've paid off some or maybe all of the mortgage. Maybe you own the house outright. If you're headed into retirement, what should you be thinking about?

MEREDITH: Yeah. Crossroads like these can put possibilities on the table that just weren't there before. It's a great time to ask yourself things like: what kind of life do you want? How much do you have in other assets? Will you need the equity in your home for income? The three most popular options on this stage are: Do you keep living in the same house? Do you sell it and downsize? Or sell it and move to a lower-cost location?

JIM: And I would actually really like to dive deeply into each of those three, but before we do, we get a ton of questions about reverse mortgages here, and I know it's a really, really complex topic. But can you sort of give us a high-level overview of what a reverse mortgage is all about?

MEREDITH: Yeah. Briefly, they can be a lifeline for some, particularly if you don't have substantial savings or income. You do need to think carefully before you go into it. They can be high-cost and have a lot of fees, and you are giving up your ownership of your home in exchange for turning your home equity into income. If you want to leave your home to loved ones, you won't be able to do that unless they buy it back from the bank after you're gone. However, if you don't have another form of retirement income, it can be a critical lifeline to generate income in retirement.

JIM: Got it. So lots to consider there, of course, but thank you for setting the table a bit. Back to your list, option number one: staying in place. Staying where you are. The house you know, the house hopefully you love. What are some considerations if you don't want to move?

MEREDITH: Yeah. This is a good opportunity to balance the math and the heart. So first, you want to do a little bit of a self-assessment around the numbers. What are your current and future needs, as well as your motivations, your wishes, and your fears? Look at your cash flow and consider maintenance costs—present and future, tax rates, monthly bills, and whether you have sufficient income to cover them over the long term. And will this property work for you over the long term? For example, as you age and could face mobility issues, do you have a good support network? Does it make sense to do some renovations now? Planning ahead can be really valuable so you don't have to make big decisions in a crisis.

Just be honest with yourself around whether you're making this decision out of fear or whether you're going towards something.

For example, some people really want to be there as long as they can, but others can feel like they're held back by stuff. Think through what—whether you're there out of inertia or whether this is truly where you want to be over the long term.

Balancing heart and head is wise here, and having honest conversations with family and working with the financial professional to consider the numbers can help you find the answer that's right for you.

JIM: Yeah, definitely the idea of being anchored with your stuff is a big consideration, and it plays into the second option you mentioned there: selling and downsizing. So maybe you like your state, you like your city or town, you just want to be in a smaller place.

MEREDITH: Yeah. You may want to stay in the area because it's close to family or friends. You could be involved in the local community, but you're in a big house with rooms that you just don't use. Or an expensive neighborhood with schools you don't need. In this case, downsizing could make some sense.

For those who have decades of accumulations is where that stuff can come back and haunt you and it can really feel daunting, but it can be freeing to work through it and let go of some of it. And in a lot of cases, your adult children will thank you. Take it one room at a time and enlist family members to help.

Just remember: Home is where you are. While it can be hard to let go of a home that has worked for you for years or even decades, many people do feel a sense of relief after they've made that leap. If you don't have enough saved for retirement, downsizing can help you free up some cash flow. Just keep in mind that when you downsize, sometimes the costs end up being somewhat neutral because you are buying a more updated place that might have about the same cost. Either one can be fine, just be introspective and run the numbers and think through what you really want.

JIM: Got it. I want to talk about option three right now: relocation. My mom really surprised the whole family a few years ago when she sold the big place up north and moved to Florida like millions of people before her. What about relocation as an option for folks?

MEREDITH: She is definitely not alone on that one. Where you live in retirement can have a dramatic impact on your lifestyle and your ability to leave a legacy. Consider the social connections and quality of life, including that weather, walkability, cost of living, cultural elements—costs do vary significantly across the U.S., so moving from a higher-cost region to a lower-cost one could supercharge your retirement plan, which sometimes can be a great bonus. Change can be hard, but focusing on what you do want versus what you don't want can help you feel really good about what you ultimately decide. It really is a personal decision. Just run the math and align your decision with both the tangibles and intangibles.

JIM: I'm glad you mentioned cost, Meredith, because weather certainly had part of—made part of my mom's decision easier. But it's so much less expensive to run her life in Florida than it is up north. Property taxes alone are shockingly lower.

MEREDITH: Yeah. Taxes can have a really big impact on your financial picture over the long term. Real estate taxes actually vary quite widely by city and town within—even within a state. It's good to look up the numbers for actual cities and towns that you're considering and write them down. For example, on a $1 million home, the average nationally is $10,000, but I've seen it as low as $2,800 a year versus $26,000 a year. You also want to factor in other taxes like capital gains, estate planning, sales tax, income tax rates in the locations you're considering. Some of these may be more of a factor than when you were working and others might be less.

JIM: I want to also ask...kind of a difficult conversation to start with family members. It's the idea of what happens to your house—your property—after you die. We mentioned a lot of equity can be built up in your home, and we know a lot of folks struggle with how to even begin to have the conversation to decide what to do with that when they're gone.

MEREDITH: Yeah. For many families, deciding what to do with the home can be one of the more complex parts of your estate plan. If you want to leave your family home to loved ones, make sure you document your wishes and be very clear about them. In some families, money can be equated with love and these decisions can create unintended issues and conflicts. Get input from everyone and make your own decision. It can make planning easier to have the family conversation in advance, explain your why, and get some feedback. Our website has a life events section for more information on buying a house and aging considerations as well as conversation guides to help you broach these subjects with family. Talk early and often. Conversations about aging can be difficult. Your heirs could end up incurring costs that they may not want or it could be something that they're really attached to. This is why the conversation's so important.

JIM: I know you've got a great story, if you don't mind sharing it, about your mom in this exact situation.

MEREDITH: Yeah. She was really stressing about their estate plan and what do they do with the house. I think she had some visions of perhaps my brother and I arguing about him being a little messier and me being a little cleaner or maybe working out a schedule to share the house; things like that. But the funny part was once we had that conversation, said, "I don't want the house," and I said, "That's another thing for me to manage and another expense. I'd rather you sell it and use the money for yourself." So, you know, that conversation could have saved her 10 years' worth of stressing about this.

At the end of the day, whatever you decide, just make sure you contact an estate planning attorney and put your wishes in writing.

JIM: Yeah. Great, great suggestion. In fact, can you recap all the other stuff that you just covered for us, please?

MEREDITH: Yeah, things to consider. Understand how housing expenses and cash flow factor into your retirement plans. Acknowledge the nonfinancial considerations that are impacting your decisions. Have a family conversation before finalizing any of those decisions, and make your own choices. Document your wishes and make sure your family knows where those documents are. And work with a financial professional to help you find that answer that's right for you.

JIM: Really, really strong advice there, Meredith. So thank you again for taking the time to be with us today.

MEREDITH: Thank you, Jim, for having me.

JIM: Yeah, of course. For our viewers, thank you for making time to be with us today as well. If you've got any questions about the topics that we covered today, feel free to check out Fidelity's website. You can look under homebuying or look under life events; you can also call us and speak with someone; or you could download the Fidelity app on a mobile device and do some research there as well. Those are all great ways to continue the learning process before you make these really important financial decisions.

I want to thank Meredith Stoddard again for making time and being with us here today. And, again, thank you for watching. Have a great day.

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