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Should you own or rent? Some advantages most people don’t consider

Before the financial crash, the conventional wisdom was that it was almost always better to own a home rather than rent. It seemed like home prices always went up, so there was no reason to pay a landlord if you could pay a mortgage lender instead and build up equity every month.

Since the crash, however, home price gains are more uncertain, and many people are crunching the numbers and concluding that they’re better off renting.

But are they really?

Everyone’s situation is different, of course, but when many people do the math, they don’t consider the many legal and tax advantages of home ownership. In some cases, these advantages could be enough to tip the scale.

One obvious example is the home mortgage interest deduction. In general, home mortgage interest is deductible on your federal income tax return on loan amounts up to $1 million. This alone could save you thousands of dollars a year in taxes, and make home ownership much more attractive.

Most people are aware that they can deduct mortgage interest, but here are some other advantages of ownership that people often don’t think about:

- You can generally deduct the property taxes you pay on your federal taxes as well.
- Owning a home typically increases your credit score, which can save you a lot of money whenever you apply for credit. (You may have noticed that one of the most common questions on credit applications is, “Do you own or rent your home?”)
- You can borrow against the value of the home with a home equity loan, usually at very advantageous rates. And you can generally deduct the interest you pay on

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Should you own or rent? Some things to consider

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such a loan on your federal taxes.

- When you sell your home, you get to keep the amount of any appreciation without having to pay capital gains tax – up to $250,000 for singles and $500,000 for married couples. If you rent instead and invest the amount you save, you'll probably have to pay tax on your gains. (And don't forget that capital gains taxes are slated to increase dramatically starting in 2013.)

- If you have a fixed-rate mortgage, you'll always know how much you owe, and you'll never have to worry about surprise rent increases.
- A fixed-rate mortgage is also a great hedge against inflation, because as inflation rises, the "real" amount you owe each month diminishes.
- If you work from home, you might be able to take a deduction on your taxes for the expenses of maintaining a home office. (You can do this even if you rent, but you can typically deduct more types of expenses if you own your home, such as insurance, repairs and depreciation.)
- Moving expenses may be deductible if you move for work, or if you're self-employed. (Renters can deduct moving expenses, too, but they can't deduct the amount they forfeit if they have to break a lease.)
- In many states, if you run into financial trouble, there are "homestead" laws that allow you to keep all or part of the value of your home away from creditors.
- If you own a home with a spouse as tenants by the entireties, then even if one of you incurs a large debt or gets hit with a lawsuit, you can't be forced to sell the home.
- If you have medical problems, you may be able to make improvements to your home to accommodate your condition and then deduct them on your taxes as a medical expense.
- If you own a home and want to give it to your children, you may be able to save a lot of estate taxes by putting the home into something called a "qualified personal residence trust."

Of course, there are other intangible advantages to home ownership, such as the fact that you'll never have to worry about having to move if your lease isn't renewed, and you'll never have to get a landlord's approval if you want to repaint or redecorate.

But the financial and tax advantages are very significant, too – often much more so than most people realize.

New federal rules will make 'short sales' much easier

New federal rules will make it easier and quicker for homeowners to qualify for a "short sale" of their property.

A "short sale" occurs when a home is worth less than the amount owed on the mortgage. The lender agrees to accept less than the full amount of the loan, and the owner is able to escape the mortgage debt and avoid foreclosure.

In the past, short sales have often bogged down in delays and cumbersome regulations.

The new rules apply to mortgages held by Fannie Mae and Freddie Mac. Together, the two companies own mortgages on about 4.6 million homes that are "underwater" (worth less than the outstanding mortgage debt). Of those homes, about 80% of the owners are current on their payments.

Under the new rules:

► For borrowers who are behind on their payments and in serious financial trouble, the required documentation has been drastically reduced. Documentation is essentially eliminated for anyone who is at least 90 days behind on payments and has a credit score of less than 620.

► For borrowers who are current on their payments, mortgage servicers can now process short sales without additional approvals from Fannie or Freddie if the borrower has a hardship. Eligible hardships include the death of a spouse, divorce, disability, and a job transfer more than 50 miles away.

► Military personnel who are transferred are

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Here's the real reason many have trouble getting a mortgage

Mortgage rates have been at historic lows, but a lot of people still have trouble getting a mortgage because the lender makes them jump through hoop after hoop after hoop.

What most people don't know is that a big reason this is happening is something called "put-backs."

About 90% of the home mortgage loans in the U.S. are sold by the lender to federal agencies or to government-sponsored companies, chiefly Fannie Mae and Freddie Mac. These purchasers buy loans that meet certain specific standards.

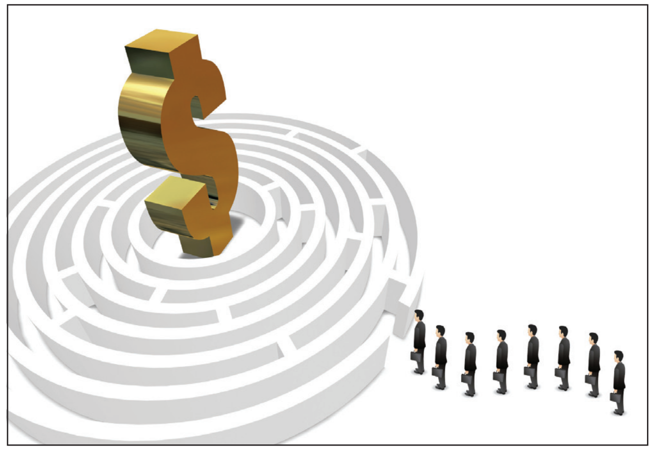
Increasingly, when a loan goes bad, Fannie and Freddie are combing through the original documentation looking for flaws and mistakes. When they find one, they demand that the sale be undone and that the bank take back the loan – which is known as a "put-back." This results in a big loss for the lender.

Recently, Fannie and Freddie have demanded that banks take back $66 billion worth of mortgages that were made between 2006 and 2008. The amount of "put-back" demands last year was up 37% over the previous year.

As a result, banks are increasingly scared. Rather than just making sure that the borrower can repay the loan, they are triple-checking everything and trying to make the loan documentation "bulletproof" so that they won't be stuck with a put-back.

According to a recent survey by the Federal Reserve Board, fear of put-backs is the number one reason that banks are tightening standards and refusing to make loans to people.

In many cases, banks are demanding full explanations for any recent bank deposit, however small, to make sure that the applicant isn't borrowing money from family members for a down payment. Other banks are refusing to loan money unless the applicant makes repairs to the property first, rather than allowing the applicant to fix the home up after moving in.



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The new standards are especially tough for people who have recently moved, people who work on commission, people whose income consists largely of bonuses or tips, and people with seasonal income.

In August, the average person who was *denied* a conforming mortgage loan had a credit score of 734 and a 19% down payment. In the past, such a person would probably have breezed through the process without a problem.

In an effort to help, the Federal Housing Finance Agency recently issued regulations limiting put-backs somewhat. Starting with mortgage loans made in 2013, Fannie and Freddie won't be able to demand a put-back for certain types of flaws if the borrower has made payments on time for three years.

On the other hand, provisions in the Dodd-Frank financial overhaul law will increase penalties starting in 2013 for banks that make mistakes in loan documentation. So banks may still be "playing defense" for a while longer.

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Short sales

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automatically eligible for short sales, and Fannie and Freddie will not ask them for any additional payment to cover the shortfall, even if they could afford a partial payment.

► For borrowers who have a home equity line, Fannie and Freddie can now offer the second lender up to $6,000 to gain its approval for the sale. Previously, there was no set limit, and many home-equity lenders repeatedly delayed approval of short sales as a tactic to negotiate for a larger repayment.

► Mortgage servicers must now review all short sale offers within 30 days, and give the borrower a final answer within 60 days.

New 3.8% tax on investment affects real estate in 2013

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A new 3.8% tax on investment income will take effect in 2013, and will affect many people who have rental income or who sell real estate.

The tax was included as part of President Obama's health care law. It applies to single filers with adjusted gross income over $200,000 and married filers with adjusted gross income over $250,000. (It also applies to trusts and estates with undistributed investment income of more than about $12,000.)

The IRS hasn't issued detailed guidance on the law, so it's not entirely clear how it will work. However, it appears that it will apply to:

Vacation homes. If you sell a vacation home and have a capital gain, the tax will apply. If you rent a vacation home to others for more than 14 days a year, the rent (minus expenses) will be subject to the tax.

Investment property. If you have rental income from investment property, the amount (minus expenses) will be subject to the tax. But this is true only if you rent the property "on the side"; if your sole business consists of owning or operating real estate, then the rent would be considered business income and not investment income. Either way, though, if you sell investment property and have a capital gain, the gain would likely be subject to the tax.

Sale of your home. If you sell your principal residence and you have a capital gain of more than $250,000 (for single filers) or $500,000 (for married couples filing jointly), the excess will be subject to the tax.

The flat 3.8% tax applies to (1) the total amount of investment income, or (2) the amount by which adjusted gross income exceeds the $200,000 (single) or $250,000 (married) thresholds – whichever is *less*.

Because the amount of the tax is significant and the details are uncertain, anyone who is affected by it would be well-advised to consult with an attorney or tax expert.

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