EPISODE 1049

[ASK FARNOOSH]

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FT: Welcome to So Money, everybody. I'm your host, Farnoosh Torabi. It is May 29th, 2020. If you've been listening to the show this week, you know we've been pretty obsessed with real estate. If you've been following me on YouTube and Instagram, you know that I just did a video on real estate. First, the podcast on Monday, we had a replay of my conversation with Ilyce Glink who is a real estate pro, and she has a lot of insight on what's happening from both sides of the real estate equation as a buyer, as a seller, what to expect right now.

Then on Wednesday, we had this, this is cool, Tracy Tutor from Million Dollar Listing Los Angeles, a show on Bravo. It's one of my favorite shows. If you like real estate, some might call it real estate porn, that's Million Dollar Listing, and Tracy is the first and only female realtor on the show. She's soon out with a new book called *Fear Is a Four-Letter Word,* so we were talking about her book but also her perspectives on real estate, where she sees prices going, and a really interesting conversation with her on my YouTube channel. I posted a video, because everybody is asking about real estate right now. It's a hot button issue, and even in this episode we have a number of questions regarding real estate.

If you're into this topic, hang tight. We've got some additional questions regarding this. But in my YouTube video, I provided a checklist for homebuyers. A lot of people are asking, "Is it a smart time to buy a home," and my response is it's not really the question you should be asking. The right question is is it a smart time for me to buy a home. It's a very personal big financial decision, so you don't want to just base it on what's happening in the market or where interest rates are. I mean, all that is important to some extent but it's not what should drive your choice to buy a home. Instead, here's the checklist.

You can skip the video. I'll just give you the checklist right now. Grab a pen. Do I have a stable job or reliable income if I'm self-employed? This is of the utmost right now. It's always important, of course, to have income when you're making a purchase like a home. But banks, I will tell you, are particularly sensitive to this because we know that unemployment is rising right now and getting a mortgage takes at least 30 days. In that timeframe, there's a chance that your company could have a big layoff. Your business could suffer some losses, and the banks are going to want to know about that. If they're underwriting a mortgage, they want to keep abreast of what's happening in your business.

I'll tell you, from our end, when we were closing on this house that I'm sitting in right now in New Jersey, the day before our closing, the bank called my husband's employer. They called my accountant to, again, verify our employment status to make sure that we hadn't lost our jobs or my business hadn't gone under. This is how sensitive they are to this. So if you think that your company is on rocky terrain or you're not having a great year with your business compared to last year, you better be ready to back that up and prepare for a lot of query around this. That's just the truth of the matter, and so that's number one. Do I have job stability? If you're answering yes to all these things, that means that you're in a really good position to become a homeowner right now.

Number two, do I have a credit score that is in the 700s or higher? One, because that's going to mean a better interest rate, more chances of getting a good loan. But also, banks are raising their lending standards right now. Given what's happening in the marketplace, credit is getting a little bit harder to access. It's similar to what happened during the Great Recession. We're seeing signs of that again where credit is not as widely available, and it's only going to the people, the borrowers that can really prove that they're going to good for it. This is frustrating. I know a lot of people have credit scores in the 600s. They still want to become homeowners. It's still possible but I'm just saying, some banks are drawing the line in the sand, and they're saying, "Unless you have a 700 score or higher right now, we will not work with you."

Next on the checklist, do you have about a 20% down payment, plus another 3 to 4% in savings for closing costs? Sometimes, closing costs can get tacked on to the mortgage but sometimes not, and 20% may seem really high for people all around the country. But I know in areas like New York and California, these metropolitan areas and the surrounding suburbs, that's standard. I think that, again, with lending standards going up, the down payment requirements are also going up. If you could do it for 10% six months ago, I think banks are going to want you to have a little bit more skin in the game. Times are tough.

Next, can I afford the potential thousands of dollars a year in home maintenance and improvements? Owning a home costs money. It's a lot of operating expenses. When I moved in the first weekend, I had to call a plumber because we discovered a leak, and that was a $150 I wasn't planning on spending. That was just on day two. Speaking of the cost of owning a home, there are a lot of different rules of thumb around how much of your budget should go towards owning a home. My feeling is that 30% is the max. 30% of your budget, it's your take-home pay, should cover the mortgage, taxes, and insurance.

If you can squeeze all that in and still have 70% of your budget left to play with that month, you're still in safe territory. You cross that 30% mark and it gets a lot tougher, right? Because think about it. If you've got also student loans or you're planning to start a family or you have a car loan and, of course, then there's food, and all these other things, you don't want to go to bed at night worrying about paying your mortgage. You want this to be a comfortable expense for you. This is important, and it's on the checklist. Am I buying this home because it will make me happy and not because it's something that my family wants me to accomplish? This is actually a question I have coming up in the show, a listener addressing this and saying, "I got money from my parents, and they really want me to use this to buy home. I don't want to do. What do I do?" We're going to talk about that in further detail but really important that you're doing this for yourself. That this is not something that you're doing under duress because you feel like this is what society expects of you, your family, your friends.

Next, does it make sense for me to even own a house right now, because what's the rush? There's a lot of benefit to renting. We rented while we were in between owning because we wanted flexibility. We wanted that sort of real estate liquidity to be able to leave our apartment, break our lease if we had to, or sublet our apartment, and then having to sell our home to buy a home. But for others, renting has other advantages because it allows you to better pursue your lifestyle. If you're someone who is transient, if you own it right now or maybe you're not. But before this and after this, you're going to be traveling for work. You're going to be traveling a lot for other reasons. You don't want to set roots down. You don't want to pay the taxes that may come with owning a property because why would – If you're not even benefiting from being in that town because you're up out and about and traveling for work. I think that renting definitely has its merits. Owning is not for everybody.

Am I okay when it comes to selling this house and I won't have really made a profit, because owning this home after all is not really a “investment”? Some people have questions about this. What do you mean, Farnoosh, a home is not an investment? That's contrary to everything we hear. Investing in a home versus living in a home as your primary residence, two very different things. There’s investing in a home because you want to become a landlord. You want to run an Airbnb, you want to be cash-flow-positive every month, and you want to leverage debt to create this investment vehicle for yourself. That is separate from what we’re talking about, but living in a home and paying that mortgage and paying the taxes and paying all these maintenance costs we’ve been talking about. Over the years, yes, your house may appreciate, but that’s not where the equation stops. You have to also factor in things like inflation and all of the sunk costs. At the end of the day, did you eke out a profit from living in this home? There were many other benefits to living in this home, right? You got to benefit from a roof over your head, a great neighborhood, stability for your family, the pleasures that come with homeownership. But on a cost analysis basis, was this a profit?

That is up for debate. It’s not – You can’t just make a blanket statement and say, “Owning a home is a great way to build wealth.” It has happened for people. It’s happened for me because I bought in certain markets like New York City where there is a higher chance for a greater ROI than, say, a suburb. But overall in this country, and then we’re going to talk about the stat later in the show, real estate accounting for inflation, the average home value has risen by just 1.5%. So then you take out your cost of living in that home and you're not talking about profit here, so we get really excited that real estate is an investment and that it's an investment class if you are approaching as an investor but not as a homeowner/resident. Does that make sense? It could happen for people, but I don't want you to go on with this intention and then be disappointed when it doesn't happen for you. So you have to be okay with that before you make this purchase.

Then when the purchase is done, this is the last on the checklist, will I had at least six months’ worth of expenses saved in a rainy day account? Because if you lose that job, you can't work for any reason and your finances become vulnerable. You don’t want to lose this house, right? You want to be able to protect your home. So more than ever, having a rainy day account is vital when you become a homeowner. That's the checklist, and I know it’s just the tip of the iceberg.

So if you have more questions on this, and I know you do, don't be shy. Submit those questions. Go to Instagram. Follow me there, @farnooshtorabi . Direct message me. Or you can send me a question on the website by clicking on Ask Farnoosh.

We're going to go to the iTunes review section now and pick our reviewer of the week. This week, it's Amy Abroad, who left a review on May 26th, and she says I'm a bad ass. Thank you, Amy. She says, "I first heard Farnoosh as a guest on another podcast, a financial independence podcast hosted by middle-aged white guys. Then I realized that most of the financial podcasts in my feed are hosted by middle-aged white guys whose wives are mostly stay-at-home moms. Of course, I can learn from anyone. But, wow, I'm so glad to add Farnoosh's voice to my daily podcast feed. She brings a fabulous perspective as a woman working hard for her career and her family with a relatable yet aspirational story. Thanks, Farnoosh."

Thank you, Amy. I really appreciate this feedback, and it's so nice to be recognized as someone who does provide diversity and a new take on money and family and work, and I'm so proud to be someone that is in your podcast feed. Thank you. I love to connect with you as my thank you for leaving this generous review. Send me a note. Either farnoosh@somoneypodcast.com is one way to get in touch or on Instagram and let me know you're the Amy who left review on May 26th. I'll send you a link, and we can have a free 15-minute money session and talk about whatever you want.

Right before we get to the mailbag though, I want to offer a freebie to everybody. I'm going to summer camp in about a week and I want you to come with me, a virtual summer camp hosted by Create & Cultivate, Digital Summer Camp on June 6th, 2020. It's a whole day of learning, engaging, investing in your professional pursuits. I'll be there sharing my advice on how to start and grow a podcast. A lot of us want to include a podcast in our business mix and as a way to connect further with our clients, with our friends, with our audience, so I'm going to talk about how I've been doing it, best practices. There are 100 free tickets available for those who act fast in my community. That's you. If you'd like to join, go to createcultivate.com. Use the code campxfarnoosh when signing up for their digital summer camp, and you're going to get a free ticket to attend. It's normally I think 30 bucks, so this is a nice savings and it's a full day of really rich programming, incredible guests, incredible speakers. Again, I'll be there talking about podcasting but also so much more. Hope to see there, createcultivate.com, code campxfarnoosh.

All right, let's go to your questions. Our first question is from Jennifer on Instagram, and she says, “Hey, Farnoosh. I’ve been listening to your podcast. It has been bringing me so much inspiration to finally build a business from my hobby of food blogging. Love your show and here is my question. What should I do with a large chunk of cash that I was recently gifted by my parents? I know I’m lucky to be in this position. This was given to me as a down payment for a house. However, I'm wondering if I should be investing this money. I know that my parents expect me to buy a home in the next year but I feel like investing this money will go farther in the long run for me. I don't want to disappoint them because what if I invest the money and then it tanks in the next year. Then I would seem irresponsible when they ask me what happened. Not sure what to do. Appreciate your thoughts on this. Either way, I'll continue to listen and be a lifelong fan and listener.”

Well, Jennifer, I love your question. Congrats on this nice little windfall or a big windfall. You didn’t mention how much, but I'm going to guess sizable because it was meant for a down payment on a home. This is tricky, right? When our parents get involved in our personal finances because they give us money, it’s not just a free gift, right? It definitely has strings attached, and in this case they're telling you what they want you to do with this. So the question is do I fulfill their wishes or do I do a 180 and do something completely different and potentially harm the relationship, right? I mean, look, they might not even give you this money if you tell them you want to do something else with it, so there is that.

It requires a conversation with your parents, and I think honesty is the best policy. I think that if you are coming from the school of thought that investing might be a better way to make the most of this money for you, because maybe you are behind on saving for retirement and that is important, we know now more than ever, of course, that retirement – A lot of us have to delay retirement because of what's happening in the market right now and the economy. A lot of people are arriving at retirement with not enough. Your parents might empathize. I don't know. But coming at it from that direction and saying, “Look, I really appreciate this money. I understand that there is a lot of value in using this towards owning a home. But I'm coming at this with another idea and I would like to have a conversation about it. It’s not really an attack or here's what I'm doing and I'm not going to listen to you, but let's have that discussion and come to the table which the research with thoughtfulness." I'll give you some research for this conversation if you really want to go with ammunition, okay?

Historically speaking, the stock market has produced better gains than owning a home. We talked about this a little bit earlier when I was giving you my checklist for homeownership. You can assume that it's going to be a great investment. According to fool.com, which is a great resource – It's been around for ages, so I know it's a great resource. It hasn't gone kaput over the years. It's been a trusted resource for financial information, investing guidance. But since 1940, according to fool.com, the median home value in the United States adjusting for home sizes, which have gotten bigger over the years and adjusting for inflation, the average home value in this country has risen by just 1.5% per year. Compared to stock returns, stocks have generated roughly 7% per year over the long run, and that's after accounting for inflation. So the stock market has produced returns at more than four times the rate of real estate appreciation.

If you're really leaning towards investing with this money, this is some information that might be useful to you as you're having this conversation, and explain to your parents that you're investing for the long run. You're not investing in one stock and hoping that you're going to gain all this money in a year. That this will be volatile but you have time, and that is why it makes sense for you to get in now as opposed to 10 years from now. Look, you don't have to do one or the other either, right? You don't have to just buy a home or just invest. Ideally, you can do both. Maybe not both at the same time right away, but eventually both will be on your financial plate.

I you just want to have this conversation with your parents. I don't know what your relationship is with them. I don't know how open-minded they are. I don't know how much they require this money to be used towards a home. If you don't want to do it, you might risk not getting this money from them, and that's another thing that you might want to think about. Is it worth it? Maybe you use this money to buy the home. Then on your own, you make a commitment to investing in your 401(k) at work or your IRA and things like that to help you save better for retirement.

Next up is a wishy-washy listener, anonymous. The question is, "I'm currently in good financial standing and I have my personal finance 101 down. I've got the budget. I'm maxing all my retirement accounts. I've been saving for a house. The problem is this goal of buying a house has always been something that I feel lukewarm about. I'm not 100% sure I want the responsibility of owning a house in a situation where I'm not sure when or even if I'll buy a property where should I be stashing the savings. I'm thinking 50% in the market, 50% in the HAS, health savings account, but I would like your thoughts."

Well, self-described wishy-washy listener, I think if there's still a chance that you want to use this money for a house, even if there's like a 10% chance you want to use this money for a home in the next five or six years, I wouldn't be putting this money in anything volatile like the stock market. I would want it in a liquid account, FDIC-insured. That could be a CD, a high-yield savings account. If you're certain you do not want this money, you will not need this money for any reason, home or otherwise in the next five, six years, then, okay, putting it in an index fund or like the market as you said, as well as your HSA. It's riskier but you can afford it. You can better afford the risk. That's the short answer. If you're not sure right now what you want to do, but there's still some chance you might want to buy a home with that, I would not be putting it in the market.

Caitlin has a question about resources to learn more about retirement, all the different retirement plans. She says, "I currently have an optional retirement plan that my employer contributes to. I don't contribute to it, just them. I'm thinking about opening up a Roth IRA but I don't know how to start or where to look. Should I keep my retirement accounts all in one place or spread them out? Two questions here really from Caitlin. One, resources for learning about retirement accounts and, two, is it smart to have retirement accounts all over the place or just to have one retirement account.

Firstly, resources. I like Investopedia. I like fool.com, which I just referenced. I like NerdWallet. These great sites can provide you with a lot of comparisons to look at what does a Roth IRA offer, what does a traditional IRA offer, what does your 401(k) at work if your employer offers this offer. Second question, whether it's helpful to spread out your investments, it can be. It can be because there are different benefits to contributing to something like a 401(k) versus a Roth IRA. The big difference is, of course, the tax benefits, and people like to spread out their investments for at least that reason, which is having different tax exposures in retirement. It diversifies your tax exposure.

The 401(k), which you don't have but let's just talk about that for a second, that does allow you to tax-deduct your contributions today. Then when you withdraw in retirement, you pay taxes on it then. A Roth IRA is the reverse. A Roth IRA, you make contributions post-tax, so you pay your taxes and then you invest in your Roth IRA. Then when you go to withdraw that money in retirement, you don’t have to pay taxes on it in retirement. At retirement age, we don't know for sure where taxes are going to be. Will our tax exposure be greater than or less than where it is today? Since we don't know with certainty, people like the diversity to have to pay taxes in one account but not pay taxes in another.

Employer-sponsored retirement accounts are a great place to start sometimes, and then you can supplement with some of these other vehicles. But it's great to start because, one, it provides you with a chance to automatically contribute to the account from your paycheck. Number two, in some cases, there is a match. If your company offers a 401(k), I would do that. But if you sort of feel like you've exhausted the benefits in this optional retirement plan, then, yeah, you might want to move on to something different that has maybe a different bit of tax exposure.

Here’s the other thing about opening up our IRA versus an employer-sponsored account. IRAs tend to have more options, and within those options you might find cheaper investment options like more index funds, more variety of ETFs. Whereas a 401(k), sometimes you feel a little bit more limited as far as what you can invest in. For that reason too, spreading out your investment dollars for retirement can be wise because you get to bank on these lower fees elsewhere. But good question, Caitlin, and good luck to you.

Last but not least, Caitlin has an investing question as well, but this is about socially responsible investing. Here is Caitlin's question. “I am 23 and I’ve just finished paying off student loans. I’m actually working in a job where I’m making enough money to start investing, and I want to start putting some money into an IRA and then also into an index fund. I also would like to invest in companies that align with my values. Is it possible to get a return on your investment and support ethical companies? Do you have any suggestions of how I can find out more about this? Your podcast has been a big help.”

Kelsey, congratulations! Paying off your student loans at 23, bravo, and working. Thinking about investing at such a young age, so, so great. You are way ahead of the curve. So good news, socially responsible investing is a thing, and it is a growing saying. What is it? It's the practice of investing money in companies and funds that have positive social impacts, which we know is increasingly becoming important to us. There are dozens of new funds and investing vehicles that are available to investors. You always want to read through, of course, the fine print. You can learn more about these funds on their prospectuses, which they have on their websites publicly available, which can help you better understand how that fund is investing. What companies are they investing in and why? What are the metrics that they're using to measure social responsibility?

This is very broad. I was talking about this with my brother who really loves to invest and is curious about investing, and it's such a broad category, so you might go into this caring exclusively about companies that, let's say, are environmentally conscious that have a low carbon footprint, that have little waste, and are conscious about packaging and delivering, and this and that. Others might be more interested in the way that the company runs its business internally. Is it inclusive? Does it promote diversity? Does it have equal pay? You might find a company that has all of these things. You might find a fund that has all of these things. You might have a fund that is just kind of looking at it through one lens or a few lenses. This is why the research on your end is really important, and the research is out there.

As far as the returns, your question is about can I make money off of this. The answer is you should be able to make money off of this. I know that there are a lot of stats out there that suggests that SRI, socially responsible investment funds, have been keeping pace with the market. Depending on what index you're looking at, the returns are different. But in general, they are keeping pace. In some cases, they are exceeding the market. So I wouldn't just invest solely in SRI. I would diversify, right? That's tried-and-true principle of investing. So within your portfolio, you've got some SRI funds or ETFs, as well as some other broader market; index funds, ETFs, specialty ETFs, things like that.

Where you can begin to research this is if you have a 401(k) at work, talking to that 401(k) provider about these different options, and then they can provide you with the prospectuses. Then also, Morningstar.com is a great resource. I've always used Morningstar in my own research as a journalist. It's been around forever, and so I like it because it provides readings and research and really easy to navigate. You can look up funds and quickly get to what you need. Additionally, if you're working with a brokerage, Schwab or Prudential or Vanguard, those entities as well will have information. This is something that’s really popular. They know this and they’ve begun to create resource areas on their websites dedicated to this. Many brokerages also offer a list of socially conscious funds that they offer that’s easy to access and read up about.

Number one, do your research. Number two, don’t be afraid to invest in SRI funds because of the potential losses. Historically, we see that they do pretty well. I think they’re going to do even better. This is the future. But great question, Kelsey. Great work and thanks so much for being part of the So Money community.

That’s a wrap, everybody, and happy last weekend in May. Make it a good one, and I hope your weekend is So Money.

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