

# Smart Home-Buying Tactics

**F**or many families, their largest investment is their home. But home buying is extra complicated for military families, who tend to move frequently and sometimes with little notice. At the same time, servicemembers have access to special mortgage programs and tax breaks to help them afford a home. Be sure you make the most of these special benefits and protect your investment.

**Should you buy or rent?** Members of the military receive a tax-free housing allowance to cover all or part of their monthly rent or mortgage payment. And if you own a home, you can deduct 100% of your mortgage interest, even if you're paying it with tax-free money. Nonetheless, it can still be tough to decide whether to rent or buy a house when you may only be stationed in an area for a few years.

When home prices were rising quickly, many servicemembers bought homes even if they only expected to live in an area for a relatively short period of time, with the hope that they could sell for a profit (or rent it out for more than their monthly payments) when they were transferred. But you can't count on either outcome in this economy.

Patrick Beagle, a certified financial planner who specializes in helping military families, recommends renting for at least a few months when you move to a new area, so you'll learn about the neighborhoods and can pick the best place to live. Then, he recommends buying a house only if you plan to live in the area for at least three years—five years is even better. (Remember, the home will probably have to appreciate in value by 6% or more just to cover the costs associated with buying and selling.) He also recommends limiting housing costs to no more than 30% of your take-home pay, so you won't struggle with monthly



**Gary and Regina Bartels, with son Sammy, used a no-down-payment VA loan to buy their home, and used their cash to pay down high-interest credit-card debt.**

PHOTOGRAPH BY COLIN TODD

expenses. Don't forget to include the cost of homeowners insurance, property taxes, utilities and regular maintenance when toting up the real cost of owning. The housing calculators in the tools section of [Kiplinger.com](http://Kiplinger.com) can help you run the numbers.

Also remember that your Basic Allowance for Housing (BAH) will vary depending on the cost of living in your location; if you move to a new area, your housing al-

lowance may be more or less than you're currently receiving. To check on the BAH for your rank and zip code, use the tool at the Department of Defense Web site (<http://perdiem.hqda.pentagon.mil/perdiem/bah.html>).

When deciding how much house you can afford, be particularly careful if you'll be leaving the military soon. After you leave, you won't get the tax-free housing allowance anymore, you may have to

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pay state income taxes for the first time, and your job may not be as stable (a potential layoff becomes much more of a concern when you're in a civilian job). Keep these realities in mind when calculating your expenses, and build up a bigger emergency fund to help you pay the bills for at least a few months if you or your spouse lose your job.

**Should you take advantage of special mortgage options?** Active-duty military personnel, as well as certain veterans, reservists and National Guard members, are eligible for Veterans Administration loans, which generally allows them to borrow up to \$417,000 with no down payment or private mortgage insurance (the cap is higher in certain high-cost

counties; go to [www.homeloans.va.gov](http://www.homeloans.va.gov) for a full list of the current limits).

VA loans are made by private lenders and interest rates may vary. But they can be particularly valuable for people who don't have the money to make a 20% down payment, would otherwise have a tough time qualifying for a loan, and who would be required to buy private mort-

### Q+A

#### How a Home Fits into the Financial Puzzle

*I am currently serving in Iraq and will be coming home soon. I recently reenlisted in the Army and received a bonus of \$29,000, and I have extra money from my tax-free income and combat pay while deployed. Where is a good place for the money? I'm paying 7.9% in interest on a \$9,000 credit-card balance, but my main goal is to support an upcoming down payment for a home and long-term investments.*

It's such a great idea to plan for the bonus while you're still deployed. That way, you can take advantage of the military's Savings Deposit Program, which lets you invest up to \$10,000 in an account that earns 10% per year. Interest stops accruing 90 days after you leave the combat zone, and the interest is taxable when the money is withdrawn.

Try to keep the maximum in that account as long as it continues to earn interest, which will give you a much better return than any other short-term savings option.

Meanwhile, use \$9,000 of the bonus to pay off your credit-card debt. Getting rid of those interest payments will make it easier to reach your other goals—and having a lower balance could also improve your credit score and help you qualify for a better mortgage rate.

Then use some of the remaining money to build up your emergency fund, which can help you avoid landing in more debt if you have any unexpected expenses. Advisers generally recommend keeping at least six months of expenses in a money-market or savings account that you can access in an emergency—or more if you can afford it, especially when you buy a home.

After the money in the military Savings Deposit Program stops earning interest, you can put some of it toward the down payment on a house. You can buy bank or credit-union certificates of deposit or other short-term investments to match your home-buying time frame. But don't risk the money you

want to spend on a house in the next few years in the stock market. "Investing in the stock market is just for money that you won't need for at least three to five years," says Brooke Salvini, a CPA and financial adviser in San Luis Obispo, Cal.

If you take a VA loan and don't need a down payment, add some of the money to your emergency fund—you'll probably need cash for an earnest-money deposit on the home and closing costs, and it's a good idea to have extra money for unexpected costs, because you won't have home equity to tap in emergencies. Homeowners with VA loans can always add money to their payments to pay extra principal without penalty—a good way to build instant equity.

Once you have a cash cushion, add some of the extra money to your retirement nest egg, investing either in your Thrift Savings Plan or a Roth IRA. Since part of your income for the year was from tax-free combat pay, the Roth will give you extra tax ben-

efits—making the money tax-free going in and tax-free coming out. You can invest long-term money in a diversified portfolio of stock and bond funds. Or you can put it in a target-date fund, which invests your money in a portfolio of funds to match your time frame, then gradually shifts to more conservative investments as your withdrawal date gets closer.

If you're worried about timing your investments during a volatile market, consider using dollar-cost averaging to invest a portion of the extra money with each paycheck; dollar-cost averaging buys more shares when prices are low and fewer when they're high. Or you could break your investments into three sections and invest one-third of the bonus money every six months, a strategy that Dan Joss, a certified financial planner in Fairfax, Va., calls "diversifying by time." Joss's reasoning: You won't know whether stock prices have bottomed until sometime after the fact, so hedge your bets.

gage insurance, which usually costs 0.5% to 1% of the loan amount each year. For more information about VA loan eligibility and rules, visit the Department of Veterans Affairs Web site ([www.homeloans.va.gov](http://www.homeloans.va.gov)).

If you have a good credit rating and enough money to make a down payment, however, you might get a better deal on a standard mortgage. To improve your chances of getting a good rate, check your credit report for errors. You can get one free copy of your credit report each year from each of the three credit bureaus at [www.annualcreditreport.com](http://www.annualcreditreport.com).

Active-duty servicemembers and their spouses can also get a free BrightScore report, which includes a summary of your credit report and an action plan to improve your credit score. Contact the Personal Financial Manager on base or your base community-service office for more information and resources. And you can learn about strategies for improving your credit score at [www.MyFico.com](http://www.MyFico.com), a consumer-information site run by Fair Isaac, which developed the credit score most lenders use.

Deciding whether to take the VA loan or a standard loan also depends on your family's circumstances and other potential uses for your cash.

Captain Gary Bartels, 32, left the Army in June 2008 to start a job as a production supervisor at Mitsubishi Caterpillar, and moved his family to Houston from Sackets Harbor, N.Y., near Fort Drum, where he had been stationed. Gary and his wife, Regina, were anxious to buy their first home so they could settle in with 2-year-old son, Sammy, and new baby, Joe.

Although Gary qualified for a VA loan with no down payment, he also considered other options. Just before he left the Army, he was earning extra money at Fort Bragg, in Fayetteville, N.C., by training National Guard troops for deployment in Iraq. He wondered whether he should use the additional income to pay down \$18,000 in credit-card debt or save for a down payment on a traditional loan.

Gary ended up getting a VA loan, and because he didn't need to make a down payment, he used the extra cash to attack his high-interest credit-card debt. He also kept some extra money on hand for moving expenses, closing costs, maintenance and other unexpected costs that come with a move.

Opting for the no-down-payment route makes it particularly important for the Bartelses to plan to stay put for a while. A dip in home values could put the

## Special tax rules are designed to help military families who decide to rent out their homes when they are transferred to their next duty station.

family in the unenviable position of being "upside down"—that is, owing more on their home than they could get by selling it. The bigger the down payment you make, the more cushion you have against that happening to you.

Once the credit-card debt is paid off, Gary and Regina should focus on building up their emergency fund to hold at least six months' worth of living expenses. Then they can put extra money toward retirement savings, college funds for the kids or paying extra principal on the mortgage. "One thing I learned at West Point," says Gary, "is that when you accomplish small goals, it increases your confidence and momentum."

**Should you rent or sell?** What do you do when you're transferred after buying a home: sell the place or hold on to it and rent it out? Special tax rules help military families who do plan to rent their homes after they move.

Most homeowners need to live in a house for two of the five years leading up to the sale in order to claim tax-free profit on the deal (up to \$250,000 if you're single, or up to \$500,000 tax-free profit if you're married filing a joint return). But because they move frequently, military families need to live in the house for just two of the preceding *ten* years in order to qualify for the tax break. For more information on this and many other tax rules, see IRS Publication 3, *Armed Forces Tax Guide*, at [www.irs.gov](http://www.irs.gov).

If you do rent your house after you move, set aside an emergency fund to help cover your mortgage and other expenses if you don't receive rental income for a few months—a lesson that many families are learning in a tough economy.

A San Diego military family recently called on financial planner June Walbert for help. The family had bought a big house in the midst of the housing boom and rented out their old home. The rent arrived on time for two years, but then hard times hit their tenant, and the payments stopped.

Housing values in San Diego had plummeted by that time, flooding the rental market with other homes and making it tough to maintain the level of rental income the couple had counted on to afford their bigger house. The family put the small house on the market but had no luck selling it. Because they lived in the same area (which isn't an option for military families who have moved), Walbert recommended that they downsize: "My advice was to go back to the house they knew they could afford and sell the bigger house."

Walbert says that building an emergency fund for their original house before they started renting it would have been a smart move. Then, if it wasn't rented out 100% of the time, "they could still afford the mortgage payment without throwing their finances into a tailspin." That emergency fund becomes particularly important if you're stationed in a new city and don't have the option of returning to your old home. ←