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The Benefits Of Buying A Home With Cash

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Like Hoffman Development Group's other projects, Charlie Brasington suspects the majority of home buyers for this Tampa, FL condo building will be 100% cash.

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When a 62-year-old financial advisor bought a two-bedroom Manhattan co-op recently, he showed up at the closing with a check for the full $970,000 purchase price. No mortgage? “The money I had in cash was sitting getting 0% interest,’’ explains the man, who asked not to be named. “It made absolutely no sense to borrow.”

There were other benefits as well to buying for cash, he says. He figures he got a “liquidity discount” for being able to close quickly—the asking price had been $1.05 million. And he avoided the hassles and paperwork that come with getting a mortgage these days. At the closing, he gloats, “they spent more time making photocopies than anything, so we sat discussing Broadway plays.”


Video: A Cash-Only Apartment In Greta Garbo's Building

Similar closing scenes are playing out across the country these days—minus the theater chitchat. Rates for 30-year fixed mortgages are hovering at 4%, and 15-year fixed loans can be had for 3.5% or less, the lowest in more than 50 years. Yet the National Association of Realtors estimates that roughly 30% of U.S. home buyers are now making their purchases 100% in cash, compared with 15% in 2008.

Some cash buyers are foreigners, who have never easily qualified for U.S. mortgages. Some are very-high-net-worth folks who have long favored cash for their multimillion-dollar trophy mansion purchases. The increase in cash buying comes mainly from two other groups: real estate investors, who nowadays rarely qualify for mortgages at all, and older buyers (like the New York financial advisor) who could qualify for mortgages but don't want to.

In foreclosure-plagued Florida, where prices in some areas are down 55% from the peak, investors and snowbirds bearing cash dominate the market. Charlie Brasington is chief executive of Hoffman Development Group, which since 2008 has been using cash from private investors to buy distressed Tampa- and Palm Beach-area condo buildings from banks. Hoffman fixes the properties up and then sells the units to end users. Brasington reports two-thirds of the roughly 300 units Hoffman has sold so far, through Engel & Völkers, have gone for cash, as have all eight of the $1 million-plus penthouses it has moved.

"These people probably have $5 million or more, so to take 10% of it out and buy a quality home in Florida and know that you've got your stake in the sand, that may be a good investment," Brasington says. "Your cash is not making money in a CD, that's for sure, and in the stock market there's volatility. In real estate, sure, you may have some downward trend still, but there's not that volatility anymore."

A sales pitch? Sure. But recent cash buyers make similar points, and signs abound that Florida prices may have bottomed. If you're considering a cash purchase, here are some pointers.

Cash buyers often get a discount

"Until recently I'd say sellers didn't care that the buyer was coming in all cash or financed, they just wanted the highest number. Now the game has changed,'' says Tracie Hamersley, a senior vice president at Citi Habitats, a New York City-based realty firm. "While banks are lending again, it is much more onerous, and there are many hoops to jump through. So someone who can close in cash can in most cases qualify for somewhat of a price discount based on that sureness of a sale."

That cash-is-king phenomenon is being reported by Realtors across the country. "It's like all of a sudden having this four-star gold status," says Karen Bergin of Coldwell Banker Advantage in Overland Park, Kans., who has represented three baby boomer cash buyers so far this year. One of her clients, a couple selling their western Kansas farm to relocate to the Kansas City area, even managed to secure an extended closing period while they awaited a buyer for their farm.

Closing costs are lower with cash

Cash buyers can also save on closing costs. You don't have to fork over money to pay a bank attorney for the mortgage. This is an expense that can run $750 and up (although it can be wise to retain your own lawyer). You don't have to put real estate taxes in escrow up front nor pay the estimated $300 to $600 for a mortgage application plus additional thousands in loan origination fees and assorted junk charges. And you aren't required to cough up $400 to $600 for an appraisal, which mortgage lenders insist upon, or, in a growing number of cases, multiple appraisals. (The multiple appraisal requirement is popping up in foreclosure-riddled areas where nondistressed homes have few sales to be compared against.)

Should you get an appraisal anyway? Most Realtors still strongly recommend one, in addition to a home inspection, to ensure you aren't overpaying or buying hidden structural problems. But if it's clear you've negotiated a good price, an appraisal may not be an imperative.

Another expense that will drop: title insurance, which offers protection against problems with the chain of ownership and preexisting claims like unpaid property taxes or liens placed by stiffed contractors. On a $600,000 house with a 20% down payment, title charges, which include researching local land records, can easily top $2,000. But roughly one-third of that is for coverage that protects only lenders (which, of course, they mandate you get and pay for). Cash-only buyers don't have lenders, so there's an immediate savings right there. Indeed, as a cash buyer, it's up to you whether you want title insurance at all. Realtors say it's a prudent add-on.

Getting a mortgage is not guaranteed

No matter how good your credit, if you haven't gotten a mortgage in a while, you could be in for a shock. Even if your finances pass muster, the lender will likely pull the funding if the required home appraisal doesn't reach the price you've agreed to pay. That's the biggest issue hampering home sales this year, says Jed Smith, a managing director at the National Association of Realtors, which tracks sales data. The mortgage approval process also takes longer these days—an average of 45 days, up from 30 in 2008, according to online mortgage supermarket LendingTree.

Here's another factor to be aware of. The maximum size for "conforming" government-backed loans—those carrying the lowest rates with a traditional 20% down payment—was reduced in October. In highest-cost jurisdictions, such as New York City, Bergen County, N.J. and Los Angeles, the maximum is now $625,500, down from $729,750. Most everywhere else the maximum is now $417,000, down from $443,750. Those taking larger nonconforming loans generally must pay a 0.5% higher rate, put 30% down and meet even tougher credit standards.

On the other hand, if you are a cash buyer, all these mortgage difficulties are to your benefit, since they could wipe out other potential bidders who do need a loan. (If you're paying cash, make a bid that doesn't have a mortgage contingency—and stress that point to the seller.)


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You're giving up a tax break—now
Interest on up to $1.1 million in mortgage principal originally used to buy, build or improve a first (and second) home is currently tax-deductible. But if you later borrow against your equity for anything other than home improvements (say, for college tuition) your deduction is far more limited. In that case, interest on only the first $100,000 of home-equity borrowing is deductible, and even that isn't allowed when you're calculating whether you owe more under the dreaded alternative minimum tax. (You might be stuck in the AMT if you pay high state and local taxes and earn between $200,000 and $500,000.)

Keep in mind that this is all under current law. There's been lots of talk in Washington about a tax reform that might lower tax rates while curbing tax breaks, including the mortgage interest deduction.

Even without a mortgage you get two other tax breaks from owning a primary residence. First, when you sell, the initial $500,000 in capital gains profit per couple ($250,000 for a single) isn't taxed. Second, you're getting a tax-free economic return on your investment in the form of free rent for all your years of residency.

Cheap money is relative
With rates so low, why not take out a mortgage and use your spare cash to invest? That's an attractive option, but only if you believe your aftertax return on that investment will be greater than your aftertax cost for the mortgage, says James Maule, a Villanova Law School professor who specializes in taxes. He explains, "It depends on where you think your cash will make the most money or be the safest investment."

Finally, don't let the mortgage question obscure the bigger issue. Since you can always rent, is buying a house in the market you're looking at a good investment? That depends on whether prices have bottomed (or are close to bottom) and how high local rents are.

Remember that New York financial advisor who paid cash for his co-op? Here's a little insight into how this longtime renter decided the time was finally right to buy.

He figures the apartment he bought would rent for $5,000 a month or $60,000 a year, a 6% yield on his $970,000 investment. But he pays the co-op corporation $2,540 a month, or $30,480 a year, in maintenance charges to cover things like building operating expenses, property taxes and debt service on the building's own borrowings. If he itemizes he gets to deduct his share of those tax and interest bills. So he reckons he's still getting a 3% yield on his $970,000 investment, compared with the 2% that U.S. Treasury bonds are paying.

That assumes no appreciation of the apartment—and he does expect some. After falling roughly 23% from their 2008 peak, Manhattan co-op prices have been showing signs of a revival. Moreover, rents there are rising fast, up 7% in the year through October, according to Citi Habitats.

All in all, a sound use of money he’d otherwise have sitting in cash. Not that he intends to rent out the apartment, mind you. He and his wife plan to enjoy their new home, particularly the five walk-in closets, a coveted amenity in the cramped quarters of Manhattan.