December 2007

Mortgage Minute

Separating Equity the Sequel

More thoughts on creating financial safety by separating home equity.

This month we will continue our series of looking differently at mortgages. Last month the topic was separating equity out of our homes as a means to create more financial safety and I want to continue that dialogue.

At the heart of the American dream is owning our own home free and clear, but the way most people go about accomplishing this goal, by making extra or larger payments, actually creates more risk than it does safety. This strategy lowers the principle balance very slowly over a long period of time.

By giving you a mortgage loan, the bank takes on the risk that the loan will be repaid, either by the borrower or by selling the home in the case of a borrower's default. They hedge their risk by requiring either a down payment of 20% or mortgage insurance. As the value of the home increases and the mortgage balance decreases, the bank's risk decreases becoming more secure in its position. But over time the homeowner stands to lose more and more equity.

It does not matter if you owe $5,000 on your home or $500,000, if you have a lien on your home and if you default you will lose the equity you have worked so hard to build. I recently heard John Miller, economist for US Bank, say, "The last thing in the world a bank wants is to take a house back." So why should we give them a reason to?

Two homes in the same neighborhood are valued at $300,000, one with a mortgage of $250,000 and the other $100,000. Hard economic times hit, both of these homeowners lose their jobs, the housing market is flooded with homes for sale and consequently, home values plummet. Not being able to make the payments and not being able to sell their homes, the bank has the option to foreclose on both properties, but because of the housing market, they are now only worth $200,000. If you were the bank and had to choose whether or not to foreclose, which house would you foreclose on first? The only thing a bank wants less than to take back a home is to lose money.

Whenever financial decisions are made there are the numbers and then there are emotions. Ultimately you should do whatever it is that helps you sleep better at night. My hope here though is that you aren't sleeping better under a false impression of financial safety. Financial safety is found in having a liquid asset that can be easily accessed in the case of an emergency or time of dire need.

I hope none of us have to face the hard times of not being able to pay our bills due to forces outside of our control. But, how comforting would it be to know that we could weather that financial storm if need be?

Today's Rates at a Glance

30-year fixed
5.500%
(APR 5.679%)

30-year fixed
100% LTV no MI
6.000%
(APR 6.167%)

FHA 30-year fixed
up to 97% LTV
5.500%
(APR 6.184%)

Calculations based on a first-time homebuyer purchase, loan amount of $200000 and an 80% loan to value (unless otherwise noted). Rates include a 1% origination fee and are as of 12-3-07 and are subject to change.

Identity Theft Tip of the Month

You shouldn't leave your purse or laptop in plain site when you leave your vehicle. It is always a good idea to secure valuables or bags of presents in the trunk if they must be left behind.

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