January 2008

Mortgage Minute

Putting Home Equity to Work For Us

Wealth building principles using separated equity.

Now that I've convinced you that separating equity from our homes creates financial safety, I'd like to move on to the topic of how this separated equity can help build wealth over time.

Most people realize that paying down a mortgage is not the same as "making" more money when the home is sold. The mortgage is simply acting like a forced savings account. The appreciation of our homes and subsequent gain realized by this appreciation is not impacted by the mortgage balance. A home's equity has no rate of return. It is important to realize that by leaving the equity in the home the only "gain" is the lack of a cost from separating it. This cost might not be as significant reason as you might think to leave it there.

Two fictitious households wish to invest/save for the future. The first household, the Smiths, cash-out $100,000 in home equity by getting a mortgage at a 6.5% interest rate and invest this $100,000 which earns a yearly rate of return of 7%. The second household, the Johnsons, plan to make monthly contributions to an investment account that will earn the same 7% rate of return.

The Smiths have a monthly cost for their mortgage of $563.33, but remember this interest is tax deductible, so they realize a true cost of $357.50* each month. The Johnsons invest the same $357.50 each month into their investment account.

After ten years the Smiths have an account balance of $199,801 while the Johnsons have $100,000 of equity and an account balance of $61,878 for an asset total of $161,878. After fifteen years the Smiths account has a value of $283,242 while the Johnson's asset total is only $213,314.

It is easy to see that the "cost" the Smiths incurred on a monthly basis wasn't a cost at all. I'm intentionally ignoring some aspects of this example if it were to play out in real life, like some tax implications and costs associated with the refinance. I'm ignoring them because they don't effect the outcome and only muddle my point, which is that the Smiths utilized their home's equity to create more wealth than the Johnsons *with the same money*!

I will reiterate that I am not advocating borrowing money at 9% and trying to play the market to somehow time things or pick the "right" stock. This principle will work if given time and a properly diversified portfolio. My ultimate goal for you and your family is to create financial safety, stability and more wealth. I'm ready to discuss creating these things for you today by including some separated equity in your financial strategy.

*assuming a 25% federal and 9% state tax bracket

Today's Rates at a Glance

30-year fixed
90% LTV no MI
Cash-out Refinance
6.125%
(APR 6.301%)

30-year fixed
5.750%
(APR 5.932%)

30-year fixed
Non-owner
6.375%
(APR 6.564%)

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 12-31-07 and are subject to change.

Identity Theft Tip of the Month

Do not have your driver's license number or home phone number pre-printed on your checks. This limits how much information can be gathered from them.

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