November 2007

Mortgage Minute

“Help! I’m trapped and I can’t get out!”

Thoughts on using real estate equity.

This month’s newsletter will be the first in a series presenting ideas and questions with the goal of getting us to think differently about mortgages. My thoughts may contradict financial advice you’ve received so far in life, or may be counter-intuitive, but I hope you will keep an open mind as we explore. It is not my intention for you to think like me, but more so that our discussion will spur critical thought. Let’s ease into it, shall we?

In my former life as a high school math teacher I had a series of lessons on exponential growth in my Algebra 2 class. One of these lessons involved exploring the use of extra money in our budget. Everyone has “extra” money lying around, don’t they? We would compare using this money to pay down the principle balance on a mortgage vs. saving or investing this money. Over time we could see that because of compounding interest, a.k.a. exponential growth, that we might be able to pay off the mortgage sooner by investing the money rather than accelerating our payments.

We will revisit the idea that we made more money with the above strategy later in the series, but this month I want to focus on what I *didn’t* realize I was teaching. Hidden in my Algebra lesson is the idea of safely separating equity from the real estate we own so that it is accessible when we need it most.

A lender decides to give someone a mortgage loan based on the borrower’s ability to repay the loan; not really on the value of the property. Banks won’t give a mortgage loan unless the borrower can demonstrate the ability to make the payments. Even if they need it badly, and they have been making extra or accelerated payments, and there is a lot of equity to borrow against.

Life is unpredictable and we never know what’s around the corner. In the case of job loss, disability, relocation, medical emergency, uninsured loss, or (insert your choice of personal disaster), wouldn’t it be better to have immediate access to money in savings as opposed to non-access to home equity?

I will clarify a couple things before I conclude. I am not talking about cashing out all the equity in your home and putting it into risky, aggressive investments. I’m talking about safely separating equity in the case of emergency. Talk to your financial planner, he or she should be able to give you several options of where you could safely tuck the money away. If you don’t have a financial planner, get one.

I’ve often heard as a response to this line of thinking that it is “risky” because the money might be spent on non-emergencies or be used to live beyond our means. This is not what I would define as risky but rather as a lack of financial discipline. If you need certain procedures in place to create more financial discipline for yourself, then do it. Don’t let this lack of discipline deter you from establishing a more secure financial strategy.

We will continue our discussion next month as we look at how paying down the principle balance on a mortgage over time, out of fear of losing your home, actually might make losing it more likely. Be sure to tune in next time for more “crazy” finance talk.

Today’s Rates at a Glance

30-year fixed
6.000%
(APR 6.190%)

30-year fixed
95% LTV no MI
6.125%
(APR 6.301%)

My Community
5/1 ARM IO
100% LTV
6.625%
(APR 7.275%)

Calculations based on a first-time homebuyer purchase, loan amount of $200,000 and an 80% loan to value (unless otherwise noted). Rates include a 1% origination fee and are as of 1-01-07 and are subject to change.

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