



## Mortgage Planning

**L**ast month we introduced a series of “facts and fallacies” regarding mortgage planning. We continue this month with additional concepts and fallacies—

*Fallacy Number Five—You should purchase the most expensive home you can afford.* It makes sense that a home is an investment and therefore, the more expensive home will be a better investment. In addition, who doesn't have the *American Dream* of a home that is larger? Yet, by purchasing a more expensive home, remember that you are going to be paying the mortgage payment for quite some time as well as maintaining a larger home.

This is where many encountered problems after the real estate boom of the past several years. They were told to “leverage, leverage, leverage” by financial advisors. Therefore, they put no-money down and opted for mortgages that did not require them to pay all the interest they owed. When the rates and requirement payments on these adjustables increased, many could not afford the payments on these homes.

*Concept Number Five—It is a Good Idea to Have Someone Make Your Payment For You.* Who would not want to make their mortgage payment? What we mean here is that it is a good idea to purchase a more modest home and then purchase an investment property. For example, instead of stretching to purchase a \$600,000 home, why not live in a \$300,000 home and purchase a \$300,000 rental property? Now you have someone making half your

mortgage payments and you still have the same amount of total investment.

Of course, you must be able to afford both homes. What if the rental property is vacant for six months? Could you carry both payments? You must always be prepared for vacancies, however, generally two \$300,000 homes will be easier to afford than one \$600,000 home even if the rental home is only rented 75% of the time.

### The Facts & Fallacies Part Two

*Fallacy Number Six—Maintenance on Your Home Will Eat Up Your Profits.* There is no doubt that owning a home will cost more in terms of maintenance costs. You don't have a landlord to replace appliances and the roof. But it won't completely wipe out your profits. Why? See the next concept...

*Concept Number Six—The Home Will Get Cheaper As Time Goes On.* Even though maintenance will be a cost, a mortgage is only partially subject to inflation while rent is 100% subject to inflation. Aside from increases in rates due to ARM adjustments (remember rates can go down on an adjustable as well), the only portions of a mortgage which are subject to inflation are insurance, taxes and association fees (if there are any). This may be as little as 20% of the total payment, which means that if the housing inflation rate is 5.0%, your rent will go up 5.0% each year, but your mortgage payment only 1.0% each year. Your rent will go up 65% in ten years and the mortgage payment will go up less than 20%. This is a huge savings that will outweigh maintenance costs.



*The Final Fallacy—My Mortgage Loan Officer is a Financial Planner.* While there are some loan officers that are financial planners—99.9% of loan officers are not financial planners. You should seek the advice of a financial planner before undertaking any mortgage transaction and if you do not have one—your loan officer should recommend one as well as a tax-advisor. After all, this is your largest investment.

*The Final Concept—Equity in a Home is a Good Thing.* Many planners will advise that you could put that equity to good use in many ways. And they are right. Especially if your retirement plan is underfunded and you are not taking advantage of the “second most important” American tax benefit. On the other hand, Americans in general have too much debt. No one ever went bankrupt by paying off their mortgage. In other words, we tend to leverage ourselves too much, not sit on too much cash. This is why the advice of a financial planner is so important. You should have a balance between investments and equity. But don't let anyone ever tell you that equity is bad. How many Americans would love to have their mortgage paid off tomorrow? This is truly the *American Dream*...□

