My House, Et Cetera

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Who said a house is not a home? In most cases, it is. Your house can also be your castle. In fact, it can be anything you want it to be, except one thing: your bank. That may sound like a strange statement - but many feel that their houses are their banks, savings accounts, and educational and retirement funds, all rolled up into one. Maybe I should explain.

When you buy a home, you usually have to get some form of financing to purchase it. This is called a mortgage. If the home sells for $100,000, you need to pay a certain amount as an initial payment, and the rest is borrowed from a lending institution. This is then paid off over a period of years. The lending institution charges you to borrow that money at whatever the going rate of interest is at that time. Initial payments by an individual usually range from as little as 5%, up to as much as 20%. You can even set up a 20% first mortgage with a 20% second mortgage, which allows you to get into a home with almost no out-of-pocket money. The payback of the loan is usually either 15 or 30 years. That is how a mortgage works.

Many people feel like they should pay off this loan or mortgage as soon as possible. They get the thought in their minds that any debt is bad, and it needs to be eliminated. They opt for a 15-year mortgage and then make additional payments to get out from under this debt. They also feel that their homes have now become banks, and that they have built a huge savings account within this home/bank: it is their future; it is the money they will need and use for the education of their children and it is also their retirement account, all rolled into one neat package - their own private bank.

Sounds wonderful, doesn't it? Your house; your home; your castle; your education funds; your retirement - your bank! "And they all lived happily ever after..." Is that how it really is once you take off those rose-colored glasses? After all, debt is a "four-letter word."

If you have a new 30-year mortgage for $100,000 at 6%, and you pay an additional $100 per month into principal payments, you could pay off your loan in just 21 years and save almost $40,000 in interest. What that boils down to is that your "extra" payments toward the principal "earn" an investment return equal to your interest rate (6%, in this example). Sounds great, doesn't it? Is there a downside to this? Once your "money" is in your home, how do you get it out? Do you have a little door in your backyard that you can just open and take out your money? I know I don't! There are two ways to get to the equity in your home: You must either sell your home; or take the money out as a loan.

If you take money out as a second mortgage or a home equity loan, it will be at the current interest rate. What will that be when you want to get to "your" money? Who knows? It could be at a similar rate, or it could be a lot higher. If you have a 6% rate (or lower) currently, a few years from now I am sure you will be looking at a much higher rate. That means you must now pay more to get to your own money. Yes, that interest is deductible, but it is false security when you have to start "buying" tax deductions!

You have to remember one thing: Mortgage debt is one of the best debts you can have. In most instances, it is for a long term, at least 15 or 30 years, and the rate of interest is usually fixed. It is also one of the few debts that - if the rates do get cheaper - you can refinance your loan and take advantage of the lower rate, like many have done recently. There are some new variations on mortgages springing up that you might want to explore. Portable mortgages; no-cost mortgages; 5-25 mortgages; 7-23 mortgages; arms; the list will continue to grow as rates change and lenders get more creative. The one thing to remember is to take a look at them and decide which one fits your needs the best. Don't go with the "mortgage of the month" deal!

Remember that the interest on the entire loan is tax-deductible. If your loan is at 6% and you are in a 30% tax bracket, your net interest rate is just 4.2%. The higher your tax bracket, the lower your net cost. Mortgage money is the cheapest money you will ever buy. If that is the case, why pay it off early, especially if your money is then only available to you at the going rate of interest? Think about that one.

Not only is this money tied to the current interest rate, but you must also be concerned about the value of your home keeping up with inflation. Most homes in the United States have only appreciated at the inflation rate, around 4% per year. Yes, there are areas where they have gone up a lot faster, but the opposite is also true, and real estate always goes through its ups and downs. You might need to tap your equity when the market is very low and interest rates are very high. You must also be able to show that you can pay off that loan, so you might have a problem using your equity for retirement.

You do need to build equity, but you need to have it in areas that are easier to get to with no strings attached. You also need to build retirement benefits that will be there when you need them; the same is true with educational funds. There are many methods available to you that work much better than using your home as your only place to stash cash. Your house is your home and your castle, but there is no need to build a moat around it with drawbridges and put a vault door in place of the front door. Leave that expense to the banker down the street! You have enough to deal with when it comes to fighting the weeds and the crabgrass!

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