Be It Ever So Humble

In this, my introductory column, I want to distinguish myself as quickly as possible. However, I think it's important to make it clear that I'm not suggesting anything overly radical. I'm also not advising anything that I wouldn't do myself.

Everyone is told, at one time or another, that your home is the single most important investment you will ever make. I have two issues with this common and oft repeated statement. First, the building you own, the building in which you live should only be considered an investment in the long-term. No one wants to move every two years, and your investment strategy as pertains to your house should be based on a longer time horizon. Second, the investment is a house; a home is a lifestyle choice. Before tackling the heart of this column, issue one above, let's take a quick look at issue two: your home as a lifestyle choice.

As a confirmed bachelor, the house I may find that would be perfect for my lifestyle may be a small one. I might find a house with two bathrooms in an urban, upscale neighborhood with the worst schools in a fifty-mile radius. I'm single, I have no children and I have no desire to have children. For me, this house is perfect. Unless, that is, I'm planning to sell it in two years at a nice profit.

If I look at my purchase of a house strictly as a short-term investment, intended to net me a tidy profit of 15% - 20% in the next thirty months, the house in the urban upscale neighborhood is the worst possible choice. The neighborhood and house both scream for a very specific buyer; single people or childless couples in their late-30s or early-40s. There may be many of these buyers, or their may not. From a strict, investment standpoint, the urban house is a lousy choice.

But, from a lifestyle perspective, the suburban house is an equally bad option. The streets, with their picket fence lined yards and laughing children will definitely appeal to the constant inflow of young couples and families that migrate around the nation for a variety of reasons. With good schools, parks and other families in the neighborhood, the second house is one I can expect to sell rather quickly, when the time comes. From a pure investment standpoint, I should buy this house. I will be happier when I go to sell it in eighteen months. Of course, I will be miserable the entire time I live there.

My point is this: Buy your house for your lifestyle. There are better ways to invest than a house. There are assets that have greater liquidity: stocks and bonds, for example. In the event of a catastrophe, even a 401-K is a more ready source of funding than a house. Even in the hottest real estate market, a house can languish unsold for weeks or months, and even when a contract is written, weeks can pass before closing.

With all these facts in mind, you may ask why I advocate buying a house at all. Certainly, renting an apartment or a house is a cheaper option, at least in the short run. There is no large down payment required for a rental property and you always have the ability to leave in a hurry, should circumstances warrant. Where is the advantage in buying a house?

The first, and most important advantage to buying a house, as part of a long-term investment strategy, is as a hedge against inflation. Any 20-year, 25-year or 30-year fixed-rate mortgage has the distinct advantage of never going up. While insurance and taxes may increase marginally, the bulk of any monthly mortgage payment is principle and interest on the loan itself. While the rent on any apartment can, and likely will, go up every year, your house payment will remain relatively flat. Imagine that you put 20% down on a $150,000 house today. At current interest rates, your payment would be near $720 per month. If you were to rent an apartment for the same amount, and your rent went up a mere 3% per year, in five years you would be paying an extra $90 per month for the same home. At 5% per year, that figure jumps to $155 per month. Truly, a house is a great hedge against inflation.

But more than being a way to ensure that your future raises aren't completely consumed by the inflation in your rent, a house can be a valuable part of a long-term investment strategy. Using your house as part of your personal "capital structure" can open great opportunities for personal leverage and the growth of personal wealth.

Recently, with mortgage interest rates coming down and housing prices increasing, homeowners are looking at new options on their mortgage. Refinancing a house at a lower interest rate, especially for a shorter term, has become increasingly popular. I'm all for refinancing at a lower interest rate, but is a shorter term the best idea?

Let's go back to the house you bought two paragraphs ago. With a $120,000 mortgage, you got payments of $798.36 when you financed at 7%. Now, interest rates are down, the value of your house is up and you're ready to refinance, what are your options?

The first option is to refinance from a 30-year to a 20-year mortgage. In this scenario, you still owe $117,474 on the original $120,000 mortgage. Assuming there are no points or origination fees, you will see your monthly payment increase by about $50 and you will have cut the time until you pay off your house by eight years. That's great, if all you care about is owning your house outright.

If, however, you want to get the biggest bang for your buck, may I humbly offer a second option? If you are able to get your house re-appraised, you can increase your overall wealth by refinancing with a bigger mortgage on another thirty-year note. This is very much like taking out a home-equity loan with one difference: you're really just creating a larger primary mortgage.

When you bought your house, it was appraised at $150,000. Now, two years later it has appreciated, from $150,000 to $165,375, a 5% annual increase in value. You can take a new mortgage up to this amount, but wisely you chose to avoid Primary Mortgage Insurance and only borrow 80% of the appraised value. Your new mortgage is for $132,300. You've taken $14,800 of your homes equity out in cash and your monthly payment is $5.15 less than it was before you refinanced.

In the twenty-five years ended in January, the S&P 500 has grown at an average of 9.5% per year. That even includes the bad years of 2001 and 2002. Since the S&P performs well over time; it's conceivable that the trend will continue. The combination of reasonable stock returns and relatively low mortgage rates allows most homeowners to do what, until now, only large corporations could do: use financial leverage.

By using debt in your home as equity in the financial markets, you have the potential to realize comfortable gains, even though you're paying interest on some of your money. Think about it. That $14,800 equity you took out of your home will cost you $85,000 in principal and interest over the next 30 years. That's a lot of money. But, at historical returns, it will net you $225,000 profit in the market. This is the largest advantage your house can provide you, financially.

As you live in your house, think about the long term. You should never be in a position where you have paid off your mortgage before you have stopped working. Your house is the biggest opportunity for financial leverage available to you. Every few years, you should be considering the following:

•Has my house appreciated significantly? If so, will I be able to have my house reappraised when I refinance?
•Have interest rates gone down or remained flat since my last refinance?
•Has my income increased significantly since I last refinanced?
•Do I have at least ten years remaining before retirement?

If the answer to all of these questions is yes, it's time to refinance.
You should be looking at another refinance of your house. Always try to balance two important aspects of your decision: keeping the payments as close to what they were before as possible, and taking as much cash equity out of the house as possible. If you think of your house, not as an investment in and of itself, but as a tool for leverage, you'll be happiest. You won't be looking for a new house every couple years, and you'll never be uncomfortable in a house that's more house than home.