[IMAGE]

The Pros and Cons of Mortgages

By Stanley Greenfield

Mortgages truly are the eighth wonder of the modern world. You might think that's a bold statement, but think about it for a moment. You decide you want to live in a house. So, what do you do next? Humor me for a moment, and let's assume mortgages haven't been invented yet.

What do you do first? Start saving money? If the house costs $100,000 (more humor), how much can you save a year? After expenses and taxes, let's say you're lucky enough to save $5,000 to $8,000. That means it will take you anywhere from *12 to 20 years* to save enough to buy a home. Yes, you will earn some interest on that money, but realize "Murphy's Law" also might come into play, which might force you to take some of that money out for emergencies.

Let's take the analogy a step further. You get lucky and along comes Max Mortgage, the man who invented the mortgage. Now you can buy that home you've been dreaming of *today*. How amazing! You can live in your home and enjoy it while you pay for it. Ronald Rents (yep, the man who invented rent) might not be too happy about this new development, but you now have the home of your dreams. All you have to do now is come up with enough money for a partial or down payment and some legal fees, and you can move in and start paying off the balance.

image - Copyright â Stock Photo / Register Mark Not so fast. Since Max came up with his idea of the mortgage, many variations have been created. The so-called *basic mortgage* is one where you pay off the house over a 30-year period after the initial down payment. Since you have borrowed the funds, you do pay interest for the use of that money. The IRS has determined that it's a good thing to own a home, so it decided the interest payments are tax deductible. The ninth wonder of the modern world!

image - Copyright â Stock Photo / Register Mark In the early years, the vast majority of what you're paying is interest and is tax deductible, so your "net" cost after taxes is even lower. If your monthly mortgage payment is $1,000 and you're in a 30-percent tax bracket, your net cost is only $700. At this point, I think I can safely say mortgage money is the cheapest money you will ever buy. Don't ever lose sight of that fact.

Like I said earlier, there have been many variations on the basic mortgage idea. You can get a mortgage that only runs for 15 years. But why would you do that? You're paying interest on the amount borrowed, so the shorter the payment period, the less you pay in interest. However, since mortgage money is the cheapest money you will ever buy, why would you want to pay it off early? It might be a personal decision, but it's not a good financial decision.

Another point to keep in mind is that when you get a mortgage, it can be at a fixed rate of interest for the amount borrowed. You also can get a mortgage with an interest rate that can vary either up or down. If rates go down, you'll have a cheaper rate, but if they go up, you'll have more interest to pay - if you can afford it. Since we can never predict the future, you want to know what you can afford and keep your rates locked in so you don't have any "surprises" in the future.

Other variations can come into play as well. Don't have the money for the down payment? Not a problem. You can borrow that, too, and get a tax deduction on the interest payment.

image - Copyright â Stock Photo / Register Mark I would never recommend buying a home with the idea that you will hold it for a year or two, and then sell it and make a big profit so you can buy an even bigger home (and maybe sell *it* after a few years for an even *bigger* home). There are a lot of assumptions in this equation. The first one is that the value of the home will appreciate enough so you can cover all of your initial costs, plus make a profit; and that the market will be a good one for selling. There are two very big "ifs" in this scenario. What if your home doesn't appreciate and what if the market isn't a seller's market? It's a risky game to play and you might lose, as many have done in the past and will again in the future.

image - Copyright â Stock Photo / Register Mark Real estate is not always a good investment. Homes in America have appreciated at about the same level as the inflation rate. Some areas of the country have done much better and some have done worse. Overall, the rate of growth has been around 3.5 percent per year, which is nothing to get particularly excited about. Buy a home because you want to live in it. If it does grow in value, consider yourself lucky.

image - Copyright â Stock Photo / Register Mark Some people get very excited about how much equity they have accrued in their house. Think about that for a moment. How do you get to that money? There are only two ways: sell the home or borrow the equity. If you sell, you still need a place to live, so the equity probably will go into the down payment on a new home. If you borrow, you will pay whatever the current cost of money is. Since you bought that home, the cost of money may have gone up quite a bit. Since this is a "new" loan, the rate will be based on the current costs, not your original cost.

I could go on and on about other variations on mortgages, but I think I’ve covered the basic ideas and concepts. Here’s the most important point: Do a little homework and become an educated consumer before you sign on any dotted line. Understand how mortgages can work for and against you. What it all boils down to is that you have options. Choose them wisely.

Stanley Greenfield, RHU, is a financial consultant and health insurance underwriter in Jacksonville Beach, Fla.