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10 Great Reasons to Carry a Big, Long Mortgage

Never own your home outright. Instead, get a big 30-year mortgage, and never pay it off (assuming you can afford to make the payments on the mortgage).

Now, I know that you don't want a mortgage. What you want is a house, but to get it, you must obtain a mortgage. If you're like most folks, you hate your mortgage, and you'd love to get rid of it as soon as possible. You grimace at every monthly payment, and you know that, over 30 years, you'll pay more in interest than you paid to buy the house in the first place.

That's why you put down as much money as possible — to keep the mortgage as small as you could. You might have taken out a 15-year loan to get the loan paid off in half the time, and might even be making extra payments, or perhaps signed up for one of those biweekly loan programs, all to enable you to get rid of the mortgage just as quickly as possible.

You do all of these things, of course, for a very basic and deep-rooted reason: because your parents taught you that you should never have a mortgage, and the key to the American Dream is to own your home outright.

Yet, a Big 30-Year Mortgage Is Best

Although your parents' advice once made sense, today it is completely wrong. In today's economic environment, a big, 30-year mortgage may be the best thing you can have. (Now, don't confuse the idea of a big mortgage with that of a big house;

So: Never pay off the mortgage. Reject 15-year loans, never make extra payments, and forget about those biweekly mortgage payment plans.

Before you dismiss all this, read on — because I'm about to show you how your mortgage can help you build wealth over the long term.

First, understand that everything you know about mortgages — and particularly what you fear about them — is wrong. The myths you believe were told to you, bless their hearts, by your well-meaning parents and grandparents. They told you that mortgages are dangerous, that having one means you can lose your home. They told you this because they remember the Depression era, a time when millions of Americans lost their homes. Although mortgages were indeed dangerous in the 1930s and 1940s, the rules of money have changed and, unfortunately, your elders don't realize this. So, by learning why your elders were correct in their desire to pay off *their* mortgages, you'll come to understand why you should keep *yours*.

Times Have Changed...

In the 1920s and 1930s, banks were permitted to cancel mortgage loans at any time. And when the stock market crashed in 1929, that's exactly what happened. You see, back then, investors were able to buy stocks with just a 10% down payment — Wall Street loaned them the other 90%. But when the stock market crashed on October 29, 1929, brokers demanded that their clients pay back their loans. The investors had no choice but to go to their banks and withdraw whatever cash they had. Quickly, the banks ran out of cash. So, they turned to *their* borrowers — homeowners who had taken out mortgages — and demanded instant repayment. Those 30-year loans were suddenly due in full immediately. The result: Millions of Americans, unable to pay off their loans, lost their homes to foreclosure. Thus, the lesson was learned: Americans learned that you must own your home outright, with no mortgage, for that is the only way you can be sure that you'll never lose it. This mantra was indelibly etched into the American psyche.

But Congress changed the rules decades ago. As a result, banks are no longer permitted to demand that you repay your mortgage loan immediately. If you make this month's payment, the bank can do nothing but wait for next month's payment. Therefore, carrying a mortgage does not carry the risk it once did.

Still, many people believe mortgages are expensive, and you'd rather avoid paying all that interest. That's why you like the idea of sending in extra cash with your monthly payments. You know that paying off the mortgage early will save you huge amounts in interest charges. Although that's true, you need to turn that coin over, because there's another side you have

overlooked. To help you understand why paying off the mortgage is a bad idea, let's explore my *Ten Great Reasons Why You Should Carry a Big, Long Mortgage*.

Reason #1: Your mortgage doesn't affect your home's value.

You're buying your home because you think it will rise in value over time. (Admit it: If you were certain it would fall in value, you wouldn't buy it — you'd rent instead.) Yet, the eventual rise (or fall) in value will occur whether you have a mortgage or not. So go ahead and get a mortgage: Your house's value will be unaffected.

That's why owning your home outright is like having money buried under a mattress. Since the house will grow (or fall) in value with or without a mortgage, any equity you currently have in the house is, essentially, earning no interest. You wouldn't stuff ten grand under your mattress, so why stash two hundred thousand into the walls of the house? Having a long-term mortgage lets your equity grow while your home's value grows.

Reason #2: You're going to build equity anyway.

Many homeowners try to build equity in their house by paying off the mortgage. But that produces weak results when compared to the equity you can build simply by watching the house appreciate in value over the long term. So go ahead — keep the mortgage. In the long term, you'll build plenty of equity anyway.

Reason #3: A mortgage is relatively cheap money.

There's no way you can avoid debt in today's society. Cars and college — let alone big screen TV's — virtually require you to have loans. And you'll find that mortgages offer you perhaps the cheapest way to borrow. Mortgage loans offer low interest rates because you post the house as collateral: If you fail to repay the loan, the lender sells your house to recoup its money. (By contrast, if you buy clothes with VISA, the credit card company can't repossess your sweater when you fail to pay your credit card bill. That's why VISA charges as much as 18% to 24%: Collecting high interest from some customers reduces its losses when other customers don't repay their loans.)

Reason #4: Mortgage interest is tax-deductible.

Not only are mortgage loans low in cost, the interest you pay is tax-deductible. You can save as much as 35 cents in taxes for every dollar you pay in interest. That means a 6% mortgage loan really costs as little as 3.9%. Why carry 18% credit cards, paying interest that is not tax-deductible, when you can instead carry a 6% mortgage with interest that is tax-deductible? Your mortgage is probably the cheapest money you can borrow, so it makes sense to get as much of it as you can.

Reason #5: Mortgage interest is tax-favorable.

Assume you have both a 6% mortgage and a 6% profit on your investments. The mortgage is deductible at your top tax bracket, but the investments are taxed as low as 15%. For someone in the 25% tax bracket, that means the mortgage costs them 4.5% while the investment nets them 5.1% after taxes. In other words, tax law makes it beneficial for you to maintain your mortgage.

Reason #6: Mortgage payments generally get easier over time.

Carrying a mortgage gets to be fun, too. Yes, *fun*. My father used to love to talk about his mortgage — all \$98 per month of it. You see, he and my mom bought their home in 1959 for the whopping price of \$19,500! Yet, my dad tells how his father thought he was crazy. How in the world was my father going to be able to handle such a huge mortgage payment, Grandpop Max asked. After all, my father was earning less than \$3,000 a year back then. To spend \$1,200 a year on mortgage payments...Grandpop Max thought my dad was nuts!

Of course, by the 1970s, Dad was laughing about it. Why? Because his monthly payment in 1974 was identical to what he was paying back in 1959. Yet, Dad's income had risen steadily. Thus, his mortgage payment had become insignificant when compared to his income — not to mention the fact that his house had grown substantially in value.

You might be struggling to make your mortgage payment at first, but over time, you can generally expect your payments to become cheaper relative to your income — especially if

yours is a fixed-rate loan as your payment will never rise but your income probably will.

Reason #7: *Mortgages let you sell without selling.*

In time, you may well find that your home has grown substantially in value, and you may begin to worry that you might lose that equity if there's a decline in real estate values. You don't want to sell the house, which is the obvious way you can capture the value, but there is another answer: Get a mortgage. By cashing out some of the equity, you essentially collect part of the value of the house in cash without actually having to sell the house.

Reason #8: *Large mortgages can let you invest more money more quickly.*

Assume you own a house and want to buy a larger home. So you sell your old house and net \$300,000. Now you're ready to purchase a new \$500,000 home. How much should you put down? Should you make a 10% down payment of \$50,000? Or should you put down the entire \$300,000 in proceeds from the sale of the old house?

Big mortgages mean small down payments. Small down payments mean you can retain lots of cash that you can then invest.

Small mortgages are the opposite: Small mortgages require big down payments, which leave you with little to no cash left over for investing.

In the above example, the \$50,000 down payment (assuming a 7% mortgage rate) produces a monthly payment of \$2,994*, while the \$300,000 down payment results in a monthly payment of \$1,330.

So, the small down payment lets you invest \$250,000 right now, while the big down payment costs \$1,664* less per month. That's money you can invest monthly. Do not spend the money on vacations, furniture, cars, or college. You should invest these assets prudently. If you don't know how to do that, turn to a professional financial advisor for help.

So which would you rather do: invest \$250,000 today, or \$1,664* per month for 30 years?

Without question, investing the larger lump-sum today produces a larger investment portfolio than investing a small amount over long periods. Assuming both investments earn 8%, the account that's started with \$250,000 will be worth \$270,000 in just 1 year, while the account that invested \$1,664 monthly would be worth only \$20,717. After 15 years, the lump-sum investor has \$793,042 — \$217,235 more than the monthly investor. Same story after 30 years — clearly, the bigger mortgage leads to a larger investment portfolio!

Reason #9: *Long-term mortgages can help you create more wealth.*

Do you merely want to eliminate your debt, or do you want to truly build wealth? Please realize that the former does not automatically result in the latter. Indeed, many people who are debt-free are also dead broke.

So, the real goal is to create wealth. You do that by adding as much money as you can to your savings and investments. And the best way to do that is to lower your monthly expenses. That's why long-term loans are better than short-term loans: The longer the term, the lower your monthly payment. And the lower the payment, the more money you have left over that you can place into investments.

Reason #10: *Mortgages can give you greater liquidity and greater flexibility.*

Let's look at a hypothetical example for illustrative purposes. You have two guys, Sam and Nick. They both earn \$75,000 a year. Both have \$50,000 in cash. Both buy a \$250,000 house. Nick wants to minimize his mortgage, so he uses his \$50,000 in savings as a down payment, and he opts for a 15-year loan at 6.75%. His monthly payment is \$1,770 — but only 64% of that payment is tax-deductible interest; the rest is principal. Therefore, Nick's net after-tax cost for his mortgage is \$1,489. And to pay off his mortgage even quicker, Nick sends in an extra \$100 with every payment. Of course, these payments are devoted entirely to principal, and therefore provide no tax deduction.

Nick's decision to send extra payments to his lender is a critical point. You see, every time you send extra money to your mortgage company, you deny yourself the opportunity to invest that money elsewhere. In business school, professors call this "opportunity cost." It means,

essentially, that every time you turn left, you deny yourself the opportunity to turn right. So, although paying off the mortgage saves you interest, you deny yourself the chance to earn interest with the money you used to pay off the mortgage.

Sam understands this, and therefore, he obtains a 30-year mortgage at 7% (a bit higher than Nick's rate). He puts down just \$12,500 and finances the rest. Even though Sam's mortgage balance is bigger than Nick's (\$237,500 compared to \$200,000), his monthly payment is lower (because it's a longer term). That's not all. A full 88% of Sam's payment is interest, meaning that Sam's after-tax cost is just \$1,234 a month — \$255 less than what Nick has to pay! (It's possible that Sam might incur an extra cost for Private Mortgage Insurance which could affect this math.) Sam invests this savings of \$255 each month for five years, earning 8% after taxes per year. And, instead of sending an extra \$100 a month to his mortgage company, as Nick does, Sam adds it to his savings.

Over five years, Sam has about \$79,000 in savings and investments. Nick, however, has no cash whatsoever, because he's placed every available dollar into mortgage payments. So, when both men suddenly find themselves out of work, Sam is in excellent financial condition, but Nick is in real trouble. He has no savings to tide him over, and he can't gain access to the \$100,000 worth of equity that's in his house because, being out of work, the bank turned down his loan application. (It's true: Lenders don't care about how much equity you have in the house. They lend money only to people who can repay the loan. With no job, Nick has no income, and therefore, he cannot qualify for a loan. Indeed, Nick has fallen victim to the biggest misconception in real estate: A mortgage is not a loan against the house; it's a loan against your *income*. Without an income, you cannot obtain a loan.)

If Nick doesn't get a job real soon, he may lose his house. How ironic! Nick, who never wanted a mortgage in the first place and who did everything he could to eliminate his mortgage as quickly as possible, is now in serious financial jeopardy! Sam, though, is in much better shape. With \$79,000 in savings, he's easily able to make his payments each month. In fact, he can make mortgage payments for four years, giving himself plenty of time to find a new job!

And that's really my point. When you have a mortgage, you are required to make only that month's payment. As I explained at the beginning, you are never required to pay off your loan immediately. You might *want* to do so, but that doesn't mean you must do so.

You must not send extra payments to your mortgage lender. Invest that money instead, just as Sam did. Never prepay your mortgage payments like Nick did, because once you give money to a lender, the only way you'll ever get it back is to re-borrow the money or sell the house. Selling your home is the last thing you want to do, and if unemployed, you probably will be unable to get a loan when you need it most. Besides, if you're simply going to borrow it back later, why bother giving the money to the lender in the first place?

This explains why you should not participate in biweekly loan programs. They promise to pay off your 30-year loan in 22 years by having you make half the payment every two weeks. But this gimmick is nothing more than a math riddle. You see, there are 52 weeks in a year, so making half your payment every two weeks means you'll make 26 half-payments. That's the same as 13 full payments. And *that's* why you'll cut your 30-year loan to 22 years: You're simply making extra principal payments. Don't do that. Make your normal payment instead, and place that 13th payment into savings and investments.

Okay, you're convinced. So, tip your hat to your spinning-in-his-grave grandfather, and get a big, long-term mortgage today!

*Figure does not include PMI which may be incurred.

The examples used here assume the rate of return on investments will be greater than the interest rate paid on a home mortgage. As there are risks with virtually any investment, there can be no assurance that you will achieve returns greater than the interest rate on your home mortgage.

What the Academics Say About Mortgages

“Thus, a homeowner with a long time horizon and a willingness to assume some risk will likely have a much higher net worth than someone who selects the less risky option of the 15-year mortgage.”

"The Effects of Income Tax Rates and Interest Rates in Choosing Between 15- and 30-Year Mortgages." *The CPA Journal* #65, 1995.

"...home owners...may not be adequately considering the opportunity costs of the investment in their home. Individuals should not attempt to analyze the mortgage decision in isolation from their overall personal financial plan. Instead they should consider the mortgage decision along with their plans for long-term investing, insurance needs, tax planning and so forth. If the only way home buyers can afford the higher 15-year mortgage payment is by delaying long-term investments or by limiting the funds they commit to a long-term investment plan, they may be better off in the long run by taking the 30-year mortgage with the lower payment and investing the difference...."

"...the 30-year mortgage is clearly the best financial choice for many home buyers."

"15-Year Versus 30-Year Mortgage: Which Is the Better Option?" *Journal of Financial Planning*, April 1998.

"Planners must consider many factors when analyzing the 15-year versus 30-year mortgage option, but certain issues deserve mention. First, even if the mortgage is held to maturity, the argument that the 15-year option is optimal because fewer total dollars are spent to purchase the home is seriously flawed. The fact that a smaller total dollar expenditure is required for the 15-year loan is irrelevant to the maturity decision."

"Including a Decreased Loan Life in the Mortgage Decision" *Journal of Financial Planning*, December 2003.

"Advantages of the 30-year mortgage include lower monthly payments and accumulated wealth, in an investment account available to help alleviate hardships. Withdrawals from the investment account would be free of penalties for the non tax-deferred accounts, and free of penalties for the tax deferred....The data showed that a borrower...willing to invest with a risk level associated with the S&P 500 would benefit from a 30-year mortgage."

"Effect on Net Worth of 15- and 30-Year Mortgage Term." *Journal, Association for Financial Counseling and Planning Education*, 2004.

"When households have a substantial risk of unemployment -- or of a big fall in income -- a long-term fixed rate mortgage looks preferable."

"The long-term fixed-rate contract becomes more attractive as people start to borrow a lot."

"It is reasonable to expect that if consumers in the UK were helped to understand better the risk and cost profiles of different types of mortgages there would be more longer-term fixed-rate lending."

"UK Mortgage Market: Taking a Longer-Term View. Final Report and Recommendations." HM Treasury on behalf of the Controller of Her Majesty's Stationery Office, March 2004.

"The popular press, following conventional wisdom, frequently advises that eliminating mortgage debt is a desirable goal. We show that this advice is often wrong...mortgage debt is valuable to many individuals."

"Mortgage Debt: The Good News." *Journal of Financial Planning*, September 2004.

"Better financial results accrue to some borrowers when they select a 30-year mortgage coupled with a simultaneous investment plan rather than a 15-year mortgage term and a subsequent investment plan...for the vast majority of borrowers, there remains a significant probability that the 30-year mortgage is the better mortgage product even in higher mortgage rate scenarios. Further, the financial benefit associated with a 30-year mortgage increases as the borrower's marginal tax rate and risk tolerance increase."

"Is a 30-Year Mortgage Preferable to a 15-Year Mortgage?" *Journal, Association of Financial Counseling and Planning Education*, 2006, Volume 17 Issue 1.

"...U.S. households that are accelerating their mortgage payments instead of saving in tax-deferred accounts are making the wrong choice...in the aggregate, these mis-allocated savings are costing U.S. households as much as \$1.5 billion dollars per year."

"The Tradeoff between Mortgage Prepayments and Tax-Deferred Retirement Savings." *Federal Reserve Bank of Chicago*, August 2006.

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