

Keeping Your Eye on the Ball: The Financial Benefits of Homeownership

KEN HARNEY- NAHB "House Keys" Consumer E-Newsletter

Keep your eye on the ball: That's essential advice not only for many sports, but for anyone thinking about buying — or not buying — a house this spring or summer. With all the negative news about real estate lately, it's easy to get distracted. Maybe a house isn't such a great investment any more, you might wonder. Maybe it makes sense to wait for awhile and see how things shake out.

Those are absolutely reasonable considerations. And there's no question that buying a house — especially your first — can be a perplexing, even scary, matter. I remember buying my own first house years ago, toward the end of a boom period in prices and sales.

My wife and I said to ourselves: After years of high appreciation, we probably won't see a gain in the value of this house for a long time. Given our timing, maybe this won't be a smart move.

Well, we did buy the house with a small down payment. And yes, the market was flat for the first year, and only perked up a little in the second year. But by the third year, we knew we had done the right thing financially.

Our small down payment had allowed us to purchase a relatively large asset — a three bedroom house on a quarter-of-an-acre lot. Even when the property gained only 2 or 3 percent a year, that turned out to be quite a lot of gain in dollar terms, thanks to the "leverage" or multiplier power of home real estate.

Leverage is one of the key differences between buying a house and buying stocks or bonds. Consider this example. Say you buy a \$250,000 house with a 5 percent down payment (\$12,500). Assume that, like my own first home, the market basically was soft for the first year or so.

But now let's say that during the second year, the local real estate market begins to warm up and home values rise by 5 percent — which is roughly the average annual appreciation rate in the United States since the 1970s, according to the federal government.

Now your house would be worth 5 percent more than you bought it for, \$262,500. And, thanks to the power of leverage, you've already doubled your initial \$12,500 cash investment. You've got a net \$25,000 in equity.

If it continues to appreciate by that historical average 5 percent rate, it would be worth \$275,625 at the end of year three, \$289,406 at the end of year four and \$303,876 at the end of year five.

During that time — even without a big boom in property values — your \$12,500 would have more than quintupled to \$66,376, and you would control an appreciating asset worth nearly \$304,000!

Compare that to a bank account at 5 percent interest compounding annually. Your \$12,500 deposit would grow to just \$15,194 by the end of year five, a \$2,694 gain.

Or compare it with most stocks or bonds, where there is no leverage. You put up your \$12,500 and you get \$12,500 (or less) worth of stock in exchange. That stock may go up or down, but

unless you are very lucky, there's little chance it will give you control of a \$300,000-plus asset or a \$54,000 profit on paper in just 60 months.

And by the way, unlike any profits from other financial assets, all of your capital gains from owning a house are virtually certain to be tax-free (up to \$500,000 for jointly-filing couples, up to \$250,000 for single filers).

Then there is the functional value of owning a home, in a flat market or a surging market. You can't live in a bank account or a stock portfolio. But your house will both shelter you and your family, and help build you a nest egg that grows and grows over time.

Do I sound like I am enthusiastic about owning a home?

I should be. I've owned a number of them, and have never regretted the then-scary decision my wife and I made to ignore the short-term discouraging conditions in our local real estate market, and to take the longer view and put our scarce dollars into a modest house.

Flat or down markets, in fact, may well be the best times for buying a first house. Prices tend to be lower and more affordable. Home builders and sellers tend to be more willing to negotiate, and mortgage rates — like today's — often are lower than during high-inflation periods.

Before making the big decision to buy — or not to buy — make sure you've done your homework and have a good grasp of your own household financial situation and your capacity to handle the costs and responsibilities of a home.

Study the various mortgage options that are open to you. Some of them are designed to lower your payments during the early years — when you may face the toughest budget squeeze — and recoup the deferred amounts in later years, when you're better able to handle higher payments.

Make sure you know — and can handle — all the costs associated with a purchase, including closing fees, ongoing property taxes, regular maintenance expenses, homeowners association fees, to name just a few.

Once you've done all this, you should be ready to stand up and take your turn at bat. Keep your eye on the ball — the overwhelming financial advantages of investing in a home — and get into the game.

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