

## Your Best Investment? The Pros and Cons of Owning a Home

Almost seven out of ten American families are owners rather than renters – with good reason.

Congress has showered real estate with tax breaks, making it possibly the most tax-favored investment. Indeed, even after the recent slump in property prices, many folks boast that their home is the best investment they ever made.

Homeownership also has enormous emotional appeal. We like to own the four walls that surround us. We tend to show far greater patience with real estate than with, say, our stock market investments, in part because we don't get continuous price updates. Yes, our homes may have lost value this year – but because we don't know precisely how much, it is hard to get too upset.

Still, this doesn't mean you should load up on real estate. Here is why a home can be a great investment and where things might go wrong.

### HITTING A HOME RUN

At first blush, real estate doesn't seem like any great shakes. According to home finance corporation Freddie Mac, home prices have climbed 4.3% a year over the 30 years through year-end 2009, versus 3.5% for inflation.

Yet many folks fare far better than these numbers suggest – thanks to their mortgage and the way it leverages gains. Let's say you purchase a \$200,000 home. You borrow \$160,000 and put down 20%, or \$40,000, which represents your initial home equity. If your home's price climbs 20% to \$240,000, your home equity will jump 100%, from \$40,000 to \$80,000.

Your home equity will also grow as you pay down your loan balance. In effect, you're saving money with every monthly mortgage payment.

On top of all this, there are the tax breaks. You can deduct the interest on up to \$1 million of mortgage debt used to acquire a first or second home.

**“You want to buy a house that's the right size for your budget, the right size for your family – and that you can see living in for a good long time.”**

You should also be able to deduct your property taxes, as well as the interest on \$100,000 of home equity borrowing used for any purpose. When you sell your home, you can exclude up to \$500,000 in capital gains if you are married and \$250,000 if you're single.

But maybe the biggest benefit comes when you get the mortgage paid off. At that point, you will still have to pay property taxes, homeowner's insurance and maintenance costs. But the monthly mortgage payment will be gone – and with it one of your biggest living expenses.

### STRIKING OUT

Sound attractive? Now, consider the downside. While a mortgage can leverage your home's price gains, the math can also cut the other way. Take the example above. What if your home's value drops from \$200,000 to \$160,000? Your \$40,000 down payment would be wiped out.

Leverage also doesn't come cheap. Mortgage interest may be tax-deductible. But it is still costing you a bundle. If you pay \$1 in mortgage interest and you're in the 25% tax bracket, you will save 25 cents in taxes – which means the other 75 cents is coming out of your pocket.

The costs don't end there. When you buy, you will be dinged for a home inspection, title insurance, legal fees and mortgage application costs. You might also pay points to get a lower interest rate on your mortgage.

Once you own the place, you will have hefty ongoing costs, including the monthly mortgage, homeowner's insurance, property taxes and maintenance expenses. You may also make home improvements, which tend to be money losers. Time to sell? You may lose 5% or 6% of the selling price to the real estate brokerage commission.

In fact, if you deduct all the costs of homeownership from your home's price appreciation, you may find you have made little or no money. For the same reason, if you buy a vacation home for your own use, you probably won't notch much of a profit.

### SKIPPING THE RENT

That doesn't mean homeownership is a bum deal. Sure, you may not make much on the appreciation, after all

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costs are considered. But you also get to live in the place without paying rent. Indeed, this rent-free living is the big payoff from buying a house. Imagine you didn't own your home and instead had to rent it. You might end up forking over an annual sum equal to maybe 7% or 8% of your home's value. That is an indication of how much value you're getting by owning your home and living in it.

What should you make of all this? On the one hand, you don't want to buy a house that's too small or you could quickly become dissatisfied and end up moving. That will mean incurring the steep cost of buying and selling real estate.

On the other hand, you don't want to buy a place that is too big for your family. The reason: You are tying up a heap of money in an asset that won't generate much price appreciation and that you aren't making full use of.

Moreover, a big house and the accompanying mortgage payments may leave you with little financial breathing room. If you get hit with a slew of unexpected expenses, the sizable monthly mortgage payments may quickly become a millstone.

The bottom line: When you hunt for a home, try to hit the sweet spot. You want to buy a house that's the right size for your budget, the right size for

your family – and that you can see living in for a good long time.

#### HOME PAGES

- Get an estimate of your home's value at [www.zillow.com](http://www.zillow.com).
- Hunt for your next home at [www.realtor.com](http://www.realtor.com) and explore different places to live at [www.bestplaces.net](http://www.bestplaces.net).
- To see how much you might recoup from a remodeling project, check out the Cost vs. Value survey at [remodeling.hw.net](http://remodeling.hw.net).

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Sourcing: Statistics on homeownership come from the Federal Reserve's Survey of Consumer Finances 2007.

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