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Who Really Wins by Paying a Mortgage Off Early?

Have you ever gazed across the Singapore skyline at dusk? It is a beautiful sight. Each time I come home at night I open the curtains and take in the beautiful city view--my key criteria when I was selecting my home. Tonight as I take in the view, I find myself asking, *why do banks own all the skyscrapers?* Banks seem to have so much money they send dollar-sign shaped stars into the night sky above Singapore. Where does all that money come from?

Need Money?

When you need money who do you call? The Bank! They are always happy to offer you a loan. The less you really need the money, the more you can borrow and the better the terms. Just need a little money for a year or so...we've got a great credit card deal for you, don't worry about that 21% interest thing, just sign here. Need a car, no problem, we've got the loan for you. These shorter-term high interest loans on depreciating assets are the worst place for consumers to borrow, and are the beginning of a spiral of debt that keeps most from ever becoming wealthy.

Need a home? Well, the banks will trip over themselves to attract you to their door for this big loan. Why is that? What's so attractive about loaning money for a mortgage?

Mortgage Loans

Banks love mortgages. They often have wars with each other to attract new home buying clients with low initial interest rates. That's good news for consumers. In fact, a long-term low interest loan on an appreciating asset is the best way to borrow money. You have the following advantages on your side as a consumer...

- Since a home loan is secured the interest rates are low. Secured means the bank has the ability to take the home back if you don't make payments on the loan.
- Mortgages are long-term, sometimes up to 30 years or more. Such long time frame puts inflation on the side of the consumer. While the mortgage loan payment remains level month to month, year to year, decade to decade...the spending power of the dollars erode every year. That is, your \$1,000/month payment today will only seem like a \$774/month payment 10 years from now. Why? Because an average 5% per year inflation rate will make the value of every dollar shrink every year as good and services become more expensive.
- Long-term mortgages are also nice if you are early in your career. You are likely to show increasing salary each year which will make the level mortgage payment become an ever lower percentage of your salary.
- Over long periods of time, your home is likely to increase in value. This makes your equity in the home grow faster than just the payments on your loan alone.

- Best of all, you can enjoy all the benefits of living in your home as the full owner even as the bank has paid for most of it.

Building Skyscrapers

Back to those starry skies filled with bank buildings in Raffles Place for a moment more. If home loans are good for consumers, how do banks make so much money? Simple, they focus on three basics of finance...

First, you pay the interest early and the equity late. For example, your \$1,000/month mortgage payment during the first year of a 30 year loan may be composed of \$990 interest and \$10 equity. After the end of year 1, you own little more of the home than at the start of the year. Then, by year 20, you are still paying \$1,000/month, but now maybe \$800 goes toward equity and just \$200 toward interest. The bank wants their interest money for the whole 30 years as soon as possible, and will collect a big chunk of it over the first 10 years of a 30 year loan.

Second, the bank knows most people will sell their home in less than 10 years to upgrade to a larger or newer home, or to relocate outside Singapore, or a host of other reasons. Since they have collected a huge amount of their interest from you during these early years, you still owe the bank nearly the entire balance of the loan when you sell early.

Third, and most clever the bank encourages you to pay off your loan early. They will put together fancy tables that make you think you save huge amounts of interest payments by making extra payments every month or year, or paying off early during the last 15 years of a 30 year loan. Why would the bank want to help you out like that...because they have already collected massive interest payments from you and now they want their equity back to re-lend it to someone else to start the early-loan interest loading with a fresh client.

On the surface, making early mortgage payments looks consumer-friendly. Under the surface, it is building another skyscraper. To take full advantage of the long-term low interest loan, make no early payments and certainly don't pay it off early. Take that extra money and do with it what the bank wants to do...put it to work. Put it into the stock market...in fact, to really get even, buy shares of your bank and profit from all the other mortgage clients less savvy than yourself.

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