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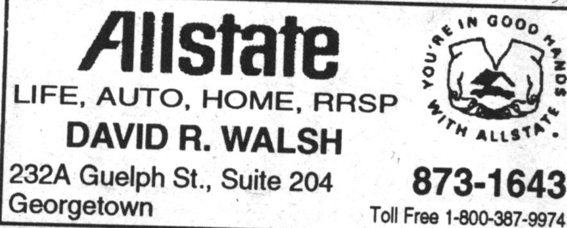

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Can financial planning help pay for your house?

By Paul J. Rockel

Sometimes we disagree with these statements:

"One of the wisest investments you can make is to pay down your house mortgage quickly".

"You can save thousands of dollars by paying the house off as quickly as possible".

Statements such as the above are written and told every day.

And they are correct...partly.

Anyone with a set of mortgage tables and a calculator can show you how much you can save by paying down the mortgage quickly. A simple example is a $100,000 mortgage at 9% interest with a 15-year amortization. The payment is $1,004.52 per month x 15 years = $180,813.60 to pay it off. The same mortgage, spread out over 25 years would cost only $827.98 per month x 25 years = $248,394.00. That's $67,580.40 more. Therefore, it's wise to pay off the mortgage quickly, right?

Some of us say "no".

Why?

As financial planners, many of us know some simple rules that we apply to our lives and the lives of those who seek our advice.

For instance, we know that there are only two ways to earn income, namely: 1) Person at work (1st income); 2) Money at work (second income). We know that time is the most important factor in building wealth, or building that second income, namely "Money at work" for you; 3) We know there are ways of saving that have proven, over the long haul, (such as 15 years) to give returns that exceed the cost of mortgages.

Let's apply these three concepts of financial planning to the purchase of our house.

Couple "A" do their mathematics, and read the articles saying how much they can save by paying down their mortgage quickly, so they decide on the 15 year amortization period. As shown previously, a $100,000 mortgage at 9% interest would require payments of $1,004.52 per month.

Couple "B" decide to consult their financial planner before they commit to the mortgage. The planner suggests they take the 25 year period, with payments of $827.98 per month and save and invest the difference ($1,004.52 minus $827.98) = $176.54 per month.

They follow this advice and make their monthly payments, saving the difference into a mutual fund.

Let's look ahead 15 years.

Couple "A" proudly state: "Hey, look at us! Our house is paid for. Whoopee...no more payments".

Couple "B", on the other hand still have 10 years to go. Too bad!

But is it?

That monthly $176.54 saved and invested into mutual funds is now worth (at 15%) $115,918. (As an example: since 1964 with the Templeton Growth Fund, during the worst 15-year period, the fund averaged 16.1% return per year. In that worst 15 year period, the $176.54 per month would have grown to $128,111.66).

Couple "B" now decide that they too will make no more payments from their salaries or wages. They have now developed a pool of money ($115,918) and they are going to convert it into their "second income...which is 'Money at Work'".

Because the mortgage payments are $827.98 per month, they start a mutual fund withdrawal plan of $827.98 per month which is deposited directly into the financial institution which holds their mortgage for the next 10 years, when the mortgage is paid off. (By the way, that $827.98 comes virtually tax-free. However, the explanation for that requires another article).

Now, look at the results.

Remember, both couples ended up paying out from their salaries a total of $1,004.52 per month for 15 years. Couple "A" ended up with their house free and clear.

Couple "B" ended up paying out from their salaries $1,004.52 per month, of which $827.98 went to pay their mortgage and $176.54 was invested. After 15 years, they took an income from the investment for the next 10 years to pay off the mortgage.

Neither Couple "A" or "B" saved a penny from their salaries for the next 10 years.

Couple "A" have their house.

Couple "B" have 1) their house paid for and 2) probably a whole lot more than the $115,918 investment value left (they were only withdrawing 8.57% of that investment each year while it was averaging more than that) plus 3) if they want to keep that $827.98 income coming to them each month, they will have that much extra each month to spend.

Both couples expended the same amount over the same time. However, couple "B" by using some astute financial planning, has over $100,000 more in assets, plus extra monthly income, and both had their houses paid for!

Does financial planning pay?

Which couple would you rather be?

If you would like a free chart showing the 5, 10 and 20 year period investment results between 1964 - 1992 for the Templeton Growth Fund, contact Peter C. Masson, M.B.A., Regal Capital Planners Ltd., 10 Fagan Drive, Georgetown, Ontario. Phone 877-7216.

Paul J. Rockel is the author of "Why I Invest in Mutual Funds" and Chairman of Regal Capital Planners, a 25 year-old financial planning company with offices from coast to coast in Canada.