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Home, Sweet Castle – Many Homeowners Start Large and Move Upward

By John K. Ryan, The Star
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A prevalent trend within Generation X (those born from the mid-1960s to the 1970s) is the pursuit of ever-larger homes. Part of that comes from Gen Xers' higher incomes, coupled with more flexible mortgage requirements, which have enabled them to buy homes sooner than baby boomers (those born between 1946 and 1964) did. A U.S. Census Bureau survey indicates that 47 percent of 25- to 34-year-olds owned a home in 2003, compared with 43 percent in 1990.

According to a report on HousingZone.com, the major motivating factor for Gen X homebuyers is home equity. NQuery research shows young homeowner focus groups said their homes were a mechanism to build wealth rather than a place to "plant some roots." Most agreed they would be in a different home in five or fewer years. Across the United States, home equity grew from $5.7 trillion to $7.7 trillion during a three-year period ending in March 2003.

Home equity is the single largest component of net wealth for most families in the United States. For some, however, leaping into the housing market is a high risk because it is done so through no-interest loans that minimize monthly payments. "What these homebuyers need to understand is that the interest won't stay low forever," said Cindy Menker, a financial planner with Contour Financial in Orland Park. "That mortgage payment will balloon eventually. People think too much about the tax deduction for mortgage interest, but there are other considerations such as property taxes and money spent for upkeep. This should all be considered before buying a bigger house."

In some of the more high-cost housing markets in the Northeast or on the West Coast, homebuyers have turned to 40-year fixed-rate mortgages in the pursuit of homeownership. According to Bankrate.com, a partner of MSN Money, the primary advantage of a 40-year fixed-rate mortgage is making monthly payments more affordable without taking on the risk of an adjustable rate. Bankrate.com cautions, however, that the difference in payments may not be that significant. The site offers as an example a $200,000 mortgage financed for 30 years at a fixed rate of 5.75 percent, which would carry a monthly payment of $1,167.15. That same mortgage, stretched for an additional 10 years, reduces the monthly payment by slightly more than $100 to $1,065.78.

Other negative factors to consider with a 40-year fixed mortgage include rates are often a quarter to a half percentage point higher than a traditional 30-year fixed-rate mortgage. And homeowner equity on a 40-year mortgage builds at a snail's pace. Some financial experts preach that homeowners should not automatically assume home cost appreciation is inevitable. Catherine Williams, vice president of financial literacy for Consumer Credit Counseling Services of Greater Chicago, cautioned those who treat their house like a "piggy bank." "Home appreciation is not in the Bill of Rights," Williams said. "Appreciation is only what a ready, willing and able buyer is willing to pay."

Still, the allure to look at one's home as an investment is prevalent. The HousingZone.com report indicates home equity gains tend to have a more powerful effect on consumer spending than other gains in wealth (rising incomes, savings, stock market investments, etc.) for two reasons. Families view gains in home-equity wealth as more permanent, whereas gains (or losses) in the stock market are seen as more transitory. Home-equity growth also is more stable, largely because home values are far less volatile than stock prices.

Since 1970, the quarterly growth rate of home values averaged 6 percent (at an annual rate) with a standard deviation of 4.8 percent, while the market for corporate equities has gained 15 percent on average with a standard deviation of 33.4 percent. Based on this information, it is clear that stock values have been far more volatile than house prices. Home equity wealth also is more broadly held across the United States than stock market wealth. The U.S. homeownership rate is 68 percent, while only 53 percent of American families hold stock, either directly or indirectly.

While not a promoter of the "all eggs in one basket" style of investing, Ronald Shropshire, president of Great Lakes Bank, said he can't blame young adults who use real estate as a main form of investment. "Kids in their 20s have only seen growth in that market," Shropshire said. "To them, owning a house is a good investment, which it can be. However, I don't think that it is a good single strategy. You need to diversify. Personally, I have equity, cash and real estate investments. If the market crashes or real estate goes down, I'm not wiped out."

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