SCHWARTZ Report

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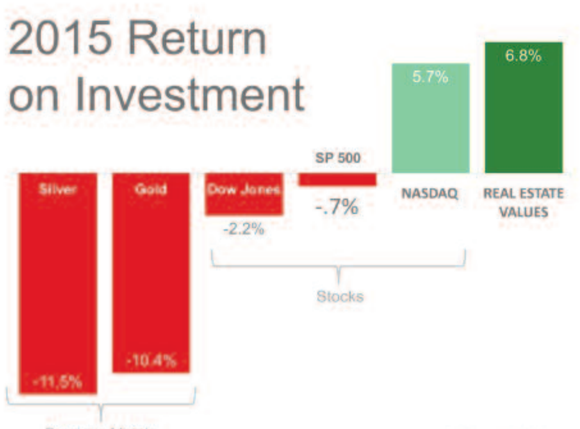
Leverage 2.0

Archimedes, the Greek mathematician and philosopher, is reputed to have said: "Give me a lever and I can move the world." He was, of course, referring to the principles of the lever and specific gravity or the use of a smaller object to move a much larger one. He was not referring to the concept of financial leverage which is a creation of later-day mystics. One miscreant singled out of the lineup of suspect causes for the recent economic malaise is the misuse of financial leverage. That, it is said, contributed to inflating the real estate bubble that burst so disastrously in 2007. When it burst the world was moved into the Great Recession. So, clearly there are proper and improper uses of financial leverage.

Now back to the ancient Greeks. Think back to your high school physics class and the picture of the 97 pound weakling using a lever to move a big rock. Financial leverage operates on the same model. It employs minimal resources (cash) to accomplish an amplified result. If a buyer were to use all cash to purchase a property, he would be using zero leverage. It would be like the weakling trying to lift that big rock himself, employing all of his strength but using no mechanical advantage. Obviously, there are limits to the size and weight of what the weakling or even the strongest man could hoist. Financially, a mortgage instrument becomes the lever. With it, a buyer can amplify his own resources to control a larger property or even multiple properties with the same amount of cash. For example, a buyer who has $10,000 can, exclusive of settlement costs, etc. buy a $10,000 property. However, with the same cash, a buyer who can qualify under the current Federal Housing Administration (FHA) guidelines could buy a $285,000 home, again, exclusive of settlement costs, etc. That buyer has just been able to multiply or leverage his purchasing power 28 1/2 times. He has used three and a half percent of his own money as a down payment and is using ninety six and a half percent of someone else's money to accomplish his goal. That is some heavy lifting!



If the value of the property he now controls goes up just five percent in the next few years, say from $285,000 to $299,250; his $10,000 initial investment is now worth $14,250 in equity. A positive change in the housing market has produced a better than 40% return on the initial investment. If you look at the nearby chart from CNBC/ Core Logic, residential real estate produced a better return on investment than nearly every other investment vehicle in 2015. The hundred-year average is more like three percent but even that is not bad considering today's ultra-low rates of return. Uncle Sam favors the widest homeownership percentage possible among his nieces and nephews and so government polices favor real estate over other asset classes. The home ownership rate was pushed to a peak of 69.2% in 2004 while the bubble was inflating. Not surprisingly, it fell back to 66.5% in 2010, after the bust, and it continues to decline. This decline is causing some to ask what is an appropriate rate of home ownership as a measure of economic prosperity?

Cont. from pg. 1

My own view is that homeownership continues to be a good long term investment for a number of reasons not the least of which is that you can't live and raise a family in your stock portfolio. A general rule is that a property owner can use leverage to generate wealth. However, if he makes a poor choice or if the market falters and he is overleveraged at the time, the resulting credit risk or default destroys wealth. Equity in one's home should not be viewed as an ATM account. Not only should the cost of obtaining a home equity loan or refinancing the existing mortgage be carefully weighed but the uses of the "cash out" should also be narrow and circumspect. It should only be used to acquire other assets which will appreciate as fast, or faster, than the home itself. Debt relief may qualify as well as funding for higher education that produces a marketable skill set. What should not qualify is "stuff". Flat screen TV's, all-terrain vehicles, boats, etc. typically do not appreciate. As my father used to say, there's no profit in machinery unless you're selling it.

What they didn't tell you in high school is that de-leveraging is harder than leveraging. It's like trying to set that big rock down easily. It also takes longer as we have seen since 2008. We are now back on a healing upward path with the hope in mind that recent housing history will not repeat itself any time soon.

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Visit my website
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11 Critical Home Inspection Traps to be Aware of Weeks Before Listing Your Home for Sale

DE, MD, PA – According to industry experts, there are over 33 physical problems that will come under scrutiny during a home inspection when your home is for sale. A new report has been prepared which identifies the eleven most common of these problems, and what you should know about them before you list your home for sale.

Whether you own an old home or a brand new one, there are a number of things that can fall short of requirements during a home inspection. If not identified and dealt with, any of these 11 items could cost you dearly in terms of repair. That's why it's critical that you read this report before you list your home. If you wait until the building inspector flags these issues for you, you will almost certainly experience costly delays in the close of your home sale or, worse, turn prospective buyers away altogether. In most cases, you can make a reasonable pre-inspection yourself if you know what you're looking for, and knowing what you're looking for can help you prevent little problems from growing into costly and unmanageable ones.

To help homesellers deal with this issue before their homes are listed, a free report entitled "11 Things You Need to Know to Pass Your Home Inspection" has been compiled which explains the issues involved.

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