



# The 5 Financial Reasons for Owning a Home

*By Brian Madigan*

So, you think that you would like to buy some real estate! In particular, you would like to buy a house.

Let's summarize the principal financial advantages:

- 1) use of rental income
- 2) use of leverage
- 3) forced savings
- 4) appreciation in value
- 5) tax free capital gain

## **Use of Rental Income**

Let's face it, you have to live somewhere. So, you will probably start out renting something. Here, you're just paying off someone else's mortgage. In the long run, they own the property, and you have nothing, but you paid for it. So, it makes sense to buy something, even if it's not quite as nice as what you could afford to rent. You just use the same money that you would otherwise have paid in rent.

This is basically free investment money, and it makes a lot of sense to use it.

If you're planning to rent, do so only over the short term, that's for a year or two. Clearly, if you plan to be in one place for three years or more then you should consider buying.

## **Use of Leverage**

Here is an opportunity to use "other people's money". Donald Trump loves this approach. Assuming you plan to get into the market but you think that the prices are a little high. This is typical, your parents and grandparents thought the same thing. What is your real opportunity cost? You were planning to buy a \$300,000 home. You have \$15,000 saved, but you decide

to wait one year. What happens? If the market goes up 5%, that same house is now worth \$315,000 one year later. If you put your \$15,000 into a high yielding bank account you received \$750 in interest. And, it's fully taxable, so you only have \$375. That means that you had to save another \$14,625 somewhere else just to buy the same house.

However, if you bought the house last year, you would have used the bank's money to secure a first mortgage at favourable rates. This would enable you to participate in the increase in value and not fall behind. Your profits are based on the total investment in the property, yours and the bank's. The increase is based on the full \$300,000 asset.

One other way to look at it, is the 'cash on cash' return. Here, you invested only \$15,000 of your own money and you made an extra \$15,000. So, that basically means that you doubled your own money in one year.

On the other hand, if you passed on the property and without the principal of leverage working for you, you would have made \$750 on your money in the bank, and been left with \$375 after tax.

So, what's the difference? Basically, \$14,625 after one year, if you use leverage.

### **Forced Savings**

If you have a mortgage, it will fundamentally operate as a forced savings plan. Assuming that you obtain a 25 year amortized mortgage, you will pay both principal and interest in your payments. After 25 years, it's paid for! No more payments, you own the property.

So, in our example, after 25 years, you were forced to save \$285,000 just by having a mortgage. Remember, the first \$15,000 was your money, and the bank financed the balance. Your new asset results from the principal paydown provisions contained in your mortgage.

### **Capital Appreciation**

Property values go up over time, and so does everything else. Part is simply due to inflation and the devaluation of the dollar, and part is due to increased scarcity. Your plan by purchasing property is to:

- 1) keep up with inflation, and
- 2) participate in an equity increase due to the increased demand for your property in the future.

What might you expect? You know, there's 1,000 years of history to suggest that real estate values double every 20 years. That's about 5% every year. You have to remember that over a 20 year period, you will likely have at least 2 business cycles (maybe 3) and you will have experienced a boom, bust and recovery. However, all in all, you are still left with a doubling in value every 20 years.

While you really don't profit with the inflation protection, you can profit substantially if you purchase well-selected property. And, historically just about all properties seem to be in higher demand, not simply the very best ones. Unlike the stock market, it's hard to get a bad piece of property.

### **Tax free Capital Gain**

Our present system of taxation exempts a principal residence from the imposition of capital gains tax. So, our system is a little different from the United States where they can deduct mortgage interest yet they are taxable on the future gain. This is the system in place here for investment properties.

One of the most significant features and biggest advantages under our Canadian tax laws is the principal residence exemption. The moral here is that you should buy the biggest and best house that you can possibly afford.

*Brian Madigan LL.B., Realtor is an author and commentator on real estate matters, Coldwell Banker Innovators Realty Inc. 905-796-8888  
[BRMadigan@Rogers.com](mailto:BRMadigan@Rogers.com) or visit [www.OntarioRealEstateSource.com](http://www.OntarioRealEstateSource.com)*