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BUY A HOUSE April 6, 2010

There are two things I think we can all agree are true today. The prices of homes in the United States are considerably lower today than they have been in years, and the interest rates on mortgages remain at historically low levels. Put those two facts together and it means you should buy a house today.

Why buy a house? Why that specific suggestion?

Because you have today the convergence of three factors you may not see again for a very long time. First, you have historically low interest rates. Second, you have reasonable prices. Third, you have tax advantages. Put them together and you have a unique opportunity not seen in decades, and unlikely to last much longer.

When you buy this house, I am specifically referring to the purchase of a home with a 30 year fixed mortgage and a modest down payment of 15-20% of the purchase price.

Let me emphasize that one more time. I am NOT suggesting a cash purchase, a large down payment, or an adjustable mortgage. I am suggesting the purchase of the best home you can find in a neighborhood you want to live in for many years. This is not a short term proposition or a speculation. It isn't about profit opportunity. It's about timing the purchase of a home to live in.

Let's look first at interest rates. Every \$100,000 you borrow at 3% will cost you \$421.60 per month with a 30-year fixed mortgage. The same mortgage at 5% will cost \$536.82 and at 8% will cost \$733.76. At 10% the monthly payment is \$877.57. (For this discussion I am ignoring down payments, escrow costs, closing costs, etc. The point here is the value of low interest rates.)

Obviously, the lower the interest rate, the more house the same monthly payment will buy. At 3%, a payment of \$421.60 will pay for a \$100,000 house. That same monthly payment will only buy a \$48,000 house at a mortgage rate of 10%. That's a pretty big difference. The low interest rates we have available today will allow you to buy much more house than you will be able to acquire for the same payment at higher rates.

But interest rates are likely to begin rising sometime soon. The US Government is currently spending \$1.49 for every dollar it brings in, with the total debt now at 57% of GDP. Spendthrift and debt-ridden countries pay high interest rates to borrow. They do not get to continue to borrow at historically low rates. No one is exempt from this rule for long. Not even the United States. This leaves little possibility for any outcome other than higher interest rates, perhaps *much* higher interest rates, sometime soon. (Besides, with money market rates at .25%, how much lower could rates possibly go from here?) Mortgage rates follow Treasury rates, so if they rise, mortgage rates rise.

Second, we are all aware of the buying frenzy that took place in real estate in recent years and the collapse that has followed. The prices may or may not be at the bottom, but it doesn't really matter. They are low enough to be reasonable.

There are a great many homes that will continue to come on the market in foreclosures over the next year or so. These will be the more expensive homes in the nicer neighborhoods. There are a huge number of them that are significantly “under water”, with a homeowner who has stopped making payments. The banks, not wanting to recognize these sour loans, have turned a blind eye for the time being. However, they cannot avoid this for much longer. Either through foreclosure or voluntary loan modification, they will have to charge off the excess principle. Either way, the end of the decline seems near at hand. Prices appear to be just about as good as they are going to get.

Third, there are tax advantages to buying a house. Some can qualify for tax credits to buy a first home, but almost everyone can take advantage of the deduction for the mortgage interest. Many taxpayers can't even itemize their deductions without the inclusion of mortgage interest expense. For those people, it means that additional items become deductible once they have sufficient mortgage expense. Then there is the tax-free profit for some homes held for more than two years. This is a very powerful combination. Tax deductible interest and tax free profits. There aren't many opportunities like that.

When you put these three factors together, it strongly suggests that buying a home at this time has benefits unlikely to be seen again for a long time. Low interest rates, reasonable prices, and favorable tax treatment add up to opportunity. I do not deal directly in real estate, so use this information as appropriate. You may want to help your children and grandchildren purchase their first home, you may want to buy that dream home you've always wanted, or you may want to relocate. You may just want to raise your current basis. Whatever your interest may be, I thought it would be remiss to let this opportunity pass by without discussion.

Regardless of what you may decide, you should be prepared for rising interest rates, modestly rising home prices, and higher taxes.

(As a quick aside, can taxing the rich solve our problems? The United States currently has \$12.25 trillion debt. If you were to tax the Forbes 400 (the 400 richest people in the United States) 100% of their net worth, you would collect \$1.27 trillion. Stated another way, if you took *every cent* the richest people have, you would only raise enough to pay 10% of our debt. Taxing the rich will not even begin to solve the problem. They don't have enough money.)

Indications are that the stock market will probably continue this rally for about another year. Then it will pause as we digest how events have unfolded, and assess where future opportunities lie. Next time, I need to tell you about the developments in biotech. The decades-long promise is *finally* becoming a reality, and it will change the world of healthcare. The investment opportunities may be unprecedented.

Cindi Showalter

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