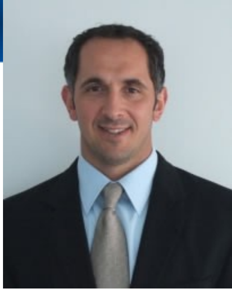

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Equity Management

Maximize Your Financial Future

Financial Planning Crisis

To any conscientious financial planner or mortgage consultant, the numbers are distressing. The federal government is so concerned that it has revamped provisions of the U.S. tax code at least three times in recent years in an effort to reverse the trend.

Recent studies have shown that most American families are now living beyond their means, cramped for cash, and few have taken adequate steps to secure their financial futures.

Only about four out of ten have established a tax-deferred savings fund - a 401(k), IRA or Keogh account - and even these forward-thinking Americans seldom contribute the maximum allowed. Today, the average balance on a 401(k) account nationwide hovers around $50,000; and half of all account holders have $15,000 or less saved against future uncertainties that often aren't uncertain at all.

Let's look at just two examples: First, college tuitions in the U.S. now double about every decade, so the cost of educating a son or daughter born today will be roughly three times higher by the time he or she graduates from high school. Secondly, the typical retired couple can expect to face an average of about $10,000 every year in uncovered medical expenses. Clearly, the time to plan is now.

Part of the problem, often the biggest problem, is a general lack of knowledge about financial planning and how to manage the single greatest asset that the majority of Americans will ever own: the equity in their homes.

The core of the American Dream, residential property is the linchpin of government tax and investment laws designed to assist the middle class. Though few homeowners think of it in these terms, their houses are legally constituted "financial shelters" through which lawmakers aim to promote saving, the accumulation of personal wealth, and the empowerment of ordinary people to educate their children and secure their Golden Years.

Managed wisely, your home's equity can yield returns far in excess of your property's market value, while shielding a greater portion of your income against tax liability. But it requires real financial discipline and professional know-how. If you have a history of poor spending habits or unwise financial decisions, it may not be for you. For those who are serious about getting their financial house in order and planning for a comfortable retirement, however, responsible equity management is among the most powerful strategies available in today's market.

Unlocking Earning Potential

The explosion in the number and variety of mortgage instruments in recent decades - fixed- and adjustable-rate loans being the best known - now allows a knowledgeable lending agent to offer terms that are virtually custom-tailored to the needs of a specific borrower.

While the basic 30-year fixed-rate mortgage remains the most popular type of loan, the growth in alternative instruments has given rise to a new class of professionals who can help you best manage your financial future. Today's mortgage consultant is far more than a bank agent or anonymous broker on the phone; he or she is an expert in the full spectrum of mortgages available. Most importantly, the mortgage consultant's interest in your account extends well beyond the fee earned on a single loan transaction.

Why? Because to properly manage the equity in your home, you will need a bi-annual mortgage "check-up" - an on-going series of regular reviews to determine whether and when to extract any accumulated equity in your home for the purpose of investing it in more lucrative, liquid, and secure funds managed by a reputable financial planner.

This is the crucial first step in unlocking the earning potential of your property: "equity separation."

Your critical partners in this approach are: a mortgage consultant to guide you through the process of regularly "mining" the cash that accumulates in your home; a trusted financial expert to safeguard it in conservative, interest-bearing funds; and an accountant to monitor your overall financial portfolio so you can realize the greatest tax savings on your new earnings.

We specialize in helping clients incorporate their mortgage into their financial plan. Give us a call today to get started!

Working Equity

Home equity accumulates in four ways: the money committed in the original down-payment; any appreciation in the local housing market over time; physical improvements or renovations; and, of course, principal payments on the mortgage itself.

Through these four avenues, cash value - or equity - steadily builds up in the property. While seemingly desirable on its face, this accumulation of wealth in the home has three detrimental consequences that are not generally well-understood by most consumers.

First, the cash in your home is "buried." Not only is it unavailable in the event of a family emergency, it is vulnerable to loss due to periodic downturns in housing values, fire, or natural disasters such as hurricanes (insurance, where available, may not cover the full market value of your home). Perhaps more critically, cash trapped in property is earning zero interest, year after year. No prudent consumer would put money into a savings account or investment plan that yields no rate of return, but many homeowners do exactly that without a second thought when it comes to their mortgages.

Furthermore, as a homeowner pays down the principal on a standard mortgage, he or she is steadily eroding the ability to take annual tax write-offs on the interest payments - which is the biggest tax shelter that most Americans will ever have. Put simply, as your mortgage interest payments decline, a greater percentage of your family's income is exposed to taxation.

So, in addition to foregoing any interest on the accumulated equity, the average consumer also unwittingly takes on greater and greater tax liability as he or she pays down their mortgage.

In purely economic terms, this could be called "irrational" behavior; but it has been the predominant approach taken by U.S. homeowners for more than 70 years. Historians trace the cause to the Great Depression, when unregulated lending practices triggered millions of loan defaults and foreclosures. The legacy of those times lives on today in the impulse felt by most mortgage holders to pay down their loans as quickly as possible so they can own their properties "free and clear."

In doing so, however, they are opting not to take advantage of overhauls in consumer protection laws, financial regulations, and government tax codes specifically designed to help homeowners generate and protect personal wealth.

In short, the range of "custom" mortgages available today - coupled with the growth in tax-exempt or tax-deferred savings vehicles like mutual funds - opens unprecedented equity investment opportunities for responsible homeowners who are committed to planning for their families' security, their children's education and their own retirements. But most Americans fail to explore the power of "working equity."

Discover how to put your home's equity to work for your family.
Call us today and learn how.

Securing Equity

Now that we better understand the advantages of equity extraction and investment, the next step is to explore specific methods of putting your cash to work for you.

Again, these options are not for everyone, and they may not even be available to homeowners who have poor credit ratings or excessive outstanding debt. In fact, many mortgage experts recommend against withdrawing equity unless you have first assembled a management team to oversee its investment - and until you have fully committed yourself to exercising the financial discipline necessary to reap the long-term rewards.

If you have done these two things, and you qualify, then here's how to put equity management to work for you:

1. Generally, the greater your income and assets - and the higher your credit rating - the more mortgage options there are available to you. The best of these options for investment purposes are known as "interest-only" (or "principal-optional") mortgages that require little or no money down. In other words, not only will you preserve equity at closing, you will also vastly reduce your monthly payment on such a loan for the simple fact that you will no longer be making amortized principal payments.

   This creates immediate liquidity for investment and preserves the greatest possible income tax deductions on mortgage interest because you will not be reducing the principal amount of the loan. Put differently, instead of investing your cash in idle principal payments, you can be investing it in tax-free or tax-deferred interest-bearing funds whose rate of return may outpace the interest rate paid on your mortgage, enabling you to effectively out earn your debt.

2. If you already have substantial equity in your home, it can be accessed through a variety of means - most commonly through a home improvement loan or simple "cash-out refinance" mortgage[1]. Again, the object is to extract cash for investment purposes while boosting the outstanding principal to create enhanced tax deductions. The difference between the nominal mortgage interest rate (plus any refinancing charges), and the superior rate of return on prudent investment funds, combined with your annual tax refund on interest deductions will be your new annual yield. When managed wisely in tax-deferred or tax-exempt investment funds, overall rates of return in the range of 8-10% are not uncommon - which is generally much higher than the interest rate on your mortgage. Better yet, your equity is now safe, growing and liquid in the event of an emergency.

3. The critical component to realizing these gains, however, is to establish a systematic approach to capturing and automatically investing these savings (including your annual income tax rebate) in secure instruments. Responsible mortgage counselors warn that even the most disciplined consumer can be overwhelmed by sudden access to so much cash, or tempted to gamble on volatile financial vehicles like stocks in an attempt to "get rich quick" by "betting the farm."

   This is why it is so vitally important to have a trusted financial adviser and an accountant to manage your investment program.

   Generally, experts recommend that liquid equity be disbursed in the following order of priority: pay off any "regressive" high-interest debt like credit cards, car payments, or student loans that eat away at disposable household income; fully fund any "tax-protected" accounts you may own, such as 401(k)s, IRAs, Keogh accounts, or state-run tuition investment mutual funds up to the maximum allowed; "store" any balance in a conservative, interest-bearing instrument like a universal whole life insurance policy that is liquid in the event of emergencies.

Again, creating the right investment plan has to be a tailored exercise - a trusted financial adviser and your accountant should discuss your willingness to bear risk, your age, income level, and any other investments you may currently own. There is no one-size-fits-all approach to equity extraction and management. But if done wisely, a world of long-term financial gains can be realized.

Our team creates customized financial strategies to help you achieve your long-term goals.

[1] It's important to consult with a qualified tax professional prior to pursuing this type of loan strategy to ensure that the interest payments are in fact deductible and to what extent.

Get Real Returns

Not only is it now possible to pay down the entire principal on a 30-year home loan in less than half the time with the accumulated interest in these equity "side funds," but a homeowner who maintains his or her full mortgage principal over a lifetime (through periodic refinancing) can effectively enlist the aid of the federal government in protecting their interest earnings and portfolio growth against current taxation.

Here's how: By investing money in tax-deferred funds during peak earning years (when most consumers are in their highest tax bracket) as opposed to paying down the principal balance on their mortgage, homeowners are shielding these funds from higher tax rates. This is the case because most retirees are in a much lower tax bracket when they begin to draw on their investment funds. So, not only is their equity safe, liquid, and growing during their working years, it is likely to be taxed at a much lower rate once they retire.

Overcoming the compulsion that many consumers feel to pay down their mortgages as quickly as possible can only be achieved by gaining a working knowledge of how to harness these various components together to ensure consistent returns on equity investments.

Decide Whether Equity Management Is Right For You

While equity management is a powerful financial strategy, it isn't suitable for everyone. It is meant for the sophisticated consumer who seeks out expert advice and has the discipline to follow it. If you are unable to adhere to a savings plan, or if you prefer the structure provided by a long-term fixed rate loan, then this type of investment strategy is probably not one you should consider. If, however, you are confident in your ability to execute a financial plan that has been carefully tailored to meet your long-term goals, then it may be right for you.

In the end, the interplay between tailored mortgage products, equity investments, compound interest earnings, and laws specifically designed to afford tax advantages to homeowners may offer the best foundation for long-term financial well-being that most Americans will ever have.

Call us today to schedule a review of your financial profile. Together, we'll determine the best way to put your home's equity to work for you.

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