Questions to Ask My Loan Officer

Equity Management

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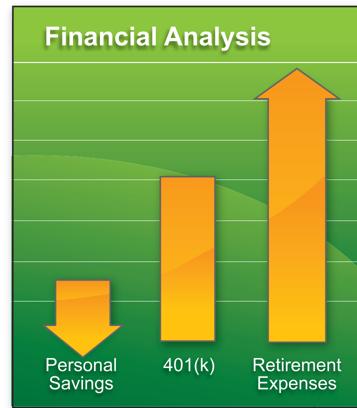
Financial Planning Crisis

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.



Approximately 32% of American households have neither an IRA nor 401k, while 68% have either one or the other or both combined, and even these forward-thinking Americans seldom contribute the maximum allowed. Today, the average balance on a 401(k) account nationwide hovers around $59,000; and half of all account holders have $15,000 or less saved against future uncertainties that often aren't uncertain at all. It's important to understand that a 401(k) account is not a pension, potentially providing income as long as you're alive. With a 401(k) plan, you only get what you put into it and the investment returns you gained on those funds. Stated another way: If you don't save, you won't have any savings to rely on when you need it in retirement.

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.

1. Maximize your retirement contributions.
2. Pay off your high interest and non-tax deductible consumer debts (i.e. credit cards, store loans, and personal loans).
3. Build a 12-month liquid rainy day or emergency fund (via checking account, savings account, or CDs).
4. Once you've accomplished the first three steps in the order listed above, then invest your left-over discretionary money into a highly diversified portfolio.

If you haven't achieved these four steps, it may be prudent to then consider a smaller down payment or accessing some of the equity in your home to accomplish these steps.

Again, creating the right investment plan has to be a tailored exercise – a trusted mortgage advisor, investment advisor, and 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.

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, 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.

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 (i.e. a mortgage advisor, a trusted investment advisor, and an accountant) 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:

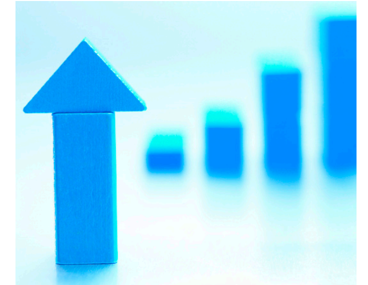
If You Are Buying a Home: Generally, the greater your income and assets – and the higher your credit rating – the more mortgage options there are available to you. You potentially could be approved for a bigger mortgage and put less money down. A smaller down payment creates immediate liquidity for investment and preserves the greatest possible income tax deductions on mortgage interest. Put differently, instead of investing your cash in idle principal, you can be investing it in tax-free or tax-deferred interest-bearing funds whose rate of return could potentially outpace the interest rate paid on your mortgage, enabling you to effectively out earn your debt. In fact, some loan programs available today allow you to put down as little as 3.5%.

If You Own a Home: If you already have substantial equity in your home, it can be accessed through a "cash-out refinance" mortgage[1]. It's important to understand that there are four steps to financial security and they should be followed in the specific order listed:

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.

That lack of knowledge comes in part from the fact that only one in five states mandates some sort of financial education in Grades K through 12. If you don't feel like you have a full grasp of financial planning, rest assured that you are not alone.

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 could potentially 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, equity management 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 may be a great financial approach.

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 an annual mortgage "check-up" – an on-going series of regular reviews to determine whether and when to refinance, or if there are any changes in your financial picture that would make it prudent to change any ways you are handling your money holistically. For example, if you are house rich but cash poor (i.e. you have a lot of equity in your house but, a small rainy day fund or savings account), remaining in this situation may not be the most prudent choice. What is prudent is having a great management team that includes a mortgage advisor, a trusted investment advisor, and an accountant to help you make the best decisions for your goals and needs.

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 critical, 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 the 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 mortgages available today – coupled with the growth and importance of investing into tax exempt college savings plans or tax deferred retirement savings plans – opens unprecedented equity investment opportunities for responsible homeowners who are committed to planning for their family's security, their children's education and their own retirements. But most Americans fail to explore the power of "working equity."