

# MORTGAGE advisor™

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## TIME FOR A MONEY MAKEOVER

Experts Share the Secrets to Safely Building Wealth in Today's Market

First in a Three-Part Series

Mary and Rich Stanley are in a rut. Like most of us, this fictional couple was raised to believe that paying off their mortgage is the ultimate goal of homeownership. In fact, their vision of the Great American Dream is to own their three bedroom, two-bath home outright -- with no mortgage. Mary and Rich are about to learn that their dream is not only outdated, it is holding them back from achieving massive wealth and peace of mind.

The Stanleys learned from their parents and grandparents that homeownership was the ultimate goal because they'd lived under the gray shadow of mortgage clauses that allowed banks to demand full payment at any time.



The problem with this type of thinking is that we're not living in the same era as our parents and grandparents. In today's world, banks

can no longer legally demand payment simply because they are short of cash. From a more practical perspective, paying off a mortgage may have also made sense 50 years ago, when people lived in the same house for 30 years or more and retired with full pensions. This, however, is not the reality today.

**“We're not living in the same era as our parents and grandparents.”**

Today, the average American mortgage loan lasts 4.2 years. People are more mobile. They're moving and refinancing, often using their home equity to remodel their homes, restructure their debt, finance their children's educations and invest in other financial vehicles. When it comes to retirement prospects, it's very rare for individuals to retire with a gold watch for 40 years loyal service. Instead, careers today are pieced together and workers must plan for retirement using whatever means they can. That is why it is time for a Money Makeover.

Changing the way the Stanleys think about managing money starts with tossing out all the outdated ideas they inherited from their parents and grandparents that are holding them back from the financial freedom they crave. Rejecting these deep seated ideas about debt and investing can be a difficult emotional process, but keeping their eye on the new life they will lead when they become free from worries about money, liquidity and security will make the transition easier.

## From Homeowners to Millionaires

Financial experts know that proper use of a mortgage loan can help turn average homeowners into millionaires. What these savvy investors know that Rich and Mary don't is the power of compounding interest.

In addition to an unconscious fear of losing their home in a Great Depression scenario, the Stanleys hate the concept of paying a mortgage because they know that over the life of a 30-year loan, they'll spend far more on interest payments than on the principal itself. On the surface, a mortgage looks like a very expensive proposition. That is why, still clothed in their age-old concepts about debt, the Stanleys made the biggest down payment possible and make extra principal payments whenever they can.

**“Financial experts know that proper use of a mortgage loan can help turn average homeowners into millionaires.”**

This might sound like a great idea, but unfortunately, saving money is not the same as making money. Paying off debt is not the same as accumulating assets. In most cases, when people like the Stanleys focus their primary efforts on paying off their mortgages, they place their savings as a secondary goal. That means that every dollar Mary and Rich give the bank is a dollar they don't invest. While paying off the mortgage may save interest, it also denies the opportunity to earn interest on that money.

## Raising the Bottom Line

For the Stanleys, time is of the essence. The sooner they start updating their thinking about investing, the greater the impact on their future. Let's look at the numbers. The Stanleys earn \$150,000 per year and have \$100,000 in savings and investments. The old way of thinking would lead them to purchase a \$500,000 home with a 15-year fixed rate mortgage at 5.875 percent using entire \$100,000 savings as a 20 percent down payment, leaving them no cash to invest. Their monthly payment is \$3,348,

and because they have a combined federal and state income tax rate of 33 percent, they are left with a monthly net after-tax cost of \$2,983. To add insult to injury, because they have a goal of paying off the mortgage as quickly as possible, they also send an extra \$200 per month toward the principal balance.

## A Tale of Two Stanleys

Adapted from the book, **The New Rules of Money**, by Ric Edelman. Our story follows two scenarios for the Stanleys who earn \$150,000 a year, have \$100,000 in savings and are buying a \$500,000 home.

SCENARIO "A" Believes in "The Old Way" paying off the mortgage as soon as possible	SCENARIO "B" Believes in "The New Way" carrying a big, long mortgage
<b>15-YEAR MORTGAGE AT 5.875% APR</b>	<b>30-YEAR INTEREST-ONLY LOAN AT 6.375% APR</b>
<b>\$100,000</b> BIG DOWN PAYMENT (20%)	<b>\$25,000</b> SMALL DOWN PAYMENT (5%)
<b>\$0</b> LEFT TO INVEST	<b>\$75,000</b> REMAINING TO INVEST
<b>\$3,348</b> MONTHLY PAYMENT (57% IS TAX DEDUCTIBLE FIRST YEAR/33% AVERAGE)	<b>\$2,523</b> MONTHLY PAYMENT (100% IS TAX DEDUCTIBLE)
<b>\$2,983</b> MONTHLY NET AFTER-TAX COST <sup>1</sup>	<b>\$1,690</b> MONTHLY NET AFTER-TAX COST <sup>1</sup>
SENDS \$200 EXTRA EACH MONTH WITH MORTGAGE PAYMENT IN AN EFFORT TO PAY MORTGAGE SOONER	ADDS \$200 MONTHLY TO INVESTMENT ACCOUNT, PLUS \$1,293 SAVED FROM LOWER MORTGAGE PAYMENT, EARNING 6.0% <sup>2</sup>

## Who Made The Right Decision?

RESULTS AFTER 5 YEARS	
RECEIVED <b>\$33,796</b> IN TAX SAVINGS <sup>1</sup>	RECEIVED <b>\$49,955</b> IN TAX SAVINGS <sup>1</sup>
HAVE <b>\$0</b> IN SAVINGS AND INVESTMENTS	HAVE <b>\$205,330</b> IN SAVINGS AND INVESTMENTS <sup>2</sup>
<b>What if each couple suddenly lost their jobs?</b>	
HAVE NO SAVINGS TO GET THEM THROUGH THE CRISIS	HAVE <b>\$205,330</b> IN SAVINGS TO TIDE THEM OVER
CAN'T GET A LOAN — EVEN THOUGH THEY HAVE <b>\$210,562</b> IN HOME EQUITY — BECAUSE THEY HAVE NO JOB	DOESN'T NEED A LOAN
MUST SELL HOME OR FACE FORECLOSURE BECAUSE THEY CAN'T MAKE PAYMENTS	CAN EASILY MAKE THEIR MORTGAGE PAYMENTS EVEN IF THEY'RE UNEMPLOYED FOR YEARS
AT THIS POINT — IT'S A FIRE SALE — THEY MUST SELL AT A DISCOUNT AND PAY REAL ESTATE COMMISSIONS (6-7%)	HAVE NO REASON TO PANIC SINCE THEY'RE STILL IN CONTROL — REMEMBER...CASH IS KING!
RESULTS AFTER 15 YEARS	
RECEIVED <b>\$60,517</b> IN TAX SAVINGS <sup>1</sup>	RECEIVED <b>\$149,866</b> IN TAX SAVINGS <sup>1</sup>
HAVE <b>\$51,832</b> IN SAVINGS AND INVESTMENTS <sup>2</sup>	HAVE <b>\$618,249</b> IN SAVINGS AND INVESTMENTS <sup>2</sup>
OWN HOME OUTFRUIT	THEY HAVE ENOUGH SAVINGS TO PAY OFF <b>\$475K</b> MORTGAGE AND STILL HAVE <b>\$143,249</b> LEFT OVER!
RESULTS AFTER 30 YEARS	
RECEIVED <b>\$60,517</b> IN TAX SAVINGS <sup>1</sup>	RECEIVED <b>\$299,732</b> IN TAX SAVINGS <sup>1</sup>
HAVE <b>\$1,092,503</b> IN SAVINGS AND INVESTMENTS <sup>2</sup>	HAVE <b>\$1,951,434</b> IN SAVINGS AND INVESTMENTS <sup>2</sup>
OWN HOME OUTFRUIT	NEVER PLAN TO PAY THEIR HOME OFF — THEY ENJOY THE LIQUIDITY, SAFETY, TAX SAVINGS, AND INVESTMENT RETURNS TOO MUCH!

The above hypothetical examples are for illustrative purposes only.  
1. Assumes combined federal/state income tax rate of 33%.  
2. Assumes 6.0% rate of return. Rate of return may vary based on type of investment.

**“Paying off debt is not the same as accumulating assets.”**

The newly enlightened Stanleys would choose to carry a big, long-term mortgage. They secure a 30-year, interest-only loan at 6.375 percent, over half a point higher but worth the investment as you will soon see. They use one quarter of their \$100,000 savings for a \$25,000 down payment and invest the remaining \$75,000 in a safe, money-making side account. The new monthly payment is \$2,523, all of which is tax deductible, leaving the couple with a net cost of \$1,690 after taxes. Each month they add the \$200 they would have sent to the bank to pay down principle and the \$1,293 they are saving from selecting the interest-only loan product to their investments. Let's say for a conservative argument that those investments are earning, on average, a 6 percent rate of return.

**“Creating wealth through equity management requires dedication to saving and investing for the future, not cashing out and spending equity.”**

In order to see the beauty of the new money mentality, we need only look a few years into the future. After just five years, under the old-money scenario, the Stanleys would have received \$33,796 in tax savings, but no gains in savings or investments. Under the new investing plan, the couple received \$49,955 in tax savings and their investment account has now grown to \$205,330. That eightfold savings increase looks a lot better to the Stanleys thanks to a visit to a Certified Mortgage Planner who knew how to craft a loan package that fit their individual lifestyle. Think what a Mortgage Planner could do for you.



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To arrange a mortgage planning consultation on strategies discussed in this article, please give me a call.