

# MORTGAGE advisor™

● ISSUE 22



**FAIRWAY**  
Independent Mortgage Corporation

**Ken Pederson**  
Certified Mortgage Planner  
CMPS  
717-431-9299  
[kenp@fairwaymc.com](mailto:kenp@fairwaymc.com)  
[www.FairwayPA.com](http://www.FairwayPA.com)

## GREEN IS THE NEW BLACK

In a Crisis, Cash is a Great Standby

### Second in a Three-Part Series

Regardless of the economy, one thing that never goes out of fashion is the need for security. What has changed, however, is the way smart homeowners are building security into their mortgages by creating liquidity. Let's take a look at how one family that has adopted the Mortgage Planning principles of keeping their equity liquid handles job loss compared to a more traditional arrangement. Because in the pay-off-the-mortgage-at-any-cost scenario, a family doesn't have any money in savings, they would suddenly be in crisis if, as the sole breadwinner were to lose his job.

The homeowner, Rich Stanley in our version of this all-too-common story, would not be likely to access his equity because banks, while they're

payments and, in fact, goes the extra mile of making additional principal balance payments, there would still be very little if any leniency when it comes to skipping mortgage payments.

While many homeowners believe that paying down their mortgages quickly is the best way to reduce the risk of foreclosure, the reality is, the exact opposite is true as this story illustrates. When homeowners pay down their mortgages, they are unwittingly transferring the risk from the bank onto themselves. When a mortgage balance is high, the bank carries most of the risk, but when it's low, the homeowner bears the risk. Banks are in a great position when balances are low, because they stand to make a significant profit if the homeowner defaults. When people use every extra bit of money to apply principal payments, they customarily find themselves with little or no liquidity. So when times get tough, they find themselves scrambling even more to make their mortgage payments. This is a very dangerous situation.

If a mortgage banker is evaluating a portfolio of 100 delinquent loans, of course he or she will opt to foreclose on the ones with higher equity first, especially if it's a declining market. The banker knows that selling the homes with the highest amount of equity will be best for their balance sheets, so they're not going to invest their primary efforts in trying to sell a home with a high mortgage. Instead of focusing on homes that are worth \$400,000, but that have \$450,000 mortgages, they'll be more inclined to turn to the \$400,000 home with a mortgage balance of \$150,000. In fact, banks have even been known to contact delinquent owners with high mortgage balances to offer assistance, stating that they want the homeowner to be able to keep their homes. The last thing a banker wants to do is to take back a home that will cause them to lose money in their attempts to resell.



always happy to lend when people don't need the money, are much more hesitant to lend to individuals facing financial trouble. Without a job, securing a loan against his home would be very difficult. Even though the equity in his home belongs to him, he has a history of on-time

Since the Stanleys have a relatively low mortgage after all those extra payments, but cannot make their monthly payments now, they have no choice but to sell their home in order to avoid foreclosure – a difficult position in the current market climate.

In the managed equity scenario, on the other hand, the Stanleys have a \$205,330 cushion in liquid savings to carry them through the job search. They don't need a loan and can easily make the monthly payments. Green is the new must-have basic when it comes to creating financial security. There's no replacement for liquid, easily accessible cash assets.

#### An Enduring Favorite

If Rich doesn't lose his job, where will the couple be in 15 years? Will they regret tossing off their traditional 15-year mortgage for a modern investment plan? If they had remained in the original loan, they would own their home outright. They would have saved \$60,517 in taxes over the past decade and a half, and their savings and investments would have grown to \$51,832, if they had put the money they would normally be using for the mortgage payment into a savings account. This scenario sounds pretty good, and without a comparison, it looks like they have done a very respectable job of managing their finances.

However, when we look at the performance of the newly structured mortgage, the perspective changes. The Stanleys are still carrying a mortgage of \$475,000, but they have saved over \$149,866 in taxes and now have \$618,249 in savings and investments. They also have the choice to pay off their mortgage balance with \$143,249 left over in liquid assets. That's \$91,417 more than they would have had plodding along in the same old financial plan inherited from their parents.

Let's assume that the Stanleys enjoy accumulating wealth and decide not to liquidate their investment account to pay off the mortgage, but instead refinance into another 30-year, interest-only loan so that they can stay leveraged and enjoy the tax benefits. In 30 years from the date of purchase, instead of the \$1,092,503 in liquid assets and \$60,517 in tax savings they would have realized, the Stanleys have accumulated \$1,951,434 in savings and investments and realized a total of \$299,732 in tax savings. Even if they then chose to pay off the \$475,000 mortgage, they would still have \$1,475,434 left over. Of course, now that the two understand the value of wealth building through mortgage planning, they'll probably choose to keep their cash in an investment account where

it is compounding and building wealth as long as possible.

This simple scenario clearly illustrates the power of mortgage planning. Unfortunately, most Americans adhere to the old style of managing money simply because it's the only way they know. But once their eyes have been opened to the reality that mortgages aren't the necessary evil the American public has been led to believe they are, few will ever go back. Used properly, mortgages can actually help homeowners to save hundreds of thousands of dollars in taxes while building wealth before only imagined.

#### Controlled Risk

Mortgage planning is not a risky proposition. It's actually the safer way to build wealth. Unlike those who choose to build equity in their homes as a primary goal, borrowers who use mortgage planning are building their freedom of choice as well as their net worth. Their money is not tied up in their home, but rather, remains accessible and liquid should they want it or need it.

Home equity is not the same as cash in the bank. There is only one thing that's the same as cash in the bank, and that is actual cash in the bank. Contrary to what most of us have been taught, being house rich and cash poor is a very dangerous position. It's much better to have access to equity or the value of a home and not need it, than to need it and not have access to it. Keeping a home safe is not a matter of accumulating equity, but rather being positioned to react to market conditions over which you have no control.

**“Home equity is not the same as cash in the bank. There is only one thing that's the same as cash in the bank, and that is actual cash in the bank.”**

Many people are afraid of other investments and allow this fear to fuel their beliefs that home equity is safer than other investments. The fact is that housing prices can and do level off. Real estate equity is actually no safer than any other investment whose value is determined by an external market over which we personally have no control. Take a look at the headlines in any paper and you will see the foreclosure rates are at record highs. These homeowners weren't bad people. They simply didn't have the cash flow to carry them through the storm, something that could easily have been avoided if they hadn't stored so much of their assets in their home equity.



**Ken Pederson**  
Certified Mortgage Planner, CMPS  
717-431-9299  
[www.FairwayPA.com](http://www.FairwayPA.com)  
Equal Housing Lender

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