MORTGAGE advisor™

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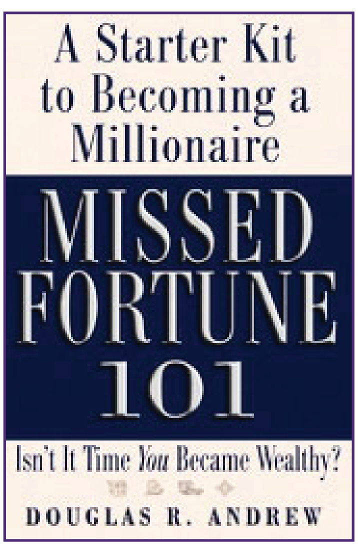

The Millionaire's Starter Kit: Missed Fortune 101

Renowned financial strategist Doug Andrew challenges conventional wisdom as he presents his paradigm-shifting views on how average taxpayers can achieve wealth using the same strategies as self-made millionaires

Part one in a two-part series

A great starter kit for becoming a millionaire, Missed Fortune 101 reveals author Douglas R. Andrew's formulas on how average, everyday taxpayers can build their personal fortunes by using their homes to engage in the very same strategies that banks and self-made millionaires have been using for generations. As Andrew challenges the status quo, he explains how tax-savvy homeowners can achieve their financial goals better, safer and faster than with traditional strategies. Andrew contends that conventional wisdom is the longer, less safe way to reach your financial goals, and that by keeping an open mind, you can find the better, faster and safer way to your financial goals.

Stop Barking Up the Wrong Tree

Most people have no idea how to manage their personal finances, so they do what seems obvious: they follow the crowd, putting money into "safe" investments and planning for retirement the way that everyone else does. The problem is, following the crowd won't necessarily bring about the best results; just because all of the dogs are barking up the wrong tree doesn't make it the right one.

The average American plans for retirement by setting money aside in qualified retirement accounts like IRAs and 401(k)s, often paying off the mortgage by making extra principal payments. While these retirement accounts offer tax deductions on the front end, they often leave investors burdened with taxes on the back end. And by paying down your mortgage, you're eliminating one of the best tax deductions that Americans have--our home mortgage interest. The fact is, there's a much smarter way to invest. By keeping an open mind and following a few basic tenets, you can put those lazy and idle home equity dollars to work, generating up to $1 million or more in additional assets than had you followed traditional investment principles.

Know the Power of Taxes

Most people are confused about taxes and consider them a liability, but they're actually useful tools. Once you understand how taxes work, you'll be better equipped to develop a tax strategy that helps you reach your financial goals faster and more efficiently. First, understand the concept of tax brackets. Your effective tax bracket is the tax percentage rate you pay as compared to your total income. This tax rate includes state and federal taxes. Your marginal tax bracket is the tax bracket that your last dollars earned puts you in. Many people erroneously believe that once they cross the threshold of a new bracket, their whole income gets taxed at that rate. The truth is you pay the higher rate only on dollars earned in excess of each tax threshold.

It's also important that you understand capital gains, which are the difference between the original purchase price and the net sales price, and are not subject to tax until an asset is sold. There is a vast difference in the way that interest is treated in terms of taxes. Smart tax strategies are based in optimizing preferred versus non-preferred interest expenses, and capitalizing on the tax-free gains that are allowed on the sale of a residence.

Preferred interest, like home mortgage interest, is tax-deductible, while non-preferred interest, like credit card interest, is non-deductible. This is a critical part of developing a smart tax strategy.

Plan Your Retirement, Not Uncle Sam's

Ill-informed retirement planning can put you in a higher tax bracket in retirement than the one you're in during your earning years. Because qualified vehicles like IRAs and 401(k)s offer tax favored treatment during the contribution and accumulation phases of retirement planning, they will be taxable when they're liquidated. Because of this, non-qualified vehicles can actually provide greater spendable retirement income. In fact, with qualified plans, if you live 20 or more years after retiring, you'll potentially pay back at least five times more in taxes during the distribution phase than the taxes you'll save during the contribution phase. This is like paying for the government's retirement, rather than your own.

Taxpayers can actually amass tremendous wealth by stepping outside the bounds of conventional wisdom and instead doing what banks and credit unions do: borrowing at one rate and investing at a higher rate. Homeowners are at a distinct advantage over non-homeowners because they can borrow against their home equity and invest at a higher--or even at an equal rate--and be better off than they'd have been if they had focused on paying off their mortgages.

Learn to Manage Home Equity Successfully

Successful investors use three criteria to evaluate investments: liquidity, safety and rate of return. When home equity is measured against these three criteria, it doesn't fare well. Home equity cannot be accessed immediately, and is therefore not liquid. It also doesn't appreciate, so it offers zero rate of return. And as far as safety goes, homes with a high percentage of equity are generally the first to be foreclosed upon, and any monies invested in your home equity are at risk of loss due to foreclosure, natural disaster and depreciation fluctuations.

Large down payments are equivalent to making a large investment to an unsafe vehicle with no liquidity and zero rate of return. A better option is to use a small down payment and invest the rest of your money in another vehicle that offers more liquidity, more safety and a higher rate of return. Arbitrage, the process of borrowing at a lower rate and earning on that borrowed money at a higher rate of interest, is not only the lifeblood of financial institutions, it's also the way that individuals can reach their financial goals faster and safer. It's the process of putting your money to work for you. Monies trapped in home equity incur opportunity costs, while monies that are kept liquid incur employment costs--the cost of borrowing the money. As any sound business understands, wise employment costs are a necessary part of business to earn a greater return than those costs. Controlling and managing your equity is key to enhancing your financial net worth.

Manage Your Mortgage to Create Wealth

When considering investments, it's important that you position your assets in an easily accessible, liquid account. After all, it's better to have access to your money and not need it, than to need it and not have it. In order to continually access your home equity, you should refinance your mortgage every time the interest rate is even .5 percent less than your current rate. This could possibly decrease the amount of time needed to gather the amount of liquid assets to pay off your mortgage by eight to ten years. Additionally, it's a good idea to refinance every time you have excess, dormant, borrowable equity in your home. You don't want your money sitting idle in your home when it can be working for you and earning a return.

When borrowed monies are invested in vehicles with compounding interest, they can yield a rate of return, even when borrowed at the same rate as the earnings rate, as long as the borrowed rate is tax preferred. For example, a $100,000 interest-only mortgage at 6 percent will cost $6,000 per year, and assuming a 33.3 percent marginal tax bracket will effectively cost $4,000 per year, while that same $100,000 earning tax-free or after-tax earnings of 6 percent will yield $6,000, a profit of $2,000 per year.

Again, home equity has no rate of return. Monies invested in home equity do not earn interest. They sit dormant in the property. Therefore, no method of paying off the principal balance of a mortgage, whether through larger down payment, additional principal payments or bi-monthly payments, is the wisest or most cost-effective way of paying off your home. A home could be "paid off" on paper while still carrying a mortgage, as long as the homeowner has enough liquid assets to pay off the balance of the mortgage should he or she choose to do so. This is how savvy investors and homeowners manage their mortgages.

Empower Yourself with Knowledge and an Open Mind

Understanding how taxes, arbitrage and sound mortgage management can affect your assets is critical to developing a successful wealth building strategy. Keep an open mind when considering your mortgage plan, and always remember your end goals of liquidity, safety and rate of return.

Your best financing plan will depend on factors like your ability to make your monthly payments, the amount of equity available in your property, the interest rate on your current mortgage, and the expected length of time you plan to live in your current home. In many cases, interest-only mortgages offer the best leverage. As with any financial plan, it's important to discuss your options with a qualified professional that is experienced in creating wealth-building plans by leveraging home equity.

In next month's article, we will continue to highlight Andrew's strategies as we review Missed Fortune 101's strategies for converting home equity into a multi-million dollar net worth, choosing the right investments, structuring your life insurance, and giving new life to your assets.

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