

Mortgages for Money Management: A Checklist of Choices and Considerations

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Leveraging a mortgage as a financial management tool is an increasing trend among prospective homebuyers and homeowners, and for good reason. With so many options available, mortgages can be molded to meet your unique financial situation, stage in life, and current and future goals. But to do so effectively, it's important to take into consideration your needs, capabilities and opportunities.

The following checklist can help give you insights as to how a mortgage can fit into your financial picture—whether you are a homebuyer looking for a new loan, or an existing homeowner ready to maximize your investment.

For Homebuyers

□ **Evaluate Earnings—Now and Later.**

Think carefully about how much your income may grow over the next several years. Would you be able to absorb a future increase in monthly payments on your mortgage? If so, you may consider an adjustable rate mortgage (ARM) or other option that allows the flexibility to implement your overall savings and investment plan, given your income prospects.

Another alternative: a fixed period ARM, also known as a hybrid ARM, which blends the benefits of an ARM's generally lower initial interest rate with the security of a fixed payment for a period of time—typically for three, five, seven or 10 years depending on the loan type. After the fixed rate period expires, the interest rate usually adjusts annually for the remainder of the loan.

But remember, some ARMs and other loans that allow lower payments early on, could translate into higher amounts later—so factor this into your mortgage decision

and have a realistic expectation about the level to which your income can accommodate increased payments.

□ **Factor in Fluctuations—From Commissions to Self-employment.**

If your income is largely based on commissions or bonuses, take into account how much it may change month-to-month and year-to-year. Similarly, if you are self-employed, do you have a steady cash flow or does your income vary each month? How about supplemental income from things like alimony and quarterly dividends. Can you reasonably rely on these to help with monthly mortgage payments?

A loan with a payment option feature such as an interest-only or option ARM may make sense when there are fluctuations of the timing and flow of income. During leaner months, the mortgage payment could be the minimum required, while in other months the fully-amortized payment amounts could be made. Again, you should carefully analyze your ability to make the monthly payments in a rising rate environment or in the event of a recasting (re-amortizing) of an option ARM loan or after the interest-only period of an interest-only loan.

□ **Estimate Equity—How Much and When.**

How quickly do you hope to build equity in your new home? Usually, fixed rate mortgages with 15-year payment terms decrease the loan balance the fastest. Other fixed rate loans have 20-, 25-, 30 and even 40-year terms.

Some ARMs with payment options offer homeowners the ability to choose an accelerated payment from several amounts every month. The accelerated payments include interest accrued, principal, plus extra principal. So, the amount borrowed could be paid down quickly to build equity, without incurring prepayment penalties that are common on some types of loans.

When it comes to how much equity you plan to build, be realistic. Keep in mind, real estate isn't a sure thing—property values can decrease. And, compared to other

investments, real estate has high transaction costs, so the home's value would have to increase by about 10 percent for you to break even when you sell. Never rely on an increase in property value to help in affording the home loan payments, or you could be headed for disaster if prices decline.

□ **Assess Your Savvy—Readiness and Understanding.**

Because a home is typically the most valuable asset in a person's financial repertoire, it is crucial that homebuyers understand the details of this significant transaction and are ready to take on the responsibility. Don't move forward with obtaining a home loan until you are comfortable in knowing all of the terms and features of the program you are considering.

Honestly ask yourself if you are sufficiently knowledgeable about managing finances to use a mortgage as a money management tool. Realistically consider your particular financial situation and take the time to learn about the financing options available to you.

For Homeowners

□ **Consider Cash-Out—For Upgrades and More.**

Increased home values in recent years may mean that your home's equity has grown significantly. So, the time may be right to consider refinancing and pulling money out of your home equity in a lump sum to fund repairs, renovations or other expenditures. After all, any upgrades you make may add to your home's value in the long run. A cash-out refinance could be a smart solution that leverages your investment by generating extra funds needed to meet your personal and financial goals.

□ **Unlock the HELOC Opportunity—Spending and Saving.**

Used to fund everything from major home improvements and vacations to college tuition and debt consolidation, home equity lines of credit (HELOCs) have proven to be a smart choice for many homeowners because, unlike regular credit cards, the

interest paid on these credit lines is often tax deductible (consult your tax advisor.) Plus, since the interest rates on HELOCs are generally lower than on credit card or installment loans, the monthly payments are also lower.

Some HELOC products also have a “no-cost” feature that waives the initial appraisal and application fees. And, typically no payments are due on a HELOC until funds are accessed, so having a line of credit in place can provide a safety net in the event of emergencies or unforeseen expenses. Usually, interest-only payments can be made on amounts drawn for at least the first five years and often for the first 10 years.

HELOCs are typically 25-year loans and their rates vary according to the prime rate.

□ **Investigate Interest—Changing and Deferred.**

If you currently have an ARM, be sure to monitor your monthly statement and understand how your interest rate is changing. Similarly, pay attention to deferred interest on option ARM products. When these rise outside of your comfort level, it may be a wise move to refinance with a different loan that has a lower rate, a fixed payment, a different loan term, or other features that make the most sense in your current financial situation. Making a move to refinance when the time is right could save you money in the long run or in the short term, depending on your needs.

□ **Aim for Another—Vacation Homes and Investment Properties.**

In recent years, growing numbers of homeowners are using the equity from their first home to springboard into a second home or other investment property. This can be an excellent way to maximize your current investment to build assets and bolster your financial portfolio.

□ **Reflect on Reverse Mortgages—Payments and Peace of Mind.**

For homeowners who are at least 62 years old, reverse mortgages can be a secure and simple way to access the equity in a home and obtain additional funds for everything from daily expenses and medical bills to maintaining a leisurely retirement lifestyle. There are generally no restrictions on how the borrower(s) can use the loan funds,

which usually can be obtained in a lump sum, monthly, through a line of credit, or other available payment structures.

A reverse mortgage enables seniors to remain in their homes for the remainder of their lives if they wish. Loan proceeds may be tax free. Funds received from a reverse mortgage are generally categorized as loan advances and not taxable income (borrowers should consult their tax advisors for details). And, reverse mortgages are usually “non-recourse,” which means that the borrower, their heirs, or their estate will not owe more than the appraised market value of the home at the time of maturity of the loan, regardless of the loan balance.

Be sure to obtain as much information as possible before obtaining a reverse mortgage and consult with your family, a financial or tax advisor, and other resources to fully explore all of your options so you can make an informed decision that’s right for you.

Whatever your financial scenario, using your mortgage as a strong money management tool can add to the quality of your investment and your quality of life. By considering the points in this checklist and assessing other key factors in your own situation, you can help make the right moves at the right time and capitalize on your home’s financial potential.

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