MORTGAGE advisor™

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# Paying Off The Mortgage: Going Broke with Safety and Stability

***Veteran Certified Financial Planner Gary Arford contends that paying off your house is just about the worst financial decision you can make. As a matter of fact, he prefers to keep his clients leveraged at 90 percent for their primary residences. Why? How can keeping the mortgage fulfill the American Dream?***

Gary Arford was 29 years old when he took over the trust real estate division of US Bank. Charged with overseeing an $850 million real estate portfolio as well as a $300 million mortgage portfolio, he soon learned that he knew next to nothing about wealth management strategies. "I was no more qualified for

that position than the man in the moon," he quips. But because Arford was determined to achieve greatness in his position, he took it upon himself to learn the business, and to learn it well.

### Misled About the American Dream

The first thing that Arford noticed was that of the 2,600 houses that US Bank managed for high net worth individuals, less than two percent were paid off. This got Arford thinking. He'd been raised with the same conventional wisdom that most of America had. He'd learned--much like the rest of us--that paying off the mortgage was the brass ring of the American Dream. "[But] the rich people weren't doing it the way I'd been taught," he states.

Arford set out to get to the bottom of the disparity in methodology, and it took him six to eight months to make a startling revelation. "I had been screwed over by people who loved me," Arford says with a laugh. In a nutshell, Arford asserts that the conventional wisdom of paying off your house is erroneous. It is not the way to use your biggest investment to make you rich.

### Don't Pay Off the House

When the primary residence is treated as a home, rather than an investment, it will not lead you to wealth. On the contrary, if you use the equity in your home as an investable asset, you are significantly more likely to build a wealthier, more financially abundant future.

"I don't believe in paying off the house," asserts Arford. "In fact, my opinion is that paying off the house is just about the dumbest decision you can make." Arford continues, explaining that keeping a mortgage is actually a safer financial decision and offers the capability of making the homeowner wealthier, providing, of course, that the homeowner does things the right way.

### Your House Is Not a Candy Machine

The primary reason that people don't capitalize on their equity is because they're using their home as a candy machine of sorts: insert some equity, get a prize. They build equity only to cash out on that equity and spend it on other things. They buy cars, vacations, or even pay off credit cards. Borrowers aren't the only culprits responsible for this trend. The mortgage industry itself promotes the use of equity to purchase nearly everything. If you encounter a loan professional

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that doesn't question and advise you on the proper use of the equity in your home, start looking elsewhere. That person will not be able to help you with your wealth building plans. But they will be perfectly suited to get you further into debt.

Arford stresses the importance of remembering that your home's equity should never be used to supplement your lifestyle. Using your home's equity to finance niceties like cars and vacations is a surefire way to foil your efforts for building a secure financial future for yourself.

### Retirement? Not at the Rate We're Investing!

Most working people have ideas or goals for retirement. However, according to Arford, over 80 percent of the middle class has not saved or invested enough to retire. Furthermore, he contends that baby boomers, who comprise the majority of the middle class, cannot hit their retirement goals if they pay off their houses.

"The average 51 year old has less than $75,000 in investment assets," explains Arford, adding that if a person is accustomed to making $100,000 per year, that $75,000 in investment assets isn't going to keep that person retired for very long. The result is that the 78 million baby boomers will be working longer, not because they want to, but simply because they cannot afford to retire and maintain their lifestyles. Fortunately, Arford has a solution. And it involves using your equity to build your net worth, rather than simply letting it sit in the house.

### How Leveraging and Investing Can Work Together

When people set the goal of paying off their mortgages, they are banking only on their home's appreciation to build wealth for them. What people don't often take into account is that this is not the way to get rich. Real estate appreciates on average only 4 percent per year, although Arford customarily uses a conservative 3 percent. While this may sound like a good investment, Arford contends that there are much better--and smarter--ways to invest your home's equity.

As an example, picture two borrowers. Both own $300,000 homes with no mortgage. Borrower #1 does not get a mortgage, but instead has a home that is paid off and lets the house appreciate. In 10 years, Borrower #1's house is worth $405,000. Borrower #2 gets an 80-10-10 mortgage totaling $270,000--$240,000 for the first, $30,000 for the equity line. The $240,000 first trust deed at 6.5 percent yields a $1,300 monthly payment, while the $30,000 equity line at 7.5 percent yields a $187.50 monthly payment. Total monthly payout for Borrower #2 is $1,487.50, or an after tax payment of $1,116 per month. Borrower #2 then invests the $270,000 at an after tax return of 9.095 percent (based on investment averages), which yields an after tax growth of $24,557 per year or $2,046 per month. The portfolio effectively makes the mortgage payment for Borrower #2, and results in an excess cash flow of $930 per month. Borrower #2's home is still worth $405,000 after 10 years, and even when factoring in the $270,000 in mortgages, the excess amount earned from the investment account totals $181,000.

At the end of 10 years, Borrower #1 has

$405,000 in home value. Borrower #2 has $586,000 in combined assets.

### The Deal Nobody Would Take

In order to further illustrate the way that leveraging and investing works, Arford uses the example of "the deal nobody would take." Let's say you get a mortgage for $100,000 at 8 percent, and can invest that $100,000 at 7 percent. Would you take that deal? Believe it or not, the deal will make money.

A $100,000 loan will cost roughly $7,800 per year. By year three, you're still paying $7,800 per year, and your balance has gone down to $97,280. But your investment account has grown to from $100,000 to $122,500, and is making $8,000 per year. By year 10, you owe $89,000, but your investment account is now worth $183,800 and is making $12,000 per year.

Using this scenario, Arford confronts conventional wisdom. "[In the above scenario], I could pay off the mortgage," he asserts. "But why would I?"

### The Caveats

There are a few stipulations that Arford sets forth for those who want to utilize this wealth building strategy. The first is that you must never use the equity in your home to purchase other items, like cars or vacations, or to pay off credit cards. Secondly, work with knowledgeable professionals who understand this strategy. Use a loan professional who understands and can guide you in this process, and find a financial planner who understands the markets and has clearly defined exit strategies. Third, remember that growing your money is going to involve risk. Markets fluctuate, so you should be willing to lose 10 percent of your investment. An ethical financial planner will do everything to protect your money, but you'll be tying his or her hands if you're unwilling to accept a certain degree of risk.

Your well meaning friends and neighbors may be the first to try to talk you out of embarking on this new investment strategy. Rather than listening to them, ask yourself why you are listening to the advice of someone who is no better off financially than you are. Seek the advice of professionals who understand these strategies. Gary Alford took 17 years to amass his first $1 million, and another 10 years to add his next $12 million. He advises on the same strategy that he uses for himself.

It's not prudent to embark on investing strategies on your own. Talk to your mortgage professional and find a financial advisor with knowledge of both investment and exit strategies. Exit strategies will help to protect you from excessive loss. But most of all, understand the importance of leveraging your house in wealth building strategies. Nothing can happen until you accept that initial premise.

"The only way that real estate works to make yourself wealthy," urges Arford, "is to leverage it." ■

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