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# Debt's Role in Your Financial Plan

As nice as it may seem, achieving debt-free status isn't always the best way to reach your financial goals. Take a look, for example, at mortgage debt. Most people can't afford to pay cash for a home, so they borrow some portion of the purchase price.

On the other hand, you don't have to look any further than the recent history of the real estate market to see how too much mortgage debt can cause significant financial problems.

## What Is Smart Debt?

Smart debt is the kind that generates more advantages than disadvantages. Here's how to recognize it:

✔ **You already have the free cash flow or liquid assets to cover the required monthly payments.** This means that you aren't counting on additional income from the asset you acquire to make the payments. While some people might find this advice too conservative, it's important to remember that the income an asset is supposed to generate can be speculative. If it's rental income, you may not find tenants or you might lose the ones already in place. If it's short-term proceeds from flipping a property, the market may not support the higher price you're hoping for. And if it's a new business, the customers might not be there in the numbers you need.

✔ **The payments don't prevent you from addressing important financial objectives.** Debt that reduces the amount you can save for a child's education or your retirement may not be smart debt.

✔ **It's to cover the big-ticket items you need to earn a living.** For most people, this means a reliable car. For the self-employed, it can also mean capital equipment or an addition to your house for your business.

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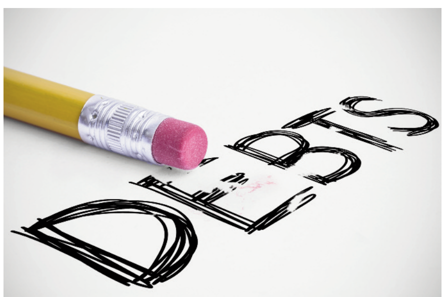


# Dealing with a Spouse's Credit Issues

Combining your finances with your spouse's may also include combining your credit histories. When you apply jointly for credit, both your credit histories will be evaluated. Some tips to consider when one spouse has a poor credit history include:

✔ **Don't apply for joint credit.** If your spouse's credit history is very bad, it may pay to leave him/her off the credit application.

✔ **Ask a parent or relative to cosign a major loan, such as a mortgage.** Before asking, keep in mind that you are asking that person to take responsibility for the entire loan.

✔ **Instead of applying for joint credit cards, list your spouse as an authorized user of your cards.** While an authorized user can charge on your credit card, you are responsible for paying the bills. If the account is paid promptly, it will be reported on both credit histories. If you make delinquent payments, only your credit history suffers.

✔ **Use other strategies to improve your spouse's credit history.** Ensure that your spouse makes all payments on a timely basis. Try to pay down as many of his/her credit balances as possible. ❍❍❍



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## Debt's Role

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**It's tax deductible.** This generally applies only to mortgage interest, but there are limitations. The IRS doesn't let you take a deduction for mortgage debt beyond $1 million on a first or second home, and that's reduced to $500,000 if you're married but filing separately. It also disallows taking a deduction for interest on home-equity loans totaling more than $100,000.

**It preserves or improves the value of your home.** Financing major repairs, remodeling, or making your home more efficient with debt can be a smart move, as long as it doesn't violate the principles suggested above.

**It doesn't push your debt-to-income ratios too high.** Financial experts and banks recommend keeping your total monthly debt payments (including rent or mortgage) at or below 40% of your monthly take-home income, and payments that don't keep a roof over your head to a maximum of 20%. Go beyond these limits, and you may find it hard to be approved for a loan when you need it.

**It doesn't reduce your credit rating.** This comes into play chiefly as a result of credit card borrowing. Your credit rating suffers when your credit card balances come close to your limit. Consumer credit experts say you should aim to keep your balances at less than 35% of your credit limit to keep your FICO scores from being reduced.

### Strategies to Reduce Debt

If your debt is out of hand, here are some steps you can take to make it more manageable:

**Refinance your mortgage.** If you haven't missed any payments and have equity in your home (it's worth at least what you owe), you may be able to reduce your mortgage payments by refinancing. Even if you have to finance closing costs, mortgage rates might be so much lower than your current rate that you still come out ahead. You might even be able to cash out some untapped equity in your home and pay off some unsecured debt — replacing high-interest, nondeductible debt with low-interest, tax-deductible debt.

**Reduce your spending on non-essential items.** Cut out as much of your monthly budget as possible, like restaurant meals, entertainment, subscriptions, premium TV packages, and expensive mobile phone data plans. Trade a luxury car you're still making payments on for a less-expensive one.

**Keep a record of every penny you spend.** Incidentals you pay for with cash can add up without you being aware of just how much you're spending. Keeping a diary could help you find more ways to reduce unnecessary spending.

**Cut up your credit cards.** This makes it nearly impossible to take on any more credit card debt.

**Pay down high-interest debt first.** Keep making the minimum payments on all your debts, but find a way to make the biggest payment possible on your highest-interest card or loan first.

**Negotiate with your lenders**. Call them to request a reduction in your interest rate, a waiver of late fees, or an affordable payment plan.

If your plan hasn't been updated lately to reflect current debt balances or you're not sure whether you're making the best use of borrowed funds to reach your goals, it's time for a thorough review. Please call if you'd like to discuss debt in more detail. ❍❍❍

## Draw Down Retirement Funds Carefully

One of the toughest decisions you'll make when retiring is deciding how much to withdraw annually from your retirement investments. Take out too much, and you could spend your later retirement years relying on the help of relatives or enduring a much lower standard of living.

Your withdrawal amount can be calculated based on your life expectancy, expected long-term rate of return, expected inflation rate, and how much principal you want remaining at the end of your life. Yet, your life expectancy, rate of return, and inflation rate are difficult to predict over such a long time. To help ensure you don't run out of retirement assets, consider these strategies:

**Use conservative estimates in your draw-down calculations.** Add a few years to your life expectancy, reduce your expected return a little, and increase your inflation expectations. That will result in a lower withdrawal amount, but it will also help ensure that your funds don't run out. Take a careful look at any answer that indicates you can take out much more than 3% to 5% of your balance each year. That doesn't mean you can't take out more, but you should be confident of your assumptions before doing so.

**Review your calculations every couple of years.** If you find you're depleting your assets too rapidly, you may be able to go back to work on at least a part-time basis. If you find that out late in life, working may not be an option.

**Place three to five years of living expenses in short-term investments.** That way, if there is a severe market downturn, you won't have to touch your stock investments for at least three to five years, giving them time to recover. ❍❍❍

# How Much Is Too Much to Pay for Your House?

While it's often said that you can't put a price on happiness, one thing is certain: you definitely *can* pay too much for the house of your dreams. The question is, how do you recognize when you're crossing the line? There's no easy answer, but here are some guidelines to help you avoid buyer's remorse on the purchase of your next home.

**1. Is the house the most expensive on the block?** It may be a cliché, but there's wisdom in the advice to buy the cheapest house on any block. The idea is that a good part of the value of a home is its location. That means how physically attractive the area is, how good the schools are, how close it is to good means of transportation, what the crime rate is, and all other factors that make a neighborhood desirable. By paying less for the structure than you might for another in the same location, you're getting a good bargain for the whole package. Go for the most expensive, and you're paying top dollar for location benefits.

**2. Pay attention to comparables.** This is where a good real estate agent who knows the area you're looking at can really help. Comparables are homes that have been purchased recently and are similar to one another in key ways, like the number of bedrooms and bathrooms, construction, acreage, and amenities. Comparables will give you a fairly good idea of whether the home you're interested in is appropriately priced.


**3. Assess the trends.** It's helpful if you can assess the trends in the local real estate market in context with the wider market and the economy. Unless you're a real estate professional or economist, though, this can be difficult to do. Still, there are a number of questions you may ask yourself to guide your evaluation:

✔ Is the community just being discovered by young, upwardly mobile families? If so, the chances may be good that the value of the home you're considering will increase for some time after you buy it.

✔ Are new roads being built in the area or existing highways being expanded?

✔ How's the economy at the local, regional, and national levels? Is it picking up or declining?

✔ Is it a real estate buyers' market — in which more people are desperate to sell than to buy and prices are falling — or the reverse, a sellers' market, where prices are rising?

The most difficult assessment to make is the point at which real estate prices have risen so fast for so long that there's a greater chance of prices falling than continuing to increase. If you can get your hands on a chart of historic prices, you might find a clue.

**4. What can you afford?** All of the previous considerations have to do with the value of the home. This one has to do with what makes sense for you to pay given your financial situation. Mortgage underwriters have their ratios to determine whether they'll approve you for the mortgage you want, but you need to ask yourself whether you should bump up against those ratios to get the biggest mortgage they say you can afford.

For example, one ratio bankers look at is your prospective monthly housing payments (including principal, interest, taxes, and insurance) compared to your household gross monthly income. Depending on the lender, the maximum allowed is 28% to 30%. Another ratio looks at your monthly minimum debt payments (including credit cards, car and education loans, and mortgage) to your income. Here, the acceptable range is generally 35% to 41%.

To avoid an uncomfortable budget squeeze once you start making mortgage payments, carefully consider — even before you go house hunting — how the mortgage will affect your budget. Don't forget to make allowances for unforeseen but common expenses like home and car repairs and medical bills.

**5. What do you really need?** Finally, it pays to put your future mortgage payment in perspective with your other financial objectives. If you buy the most expensive home you can afford, will that keep you from working toward other goals, like saving for your children's educations or retirement? Are you dipping too deeply into your savings to make a big down payment to minimize the size of your mortgage?

It can be risky to rely on your home as a wealth builder. Equity you might be counting on to tap in the future through a home-equity line of credit or second mortgage may not be there when you want it. Settling for a home that is not your dream home but is financially comfortable might be the smarter choice.

Please call if you'd like to discuss this in more detail. ❍❍❍

# Overcoming a Fear of Investing

While investing does come with risks you need to be aware of, that's no reason to avoid it entirely. If worry about losing all your money is keeping you out of the market, here are three steps you can take to overcome that fear.

## Start from a Position of Strength

If you have a mountain of credit card debt and no emergency savings, investing any of your money is likely to be a bit nerve-wracking. Before dipping a toe into serious investing, work on paying down high-interest credit card debt and establishing an emergency fund with at least six months of living expenses.

The exception to the above suggestion? Investing in your retirement plan at work. If a company match is offered, you may want to invest just enough in your 401(k) plan to get that money.

## Get Educated

Investing isn't really as complicated as it initially seems. Familiarizing yourself with how markets work and the basic principles of sound investing will help you understand that though investing comes with risk, it's hardly the same as playing the lottery. There may be no sure things when investing, but if you proceed with a smart strategy and stick with it over time, there's a good chance you'll come out ahead.

## Set a Goal

By knowing what you want to achieve before you make any specific decisions about where to put your money, you'll be more likely to invest in a way that will get you to where you want to be. If your goal is to buy a house in five years, that means investing in potentially high-return yet also high-risk stocks is not so smart. Placing that cash in a certificate of deposit probably makes more sense. But if you're investing for retirement that's three decades away, you can afford to take on more risk with your investments. In that case, higher-risk stock investments make a lot of sense. The key is to keep your goal in mind and let that drive your decisions about how to invest.

Being a little nervous about investing is normal, but you should not let it keep you from achieving your financial goals. Please call if you'd like to discuss this in more detail. ❍❍❍


# Avoid Cosigning Loans

To keep your credit rating high, avoid cosigning a loan for someone else. This can be difficult to enforce, since the request typically comes from a family member or friend.

When you cosign a loan, you sign a legal document accepting responsibility for the entire debt. If the primary borrower falls behind in payments, the creditor can come to you immediately looking for payment. The creditor does not have to first exhaust legal remedies with the primary borrower.

Additionally, the primary borrower's late payment history is likely to appear on your credit report. The debt is also listed as your debt on your credit report, which may impair your ability to obtain another loan.

If you are a cosigner on a loan that the primary borrower can't repay, call the creditor immediately and try to negotiate. The creditor may agree to settle for a lesser amount to avoid legal or collection fees. But make sure the creditor agrees to keep your credit report clean for that lesser amount. When the debt is paid, review your credit report to make sure it is reported correctly. ❍❍❍

# Financial Thoughts

The average monthly restaurant tab per household is $223 (Source: National Restaurant Association, 2016).

While eight million Americans age 65 and over have long-term-care insurance, it is expected that 27 million Americans will likely require long-term care in 2050. Women typically require care for 3.7 years longer than men (Source: *Journal of Financial Planning*, May 2016).

Approximately 22% of middle-aged, college-educated white Americans are millionaires, compared to 6% of African Americans (Source: Federal Reserve Bank of St. Louis, 2016).

Only 2% of Republicans earn more than $250,000 per year (Source: *Wealth Management*, July 2016).

The U.S. divorce rate has declined 20% since 2000 (Source: U.S. Centers for Disease Control and Prevention, 2016).

Approximately five million investors with assets of $100,000 or more use social media to investigate their financial decisions (Source: *Journal of Financial Planning*, July 2016).

The average 401(k) balance fell from $102,682 in 2014 to $96,288 in 2015 (Source: Vanguard, 2016). ❍❍❍

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