

the Mortgage Commentary

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Should you own your home free and clear?

It is a goal of many homeowners to own their home free and clear. To that end, those with the financial capacity to do so might pay all cash on a purchase or pay off their existing mortgage.

Other home owners who do not have the immediate ability to pay off their loans or buyers who can't pay all cash on a purchase still might want to retire the mortgage as soon as possible.

And although the desire to have a debt free home is understandable — it could be advantageous to have a mortgage.

Before delving into the reasons for having a mortgage, we should address the reasons for not having one — for owning your home free and clear.

A compelling reason for owning your home free and clear is that it simply feels better than it does to owe on a mortgage. Not only is it comforting to have no home debt, but it also gives a sense of financial accomplishment.

A debt free home can give great peace of mind to home owners approaching retirement. Not only is there no mortgage payment to worry about, there's also an emotional reward in having something to leave to heirs.

The above reasons may be enough to justify paying off your mortgage. But for some, these emotional reasons are not enough. For some, the potential financial rewards of a having a mortgage are more appealing.

So here are some advantages of keeping your mortgage and using funds that could have been used to pay it off in order to enhance your net worth. If you can invest the money and get a greater return than the after tax cost of the mortgage, then it can make sense to

keep the mortgage and invest the money.

Time and taxes play a big role in this evaluation.

The odds of gaining through investing your funds rather than paying off a mortgage are better if the loan has several years remaining than if only a few years are left. Here's why.

Payments made in an amortizing mortgage loan during the first years are mainly interest and during the last years are mainly principal. Interest is deductible and principal isn't. So the after tax cost of a mortgage in its final years is nearly the same as the actual interest rate. And in the early years the after tax cost is significantly less. Obviously the higher the tax rate the lower the after tax cost of the mortgage.

Mortgage debt leverages the cash investment in your home. Pay cash for an \$800,000 home that appreciates to \$880,000 in a year and that's 10% return. Put \$160,000 down, borrow \$640,000 at 6% and the return is (roughly) 26%.

Additionally, fixed rate mortgage debt is a hedge against inflation as future payments will be made with cheaper dollars.

The Mortgage Commentary is not dispensing investment or tax advice. It intends only to provoke thoughts about mortgages that might differ from commonly held beliefs.

Each home owner has unique circumstances, concerns, and limitations which influence the desirability of owning free and clear versus having a mortgage. Consult with an expert for sound advice.

Conforming Loans to \$417,000

Type	Rate	APR	Trend
30 Yr FIX	6.500%	6.578%	↓
5/1	6.375%	7.467%	→

Jumbo Loans over \$417,000

30 Yr FIX	6.875%	6.942%	→
10/1	6.750%	7.456%	→
5/1	6.500%	7.486%	→
10 Yr Bond		5.113%	↓
Prime		8.250%	→

Q & A

Mortgage Trends

QUESTION:

My mortgage payment is due on the first of the month. Is there a way for me to change it to a later date?

ANSWER:

Technically, your mortgage payments are due on the first of each month and you are in default if the lender has not received the payment by that date. However, most notes provide for a fifteen day grace period before assessing a late payment penalty, so you have until the 15th.

Your credit report will not reflect a late payment unless the payment is made more than thirty days beyond the due date. Want some good advice? **NEVER ALLOW YOUR MORTGAGE PAYMENT TO BE 30 DAYS LATE.**

QUESTION: If I get my own credit report and find that it shows a collection was filed three years ago, should I pay it off before applying for a mortgage loan?

ANSWER: No. Do not pay off the collection account if you are planning to obtain a mortgage in the near future. Discuss this with your loan consultant before doing anything. Here's why.

Credit scores are obtained by essentially taking a "picture" of your accounts at a moment in time. If the picture shows recent action in connection with a lien or collection account your credit score will suffer. And as hard as it may be to believe, it makes no difference whether the action is the filing of a lien or collection or paying it off.

So while it may seem prudent to pay off any outstanding liens or collections before ordering a credit report, the fact is that doing so will hurt your credit score.

Mortgage rates have been on the rise recently. Opinions differ about what the direction will be in the future, because economic data is mixed and because the Federal Reserve seems to be concerned about inflation.

Fed Chairman Ben Bernanke delivered a speech on June 4th at a conference on housing and the economy in which he reiterated the Fed's concern about inflation. Specifically he said that "inflation risks remain on the upside."

Although not significantly different from the minutes of the most recent FOMC meeting, and should not have taken investors by surprise, his comments caused a decline in bond prices and of course a rise in yield.

Further, Bernanke's comments about inflation concerns dampens hopes previously held by some that the Fed will be lowering rates later this year.

Perhaps we should take Bernanke at his word — that future actions by the FOMC will depend on economic data and look to that data for clues.

Remember — data reflecting a growing economy is of course good for the economy and bad for mortgage rates.

So you should get your clues from such things as job growth, new claims for unemployment, retail sales, and consumer confidence.

Remember also that the Federal Reserve does not, per se, set mortgage rates. It adjusts short term rates to influence the economy with emphasis on controlling inflation. And mortgage rates take their cue from inflation.

Perhaps we should take Bernanke at his word — that future actions by the FOMC will depend on economic data and look to that data for clues.

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