

### MANAGING YOUR MORTGAGE

For most of us, a home mortgage represents the single biggest liability on our personal net worth statement (your net worth equals your assets, or what you own, minus your liabilities, or what you owe). But mortgage debt shouldn't necessarily be viewed strictly as a liability. You might also think of a mortgage, or home equity line of credit (HELOC), as a financial planning tool that deserves as much attention and consideration as any other part of your net worth, including your stocks and bonds.

### INCOME TAX BASICS

Home mortgage debt remains one of three sources of tax-deductible interest expense left to individuals who aren't engaged in a trade or business (investment interest expense and student loan interest expense being the others). For home mortgage debt, Internal Revenue Service rules say you can deduct the interest expense on up to \$1 million (\$500,000 for married filing separately) of home-secured debt used to purchase or make capital improvements on your qualified principal and/or second residence.

You can also deduct the interest expense on up to \$100,000 (\$50,000 for married filing separately) of home equity debt secured by your home, whether in the form of a regular loan or revolving line of credit. Furthermore, unlike home purchase, investment, or student loan debt, the \$100,000 home equity debt limit is not subject to the so-called "tracing rules," which means you can use the proceeds for any purpose you like and still potentially claim an itemized deduction (subject to some limitations and potential alternative minimum tax treatment, so be sure to check with your income tax professional about your own specific situation).

When refinancing, keep in mind that any extra cash you might take out beyond the value of the old loan will count toward the \$100,000 home equity debt limit if the proceeds are used for something other than substantial (capital) improvements to your home. Finally, any "points" you might pay when taking out a mortgage loan can be deducted, as well, either in the year you pay them for an original mortgage, or over the life of the loan in the case of a refinancing. What this all means is that when you're evaluating a home mortgage or equity loan, you can't ignore the impact of income taxes and should always crunch the numbers on an after-tax basis.

### IMPORTANT QUESTIONS

As you shop around for the best mortgage or home equity loan, you'll likely be focused on getting the best rate and keeping costs low. These are important considerations, but you should also focus on the lender's range of mortgage options, as well as on the level of service and attention you can expect to receive (e.g., you want a lender who is committed to making sure you get the right loan for your needs, that your loan closes on time, etc.). Ideally, a good lender won't start talking about what they have to offer until after they've listened to you first.

Be prepared to answer the following questions when shopping for an original mortgage or when looking to refinance an existing mortgage:

- **How long do you plan to stay in your home?** The length of time before you might sell your home impacts whether a fixed or variable rate structure is best. How long you plan to stay also influences the refinancing decision, since you want to be around at least until the "break-even" point when any costs involved are offset by the new lower rate.
- **How long have you held your current mortgage?** If you already have a mortgage and plan on staying in your home indefinitely, you should consider structuring the new loan for no longer than the term you have left on your old loan. For example, if you have 20 years left on your old 30-year loan and plan on staying for the long haul, then consider taking out the new loan for 20 years or less. Otherwise, even with a lower rate you could end up paying more over the life of the loan if you start over with another 30-year term.
- **Is your current loan the original mortgage, or a previous re-fi?** Even though you have to amortize any points paid on a refinancing over the life of the loan, you can deduct the remaining unamortized points from a previous re-finance in the year of the new refinancing. Any potential tax savings will impact the economic decision to re-finance and should be taken into account.

### TO PREPAY OR NOT TO PREPAY?

Once you've found the right loan, and have borrowed no more than you need, the question may come up at some point as to whether it makes sense to prepay the principal. Principal prepayment can be done in small increments over time, or in a lump sum at some point prior to the final due date.

When does it make sense to prepay?

- **After-tax opportunity cost:** Number crunchers might choose to focus solely on the after-tax cost of money. For example, a 6% mortgage loan would actually cost 4.5% on an after-tax basis if you have a combined marginal income tax bracket of 25% (assumes full deductibility). Can you do as well or better with an alternative use of your money? Don't forget about risk: Prepaying a mortgage is a risk-free proposition.
- **Liquidity preference:** Even if you can't do as well or better with an alternative use of the money, a preference for liquidity might keep you from paying off a low-rate mortgage prematurely if the opportunity cost is negligible to you. Diversification could play a role here, as well.
- **Income tax considerations:** Don't forget: The \$1 million mortgage debt ceiling is limited to acquisition debt (purchase or capital improvement). Once you've paid off the original mortgage, you'll be limited to the \$100,000 home equity debt ceiling unless you make capital improvements or buy another home.
- **Psychological considerations:** For some folks, a strong desire to be debt-free may override other considerations. In that case, opportunity costs and income taxes take a back seat. After all, you can't put a price on peace of mind.

Whatever your individual circumstances, goals and preferences might be, you should think about the wise and prudent use of mortgage debt within the context of your overall personal financial plan.

### IMPORTANT DISCLOSURES

*The information and content provided herein is for informational purposes only. It is not intended, and should not be construed, as a specific recommendation, or legal, tax, or investment advice, or a legal opinion. Individuals should contact their own professional tax advisors or other professionals to help answer questions about specific situations or needs prior to taking any action based on this information.*