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Three Ways to Create Value Through Mortgage Planning

How to help clients make smarter financial choices

Objectives

- ✓ Cash vs. Mortgage: how to help clients evaluate whether to pay cash for a property vs. using a mortgage
- ✓ To Consolidate or Not: How to help clients evaluate the before and after-tax impact of debt consolidation
- ✓ Gift or Loan: How to evaluate the tax and cash flow impact of gifts of equity and cash gifts used for a down payment



Cash vs. Mortgage



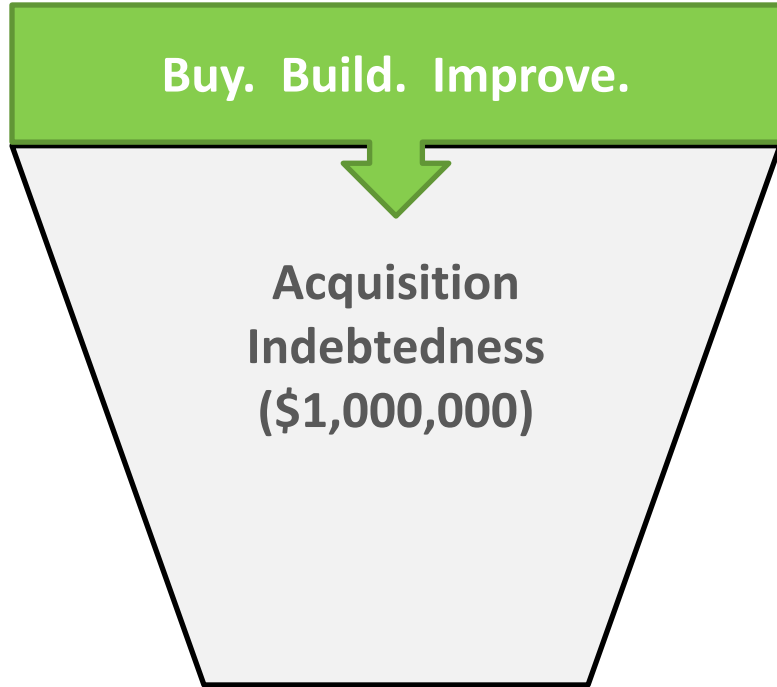


Case Study #1 (with mortgage interest tax deduction)

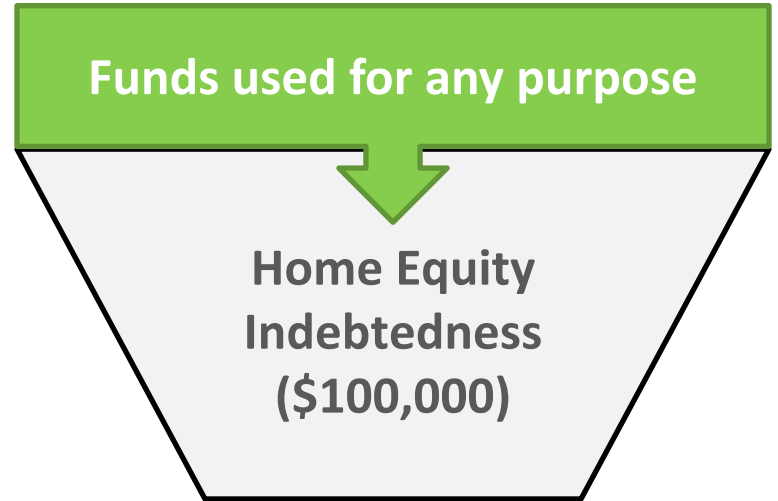
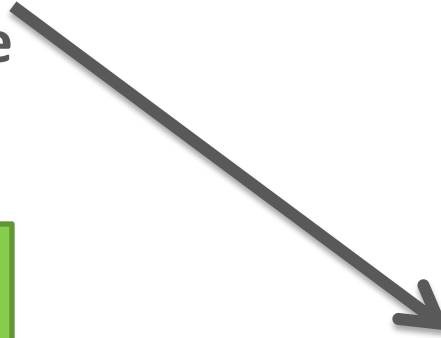
- ✓ Jane is 64 years old
- ✓ She is in a 25% income tax bracket
- ✓ She wishes to purchase a \$400,000 home
- ✓ What's the impact of paying cash vs. using a \$200,000 30 year mortgage?

* Assume that Jane is able to deduct the mortgage interest on her tax returns

**1st Lien or Subordinate Lien
HELOC or Closed-end Mortgage**



AMT = Still Deductible



AMT = No Longer Deductible



Case Study #1

(with mortgage
interest tax
deduction)

Option #1

\$400,000

Cash on Hand

-

\$400,000

Down Payment

=

\$0

Remaining to Invest

Option #2

\$400,000

Cash on Hand

-

\$200,000

Down Payment

=

\$200,000

Remaining to Invest



\$1,013
Mortgage
Payment

After-Tax
Payment
, \$826



Tax
Benefit,
\$188



Case Study #1

(with mortgage
interest tax
deduction)

Option #1

\$0 Mortgage

\$0 Monthly Payment

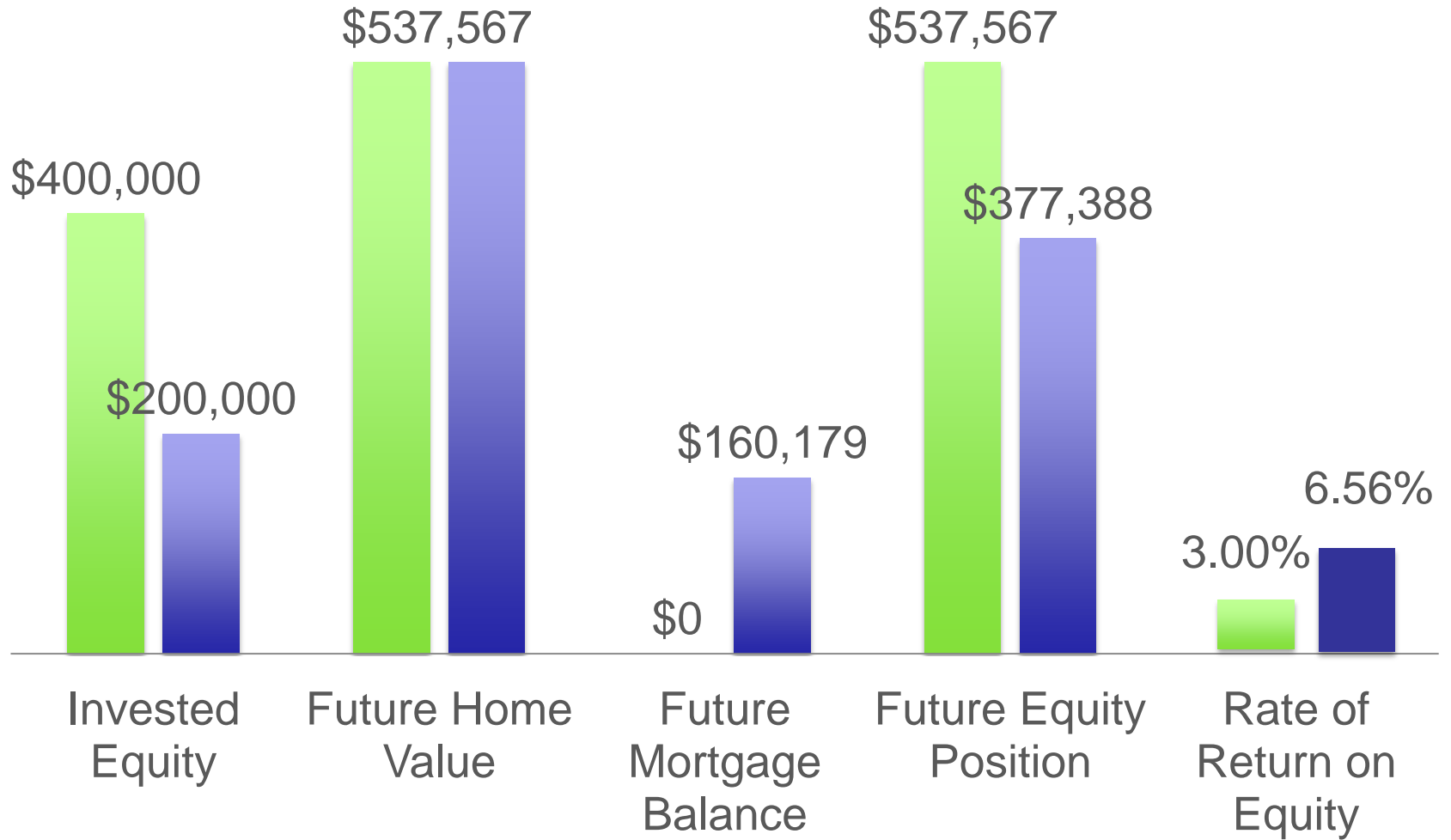
\$0 Invested

Option #2

\$200,000 Mortgage

\$826 After-tax
Monthly Payment

\$200,000 Invested



■ Option 1: Cash

■ Option 2: Mortgage

10 Year Holding Period @
3% Annual Appreciation

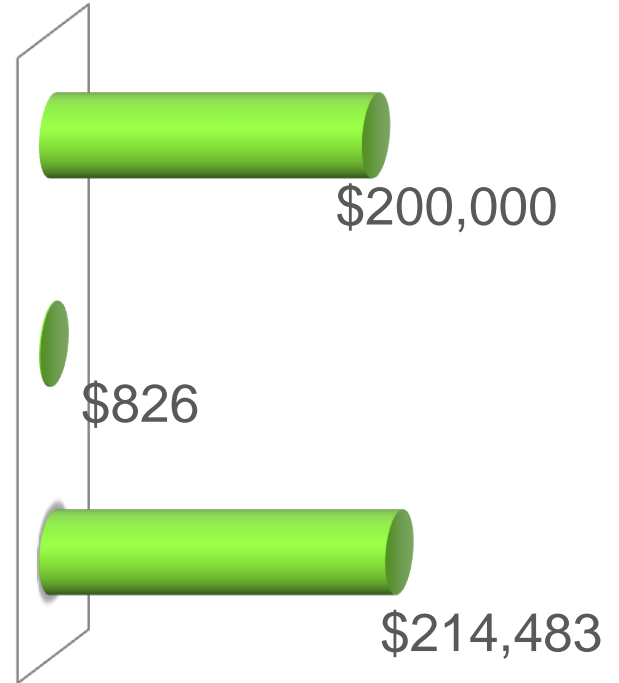


Option #2:
\$200,000
Invested @
5.5%

Present Value of
Invested Funds

After-Tax Monthly
Payment

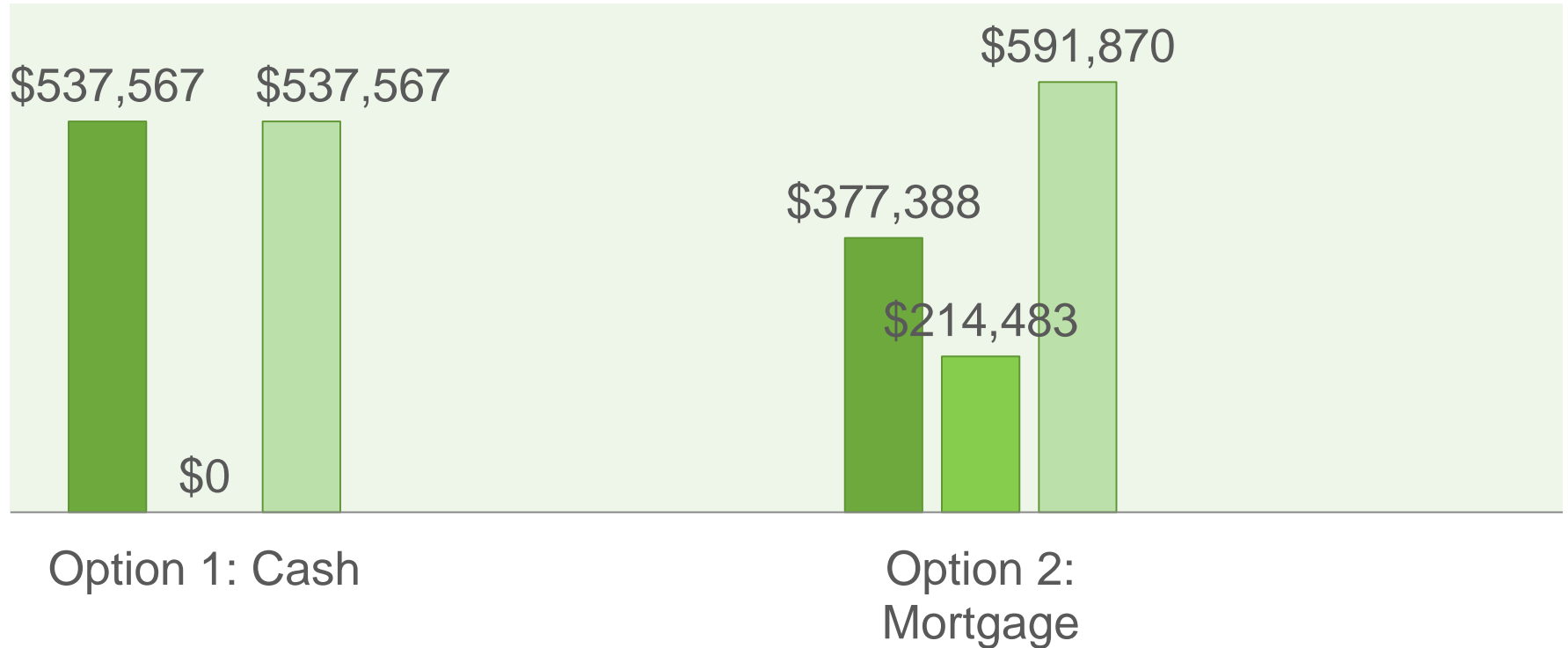
Future Value of Invested
Funds





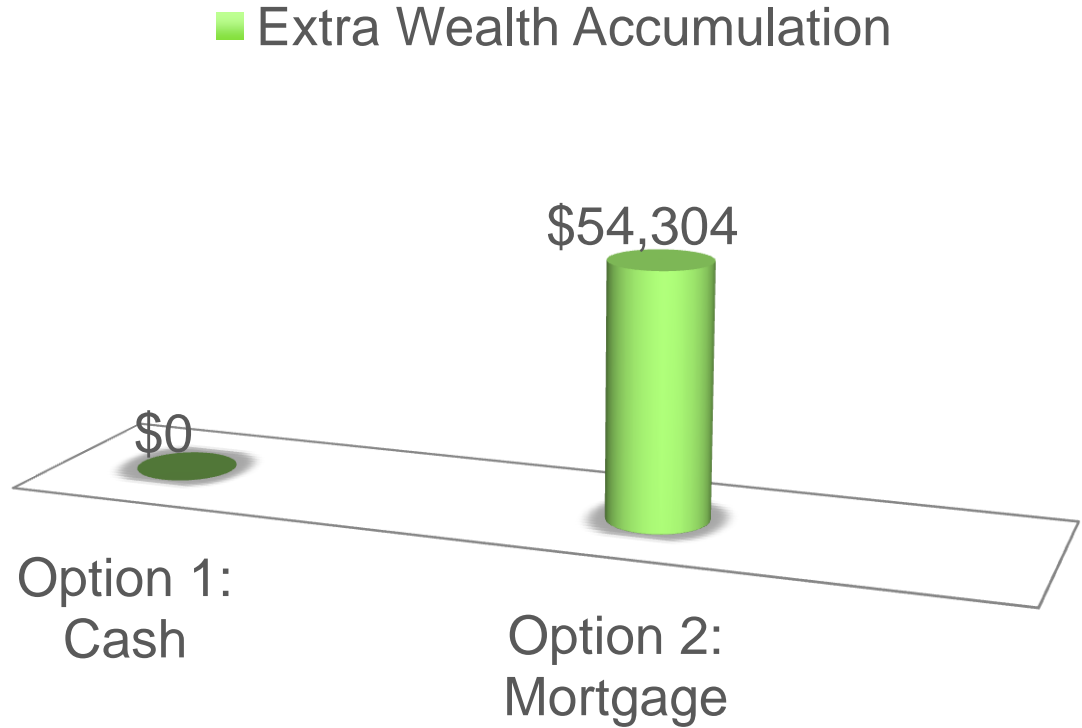
Case Study #1: Conclusion

- Future Home Equity Position
- Future Value of Invested Funds
- Total Future Net Worth





Case Study #1: Conclusion





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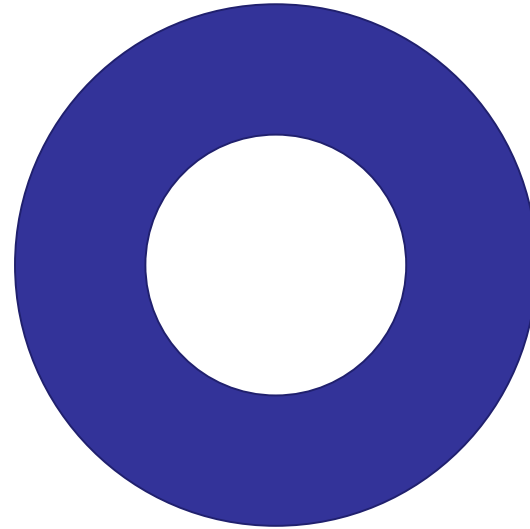
What if you **remove** the tax deduction?



\$1,013
Mortgage
Payment

After-Tax
Payment,
\$1,013

Tax
Benefit,
\$0





Option #2:
\$200,000
Invested @
5.5%

Present Value of
Invested Funds



After-Tax Monthly
Payment

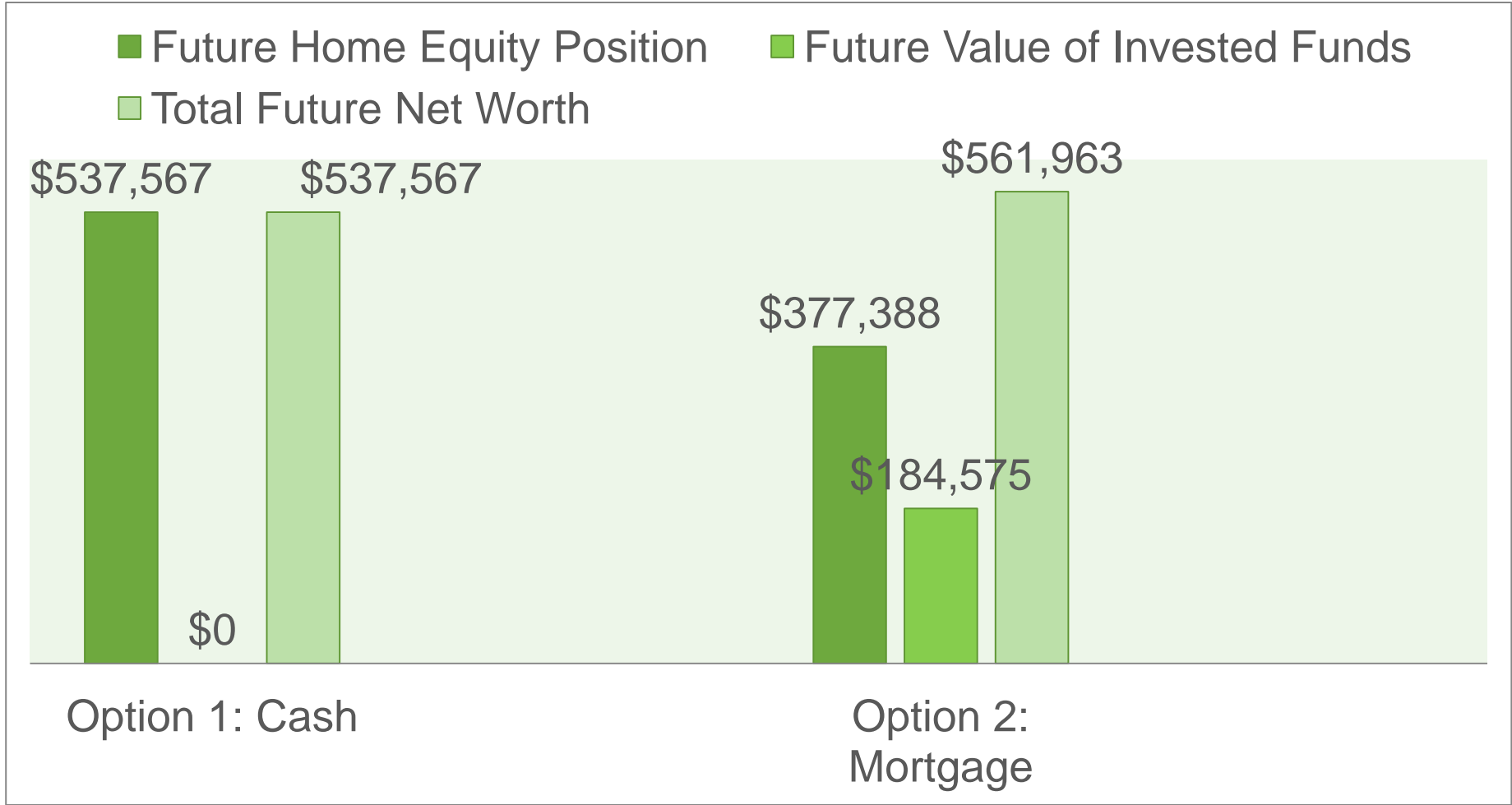


Future Value of
Invested Funds





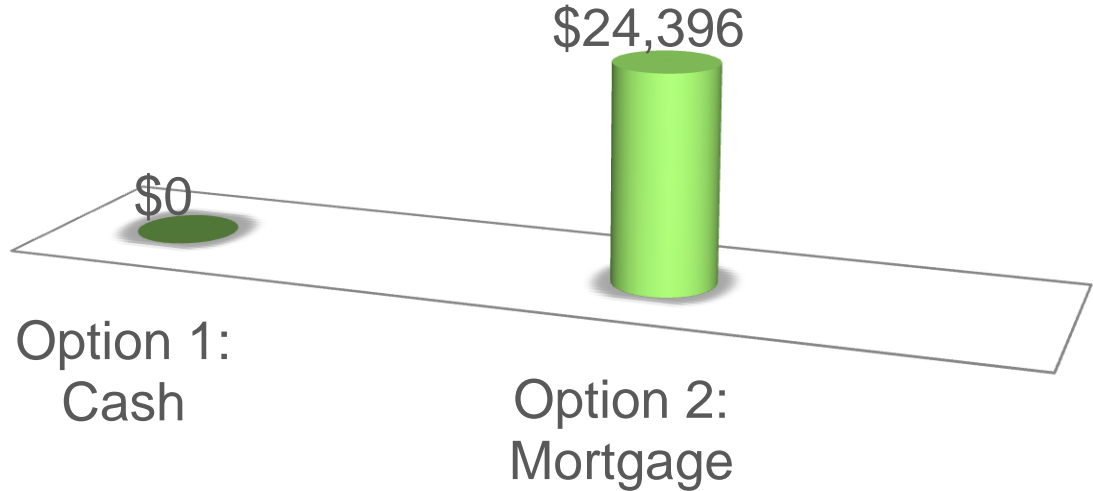
Case Study #1: Conclusion





■ Extra Wealth Accumulation

Case Study #1: Conclusion





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What if the client has **already paid cash**?



90-Day Rule



*Debt Consolidation:
What's the Impact?*





Three Factors

1. Blended Interest Rate
2. Monthly Cash Flow
3. Long-term Impact



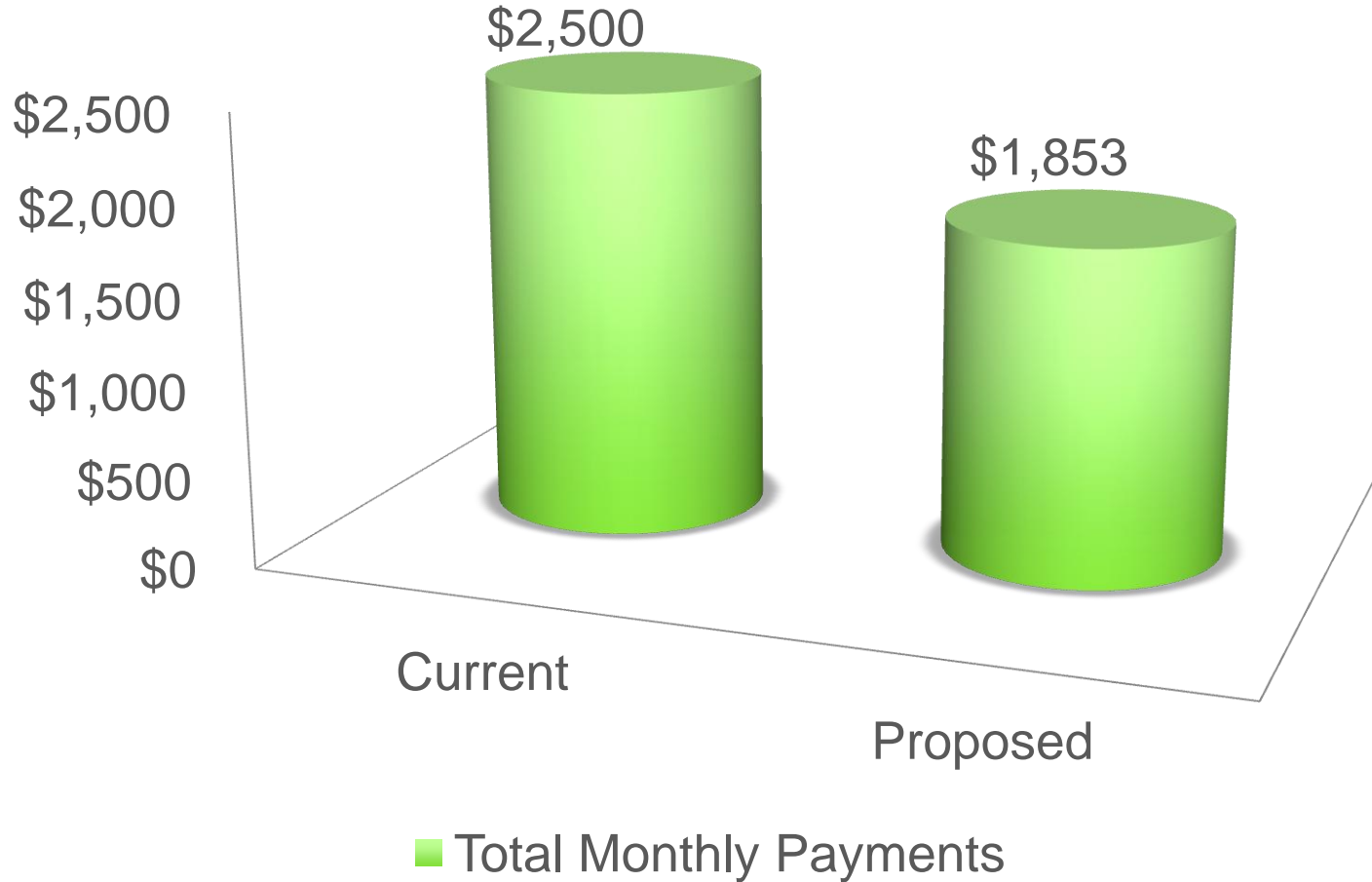
Current Debt Structure

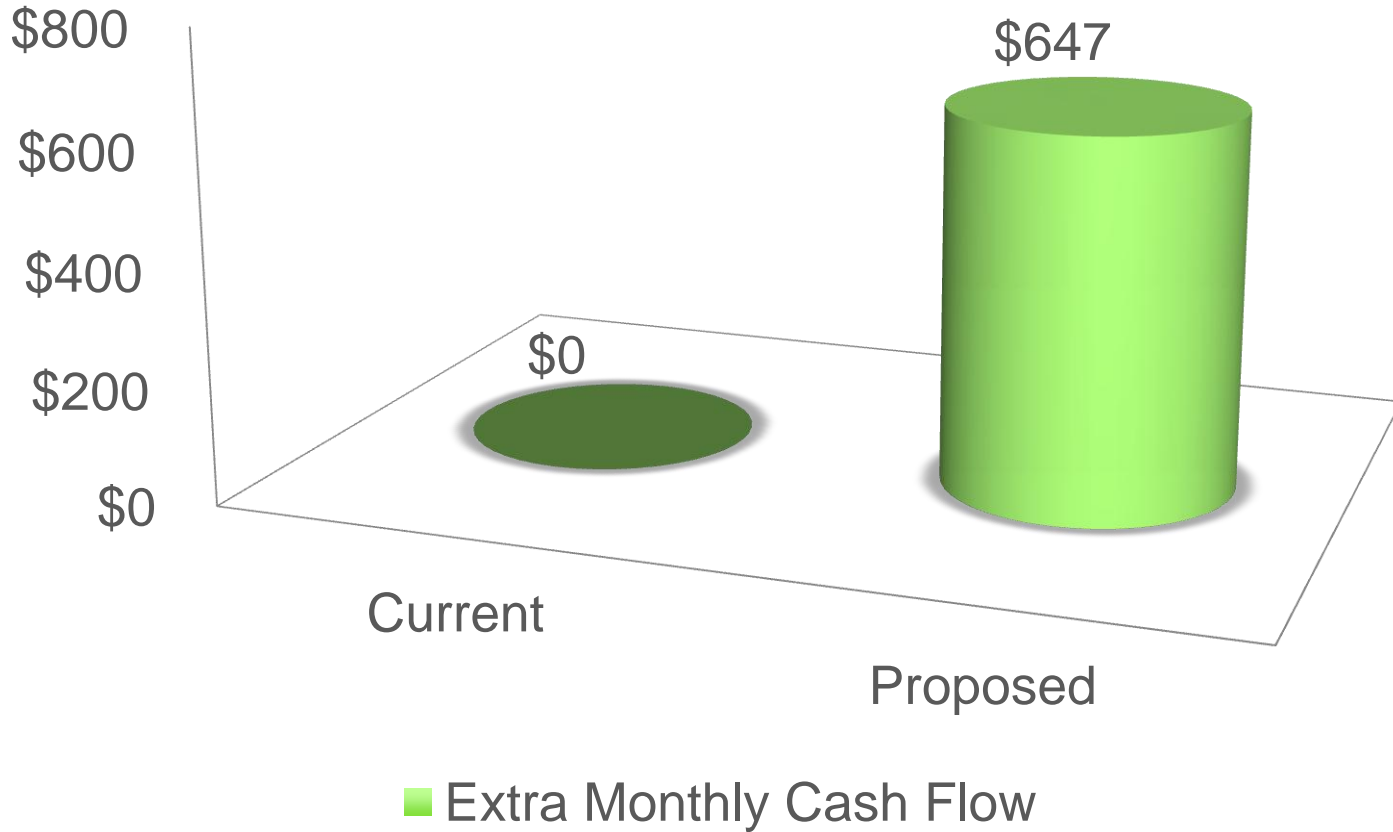
Debts	Balance*	Interest Rate	Before Tax Interest Cost	Tax Benefit %	Tax Benefit \$	After Tax Interest Cost \$	After Tax Interest Rate %
Mortgage #1	\$200,000	5.250%	\$10,500	25.00%	\$2,625	\$7,875	3.938%
Mortgage #2	\$75,000	7.500%	\$5,625	25.00%	\$1,406	\$4,219	5.625%
Car Loan #1	\$15,000	1.900%	\$285	0.00%	\$0	\$285	1.900%
Car Loan #2	\$20,000	3.900%	\$780	0.00%	\$0	\$780	3.900%
Credit Card #1	\$5,000	8.900%	\$445	0.00%	\$0	\$445	8.900%
Credit Card #2	\$13,000	7.400%	\$962	0.00%	\$0	\$962	7.400%
Credit Card #3	\$7,500	12.900%	\$968	0.00%	\$0	\$968	12.900%
TOTAL BALANCES:	\$335,502	-	\$19,565	-	\$4,031	\$15,533	-
BLENDED INTEREST RATES:	-	5.83%	-	-	-	-	4.63%

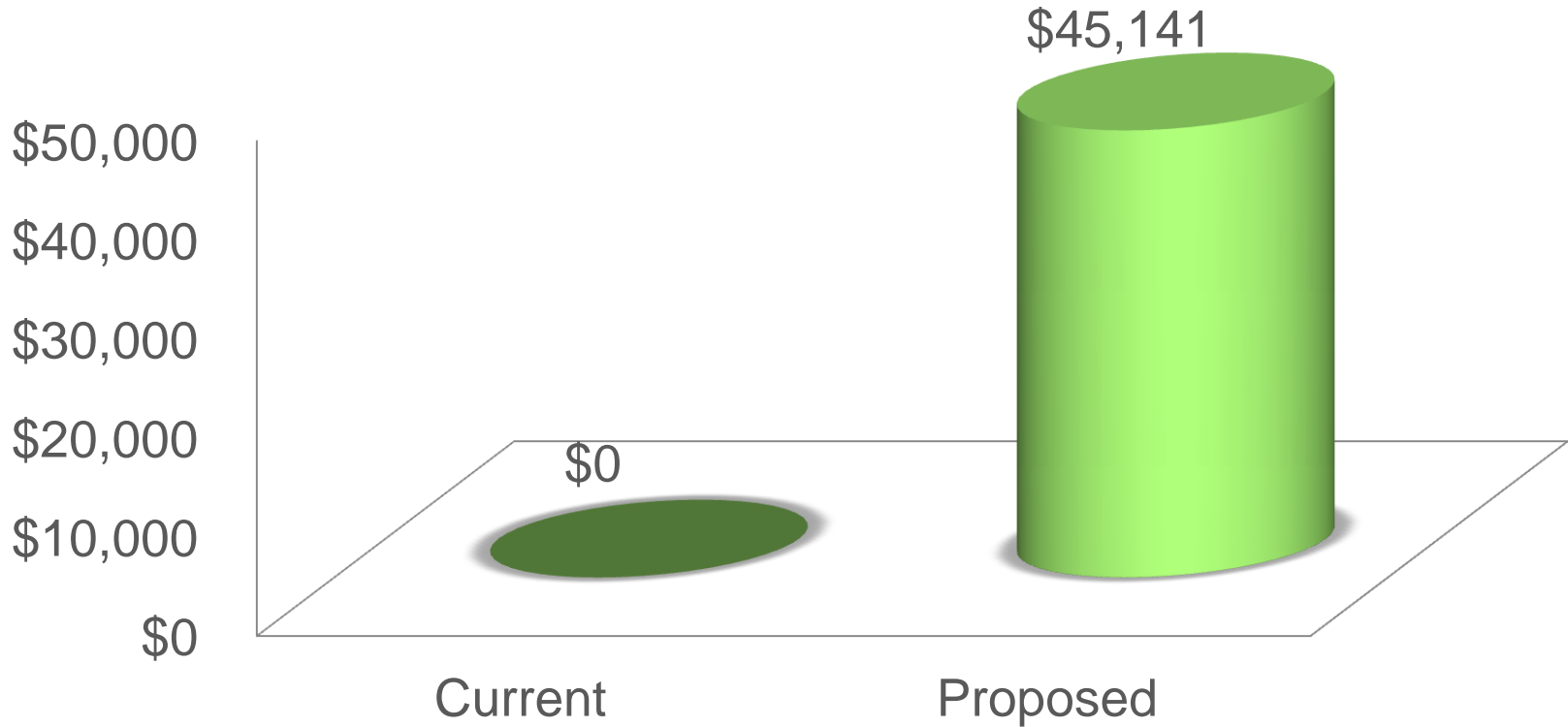


Proposed Debt Structure

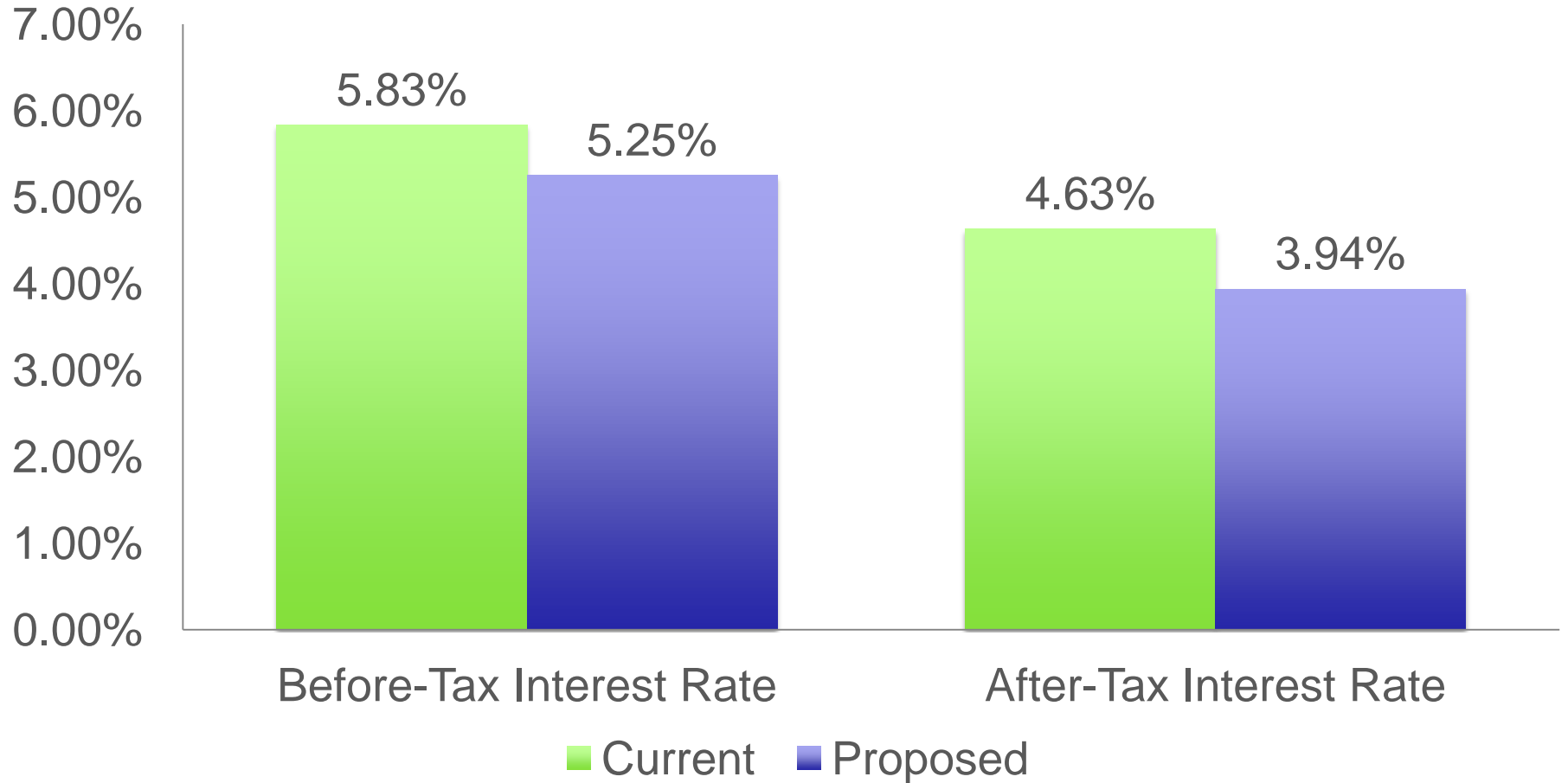
Debts	Balance*	Interest Rate	Before Tax Interest Cost	Tax Benefit %	Tax Benefit \$	After Tax Interest Cost \$	After Tax Interest Rate %
Mortgage #1	\$335,500	5.250%	\$17,614	25.00%	\$4,403	\$13,210	3.938%

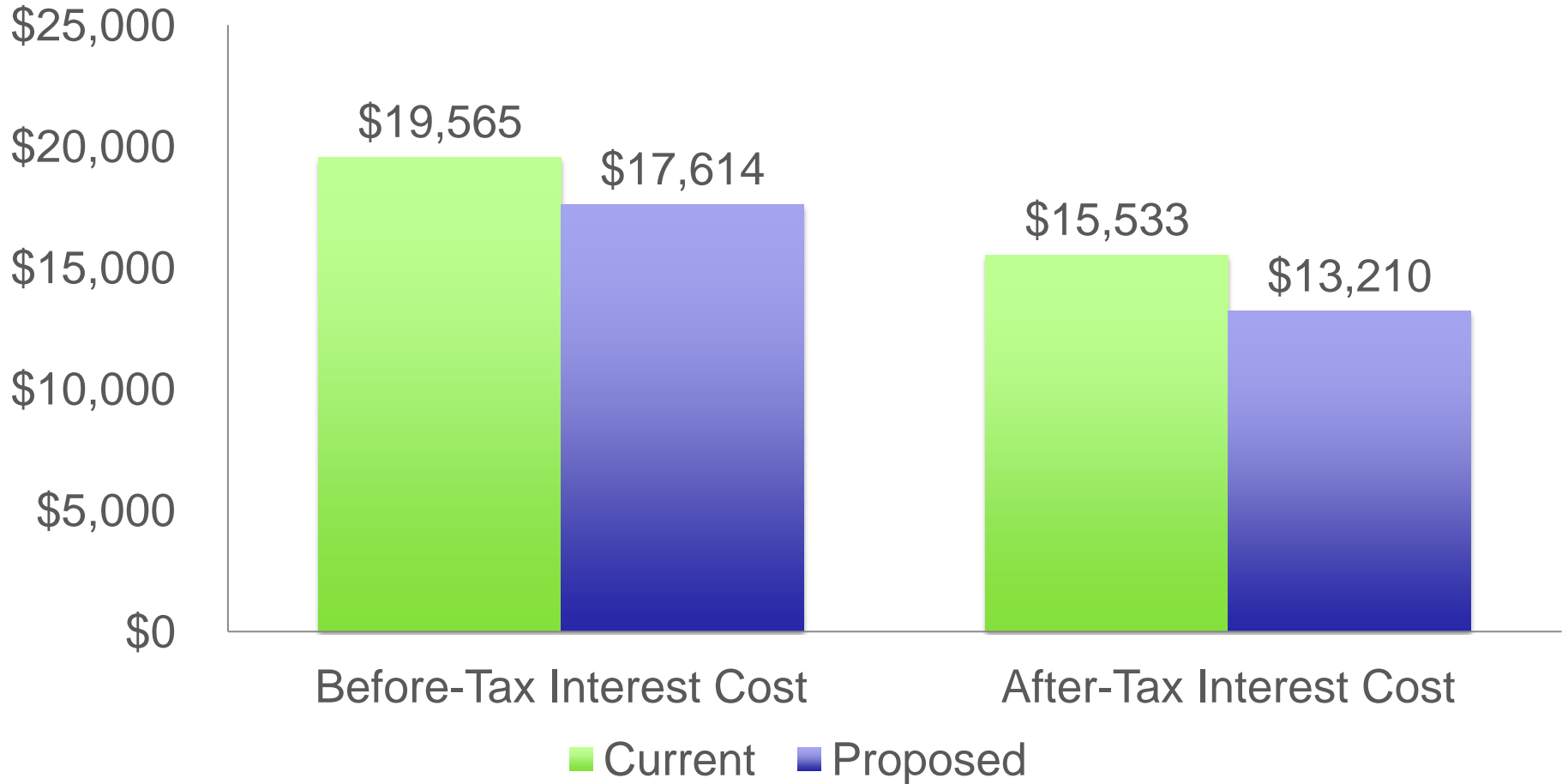






■ Extra Future Value In 5 Years @ 6% ROI





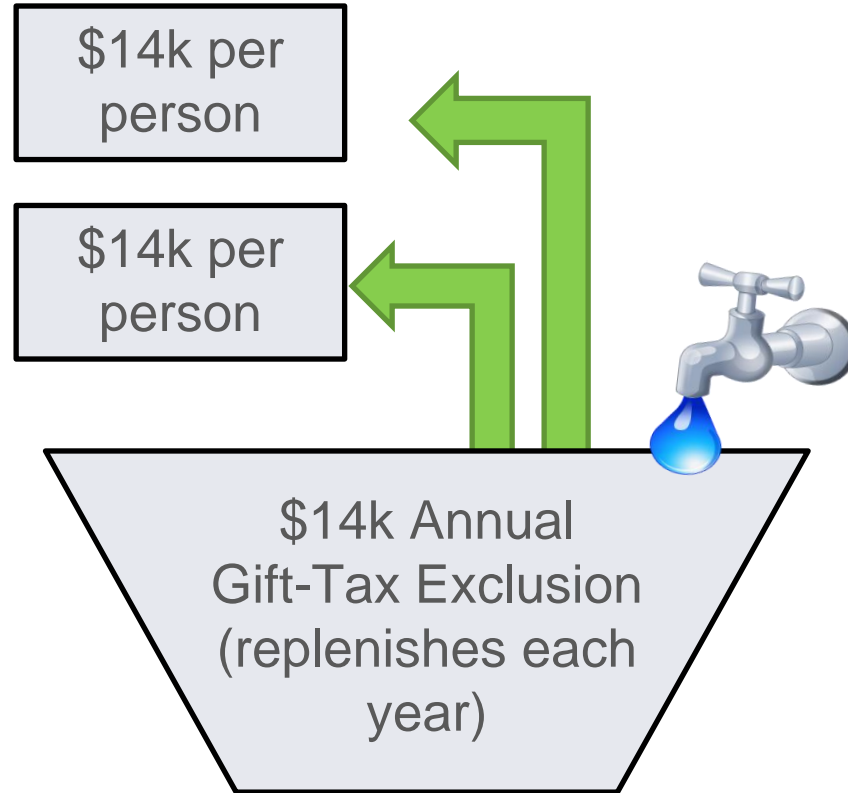
*Tax & Cash Flow Impact of
Gifts and Inter-Family Loans*

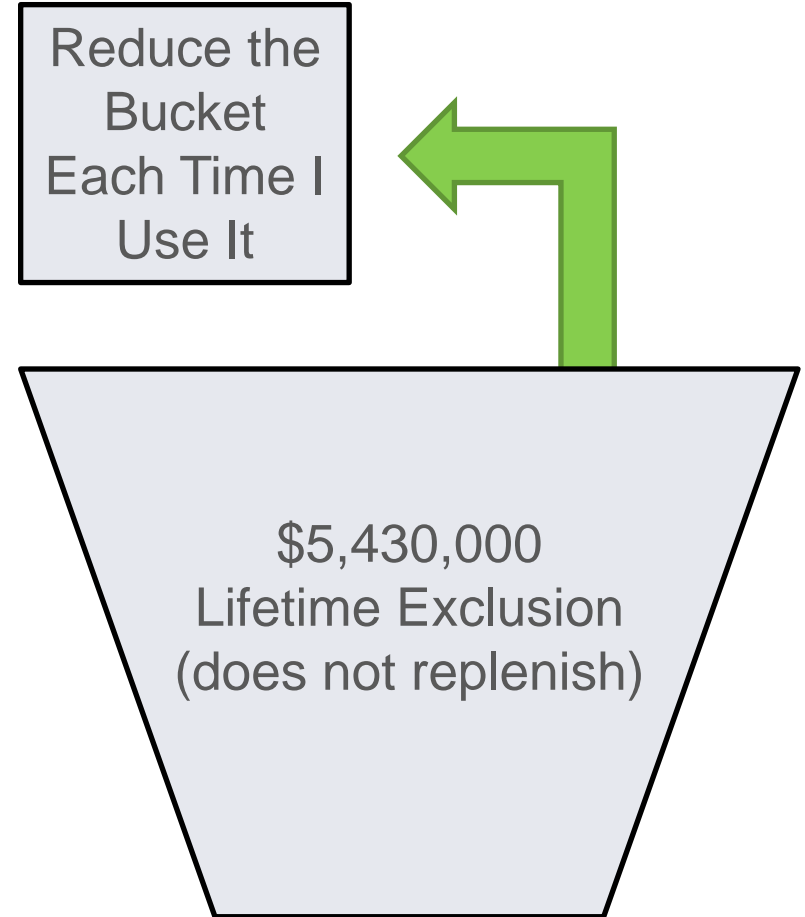
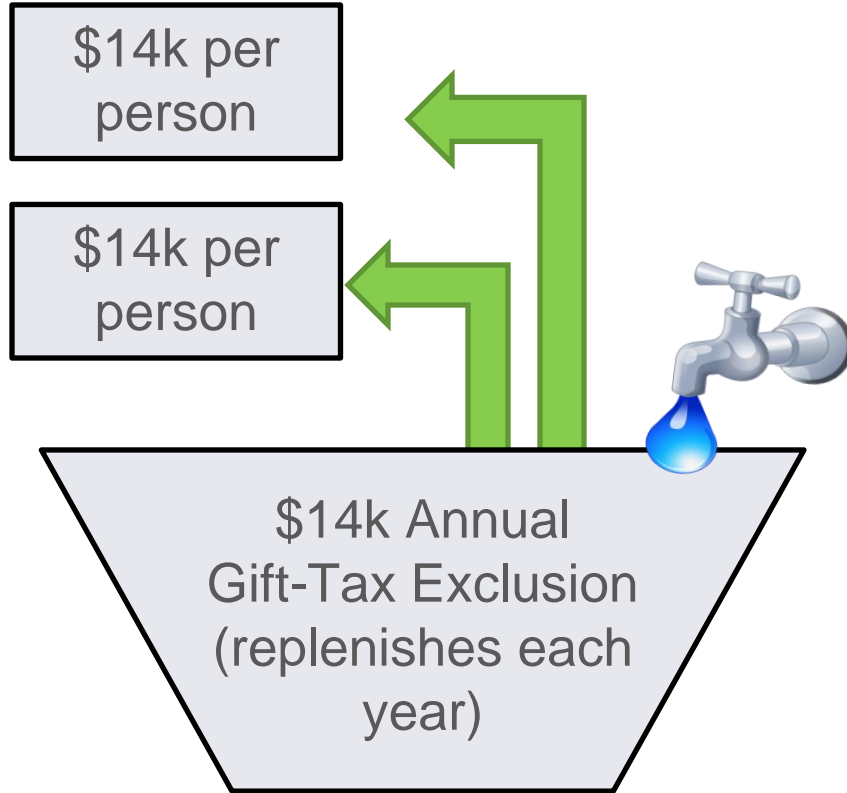




Gifts

- ✓ Purchase a Home
- ✓ Reduce Mortgage Balance to Refinance
- ✓ Reduce Negative Equity to Sell





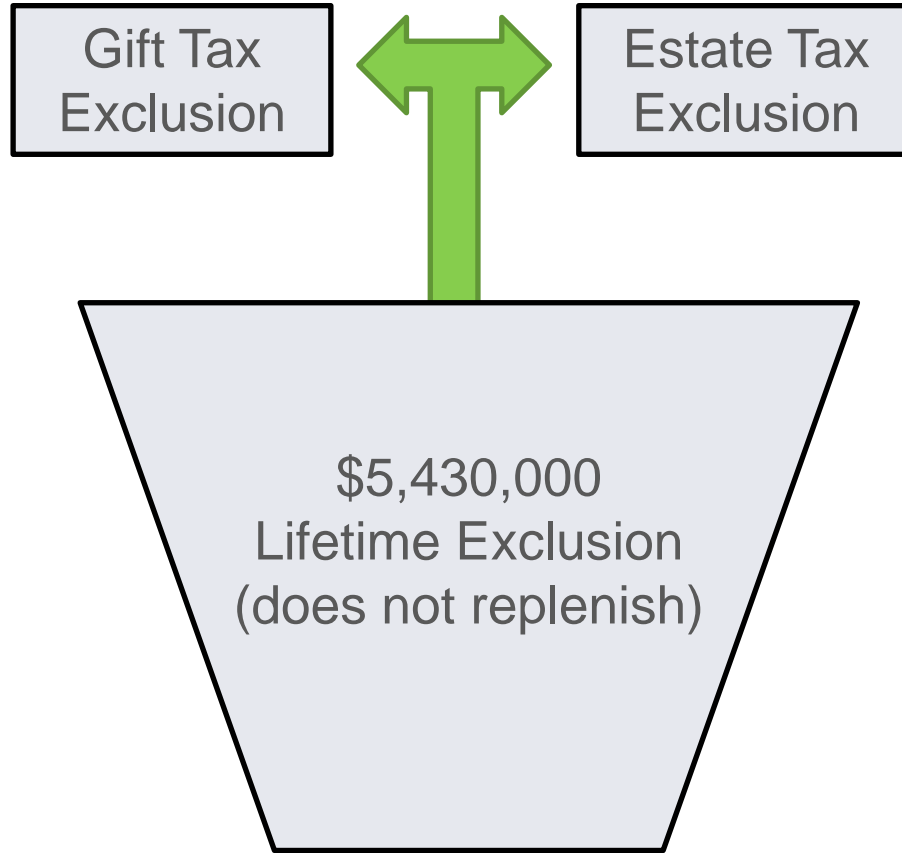


Lifetime
Exclusion
Used
(\$100,000)



Estate Tax
Exclusion
Remaining
(\$5,330,000)

\$5,430,000 in Total
“exclusions”





Federal Gift Tax

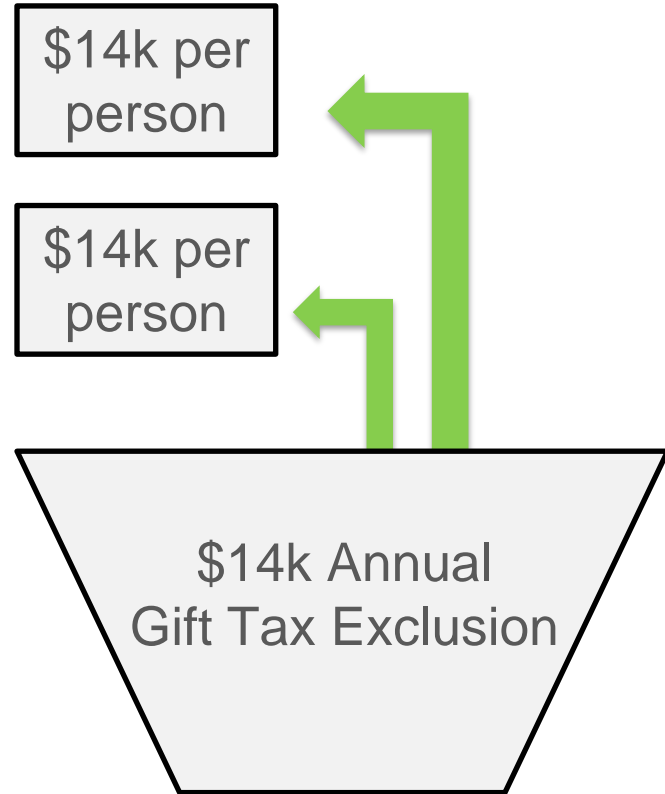
- ① Two Buckets of Exclusions
- ② No Tax to Gift Recipient
- ③ No Relationship Required



Gift Taxes Example 1: Annual Exclusion

\$56,000 = Funds Needed For Down
Payment & Closing Costs

- ✓ \$14k From Mom to Daughter
- ✓ \$14k From Mom to Son-in-Law
- ✓ \$14k From Dad to Daughter
- ✓ \$14k From Dad to Son-in-Law





Gift Taxes Example 2: Lifetime Exclusion

\$200,000 = Funds Needed For
Down Payment & Closing Costs

- ✓ \$14k From Mom to Daughter
- ✓ \$14k From Mom to Son-in-Law
- ✓ \$14k From Dad to Daughter
- ✓ \$14k From Dad to Son-in-Law

\$200,000

-

\$56,000

=

\$144,000



Gift Tax
Exclusion
(\$144,000)



Estate Tax
Exclusion
(\$5,286,000)

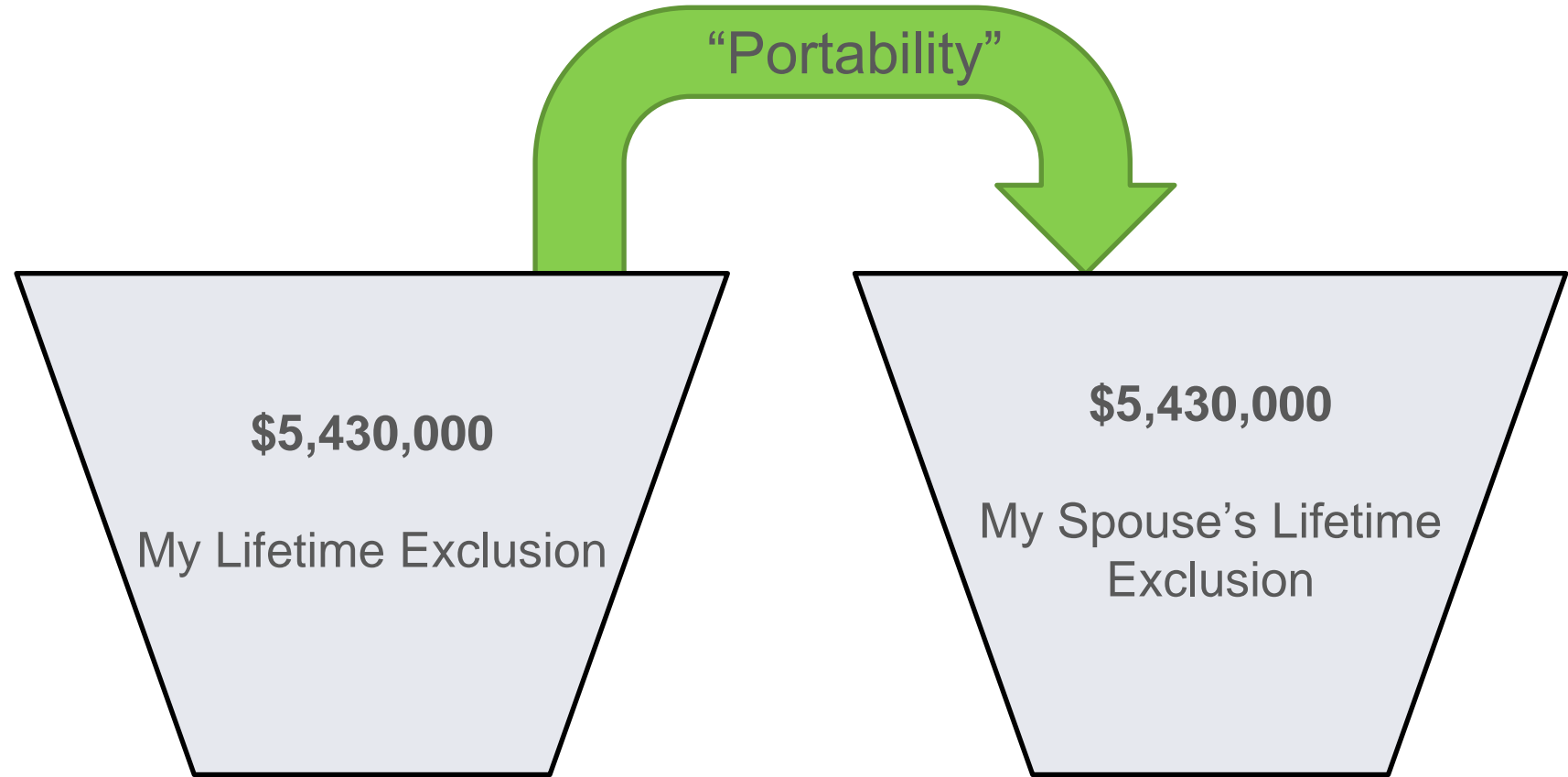
\$5,430,000 in Total
“exclusions”



Federal Estate Tax

- ① \$5,430,000 Exclusion (2015)
- ② Many States Have Lower Limits
- ③ Unlimited Marital Exclusion
- ④ Portability







\$10,860,000

Total Exclusion for a
Married Couple
Using “Portability”



But it's Just a Loan...

- ✓ **Underwriting Guidelines:**

- ✓ List loan as a debt/liability on 1003
- ✓ Include loan payment in DTI

- ✓ **IRS Guidelines:**

- ✓ Borrower must pay interest on the loan



But it's Just a Loan...

- ✓ Is the recipient of the money paying the applicable Federal Rate?
 - ✓ Short = Less than 3 years
 - ✓ Mid = 3-9 years
 - ✓ Long = Greater than 9 years
- ✓ Is the lender of the money paying taxes on the interest they receive?
- ✓ Is there a pre-arranged plan to forgive the loan?

Conclusion

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