fore, home equity simply sits idle in the home. It does not earn any rate of return. Assume you have a home worth $100,000 which you own free and clear. If the home appreciates 5%, you own an asset worth $105,000 at the end of the year.

Now, assume you had separated the $100,000 of home equity and placed it in a safe, conservative side account earning 8%. Your side account would be worth $108,000 at the end of the year. You still own the home, which appreciated 5% and is worth $105,000. By separating the equity you created a new asset which was also able to earn a rate of return. Therefore, you earned $8,000 more than you would have if the money were left to sit idle in the home. To be fair, you do have a mortgage payment you didn't have before. However, since interest rates are relative, if we are assuming a rate of return of 8%, we can also assume a strategic interest-only mortgage would be available at 7%. Also, since mortgage interest is 100% tax deductible, the net cost of the money is only 4.5%. This produces a 4.4% positive spread between the cost of money and the earnings on that money.

The story gets much more compelling over time, although the mortgage debt remains constant, through compound interest, the side account continues to grow at a faster pace each year. The earnings on $100,000 in year 1 are $8,000. Then in year 2, the 8% earnings on $108,000 are $8,640. In year 3, the earnings on $116,640 at 8% are $9,331. Since the mortgage debt remains the same, the spread between the cost of the mortgage money and the earnings on the separated equity continues to widen further in the homeowner's favor every year. If we allow home equity to remain idle in the home, we give up the opportunity to put it to work and allow it to grow and compound.

Case Study: $1,824,00 in Wealth, Using Car Payment & Excess Equity

There's a recent case study of a couple in their mid 30's living in San Diego, CA. They felt really good about their debt structure because they locked in a 30 year fixed mortgage at the bottom of the market and had a low interest rate auto loan. At the time they owed $427,300 on a 30 year fixed mortgage at 5.5% with a monthly payment of $2,469, $24,700 on a 5 year auto loan at 3.9% with a monthly payment of $496 and they have a 37% tax bracket. They had $331,700 built up in home equity. A very common (Brother A, The Old Way) scenario. After understanding the liquidity, safety, rate of return, and tax benefits of properly managing their home equity and debt structure (Brother B, The New Way), this couple decided to separate $170,000 of their equity to pay off their auto loan and invest $145,000 in a safe conservative side account. By using a 6.5% 7 year fixed rate, interest only, debt instrument (mortgage/financial tool) they were able to increase their mortgage balance to separate this chunk of equity while decreasing their net payment by an average of $530. The national average appreciation rate on real estate is 5% so it would only take 5 years of average appreciation for their home to replenish the equity being separated.

The couple conservatively invested the $145,000 lump sum and the monthly net savings with their financial planner (zero increase in monthly expenses). If we assume a conservative 7% rate of return, their investment account will grow to $630,000 in 16 years. In the 16th year, they will have enough cash in their investment account to pay off their mortgage completely if they want to; twelve years earlier than the pace of their previous 5.5% mortgage! However, armed with their new equity management knowledge, they plan to keep the mortgage well into retirement so they can keep the money in the investment account where it is more liquid, safer, and will continue to grow and compound. Their investment account balance at retirement (in 30 years) is projected to be $1,824,000 while their mortgage remains at $607,000. Getting the equity out from being trapped in their home and putting it to work with a professionally managed investment plan has added an extra $1,217,000 of wealth in 30 years andpreserved a valuable tax deduction. If the couple decides to retire in 30 years, this scenario of an $1,824,000 portfolio earning 7% will provide a continuous income stream of $122,000 a year to cover their small mortgage payment and a better lifestyle, plus a bigger estate to pass on to their children.

UNION WEST
Financial

1200 Prospect Street, Suite 425
La Jolla, CA 92037
Tel: 858.454.5343
Fax: 858.454.6771
info@unionwestfinancial.com

Other Offices:
Rancho Santa Fe
Mammoth Lakes

About the author: Eric R. Union is President of Union West Financial a company that specializes in helping clients properly manage their home equity and their mortgage to build wealth. Union West's unique mortgage planning approach has helped hundred of families.

For a free analysis to see how these concepts would apply to your spcific situation, please contact Eric R. Union at 858.454.5343 or via email at ericunion@unionwestfinancial.com.