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Locking in the Value of Your Equity in Any Kind of Market



GUEST COLUMN

By Bruce Weide

Second of Two Parts

In the last edition of the Business Journal I confessed my personal worries that the value of my home equity could well vaporize by the time the dust settles on the So. Cal. real estate market in the next couple of years.

Now, if someone had told me to get out of tech stocks and go cash in January of 2000, just think how much farther ahead I'd be today. So at present I have an unexpected real estate windfall in my home, with the writing on the wall everywhere I turn seeming to be about the coming burst of "housing bubble". Any wonder why I feel like a deer in the headlights all over again?

So what if you could actually "lock-in" the value of your equity in either an up or down real estate market? And what if, in the process of preserving or otherwise diversifying your home equity values, you still own the home as an asset, plus additional diversified assets newly created when you "cashed out" those diminishing home equity values to salvage them while you still can.

Tempting, but there would have to be a down side, wouldn't there?

Building Diversified Wealth

You see, the name of the game is actually *number* of assets you own and the growth of those *multiple assets*, not the equity you've built up in one single asset. (Which for most working people is namely their home and only their home). I don't have to tell you savvy real estate investors that rather than owning one home with \$500,000 of equity in it, I would rather own 10 homes with \$50,000 of equity each. – *as long as real estate values are increasing*. But just as such extreme leveraging can build great wealth in an appreciating market, just think of the *CRASH* you'd hear if 10 mortgaged homes took a slide in price in the coming years. One answer: It's time to diversify!

About a year ago Carrol Lloyd in the *San Francisco Chronicle* started sounding warning signals that Robert Kiyosaki himself, the financial guru who has spurred so many working people to become big-time leveraged real estate investors, has privately become "a major bubble blower". She points out "...he's begun posting articles that caution

against what might be called ‘sur-real estate exuberance.’ He confesses that he's currently *dumping* real estate that produces no cash flow” (from rental income). Holy Cow! My guess is that he’s diversifying.

Shoving all your personal worth into the equity in your home creates several problems:

- 1.) LESS SAFETY: All your eggs are in one basket. If this housing market does decline, it’s not your debt that will decrease - it’s all the extra principal payments you’ve made into the mortgage toward an early pay-off that will vanish overnight! Plus, do you know that the first foreclosure targets in a down market are those mortgages that have been mostly paid down? That’s because the bank knows they can sell that home for a discount and still recapture their loan. If the home was 100% mortgaged and the market declines, the bank doesn’t want the home, they want to *keep you in the loan and they’ll bargain!*
- 2.) LESS LIQUIDITY: Scenario 1: The greatest common denominators in home mortgage foreclosure are twofold: Loss of income or personal disability. At those times when you may most need to tap into the equity in your house, borrowing will be either very costly (when the lender discovers your circumstances) or impossible.

Scenario 2: In 1999 I was forced to sell a house in Orange I had owned for 9 years at a \$30,000 loss. I was renting the home out, and when expenses came up I couldn’t afford due to poor current cash flow, with no liquidity I was forced to sell in a down market. Adequate liquidity (money OUT of the house to draw upon) allows you to wait out down markets if you want to sell.

- 3.) ZERO RATE OF RETURN: Again, it’s not the equity that makes your home values increase, it’s the perceived desirability of the asset on the market, multiplied by the number of assets you own. Do you seriously think Donald Trump waited to pay off his loan on Trump Towers, before he started his next project? He wants *multiple appreciating assets*, baby – equity be damned!

The fact is that by proper established techniques of home equity optimization the average American family could greatly increase the safety and liquidity of their nest egg while immediately doubling their asset base and thereby often realizing an extra \$500,000 of newly found eventual retirement income, without having to devote one dime more toward retirement than they save today!

For example, in the simplest form, let’s say that you have \$300,000 of equity in a \$600,000 home. If you separated this equity from the home into a cash position, even earning only a net 6% (\$18,000), and your home value *goes down* \$200,000 in value, did you really lose the money? No, it’s still intact, plus it’s earning.

But if your home value *goes up* by 5%, was there any *disadvantage*? No. Now your home went up \$30,000 *and* your cash account went up \$18,000. In fact, you’ll find that if your goal is to pay your mortgage off sooner, then this side fund technique will get you there faster than surrendering extra principal payments to the mortgage company (which I purport you never want to do) – plus you keep *control of your equity* in the event of

unemployment or disability, when borrowing it back will be either very expensive or impossible.

WARNING: Don't do this without adult supervision, folks! The trick is that you must be fairly certain that the separated equity will earn at a rate higher than the cost of the mortgage. A good financial planner can accomplish this in ways you would not intuitively implement on your own by utilizing 2 key tools; Capturing the spreads between the *simple interest* mortgage and the *compounding interest* in the cash account; and the *tax-deductible* mortgage interest vs. *tax-free* interest earnings required as part of the cash account you set up.

We have implemented dozens of equity optimization models like this, and their outcomes can vary considerably based on age, current cash flow needs, and even what type of mortgage options are available to you.

Two good sources of reference material you can study further on this are the DVD *Why You Should Carry a Big Long Mortgage and Never Pay It Off* by Ric Edelman (ricedelman.com/store/video_mortgage.asp) and the book *Missed Fortune 101* by Douglas Andrew (available at Amazon.com).

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