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Financial Advice *for the* Baby Boomer

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"Planning for your future is the next best thing to knowing your future"

Should You Pay Off Your Mortgage?

By Howard Hook, CFP®, CPA

One of the more common questions I get asked by clients is "Should I pay off my mortgage?"

To answer that question you first need to look at the after-tax cost of the mortgage. To calculate this you need to know your marginal income tax rate and your mortgage interest rate. Your marginal tax rate is the amount of tax paid on an additional dollar of income. To find this rate, you need to look at a Federal income tax rate schedule and see what rate of tax your taxable income falls into. If you can't figure this out, ask your accountant, who should be able to give you this information. Once you know this, subtract it from one. Then multiply that percentage by your mortgage interest rate, which gives you the after-tax cost of your mortgage.

For example, if your mortgage interest rate is 4% and your marginal tax rate is 25%, then the after-tax cost of your mortgage is 3% (1 - 25% = 75% x 4% = 3%).

The next step is to calculate the cost you would incur by paying off the mortgage. There are two types of costs you will need to identify here. The first are actual costs you would incur, such as transactions costs to liquidate investments, or income taxes you would incur if you sold an investment or took a distribution from your retirement plan.

The other type of cost is the opportunity cost of not being able to earn future income on the funds used to pay off the mortgage. For example, if you used money from your savings account to pay off the mortgage, the opportunity cost would be the foregone interest on the money in the savings account. Currently this number is low. If instead you decided to sell one of your mutual funds to pay off the mortgage, the opportunity cost could be much higher, depending upon what you think the future rate of return might be for the mutual fund if you did not sell it.

Where this becomes a little tricky is when deciding whether it makes sense to sell funds in a retirement plan – such as your IRA – and use the proceeds to pay off your mortgage. One of the costs of taking a distribution from a retirement plan is the tax that would be owed on the distribution. For example, taking $40,000 from your IRA account may cost you $10,000 in

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Social Security System is Not Going Away

By Robert Epstein, ChFC®

Retirement security and protection against the risks of disability and premature death are among the most important challenges families face when they contemplate their financial goals and objectives.

Americans have developed a structure of social insurance, called the Social Security system, to help provide a foundation for success in these areas. However, in recent times, many people have become concerned that this system may not continue to operate effectively; that it is in crisis or perhaps even approaching bankruptcy. An objective view shows that this is a distortion of the situation put forward by individuals with an agenda and promoted through their mouthpieces in the press and in Congress. Rather than maintaining and improving the structure that is in place, their goal is to take it apart piece by piece.

To get a sense of the extent and depth of the benefits that workers and their families derive from the system, consider that:

- Currently, 52 million Americans – one out of every six – receive retirement, survivors and disability benefits from Social Security.
- 65% of seniors receive 50% or more of their income from Social Security.
- A 30-year-old worker with a spouse and two children earning $32,000/year has the equivalent of $465,000 of disability insurance and $476,000 of life insurance coverage through Social Security.
- 4.4 million children are receiving benefits.
- Only about 10% of American seniors live in poverty, while without Social Security it would be 44% for men and 48% for women.

For over 80 years, all benefits have been paid in full and on time.

The structure has been built over the years on a bipartisan basis. To summarize the major steps that have been taken:

Year	Administration	Program
1935	FDR	Retiree system
1939	FDR	Survivor benefits
1956	Eisenhower	Disability insurance
1972	Nixon	Cost of Living increase formula
1983	Reagan	Adjustments to regulations

For over 80 years, all benefits have been paid in full and on time. Efficiently administered, with less than 1% of program costs going towards administration, the system is transparent and reliable.

The system is funded through payments from almost 90% of American workers, of 6.2% of wages each from employees and employers, plus 12.4% from self-employed individuals, up to a maximum annual income level of $127,000 (in 2017). The trustees of the system issue an annual report which looks forward 75 years at the system's finances. Contrary to the impression you may have received from the media, the latest trustees' report states that, under current assumptions, full benefits will continue through 2034, after which benefits could continue at 75% of the current rate until at least 2090.

Benefits represent 5.1% of GDP, and are forecast to increase to a high of 6.2% by 2037. The Social Security trust fund has an accumulated surplus of $2.6 trillion, which is invested in interest-bearing United States Treasury bonds, regarded as the safest investments in the world. Not one penny of the Federal government's deficit or debt (the net total of annual deficits) comes from the payment of Social Security benefits. In fact, by law, Social Security funds are separate from the government's general revenues.

When Congress debates about whether to raise the Federal debt ceiling, Social Security need not be included in that discussion. While the government has pressing issues to deal with relating to jobs, taxes, and infrastructure, Social Security's future financing can be addressed in a common sense manner over the next

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Don't Take Homeowners Insurance For Granted

By Jamal Mahmood, CFP®, ChFC®

My wife and I just bought our first house. One of the final steps we had to take in the long, tedious process of inspecting our home, securing our mortgage, and completing our closing, was to obtain homeowners insurance.

Because I am a financial planner, with wisdom accumulated through years of experience, I went to my Property and Casualty Insurance agent's office, and had her walk me through the terms of the policy so we could customize a policy that was right for us.

Actually, that's a lie. I emailed my agent and said "how fast can you get me a policy?" She got me a quote within a day, the price seemed affordable, and so I had her bind it so I could be cleared to close on my house.

A few months later, our new house truly became our "home" when we woke up to find 5 inches of water in our basement. Our sump pump could not keep up with the rain the night before. Naturally, the call to the insurance company was full of suspense. What exactly had we bought that day? It turns out that most policies do not cover what happened to my basement that day. But thankfully ours did. We learned a valuable lesson.

Homeowners insurance policies are not all alike. The cheaper ones cover certain "named perils" only. The contract names specific things that can happen to your home that would be covered. If something happens to your home that is not a "named peril" under the policy, your insurance company would have every justification to deny your claim. A more comprehensive type of policy is an "all perils" policy. Such a policy lists certain exclusions to coverage (there is no policy that covers every possible loss to your home), but if a loss that occurs to your home is not specifically excluded, then the insurance company must cover it.

Many policies have coverage limits that are too low. A homeowners policy is designed to cover damage to the "dwelling" and the "contents" within. I have seen many policies where these coverage limits would be nowhere near sufficient to reimburse a homeowner for a significant or a total loss of their property. Sometimes, limits that were

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adequate when the policy was first purchased become more and more obsolete over time.

For this reason, regular communication with your agent or broker is important. Your insurance company has no way of knowing whether your coverage is adequate or not unless you keep them updated about your home. It is very easy for material changes to your living situation to render your homeowners' policy insufficient. If you hire a domestic employee, or begin using your home for commercial purposes, it is wise to check your policy provisions. If you purchase a trampoline or build a swimming pool, a call to your insurance company is in order.

On the other hand, certain alterations or additions, such as installing a burglar alarm, may entitle you to discounts, which you would not get unless you communicated the facts to your company. At times, people have policies with coverage limits that are beyond what is necessary, and can be reduced for valuable savings.

Another important component of a homeowners' insurance policy is the "liability" portion, which typically reimburses you for claims, judgements, and legal costs stemming from accusations of liabilities by others against you and your family. Like many financial advisors, we typically recommend that you maintain liability coverage that is approximately equal to your net worth. Most often, however, we find people simply carry the standard coverage amount of $500,000 - $1,000,000. Further, it is important to be aware that this kind of coverage extends to personal liability only. Claims of professional liability are typically not covered under a policy such as this, and require a policy that is unique to your profession.

For most people, their home and their personal belongings are not just among their more valuable possessions; they are

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Social Security is Not Going Anytime Soon

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few years without rushing into any drastic changes. Elements of a long-term solution may include:

- Modifying some aspects of the benefit formula
- Increasing the maximum annual wage level subject to taxation
- Modest increases in the payroll tax

Proposals that involve full or partial privatization of the system would only increase the risk and costs of the system. Other proposals would maintain the tax rate but reduce benefits, so that revenue surpluses could be used for general government programs.

Receiving benefits from our Social Security system is the reward of hard work and represents the values of caring for our parents, children, and neighbors. We pay into the system while we work, and receive our money back when we don't. The system has been built by generations of Americans to be an important foundation of their financial well-being. As a comparison, should we maintain the Interstate highway system, or dismantle it? The same answer applies to Social Security.

Don't Take Homeowners Insurance for Granted

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also items of significant sentimental value. The costs stemming from a loss related to your home often extend beyond the simple dollar value of what needs to be replaced. There is often significant stress that results from such losses, and one way to alleviate that stress is with a reliable homeowner's policy, one that you are confident is well tailored to compensate you and your family for the real risks you face.

In my case, the only thing that saved me from the significant expense of having to remediate my new home on my own was the fact that my agent had the foresight to add a rider to my policy that allowed it to cover the situation that we eventually faced only a few months later. I am grateful I have a competent agent whom I trust, and that our relationship helped ensure the right pieces were in place when they were needed.

Nonetheless, the fact that things worked out fine is no indication that my approach to the situation was ideal. The better approach would have been to have an in-depth conversation with my agent about my new home, and to ask for her recommendation for a comprehensive solution. Emphasize your desire for a policy that covers all the reasonable risks that your home is subject to. Then, after understanding that policy, ask your agent about which options can be removed in order to make the policy more affordable. There is nothing wrong with keeping premiums reasonable and affordable, but understand what policy provisions and coverage amounts you are giving up in exchange for the savings.

The bottom line is that homeowner's insurance is, for some people, bought in haste, and neglected once it's been bought, an approach which often results in unwanted surprises when a claim is submitted. To wisely manage the risks of home ownership, simply "having" a homeowner's policy is not sufficient. It requires a good relationship between you and your insurance company, agent, or broker, in which they understand your home, and you understand your coverage.

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income taxes, in addition to the loss of future earnings on the investment in the retirement plan growing tax-deferred. Although the income tax bite is only once, for many it still is too high a hurdle to jump over where it makes sense to use retirement funds to pay off the mortgage.

Once you know the cost to pay off the mortgage you can compare it to the after-tax cost of keeping the mortgage to see which is lower. Many people have gone through this exercise, since mortgage rates have been low. Now that mortgage rates have started to rise again, the decision may swing towards paying it off.

This is an excerpt from an article that ran in *The New York Daily News*.