

# THE PLAIN DEALER

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## ASK THE EXPERT

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**Credentials:** Certified Financial Planner, Certified Public Accountant, Certified Investment Management Analyst

**Experience:** 13 years

**Assets under management:** \$185 million

**Question:** *I would like to downsize to a ranch or a condo (for health and lifestyle reasons). I currently own my home, and it's appraised at around 120K. Most of the property I've considered is priced around \$175-\$200K. Initially, my plan was to use about 30% for the down payment, (around 60K, the mortgage would be around \$1,500.), I figure the closing cost would be around \$10,000 and I would put \$10,000 in an emergency fund. I have a credit card balance of \$9,000 (at 21.99% interest rate). I would like to pay off. I have an 11 year old vehicle, which is becoming expensive to repair. With the remainder of the money, I wanted to buy, not finance another car. I want to know if this is a prudent plan, and how is the best way to access the funds: home equity loan, home equity line of credit, or outright sale?*

**Advice:** First off, congratulations are in order for paying off your current home mortgage. That is no small feat and deserves to be recognized. Next, it's great to see that you are taking the time to develop a plan for your next series of financial moves. Mapping out a strategic

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course greatly increases your chances for both financial success and lifestyle enhancement.

In order to most effectively leverage the home equity that you've built, you will need to prioritize your goals and understand their financial implications, ensure that your financial "house" is in order, and most importantly, be honest with yourself. This last part is critical and falling short can derail even the most well conceived plan. I suggest the following course of action:

### **PRIORITIZE YOUR GOALS AND UNDERSTAND THEIR FINANCIAL IMPLICATIONS**

Based on your submission, it's quite clear that your number one goal is to purchase a new home that will offer an improved lifestyle. In order to fund this and your other goals,

I first recommend selling your existing home. This should yield approximately \$120,000.

You also indicated putting down 30% of the purchase price or about \$60,000. I would recommend trimming this back to 20% or \$40,000—this will give you increased financial flexibility and still offer the benefit of avoiding Private Mortgage Insurance (PMI) which can easily cost you \$100 per month. Lowering your down payment amount will obviously increase your loan amount and monthly obligation, however, you will lock into a historically low mortgage rate and you can avoid tapping into a home equity loan at a higher rate down the road. In addition, the extra interest paid on the loan is tax deductible which translates into a nice tax benefit.

In terms of closing costs, the \$10,000 amount you approximated seems pretty steep. Remember, determining who pays these costs is negotiable with the seller and you should aim to minimize this expense (under \$3,000 excluding real estate taxes and insurance). This industry is particularly cut-throat. Make sure to have banks and mortgage brokers compete for your business and get their offers in writing before the sale.

Next, your idea to funnel \$10,000 of the proceeds into an emergency fund is a crucial step in building financial security. You will be better prepared to deal with any curve balls life throws your way. Ideally, this amount should cover 3-6 months of living expenses.

Equally critical is your suggestion to retire your credit card balance, especially considering you are paying 21.99% interest. Paying down this balance is essentially like investing the \$9,000 at a guaranteed rate of 21.99%. Guaranteed rates of that magnitude don't exist in the investment world. Also, in the meantime, while you're waiting to sell your house, you should transfer this balance to a new card that offers a 0% rate on balance transfers in order to avoid paying interest in the interim.

With the remaining amount, you propose to pay \$31,000 cash for an automobile. After shopping around for your desired make and model, have the dealerships compete for your business to save additional hard-earned dollars. Also, it would be shrewd to research the interest rates available before you make your

	YOUR PROPOSAL	RECOMMENDATION
Sell House	\$120,000	\$120,000
New Home Down Payment	(60,000)	(40,000)
Closing Costs	(10,000)	(3,000)
Emergency Fund	(10,000)	(10,000)
Pay-off Credit Card	(9,000)	(9,000)
Remaining Amount (before auto)	31,000	58,000
Purchase Auto	(31,000)	(20,000-25,000)
Net Remaining Amount	\$0	\$33,000-38,000

final decision. In today's ultra-competitive new car market, extremely low rates have become a common incentive for buyers. If a low rate can be secured (under 3%) it will be more cost-effective to finance the purchase and sock the remainder into a savings account where yields are becoming increasingly attractive (nearing 5%). This move will also boost your liquidity.

As you can see in the schedule below, following my recommendations leaves some funds on the table. At this point, it would be wise to revisit some other areas of your financial picture.

**MAKE SURE YOUR FINANCIAL "HOUSE" IS IN ORDER**

Do you have any other financial goals or objectives? Is your retirement fully funded? If not, this would be a perfect opportunity to earmark a portion of the proceeds towards one or more of these goals. Consider a traditional or Roth IRA if you have earned income. Annual contribution limits for 2006 are currently set at \$4,000 per year (5,000 if age 50 or above) for both types.

**BE HONEST WITH YOURSELF**

Finally, in order to fully realize the benefits outlined in this recommendation, the plan must actually be executed. Often times, this can be a large stumbling block. Discipline is key. To protect against fretting away the significant "leftover" amount on frivolous items you must "know thyself". In other words, if you know that you are not a saver by nature and spend any "excess" money you have on lattes and French manicures, you may be better off committing the larger down payment amount in order to prevent it from slipping through your financial fingers.