



are “downsized” or “outsourced.” At least temporarily, those changes could put a crimp in your cash flow. Which monthly obligation will be easier to handle, one for \$1,690 or \$1,200?

Or let’s say you have the chance to buy a piece of equipment that will help you become more profitable. Maybe the extra \$490 each month is enough to make the payments. Keeping control of more of your monthly cash flow can protect you against a decline or loss of cash flow, and make it easier for you to take advantage of profitable opportunities.

**Option 3 – Out of the box – and in control**

**Take the 30-year mortgage and put the extra \$490 in a separate account, and when the accumulation is large enough, pay off the outstanding balance on the mortgage.**

This is a variation on Option 2. You are reducing your monthly commitment to the lender, and controlling the difference. If your separate account earns a net return equal to the mortgage (6% in this case), the accumulation will be able to pay off the existing mortgage at the end of 15 years.

Where should the additional \$490 be placed? There are many possibilities, and all under your control. By deciding to take full control of the additional \$490, consider some possibly advantageous outcomes:

1. Your net return might exceed 6%. If that happens, the mortgage can be paid in full in less than 15 years.
2. In the event of cash flow difficulties (loss of a job, etc.), you are committed to a lower monthly payment – and you can also draw from your outside accumulation to make the payments.
3. When presented with a business or investment opportunity, you not only have \$490 available every month, you may also have a lump sum to apply toward your participation.

**Yeah, but... If I chose Option 1, I could do some of the same things as Option 3 by taking a home equity loan.**

You could. But who decides whether or not you can take equity from your home? The bank, not you. The bank not only decides on whether to lend to you, but it also determines the interest rate, the frequency of payment, and the amortization schedule. For being “your money,” the lender sure exercises a lot of control.

**The interest rates for 15-year mortgages are usually a little lower than 30-year mortgages. Does it make a difference if the**

**interest rate is lower?**

Not really. Remember, the separate account could generate a higher rate of return than the 30-year interest rate. If it did, this would offset the lower interest charged on the 15-year mortgage. But ultimately, the difference in rates doesn’t matter much because the critical issue is “Who has control?”

**What if I earn less than 6% in the separate account?**

Let’s suppose the net return in the separate account for the entire period is only 5% annually. That means it will take longer than 15 years for the account accumulation to equal the outstanding mortgage balance. How much longer? 7 months. In a 15-year span, is seven more months really that bad, considering all the control you maintain by keeping the separate account?

Besides, if you see your ongoing net return doesn’t equal your mortgage interest rate -- make changes! It’s not as though you’re stuck in a low-performing account for the next 15 years.

**What about taxes on the earnings in my separate account?** Some accumulation vehicles have tax consequences, so that needs to be factored into your allocation decision. But even if taxes diminish your overall return, go back to the previous questions. The key issue in deciding which mortgage option to choose isn’t how the numbers work out, it’s the underlying philosophy of having control.

**I don’t trust myself to save the extra \$490 each month. With the 15-year mortgage, I’m committed to a guaranteed outcome.** Assuming you make every payment for the next 15 years, you will have a guaranteed outcome. But can you guarantee your ability to pay for the next 15 years? No.

As for not trusting yourself to save the extra \$490...that’s an attitude issue, not a financial one. Taking control means taking responsibility. If you don’t want the responsibility – of saving the \$490, of making an allocation decision – you may not be ready for the control.

**One Objective, Three Choices**

If you took “financial snapshots” at the beginning and end of this illustration, here’s what you’d see: today, \$200,000 is borrowed; 15 years later, the \$200,000 is repaid.

If everything goes as planned, all three methods will accomplish the same objective.

**Control is Priceless**

But some methods offer more than others – more options, more possibilities, more control. It’s not something you can quantify mathematically, but for those who want to maximize their financial potential, having control is an invaluable intangible asset.

**YOU MAY HAVE A FINANCIAL PLAN WITH CLEARLY DEFINED OBJECTIVES. THAT’S GOOD! BUT WHEN IS THE LAST TIME YOU REVIEWED YOUR METHODS?**

<b>Option #3</b>				
30 Yr \$200,000 Mortgage @ 6% Interest				
Year	Monthly Payment	Mo. Deposit @ 6%	Year	Monthly Payment
Yr 1	\$1,200	\$490	Yr 17	0
Yr 2	\$1,200	\$490	Yr 18	0
Yr 3	\$1,200	\$490	Yr 19	0
Yr 4	\$1,200	\$490	Yr 20	0
Yr 5	\$1,200	\$490	Yr 21	0
Yr 6	\$1,200	\$490	Yr 22	0
Yr 7	\$1,200	\$490	Yr 23	0
Yr 8	\$1,200	\$490	Yr 24	0
Yr 9	\$1,200	\$490	Yr 25	0
Yr 10	\$1,200	\$490	Yr 26	0
Yr 11	\$1,200	\$490	Yr 27	0
Yr 12	\$1,200	\$490	Yr 28	0
Yr 13	\$1,200	\$490	Yr 29	0
Yr 14	\$1,200	\$490	Yr 30	0
Yr 15	\$1,200	\$490		
Yr 16	Use Accumulation From Separate Account to Pay Off Mortgage			

**It’s not just mortgages...** Deciding on a 30-year mortgage as possibly the best method to pay off the debt may seem counter-intuitive, at least until you recognize other financial issues that can impact your chances for success. Thus, under closer inspection, the straightforward, easy-to-understand method may not be the best fit for your situation.

This evaluation of objectives -versus- methods should be applied to other financial planning topics as well. Here are two common financial planning issues where understanding the difference between the objective and the method can be critical:

- Term life insurance usually has the lowest premiums, but might **not** be the most cost-efficient coverage.
- A qualified retirement plan might offer immediate tax advantages, but also **limit** opportunities to create more wealth.

Protecting your human life value and saving for retirement are worthwhile financial goals. But the methods you choose can make a big difference in how successful you are in reaching your objectives.

## THINGS THAT MAKE YOU GO “HMMM...”

### “Stranger-owned Life Insurance”

Are you Wealthy?  
Over age 70?

Interested in free life insurance?

(By the way, if you don't die in two years, is it okay if an investor becomes the beneficiary?)

The pitch sounds like a twisted late-night TV infomercial, but it's a real and somewhat controversial way for wealthy senior citizens to afford large amounts of life insurance. The program is called “non-recourse premium financing.” Here's how it works:

1. A financing company or private investor lends you (or a family trust) the cost of premiums so you can buy a large insurance policy on your life.
2. The loan lasts for at least two years. If you die during the loan period, your estate must repay the loan, including interest and fees. But whatever is left from the insurance proceeds is distributed according to your estate plan.
3. If you live longer than two years, you must make a decision: you may pay back the loan, and retain ownership of the policy; you may clear the loan by transferring the ownership and beneficiary designation to the lender; or you may sell the ownership and beneficiary designation to another investor, and use the proceeds to repay the original lender.

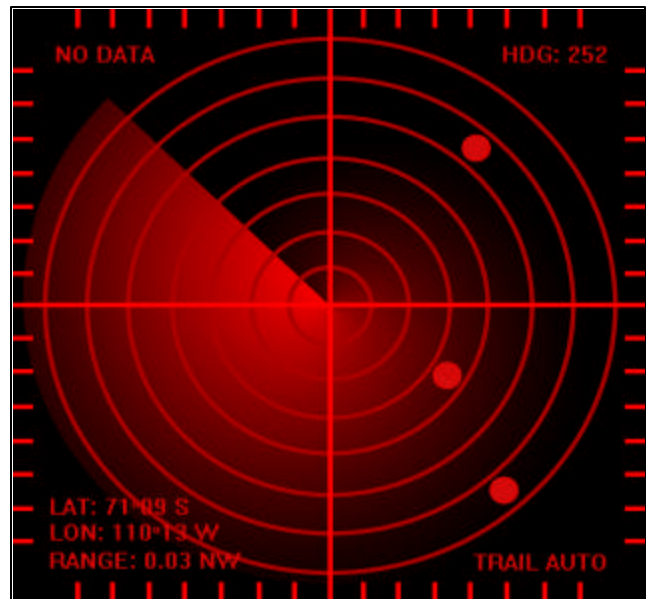
Who is offering these non-recourse premium financing deals? According to Rachel Silverman, in a May 26, 2005 *Wall Street Journal* article, “these transactions are fueled in part by hedge funds and other institutional investors, who are looking for new sources of returns.”

Some estate planners say the arrangement can be good for their senior clients, provided the loan terms are reasonable. Some participants see the transaction as a two-year, no-cost option on insurability – if I decide I want or need the insurance, I'll buy it; if not, I'll sign it over, and it didn't cost me a thing.

Life insurance companies will only issue a policy where there is “insurable interest” – i.e., there is a recognition that the individual's death would result in an economic loss to someone else. This is an easily-understood concept in family relationships, as well as business situations. Everyone is assumed to have an insurable interest in themselves, and lenders are recognized as having an insurable interest in their borrowers.

But when the purpose of lending is to buy life insurance so that eventually the lender may become the beneficiary...well, that blurs the line. Especially since some lenders will offer potential policyholders a cash payment in excess of the premiums as part of the loan. Lawyers and financial planners are debating the pros and cons of these transactions, insurance companies are starting to change their applications to reflect this strategy, and some accountants wonder if these new arrangements should receive a different tax treatment. Those critical of the plans often refer to them as “stranger-owned life insurance.”

Hmmm... In an odd way, investors are recognizing what many individuals do not: life insurance, if kept in force, is a profitable financial transaction. Which makes you wonder why so many people surrender their life insurance.



## BLIPS ON THE FINANCIAL RADAR SCREEN

If you regularly follow the financial media (newspapers, magazines, television, radio, Internet, etc.), it's interesting to note the coming and going of “hot topics” that seem to surface simultaneously, generate a buzz for a few weeks or months, then slip back into the sea of financial planning issues and ideas.

By scanning the headlines, here's an observation of some items that seem to be getting a lot of current attention:

### Blip #1

#### **Troubled pension plans are troubling Americans...**

**America's private pension rules are in need of an overhaul** – Rachel Beck, *Associated Press*, June 21, 2005.

**Is Your Retirement Money Safe?** – Jeff D. Opdyke and Kelly Greene, *Wall Street Journal*, May 12, 2005.

**Retirement fears send Congress Scrambling** – Steven Tomma, *Detroit Free Press*, June 20, 2005.

### Blip #2

#### **Longevity has a financial impact**

**Fast-Aging Japan Keeps Its Elders On the Job Longer** – Sebastian Moffett, *Wall Street Journal*, June 15, 2005.

**Study shows need to rethink health care in retirement** – Robert Powell, *MarketWatch*, March 23, 2005.

**Long-term care: No easy solution** – Andrea Coombes, *MarketWatch*, June 8, 2005.

**Most Americans Fear Retirement** – Trevor Thomas, *National Underwriter*, April 4, 2005.

### Blip #3

#### **Americans are borrowing against their real estate**

**Taking Out a Mortgage to Buy Stocks Isn't Quite as Crazy as It Sounds** – Jonathan Clements, *Wall Street Journal*, May 11, 2005.

**Mortgage-burning party poopery** – Robert Powell, *MarketWatch*, April 28, 2005.

**Hot Condos, for Just a Letter**, Kemba J. Dunham, *Wall Street Journal*, May 19, 2005.

# News Digest

(Snippets from stuff we've read, including differing points of view, not all of which we agree with. Want to know more? Give us a call and we can provide you with the complete article.)

## THE RICH ARE GETTING RICHER

The number of super-wealthy in the U.S. has surged, with 430,000 households now worth more than \$10 million. That's up from 65,000, adjusted for inflation, in 1989. In 2001, the top 1% of Americans ranked by net worth controlled 33% of all personal assets.

The rapid shift in the composition of the tiny sliver of wealthiest Americans is striking because the amount of U.S. class mobility overall hasn't significantly changed for the last three decades, according to economists. The chance that a poor child will make it into the upper-middle class – or that a rich child will fall down to the middle class – has stayed about the same, and some studies suggest mobility in the U.S. is less than in continental Europe and Canada.

Robert Frank, *Wall Street Journal*, May 20, 2005.



## IT SOUNDS LIKE PENSIONS ARE IN TROUBLE

Pension underfunding at major U.S. companies rose 27% last year, to \$353.7 billion from \$279 billion in 2003, federal pension insurers told Congress at a hearing on Tuesday. The Pension Benefit Guaranty Corp., or PBGC, released the figures at a Senate Finance Committee hearing on airline pension woes. It analyzed data from corporate pension plans whose promised benefits exceed assets by at least \$50 million.

Top executives at Delta Air Lines (DAL.N:) and Northwest Airlines (NWAC.O:) told lawmakers the companies could go bankrupt and terminate their pensions if Congress does not act immediately on legislation that would allow the airline industry to stretch out contributions to severely underfunded retirement plans.

Financed by premiums paid by corporations, the PBGC is facing a \$23.3 billion deficit fueled by having to take over the pension plans of troubled companies, most recently airlines. PBGC recently agreed to guarantee \$6.6 billion of pension obligations at bankrupt United Airlines (UALAQ.OB:), the largest pension default in U.S. history.

Reuters, June 7, 2005.



## GASOLINE CHEAP COMPARED WITH FOOD

It may pinch your pocketbook to fill up your tank, but a gallon of gasoline is cheap compared with food, water and beer, an analysis by John S. Herold revealed Wednesday.

"Even with unleaded regular selling for more than \$2 per gallon, the increase in gasoline prices since 1982 is 25% lower than the increase in food prices, 50% lower than the rise in housing costs, 70% lower than the spike in



medical costs and a whopping 80% below the surge in college tuition," the industry research firm found.

Accounting for inflation and better miles to the gallon, the cost of gasoline per mile driven is less than half of the cost of 1981 rates, according to Herold co-director of research Nick Cacchione. He called it "America's bargain liquid," at 10% less than bottled water, 33% of the price of milk and 20% of the price of beer.

Lisa Sanders, *MarketWatch*, June 8, 2005.

## FOR MANY, "RETIREMENT" IS REALLY A "REST STOP" BEFORE A RETURN TO WORK

Employers had better get used to seeing older people's résumés.

As numerous companies across the country withdraw retiree medical and dental benefits while others switch to less generous retirement plans, many aging workers who had expected to ease comfortably out of the labor force in their 50's and early 60's are discovering that they do not have the financial resources to support themselves in retirement. As a result, a lot more of them are returning to work.

Since the mid-1990's, older people have become the fastest-growing portion of the work force. The Labor Department projects that workers over 55 will make up 19.1% of the labor force by 2012, up from 14.3% in 2002.

Until recently, most economists said that older people were being lured back into the labor force largely because of opportunities growing out of the vibrant economy of the 1990's. But these days, they say, many such Americans are being drawn to work out of necessity rather than choice.

Eduardo Porter and Mary Williams Walsh, *The New York Times*, February 9, 2005.



## RETAINING LIFE INSURANCE RESULTS IN GREATEST ECONOMIC VALUE

Keeping a life-insurance policy is often a better bet than selling a policy to an investor or surrendering it, according to a new study. The report, conducted by researchers at Deloitte Consulting LLP and the University of Connecticut, analyzes the burgeoning life-settlement industry, the secondary market for life-insurance policies.

The report suggests that if a policyholder needs cash, it is smarter to sell another asset, such as securities, rather than an insurance policy. For the majority of policyholders with impaired health, "the greatest economic value results from retaining the contract until death," the researchers wrote.

Rachel Emma Silverman, *Wall Street Journal*, May 31, 2005.





## ONE QUESTION, THREE ANSWERS

**Question: Is there a real estate bubble in the United States housing market?**

### Answer #1: Yes.

According to an article in the June 18, 2005 issue of *World*, the National Association of Realtors reported that nationwide the median price of an existing home in April was 15.1% higher than it was in April 2004, jumping from \$179,000 to \$206,000. That's the biggest one-year jump since 1979. Not only are home prices increasing in value, but the Commerce Department reported that new homes sold at an annual rate of 1.3 million units in April, which is a record pace, and a jump of 13.3% over April 2004.

For some analysts, this type of sky-rocketing growth is reminiscent of the tech-stock bubble of the late 1990's and early 2000's. With declarations of a "new economy" where old measures of value didn't matter, soaring share prices for Internet and communication stocks took the Nasdaq index over the 5,000 mark, only to plummet more than 50% in the next year. (As of June 15, 2005, the Nasdaq stood at 2,069.)

Some see a similar fate awaiting real estate. In a March 30, 2005 article, syndicated columnist Chuck Jaffe reported that the PMI Mortgage Insurance Company's Risk Index showed that homeowners in 11 of the top 50 housing markets have at least a 25% chance of experiencing a decline in home values over the next two years. "When this market adjusts, it's going to be painful," says UCLA economics professor Edward Leamer, "Borrowers are getting in over their heads, and lenders are too."



### Answer #2: No.

Other experts might disagree. After all, they argue, real estate is "different."

People live in houses. Houses aren't just financial investments, like stocks or bonds. Houses have intangible values beyond their monetary worth. In the stock market, a bubble occurs when a larger number of owners of a stock feel the price has gone too high, and try to cash out at once. But how many people are going to rush to sell their homes, especially if they like them, just because the market value goes down temporarily?

In addition, Timothy Lamer of *World* noted that personal income has risen strongly in the past two quarters. And since increased personal income is a strong indicator that people can

continue to pay their mortgages, it's less likely that there will be a run on housing, because most people can afford to wait out a possible decline in values, hoping that prices bounce back.

### Answer #3: Maybe

Not every homeowner is an occupant.

Given the rising prices, speculators in hot markets are looking for homes to "flip," i.e., homes to buy and sell quickly for a profit. For example, some flipping transactions may be homes that require some repair, or pre-construction deals on condos in resort areas. The purchasers are not looking to own or reside in the property, but rather to resell it for substantial profit.

If market values decline, the opportunity for profits will dry up, and speculative investors could be left holding over-valued property. And in fact, according to Greg Morcroft in a June 8, 2005 *MarketWatch* article, a survey by Merrill-Lynch and Capgemini indicates that high net-worth individuals (HNWIs) are moving out of real estate investments. Specifically, the report noted "As we have seen in past years, high net worth individuals frequently try to anticipate future developments and stay ahead of the curve in their investment behavior. Our research found a slightly more defensive approach to asset allocation, with many HNWIs locking in some profits from the recent, dramatic appreciation of real estate."

Another possible problem is the tendency of many Americans to borrow against home equity to pay for consumer spending. An individual who purchased a \$500,000 home in 2003 with a \$100,000 down payment could have \$200,000 of equity assuming the home's current value is \$600,000. If the home's value declined or stagnated over the next few years it might not be an issue, even if the owner wanted to sell and move – provided he hadn't tapped the increased equity for other spending. But if the homeowner maximizes a line of credit, the home's value drops, and he wants to sell, there is the prospect of owing more than the home is worth.



## DON'T LEAVE "BURIED TREASURE" WITHOUT A "MAP"

Just about every day across America, a human-interest story pops up about someone finding "buried treasure" in the most unusual places. For example, the Associated Press recently reported on the experience of Linda Stafford of Omaha, Nebraska:

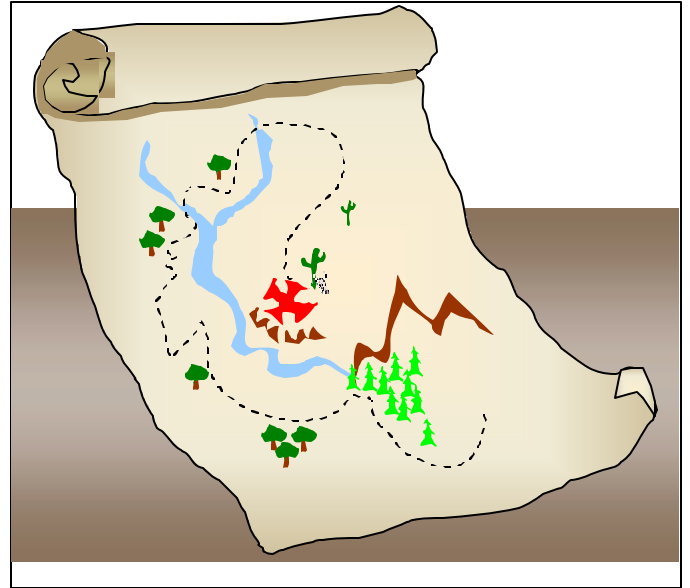
Ms. Stafford's daughters were rearranging furniture stored in her garage to make room for new items she had purchased in a yard sale. As one of the daughters moved a chair Ms. Stafford had purchased a year ago (for two dollars), she heard something rattle. Turning over the chair, she found \$10 in coins. Curious, she flipped over another chair in the set, and found \$3,000 in bills. A nice surprise for Ms. Stafford, and obviously a loss for someone else who unknowingly gave away \$3,000 in exchange for a few bucks.

While stories like this are interesting anecdotes ("I wonder why they hid the money there?"), they are also prompts to make

sure one's own assets are clearly marked, even if there is a desire to keep them hidden for a period of time. Letting something slip through the cracks today might mean losing the account forever.

Banks and other financial institutions freely admit they are holders of thousands of accounts that appear to have been forgotten or unclaimed, lost to the memory of their owners or heirs. Most of these accounts are small accumulations – perhaps they were emptied, but not closed – but others are substantial. Likewise, life insurance policies are also prime candidates for becoming “lost” assets, especially if the coverage is paid-up, and the owner has moved and not left a forwarding address. And because they aren't hidden in furniture, taped to a drawer, or hidden in a flowerpot, but are held at the financial institution, they may never be found – unless you leave a “treasure map” for your heirs and beneficiaries.

One of the best things you can do is to create a written inventory of your financial assets, and review and update that inventory at least annually. If possible, include another trusted family member or person in your review. Even if you don't want to trust them with the details today, make sure they know how to access this information should it be needed tomorrow.



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