Financial
planning strategies

# INSURING LOVED ONES, HOME FINANCING & YOUR ESTATE

## The Basics of Financing Your New Home

Buying a home is the single largest purchase most people will ever make, and for first-time homebuyers especially, the financing process can appear complicated. The following information provides you with some preliminary information to understand how mortgages work.

The two basic mortgage types are fixed rate mortgages and adjustable rate mortgages (ARMs). Deciding which is right for you depends on a number of factors, including the spread between the prevailing fixed and variable mortgage rates, the length of time you expect to own your home, the current inflation rate, and the tax savings you expect to receive from the home mortgage interest deduction.

### Fixed Rate Mortgages

A fixed rate mortgage is characterized by an interest rate that remains the same for the life of the loan, consistent monthly payments, and a principal that will be fully repaid at the end of the loan. The total amount of interest you will pay on a fixed rate mortgage increases with the term, which generally ranges from 15 to 30 years.

One major advantage of a fixed rate mortgage is the certainty of knowing your monthly payments will not increase over the life of the loan, even if interest rates rise. On the other hand, the major disadvantage is that if interest rates drop, your monthly payment will not decrease. The only way you will be able to take advantage of a drop in interest rates is to refinance the loan, which may or may not be costly, depending on rates at the time.

### Adjustable Rate Mortgages (ARMs)

An adjustable rate mortgage carries an interest rate that a lender can vary during the loan term. ARMs are designed to shift the risk of rising interest rates from the lender to the borrower. To offset the increased interest rate risk, ARMs usually offer borrowers a lower rate—compared to a fixed rate mortgage—during the first year. If you are considering an ARM, you will probably encounter the following terms:

- **Index.** An index is a benchmark used by a lender to adjust an ARM's interest rate. Commonly used indexes include the rate on U.S. Treasury securities and the average cost of Federally-insured savings and loan funds.
- **Margin.** Also called the "spread," this is the amount a lender can add to the value of the index specified in the loan agreement.
- **Initial Rate and Adjusted Effective Rate.** The initial rate is the interest rate at the start of the mortgage. It is typically lower than the amount you would owe on a fixed rate mortgage. Very low initial rates, called "teasers," are designed to persuade you to enter into the loan.

  The adjusted effective rate is the rate you pay when the adjustments kick in. It is calculated as the value of the index specified in the loan agreement plus the margin. For example, if the index value rises to 8% and the margin is 2%, the adjusted effective rate is 10%. (The adjusted effective rate is not the same as the annual percentage rate (APR), which includes the points levied on the mortgage.)
- **Adjustment Period.** Mortgage payments or interest rates may change—every six months, annually, or every three years—according to the length of the adjustment period.

- **Caps.** ARMs may include several kinds of caps. A payment cap limits the increase in monthly payments at each adjustment period. An interest adjustment cap limits the amount by which the interest rate can rise or fall at each adjustment period. A lifetime interest cap limits the maximum interest the lender can charge during the loan term. A lifetime payment cap limits the percentage by which principal and interest payments can increase during the loan term.
- **Negative Amortization.** Negative amortization occurs when your mortgage payment is less than the amount necessary to cover the interest on the loan. As a result, the unpaid interest is added to the loan principal. The loan agreement may cap the amount of negative amortization allowable.

## Understand Your Options

There is no "right" way to finance a home. All financing arrangements involve trade-offs. The more informed you are about your options, the better equipped you will be to arrange a mortgage that suits your needs.

## Insuring a Stay-At-Home Parent

The job of homemaker can be rewarding, and the care a stay-at-home parent provides is invaluable to his or her family. However, when it comes to calculating life insurance needs, many families obtain only coverage for the primary breadwinner. They may not want to consider that the death of a stay-at-home parent would not only be difficult emotionally for the family, but could also create financial challenges for the surviving spouse and children.

Since homemakers generally do not earn a paycheck, estimating the economic benefit of their contributions to the family may be complicated. Clearly, the cost of the services provided by a stay-at-home parent can be substantial, but what those costs involve depends on the family's circumstances. For example, if the children are younger, child care costs need to be budgeted.

The first step in calculating an appropriate amount of life insurance coverage for a stay-at-home parent is to assess how much it would cost to pay others to perform the tasks currently performed by the homemaker.

Here are some examples of tasks typically performed by a stay-at-home parent:

- Family Care
- Shopping
- Recordkeeping and Household Management
- Food Preparation
- Housekeeping and Maintenance
- Yard and Car Care
- Laundry and Clothing Care

In addition to having to pay for help in these areas, a family that has lost a parent may find that other expenses may increase due to pressure and time constraints. For example, the family may dine out or buy expensive convenience foods more frequently. Also, a working parent may have less time to devote to shopping for bargains on groceries, clothing, school supplies, and other items.

Replacing the contributions of a homemaker and caregiver can be very expensive, especially when factoring in the number of years it takes to raise a family. Therefore, it makes sense to obtain life insurance for the parent who works at home, not just the family's main income earner. If something were to happen to a stay-at-home parent, life insurance could help the family through the difficult period of adjustment.

Proceeds from a life insurance policy may be used to help cover final expenses or allow the surviving spouse to take a leave of absence from work in order to spend time with the children. A lump sum could also be used to help clear debt. In some cases, the policy proceeds may be used to help pay for child care or housekeeping services after the surviving spouse returns to work. Or, it may be possible to save a portion of the life insurance proceeds to help pay for future college expenses.

Although losing a parent can be devastating, financial hardship as a result of that loss does not have to be inevitable. Life insurance coverage can help ensure that the surviving spouse is not forced to work long hours or take a second job in order to pay the bills. Instead, the surviving spouse may focus on caring for the children.

It is important to assess your family's specific needs. Consult with a qualified insurance professional to review your options for life insurance coverage and prepare for the future accordingly.

## Wise Use of Credit Cards

Many Americans are living with more credit card debt than is comfortable. A significant amount of debt is owed by people who are paying considerably more for credit than they should be.

Here are some recommendations to help reduce your credit card expense:

1. Analyze your expenses to determine where your dollars are going. Look for areas where you can cut back, if only temporarily, to free up cash and pay off debts.
2. Try to reduce your finance charge obligation by shopping for the lowest possible rates. You can also go to personal finance websites and look for listings of the best credit card offers available.


3. When you receive credit card offers or applications, study them closely for practices that could cost you more than you realize, such as finance charges that may accrue from the date of purchase, even if your balance is paid in full each month.
4. Establish a self-imposed repayment schedule and stick with it. Repay debts that carry the highest finance charges first.
5. Reduce or eliminate your use of credit cards wherever possible.

**Your credit should work for you not against you—use it wisely.**

## Estate Planning: Not Just for the Wealthy

Many people think estate planning is necessary only for those with sizable assets. However, even small estates require smart planning to protect loved ones. Here are some important steps you can take now to ease your family's emotional and financial burden in the event of your death:

1. **Where there's a will, there's a way.** A will is a formal, legal document that specifies how you want your assets to be distributed after your death. If you should die without a will **(intestate)**, your estate will be distributed through the **probate** court, according to the intestacy laws of your state. State intestacy laws function like a "one-size-fits-all" will, and as a result, your assets may or may not be left in the hands of those you would have chosen. You must have a will if you wish to designate an executor for your estate, name **guardians** for minor children, or appoint other **fiduciaries**.

   When preparing a will, be sure to consult a qualified, legal professional and ensure that the document is properly witnessed. You may also want to consider setting up a **living trust**. This arrangement can allow you to transfer specific assets to your heirs without going through probate.
2. **Easy and inexpensive property transfers.** One of the least expensive estate planning approaches for married couples is to own titled property as **joint tenants**. A typical example of jointly owned property is a personal residence. When you own property jointly and either you or your spouse dies, the property automatically passes to the surviving spouse without going through probate. However, there are several other methods of joint ownership. For instance, community property states have their own laws governing the disposition of assets. Therefore, you may want to consult a legal professional to determine which arrangement would be the most appropriate in your situation.
3. **Life insurance possibilities.** For a relatively low cost, life insurance can help provide your family with the immediate funds needed to meet key financial obligations. Life insurance can also provide **replacement income** for your family if you have outstanding debt and/or provide all, or most, of your family's support.
4. **Plan for the unexpected.** Consider purchasing **disability income insurance** while you are healthy. If you have a disability policy, review it periodically to be sure it still covers your needs. Also, appoint a **durable power of attorney** and set up a **living will** or **health care proxy** to handle financial and medical decisions in case you become physically or mentally incapacitated. Many people select a spouse, a trusted relative, or a friend to represent them.
5. **Open communications are key.** Although it may be tempting to shield family members from life's harsh realities, you may discover that you can best serve your loved ones by informing them of your financial, medical, and estate arrangements.

You may want to consider taking these initiatives now, while they are fresh in your mind. Although smaller estates may have different concerns when compared to larger ones, the key to successful estate preservation is sound planning. Be sure to consult with qualified professionals about your unique circumstances.


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