8

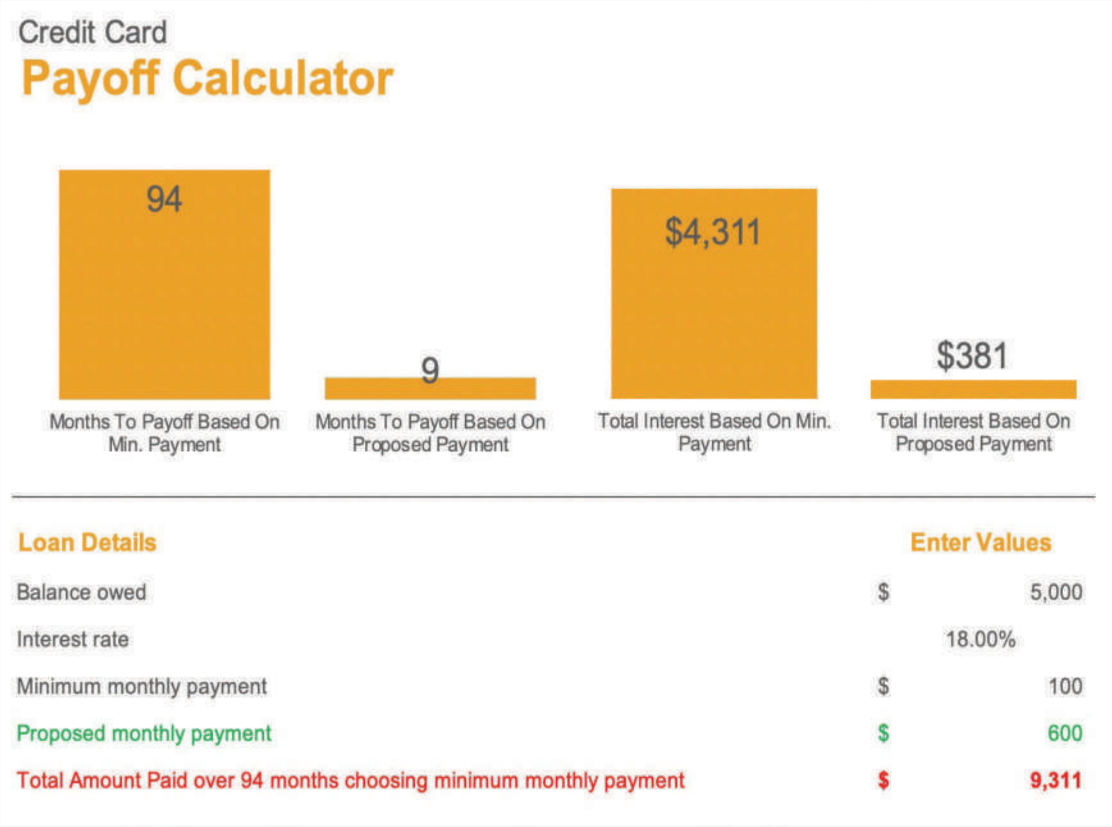
Your Loan Review

Know What

You Owe!

The Spirit of Bermuda

Scott Stallard Photography



Loan Details		Enter Values
Balance owed	$	5,000
Interest rate		18.00%
Minimum monthly payment	$	100
Proposed monthly payment	$	600
Total Amount Paid over 94 months choosing minimum monthly payment	$	9,311

Figure 3 - Credit Card Debt Calculator

Step Eight - Your Loan Review.
Know What You Owe

One - Review All your Loan Statements: Debit cards. Credit cards, auto, home mortgage, equity lines, personal loans, etc.

Review your debit, credit card statements, a mortgage statement if you have bought a home, auto loans, equity lines, and don't forget personal debt payments to friends and family.

CONSUMER CAUTION!

The difference between debit and credit cards is huge!

Debit cards deduct the charge immediately from your bank account using your money. Credit cards let you borrow other people's money (banks) and for that privilege, these generous people (well that is what we want to think) are going to charge for the use of their money.

They are never in the business of lending for free!

Yes, debit and credit cards look the same and because of the similarity – it becomes easy to use them both the same way - on all the little insignificant extras, AND the larger "cause-I-need-to feel-good" impulse purchases.

People use cards for convenience – they are so easy, making it doubly hard to keep track of what expenses, where, why, and how you paid for.

So, how much do you owe - in the short term, and the long term?

Hopefully, your answer is a good one:

Very little in short-term debt, but probably a pretty high balance in long-term debt. Why would that answer be just fine?

Two reasons:

- Consider what you have bought (you and the bank that is) by incurring that debt. Generally, this high-cost asset will be your home. However, those little every-day quick stops can add significantly to your overall debt. Your job now is to categorise your purchases into appreciation and depreciating assets. You may be very surprised at the answers.
- Mortgage interest rates are significantly lower (7% say) - more than three-four times lower - than immediate gratification credit card rates of 18%-24%.
- Verify for yourself.

Appreciating versus depreciating assets.

There are very few things in life that can be called appreciating assets; inevitably, the word asset is almost always linked with acquiring, not necessarily appreciating.

Starting with the obvious choices, clothes, fabulous shoes, jewellery, cars, toys and games, residence, computer and other electronics, intellectual capacity, in a no-brainer test, which of these listed here actually appreciate over the years.

Truly - Only one – your intellectual capacity, brainpower! Even a piece of real estate not cared for will depreciate, slowly, to be sure; the rest of the list loses anywhere from 50% to 100% of its value the minute you claim it as yours. I have seldom heard of anyone realising a profit on a fine diamond, have you? Generally, treasures in resale situations only attract 5-10% of their value; maybe that is all they are really worth.

So, does it not follow that the first place to invest is, in yourself by upgrading your education, by upgrading your job skills; never stopping the process of learning and acquiring knowledge?

That is not what we do.

> We all – and I among them – fall into the purchase mode of depreciating assets, to feel good, look good, be good "trap."

Not that there is anything wrong with this, but the more defeated we feel, the harder it is to turn down the quick fix.

Appreciating assets generally grow in value over the long-term, keep that "long" in mind given that Bermuda real estate (generally an appreciating asset) lost value during the re-cession of 2008-2016 (from which Bermuda has yet to fully recover). Historically, however, Bermuda real estate has appreciated. Real estate also provides a permanent roof over your head and you own it!

Thus, debt itself is "never good," because you and someone else owns the asset until the debt is liquidated. However, long-term debt in your financial profile is ultimately a good idea, if it is manageable (not crippling). The principal component payments of your monthly mortgage are building equity ownership into your purchased home, an incredibly right financial reason to make that your goal.

This is your challenge!

> To save for the long-term appreciating asset, while forgoing racking up debt on "things that make us feel better."

See charts next!

Assets?
Appreciating or Depreciating?

Appreciating or Depreciating Assets?			
	original purchase price	estimated resale market price	asset appreciating / depreciating?
Convertible - luxury	75,000	40,000	(35,000)
Designer handbag	2,100	600	(1,500)
Designer shoes	695	34	(661)
Designer watch - Rolex, etc.	12,000	8,000	(4,000)
Real estate	650,000	715,000	65,000
1 Share of stock in global company - Apple	22	210	188
valuation date	1980	August 2019	
Does not include Apple stock splits in 1987, 2000, 2005, 2014			
Estimated numbers stated in US dollars. Second hand prices after 1-3 years of use culled from various websites: eBay, watch shops, auto books. Note that resale prices fluctuate due to many factors: scarcity, popularity, durability, condition, etc.			

Photo sources: Amazon.com, autoblog.com, fashionphile.com, ebay.com

Two - Categorise Your Serious Purchases by Future Value.

What are your appreciating / depreciating assets? Examples: Designer bags, watches, antique chest-of-drawers, or taking friends out to lunch, groceries. When you sell these purchases (if you can sell them) – be honest now – will you get more than you paid for them?

No, almost always no, you won't - not even close to your original purchase price.

Truly. How many assets can you name that you want to (or have) purchased that will increase in value, especially if you took on debt to buy them? Answer as above, your real estate, and the Apple share certificate!

Three - Compute Ratio of Appreciating to Depreciating Assets.

Now, look at your ratio of balances between depreciating spending and appreciating assets charged.

How much have your depreciating assets decreased in value since you bought them; do you think that you can sell them at all?

How much have your appreciating assets increased in value since you purchased them?

How are the various debt repayments calculated on your credit card statement? Are you paying late payment penalties as well?

How many of these purchases did you make with a credit card?

Did you consider what the total cost would finally be, and have you figured into that purchase how quickly the asset or the entertainment could depreciate in value.

Entertainment depreciation is immediate, absolutely.

The Dreaded Debt Repayment Situation. Let's review credit cards.

See Figure 3. Credit Card Repayment Calculator chart above.

How long does it take to pay off a credit card balance? It depends upon your monthly payment!

We have a $5,000 credit card balance, built up through purchases for a designer bag, electronics, dining out, entertainment, and the like.

What is the real cost to carry this debt?

18% a year or more! Calculated on the principal balance and any unpaid interest.

- Simple calculation. $5,000 times 18% = $5,900 balance due in first year.
- Not good - an almost 20% more increase than the original amount paid, meanwhile the things you bought are rapidly depreciating in value, Particularly those dinners, wine, and beer out.
- Beware the minimum balance payment trap. Take a look at the FIGURE 3 again.
- A $100 a month minimum repayment will take 8 years plus with a huge amount of interest = total repayment over $9600! You may be paying twice, three times or more than the original cost in carrying charges. Meanwhile, your watch, and designer goodies have depreciated to less than half of the original price. Horrific! Review that depreciation chart again!
- Even with a huge increase in the monthly payment to $600 a month, it will take discipline and nine months to reduce this debt to zero including interest fees of $94 plus.
- When you are mentally persuaded to pay the minimum on your credit card, run your numbers first using any number of credit card payoff sites on the web. Most are free and can be used again and again.
- You will know exactly where you are and can plan accordingly.

There now, don't you feel better when you are in control of your finances?

Review your amortised mortgage fixed payments.

Amortised means that for every payment you make on your mortgage, the principal value owed and the amount of interest owed is reduced. After each payment is made, the new ending principal balance payment is used to recalculate the interest owed. Generally, the loan payment is the same every month, but the amount applied to principal payoff and interest varies as the amortisation process works out.

However, it is vital that you and your family as homeowners keep track of your mortgage payments, each and every month.

Mortgage servicers / banks, etc. can make mistakes.

You do not want to find out at the end of your mortgage repayment term that the payments have not been correctly applied.

A disturbing real example of this occurred when a couple walked into a bank (no personal facts disclosed here) to collect their house deed. They had paid off their mortgage. It took them twenty years, and now they fully owned their home, or so they thought.

Devastatingly, they were told that according to the bank, they had an interest only mortgage and so still owed the whole principal balance.

Of course, it was later found that the bank had made a huge mistake in not transferring the original construction loan (on paper) to an amortised loan, nor had the family ever been notified of the error.

One more hint - be sure that you fully understand the terms of your original mortgage deed, and that you do indeed have an amortised mortgage contract with your lender! And that you can prepay your mortgage principal without penalty.

Verify, verify your finances! Call your loan officer if you don't understand. I enclose links to a mortgage amortisation calculator. Consider running your numbers every other month or so against one of these calculators and verifying it against the bank mortgage statement balance.

Illustrative Example of an Amortised Fixed Rate Mortgage.

We assume initially,

- a loan amount of $420,000
- term 30 years, payments monthly
- 7% interest rate
- monthly payment, fixed of $2,794.27

Note the total interest paid over 30 years - more than the original loan!

This is reason enough to pay off your mortgage as soon as you can!

Mortgage Summary	
Loan amount	$420,000.00
Term	30 years
Interest rate	7%
Monthly payment (PI)	$2,794.27
Total principal and interest payments	$1,005,937.70
Total interest	$585,937.70

At the mortgage amortisation start, the beginning principal balance owed is the full amount as stated above. Then, it is multiplied by the interest rate attributable to the current period (MONTH) to find the interest amount due for the period.

The interest due for the period subtracted from the total monthly payment results in the dollar amount of principal paid in the period.

Hard to picture just as it is described.

See example below Chart 1 - for the first-year set months 1-12 of principal and interest payments on a mortgage!

Payment Schedule

Nbr	Payment	Principal	Interest	Ending Principal Balance
				$420,000.00
1	$2,794.27	$344.27	$2,450.00	$419,655.73
2	$2,794.27	$346.28	$2,447.99	$419,309.45
3	$2,794.27	$348.30	$2,445.97	$418,961.15
4	$2,794.27	$350.33	$2,443.94	$418,610.82
5	$2,794.27	$352.37	$2,441.90	$418,258.45
6	$2,794.27	$354.43	$2,439.84	$417,904.02
7	$2,794.27	$356.50	$2,437.77	$417,547.52
8	$2,794.27	$358.58	$2,435.69	$417,188.94
9	$2,794.27	$360.67	$2,433.60	$416,828.27
10	$2,794.27	$362.77	$2,431.50	$416,465.50
11	$2,794.27	$364.89	$2,429.38	$416,100.61
12	$2,794.27	$367.02	$2,427.25	$415,733.59

Mortgage payment chart 1

Notice that the first month, the interest owed - $2,450 - is subtracted from the monthly payment. or $2,794.27. The remaining amount $344.27 - is applied to REDUCE your actual loan - the mortgage principal. Since this is a fixed rate loan, the total monthly payment does not change. Ah, but the amount applied to reduce the principal does. Read and see!

At the beginning of month 2, the interest 7% divided by 12 (a month) - is recalculated on the reduced mortgage principal. The interest amount owed is less than the first month, so there is more cash available to apply to REDUCE your actual loan principle again.

And so on each monthly payment period - the amount of interest owed goes down and the remaining amount applied to reduce the mortgage principal goes up.

See how the amount of principal applied by the 12th payment has increased over $20 and the mortgage principal owed has been reduced by around $4,200.

If not, you need to call your bank immediately, because the entire monthly payment may have been applied to interest. Correcting this mistake is so time sensitive! Individuals who did not monitor their amortised mortgage have found it tedious and difficult to have the payments corrected, long after the fact.

Let's take a look at the payment amortisation in the 11th year - the 121st-132nd monthly payments.

Notice how your principal payment is now significantly higher while your interest payment is lower as well while the monthly payment is still the same. This is because more and more of the fixed monthly payment is being applied to your principal loan reduction.

121	$2,794.27	$691.87	$2,102.40	$359,720.16
122	$2,794.27	$695.90	$2,098.37	$359,024.26
123	$2,794.27	$699.96	$2,094.31	$358,324.30
124	$2,794.27	$704.04	$2,090.23	$357,620.26
125	$2,794.27	$708.15	$2,086.12	$356,912.11
126	$2,794.27	$712.28	$2,081.99	$356,199.83
127	$2,794.27	$716.44	$2,077.83	$355,483.39
128	$2,794.27	$720.62	$2,073.65	$354,762.77
129	$2,794.27	$724.82	$2,069.45	$354,037.95
130	$2,794.27	$729.05	$2,065.22	$353,308.90
131	$2,794.27	$733.30	$2,060.97	$352,575.60
132	$2,794.27	$737.58	$2,056.69	$351,838.02

Mortgage payment chart 2

This schedule carries on, until the very last payment in the 360th month.

I will state again please be sure to verify that your mortgage principal is being reduced - EACH AND EVERY MONTH!

The Strategy Behind Adjustable (Variable) Interest Rate Mortgages.

A variable - adjustable rate mortgage presents a greater tracking challenge, but it can be done.

An adjustable (variable) rate mortgage is a different kettle of fish entirely. Individuals may choose a variable because the initial interest rate offered will be lower than a fixed rate mortgage, while the bank will increase (or possibly decrease) the rate over a set time frame. Five-year adjustable-rate mortgages are popular. The strategy focuses on the calculated bet that five years on, the interest rate will be lower - than the current rate - at which point, the borrower may elect to move to a fixed rate loan.

However, global interest rates are subject to change fairly quickly. Your bank sets their current rate based upon global interest rate markers, say the LIBOR rate plus a local bank base rate.

What can happen is that a family may buy in at a decent lending rate, only to see the rate climb, instead of decrease. With that change in interest rate, two adjustments will happen. Your mortgage officer will lower the amount applied to your principal reduction - because the interest rate is now higher and your monthly payment remains the same; or, the bank will increase your monthly payment to compensate for the higher interest rate - meaning a higher monthly cost to you.

There are literally thousands of mortgage calculators on the Internet - with similar formats. Find one you are comfortable with - or surprise, your local bank will have calculators online as well.

The Accelerated Mortgage Principal Paydown Strategy

Fixed Rate Mortgages Provide Certainty, but what if you want to make principal payments alone (say a bonus, or savings) to reduce your mortgage faster?

Here is where you must be extra vigilant in tracking these extra principal payments each and every single time. You do not want them to be misapplied as another monthly payment - with more interest attached.

Further, you need to be assured that pre-payment is allowed under your mort- gage contract by carefully reviewing your original mortgage contract, or if you are a new home-buyer making sure you understand the conditions of the loan. Communicate with your loan officer.

Anecdotally, at least one Bermuda bank only allows principal pre-payment on mort- gages once a quarter.

I do not agree with that restriction.

> Your goal is to eliminate long-term debt as quickly as possible.

There is a calculator for that action, too.

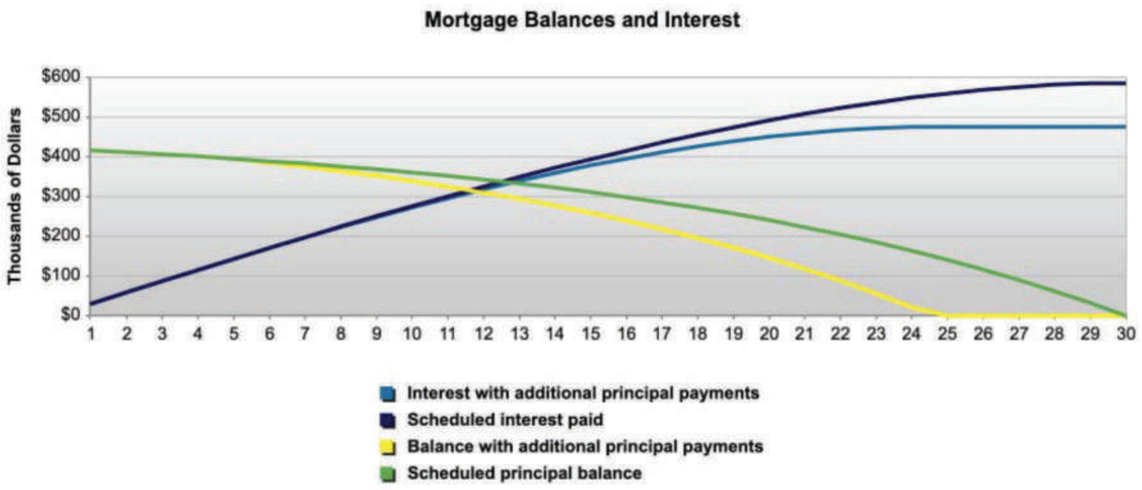
The Accelerated Mortgage Payoff. Try working with this one, to see how much faster you can reduce the time and the interest by making extra PRINCIPAL payments.

See the amazing difference by making $300 a month on the principal ONLY each and every month, or $900 a quarter.

You SAVE! $110,648 in interest!

Mortgage repayment shortened by 5 years and 4 months.

By increasing your mortgage payment $300 per month, you not only shorten your mortgage, but it will also save you $110,648 in interest.



Negative Equity.

This negativity related to your home can become an overwhelming issue in a declining economy. All along you've been encouraged to own your home - because over time it appreciates in value, now suddenly, this is not the fact in a declining economy.

Negative equity occurs when the current market value of your property is less than the balance owed on your mortgage. Example:

- you paid $500,000 at closing, borrowing $400,000.
- Your real estate agent says he can sell it for $340,000, but you still owe $372,000, or more on your mortgage.
- If you are forced to sell, not only will you not make a profit, but you will owe the bank $32,000 on the original loan, while you walk away with Nothing!

A property owner's first instinct when realising this problem, which generally, is not due to anything that the owner meeting his/her mortgage payment responsibility, is to try to sell, get out while there is still income value left.

Owners should reconsider that proposition, if they are still current on their mortgage premium payments.

Here is why!

Real Estate Market Values Are Influenced by Economic Conditions!

An economy stalls, or turns negative; real estate values, generally, will correlate with the overall market demand. Good economy= high demand= higher prices.

Conversely, poor economy = lower prices = less demand in a declining economy!

> When Economic positivity returns, real estate values are driven up again.

Negative equity is a function of the determination of the property value at any declining economic point in time. As the demand for property decreases, the supply of property inventory for sale increases; fewer number of buyers are intereste d, so the sale-able value attached to the real property depreciates. Sometimes, the price valuation is lower than the mortgage - because the property was purchased during a strong up- ward economic trend. Your mortgage may have been calculated on this sometimes significantly higher property valuation when the overheated Bermuda real estate market in 2005-2007drove values to unsustainable levels.

This is most often occurring in a stagnant or declining economy as investment in the town, city, or country decreases. Or, if a large manufacturing or services base relocates, leaving the residents with far, fewer sources of good benefit jobs. The United States is replete with small towns that have lost their major income production industry, e.g. Maytag Appliances - moved to China; textiles, GM, paper companies, Reynolds, steel mills, and so on.

All just devastating to middle class families.

The exact opposite occurs when an economy is overheated;

- investment capital flows in,
- demand for property increases,
- insufficient supply occurs;
- prices are bid up as multiple buyers aggressively seek ownership.

What should you do if you purchased your property say, during the overheated Bermuda economy of 2005-2008, paying a premium for your home?

Nothing! Right away.

Instead, take a wait and see attitude, unless you are having increased difficulty in managing your monthly payments. You still need a roof over your head. And you would be walking away from your home, that you have loved and cared for to make it yours.

Your bank may not implement foreclosure proceedings if you are always current in your payment plan. If you are experiencing cash flow challenges, talk to your mortgage lender to possibly negotiate easier payments terms until you and your family are back on track.

Banks really do not want to be in the real estate marketing business. They just want to protect their investment, that is loaning you cash - with an eventual payback of principal and interest. Non-performing loans may impact their financial statements, in changing their capital reserve ratios.

Real estate values in Bermuda traditionally have increased an average of 3-5% annually. Eventually, as the real estate tide does turn assuming that more foreign direct investments flow into Bermuda, and while this is not a guaranteed statement, you may see your property value gradually increase once again above the value of your mortgage.

Caution! Do not miss a mortgage payment!

Three – Manage Debt Payments Efficiently for Best Results!

Your goal is to decide how you are going to manage these debt payments better – by saving better and creating a realistic budget for you. Go to the beginning of STEP SIX to start your budget process.

> Malcolm Raynor, a reader of the Monseywise column contributed this so very true comment.
>
> "The key to saving is to track your spending to the penny. Your regular and big expenses items are not the ones that break your budget; it is the small items that are not planned for that can get out of control."
>
> Thank you, Malcolm!

Credit Card Debt Observations. In August of 2014, the Royal Gazette featured two in- depth articles (written by me) relative to credit card debt in Bermuda. They may be helpful to readers starting their financial review process. Link to these articles in references below!

> Uncleared credit card debts can last for years! Your impulse lunch or entertainment night – the final cost could be three to five times more than that great (or just so-so) meal.

The two questions to always ask before you hand off that debit or credit card:

- Is this purchase an appreciating asset – can I sell it for a profit, or will I get some of my money back, or will the thing be close to scrap in less than a year?
- Can I pay the total balance on my card due next month?

The potential permanent damage caused by using credit cards published in the Royal Gazette, August 23, 2014. This article is particularly relevant because it demonstrates how credit card balances increase exponentially when the family does not pay the entire balance due.

Note that you should always check with your local credit card provider to ascertain current terms and conditions. And read your credit card contract. Yes, I know it is tediously long, but…… don't you always want to be financially aware?

Those readers focused on appreciating your home as an asset, try the three-part series on Mortgage Tracking and Payment Calculator articles.

Part I - Why would you want to accelerate the principal payments on your mortgage? July 26 2014

Part 2 - Manage, track your mortgage - Martha's how-to guide, July 19 2014

Part 3 - How to use a mortgage calculator, July 12 2014

Listen to Mortgage Basics - Part 1

https://tinyurl.com/yf6h4shr

Listen to Mortgage Basics - Part 2

https://tinyurl.com/yefyt6c5

Listen to Mortgage Basics - Part 3

https://tinyurl.com/yelouo9o

References
& Resources

Thousands of free finance calculators, encompassing all facets of a financial life cycle to help individuals and their families manage their financial affairs are available on-line. Just search us, Canadian or UK websites.

Bermuda islanders not connected to the United States - simply ignore the sections on US taxation.

You can also connect with your local Bermuda mortgage lender on-line.

Clarien Bank.

Clarien offers the HomeStart Program
– helping you own a piece of the rock in collaboration with Bermuda Housing Corporation (BHC)

Butterfield Bank. Bermuda

Butterfield has a mortgage calculator on its website for estimating your financial mortgage affordability.

HSBC Bermuda. HSBC Bermuda has a mortgage calculator on its website for estimating your financial mortgage affordability.