

January, 2007

Issue 2

# CMPS *Trend Spotter*™

## CMPS Live 2007 Schedule

**January 29-31 - SOLD OUT!!**  
[Marina del Rey, CA](#)

**March 7-9**  
[Hollywood, FL](#)

**March 21-23**  
[Dallas, TX](#)

**April 18-20**  
[San Ramon, CA](#)

**May 2-4**  
[New York, NY](#)

CMPS Live is now approved for continuing education in these states:

- CA – 14 hours
- FL – 10 hours
- IL – 6 hours
- MD – 14 hours
- PA – 4 hours
- TX – 7 hours
- UT – 14 hours
- Also accepted by CFP® Board for 13 hours of CE for financial planners nationwide

If you, or your company, are interested in a customized company-wide certification program, please call or email Josephine Nicholas at 888.608.9800 or [Josephine@CMPSInstitute.org](mailto:Josephine@CMPSInstitute.org)



## New & Improved Design!

You are now able to click-through to various hyperlinks, including the original source articles where applicable!



*CMPS Trend Spotter*™ is written, edited and published by [Gibran Nicholas](#), Chairman of the CMPS Institute.

## Special Issue:

# Mortgage Planning and NASD Compliance...What's the Real Story Anyhow?

Many of you have emailed me recently about your struggles in working with financial advisors and the whole issue of "NASD Compliance". To be sure, financial planners are under more regulatory stress than ever before. Many view working with mortgage planners as a big potential liability. Many planners can't seem to understand that working with us is actually a huge blessing for them and their clients. Hopefully, this issue of *CMPS TrendSpotter*™ will help address some of the concerns that your financial advisor business partners are facing. Forgive the long-winded nature of this issue of *CMPS TrendSpotter*™, but I want to make sure that I do my best to help equip you for success! Feel free to pass this along to your financial advisor prospects and business partners.

## New Content Posted on the [CMPS Exchange™](#)!

### Mortgage & Real Estate Taxation: an interview with CPA / tax attorney Terry Lang

CMPS members can [log in today](#) and get the answers the following questions!

- Are points deductible if paid in place of traditional closing costs (appraisal, title, etc.)?
- Are real estate taxes deductible on properties that aren't qualified residences?
- If someone mortgages one property to purchase another, how is the interest on that loan treated?
- If someone buys a home for cash and then puts a mortgage on the property to cash out the equity, is that treated as acquisition interest if the mortgage is closed within 90 days of the original purchase date?
- Aside from home improvements, how can someone establish acquisition indebtedness in a home they already own?
- Buying out the interest on someone else on title - What happens to the basis in the property?
- When can you cash out the equity of a property involved in a 1031 Exchange without tax liability?

*Interview is located in the CMPS Hall of Wisdom™ under "Taxation".*



To begin with, here is a direct link to the NASD notice and investor alerts:

- [Notice to NASD Members – December 2004](#)
- [Investor Alert about Mortgaging Your Home For Investment Purposes– March 15 2004](#)
- [Investor Alert about 100% Mortgages – May 3, 2004](#)

Here is my commentary on this whole issue based on the links provided above:

Contrary to what many in the financial services arena may tell you, using mortgage funds to invest, or diverting cash flow into more productive investments through interest only mortgages is **not** uniformly prohibited by the NASD providing that two requirements are met:

- **Suitability**
- **Prudence**

**#1 - Suitability** - the strategy must be suitable for the clients' risk tolerance, liquidity, cash flow and net worth situation.

In other words, it would not be suitable to tell a widow to mortgage her property and put the funds into the latest internet stocks. Additionally, variable annuities, variable universal life insurance and other risky investments are not suitable when investing home equity funds. If you look at the arbitration cases and lawsuits involving this whole issue, the "advisors" involved were clearly utilizing risky investments that were not suitable for the clients' situations.

Typically, the funds should be invested in a balanced portfolio with reasonably conservative rate of return expectations in the 5-7% range. Additionally, the strategy itself (bigger mortgage, invest the difference) needs to be suitable for a client's individual circumstances. For example, a client who doesn't have enough funds to meet their retirement goals could benefit greatly by investing their money instead of paying extra on their mortgage or leaving their funds tied up in their home equity.

## First Lien HELOC Combined with a Checking Account... What's All the Buzz About?

We've had a lot of questions and comments recently about the **CMG Home Ownership Accelerator™** loan. This is basically a cash management account that consists of a first lien HELOC combined with a checking account.

Unfortunately, many people are using scare tactics to promote it and aren't telling the full story. A few CMPS members even forwarded me some ads by one mortgage broker claiming to be a "consumer advocate" and scaring people into this type of loan.

However, when understood and utilized properly, this loan can be a powerful financial tool. Let's also keep in mind that there is no one-size-fits all mortgage strategy. In other words, the Option ARM is good for some situations, but very bad in others. The 30 yr fixed is good for some situations, but very bad for others. The CMG Home Ownership Accelerator is good in some situations, but very bad in others.

Let's start with the negatives of this product:

- **Tax deductibility** – as you deposit your paycheck into the loan, you reduce your acquisition indebtedness. As you borrow the funds back, the interest on the newly borrowed funds is treated as home equity interest. This makes it subject to the \$100k limit and AMT. Acquisition interest is not subject to AMT.

In fact, the Federal Reserve Bank of Chicago came out with a great study a few months ago to validate this very point. The study illustrated two major points:

1. 38% of US Households are making extra principal payments on their mortgage
2. If these households re-allocate their cash flow into tax deferred investments, they would save (or earn) an extra 11 to 17 cents per dollar. This is costing US Households an average of \$1.5 billion every year

[Click Here](#) for the link to the study (definitely use this when talking to financial planners).

How could the Fed be advocating something that the NASD clearly prohibits? Unless of course, the NASD doesn't clearly prohibit this, and financial planners and compliance personnel are mis-interpreting the NASD guidelines...

One way to examine this whole suitability issue is to take a close look at the types of investments being advocated as an alternative to investing your funds in your home equity. With this in mind, municipal bonds with tax free rates of return in the 5.5% range can be great alternatives to home equity for a few reasons:

**1. Tax arbitrage for higher income clients** - Acquisition indebtedness is not subject to Alternative Minimum Tax (AMT) and neither are Municipal Bonds. If someone subject to AMT purchases their home with a larger mortgage, they will still receive the deduction for mortgage interest even though they are subject to AMT. Also, if someone invests in municipal bonds that are tax free on a federal level (and in some cases, a state level as well), they won't have to pay income taxes on the investment yield even though they are subject to AMT. Therefore, if someone in a 35% tax bracket buys their home with a larger mortgage at say 6.5%, and uses the funds they would have otherwise used as a down payment to invest in Muni Bonds that are yielding say 5.5%, this would be the result:

4.225% = after tax cost of the mortgage

5.5% = after tax rate of return on the Muni Bonds



- **Variable interest rate tied to LIBOR** – not too bad when compared with other ARMs
- **Very expensive points to get a low interest rate** – advantage of paying points depends on clients' timeframe and how the loan is being used.

Here are the positives:

- **Tremendous cash flow flexibility** – speaks for itself.
- **Pay points on drawn amount, not on credit limit** – example: get a \$1mm credit limit and pay points on \$100k to buy down the interest rate on the full \$1mm.
- **Great alternative to reverse mortgage**
- **Easier to manage household finances** - all cash flow goes through one account
- [Contact CMG directly](#) as they probably have a long list of additional positives

At least if the client is consumed with the idea of having all their equity tied up in their home, the line of credit can be used to provide some aspect of liquidity.

For example, consider someone who has a \$1mm home with a \$200k mortgage. Chances are, you're not going to convince them to take out an \$800k loan with \$600k in cash-out to add liquidity. However, it would probably be very easy to get them into the CMG loan and at least have access to their equity if they need it at some point in the future.

This results in a profit of 1.275% without the client really doing anything. If someone uses a \$1mm mortgage to buy their home vs. paying \$1mm cash for the property, they would make an extra \$12,750 per year without doing anything! There are really no risks here if the muni bond is highly rated and also insured against loss as is often the case. Compounded over 10 years, this client would have an extra \$164,000. Not bad for a situation without much risk. Alternatively, the \$12,750 in annual profit can be utilized to fund a life insurance policy that exponentially multiplies the rate of return the client's estate receives upon death and opens up new liquidity and planning scenarios for their estate tax situation.

If the client is all set with their insurance and estate situation, the \$12,750 could be invested in options, financial futures, and other derivatives to hedge against losses in their overall investment portfolio. Utilizing mortgage planning in these types of cases really enhances the clients' diversification, and reduces their overall financial risk. Contrary to being "not compliant", I would argue that financial advisors who don't look at mortgage planning as a way to diversify and reduce their clients' overall risk, are at risk of being sued for negligence and breach of their fiduciary duty to act in the best interest of their clients.

**2. Liquidity** - you could access your funds much more readily when they are invested in muni bonds vs. if your funds are tied up in your home equity. It's much easier with much less paperwork to get loans against the value of bonds vs. getting loans against the value of your home.

Remember, when utilizing these strategies, home equity interest (cash out refi not used for home improvements) and investment interest (cash out refi for investment purposes) are subject to AMT. Furthermore, investment interest is not tax deductible when the funds are used to invest in tax free bonds. On the other hand, acquisition indebtedness (a mortgage used to buy a home) is not subject to AMT. The interest would be deductible even if the funds that you were planning on using as a down payment were diverted into other investments like municipal bonds.



As they find investments that provide a higher rate of return than the LIBOR-based mortgage rate, they could draw on the line of credit and take advantage of those opportunities. Although they would not be able to write off the interest as home mortgage interest if they exceed the \$100k home equity limit, it would be deductible as investment interest to offset their investment income. Keep in mind though that this interest would be subject to AMT.

This could work for real estate investors, business owners, higher net worth individuals and those who come across great investments from time to time and could benefit from the liquidity this loan provides. This loan has many uses outside of just trying to get the home paid off sooner. I think those who sell the loan could benefit more by forgetting about the home-pay-off part and concentrating on other benefits.

Again, this loan is certainly not for everyone, but it does have its place. I highly recommend that you take a close look at adding this product to your repertoire as a mortgage planner providing comprehensive solutions.

You can learn more about this strategy by listening to conference located in the [CMPS Exchange™ Hall of Wisdom™](#) under "Innovative Mortgage Products" or by [contacting CMG directly](#). The representative servicing CMPS members is Brent Eckhardt, who can be reached by phone at (800)356-3889, or email at [beckhardt@cmgmortgage.com](mailto:beckhardt@cmgmortgage.com).

**Next Week:** A close review of Option ARMs and interest only mortgages in today's market.

Please reference CDs # 11 and 12 of the self-study curriculum for more info on Muni Bonds. Barry Habib has been advocating this strategy for years. Barry and Sue Woodard go into great detail on how Muni Bonds work in a strategy like this. Furthermore, Barry and Sue will be covering AMT issues in the updated 2007 CMPS curriculum that will be rolled out at our upcoming CMPS Live Events.

Additionally, [Mortgage Market Guide](#) has some really cool spreadsheets in their resources section that help you illustrate this concept. They have three **Velocity of Money Calculators** and a brand new **Retirement Calculator**.

**#2 - Prudent** - the strategy should not contain the risk that the client will lose their home if the investment doesn't meet projected returns or loses value.

In other words, from a compliance perspective, you can't count on the investment returns to make your mortgage payment. The strategy is not prudent if you can't afford to make the mortgage payments if the investment loses money or doesn't perform as expected.

For more info on any of this info, please reference CDs # 3 and 4 of the self study curriculum.

### **Conclusion:**

I would utilize all this info to point out why the financial planners need to work with someone like YOU who is a Certified Mortgage Planning Specialist. As someone who is CMPS certified, you understand how to properly implement these types of strategies in a way that is both NASD compliant and beneficial to clients. By working with you, clients can achieve their dreams in life AND the financial planners can stay fully compliant with the NASD guidelines on this whole issue.

