

Your Home: Mortgages, Ownership, and Taxes

- **Negotiating a Mortgage**
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Your Home: Ideas, Facts, and Strategies **To Use Today and Save for Future Reference**

Your home — one of the most valuable assets you will ever own. But managing that asset is more complicated today because of changes in the mortgage market and in government regulations on capital gain taxation, deductions, and business use of your home.

This important **Resource Report** will guide you through the many financial and tax considerations of owning a home — from its purchase to sale and the steps in between. The many alerts and strategies also apply to co-ops and condominiums, including a mobile home, second residence, or vacation home which you use personally or rent to others.

The Basic Deductions: **Interest, Points, and Penalties**

- Interest on an original mortgage, including home equity loans, is tax deductible in the year paid. Interest on refinancings is generally tax deductible, but check with your accountant; there can be restrictions and limits, particularly if you extend a personal mortgage beyond its original maturity date.

Limit on deductions: Interest is deductible only on the first \$1 million of mortgage debt and the first \$100,000 of a home equity loan, for a total of \$1.1 million. These limits do not apply to mortgages on business properties.

- Points paid to a lender on *new* mortgages or for home improvement loans are tax deductible in the year paid.
- Points paid for mortgage refinancings are deductible over the life (term) of the mortgage. *Example:* \$3,000 in points paid on a 20-year mortgage are deductible at the rate of \$150 a year.
- Points paid on *business* or *investment* properties — on both original and refinanced mortgages — are deductible over the life of the mortgage, the same as for refinanced personal mortgages.
- Property and school taxes are tax deductible in the year paid. *Tax-saving strategy:* Pay these taxes *before* yearend if you want to increase your deductions and save taxes in a particular year. You usually have an option on when you make property tax payments.

Also consider paying before December 31 next year's January

mortgage payment to increase your current year's interest deductions. *Exception:* Don't prepay expenses if you will be in a higher tax bracket next year because deductions are more valuable at higher tax brackets.

- Penalties for prepaying a mortgage loan are fully tax deductible in the year paid.

Selling Your Home

When you sell your home, your total cost basis is the original purchase price of your home *plus* closing costs *plus* the cost of any capital improvements since you purchased your home. This total cost basis, after adding commissions and other closing costs associated with the sale, is then subtracted from your selling price to come up with your taxable gain. *Other facts:*

- Single homeowners can exclude up to \$250,000 of profit on the sale of a home. Married taxpayers filing jointly can exclude up to \$500,000. After the \$250,000/\$500,000 exclusion, any remaining profit (long-term capital gain) is taxed at 15%.
- The capital gain exclusion is available *only* if the home was the taxpayer's principal residence for at least two of the five years preceding the sale. (There are exceptions, principally for job relocation and health reasons.)
- The capital gain exclusion applies to all taxpayers, irrespective of age, and for *each* sale or exchange of a principal residence, but generally can't be used more than once every two years.
- The exclusion also can apply to condominiums, co-ops, mobile homes, and houseboats, but only if that is your principal residence.

Tax-saving strategy: If you own a second home and want to avoid paying taxes on the capital gain, plan ahead. Try to make it your principal residence for two of the five years preceding its sale. *Important:* Be sure to keep a log of the time spent at each home and formally change your legal address, e.g., where your monthly bills are sent and your address on tax filings.

Recordkeeping and Cost Basis

While the \$250,000/\$500,000 capital gain exclusion makes it appear you don't have to keep good records, that's not true. Here are some reasons:

- Your home state may not recognize the federal rules. Thus, you may

have to pay state taxes on any gain.

- The exclusion only applies to a principal residence. If you sell your second or vacation home and it doesn't qualify for the exclusion, e.g., you don't meet the two-year principal residence test, you will owe tax on the gain.
- If your home is used partly for business purposes, either as a rental property or home office, you need to keep additional records, both for current deductions (e.g., depreciation, insurance, and maintenance expenses) and to document your cost basis when you sell the home.
- With the substantial increase in property values over the last five years, the capital gain could easily exceed the \$250,000/\$500,000 exclusion.

How to protect your cost basis and deductions:

- Set up a home improvement file and every year put into it your invoices and cancelled checks for any work completed that year. That way, when you sell your home, you will be able to document its cost basis for tax purposes. This information is also useful in supporting a fair market value figure when you're selling or refinancing your home.
- There is a major tax difference between *capital* improvements and *maintenance*. Only capital improvements are added to the cost basis of the property. Capital improvements include such items as air conditioning, fences, fireplaces, decks, carpeting, paneling, skylights, awnings, built-in dishwasher, garbage disposal system, etc.
- Keep all supporting documents, e.g., work contracts, building plans, surveys, legal fees, closing costs, etc. Again, you will need these receipts to document your cost basis in the property, whether personal or business. Be sure the vendor's invoice includes the date, cost, and a description of the work.
- *Tax alert on casualty and theft losses:* In planning your insurance coverage, keep in mind that you cannot deduct the first \$100 of *each* casualty and theft loss. In addition, casualty losses equal to the first 10% of your adjusted gross income (AGI) are not tax deductible. For example, if you have a \$10,000 casualty loss and your adjusted gross income is \$70,000, you can deduct *only* \$2,900; \$7,100 is *not* tax deductible ($\$70,000 \times 10\% = \$7,000$ plus \$100 deductible equals \$7,100). If you have multiple losses in any one year, the \$100 applies to *each* loss, but the losses can be combined for the 10% of AGI test.

Refinancing Your Mortgage

If your personal or business mortgage was negotiated when interest rates were high or you need additional capital now, consider refinancing to take advantage of lower interest rates. To show the impact of a change in interest rates on a mortgage or any personal or business loan financing, here are the numbers for a \$100,000, 25-year mortgage.

Conversion to other loan amounts: We illustrate a \$100,000 mortgage but you can easily convert the numbers to your mortgage amount. *Example:* For a \$250,000 mortgage, multiply the numbers below by 2.5.

Calculating the Interest Savings

<u>Interest Rate</u>	<u>Monthly Payment</u>	<u>Annual Payment</u>	<u>Total Payments</u>
9.0%	\$839.20	\$10,070	\$251,760
8.5%	805.23	9,663	241,569
8.0%	771.82	9,262	231,546
7.5%	738.99	8,868	221,697
7.0%	706.78	8,481	212,034
6.5%	675.21	8,103	202,563
6.0%	644.30	7,732	193,290
5.5%	614.09	7,369	184,227
5.0%	584.59	7,015	175,377

Savings per \$100,000 mortgage debt. The interest difference between a 6.5% and 8.5% mortgage is \$39,006 over the life of the loan. That represents a savings of \$1,560 for each year of your 25-year mortgage. Compare those savings with upfront refinancing costs of \$3,000 to \$5,000.

But the interest savings are just one factor to consider. Before refinancing properties, be sure to check out the following in evaluating a new mortgage offer:

- whether the interest rate difference is worth refinancing (as a general rule, the difference should be two to three percentage points to recapture the upfront costs of a refinancing),
- whether points are being charged and if they apply to the *total* mortgage amount or just the *new money* you receive,
- whether the new interest rate being charged is fixed or variable (an *existing* low fixed interest rate is a valuable asset), and
- how much of the interest is tax deductible, particularly on personal and investment financings where the tax deductibility of interest may be restricted.

Another consideration: How long do you plan to stay in your current residence? The upfront costs of refinancing a mortgage are more justifiable if you will be benefitting from the refinancing over many years. (See *Points versus mortgage term* on page 9.)

Be careful of mortgage extensions: If you extend a *personal* mortgage beyond its original maturity date, interest after that time may not be tax deductible. This can be a critical consideration, so check this contingency with your accountant.

Pay attention to points: Points are simply extra fees charged on a loan by a lender to increase the rate of return on that loan and to recapture the costs of processing the loan. For example, two points on a \$100,000 loan represent \$2,000. This extra cost is usually paid upfront when the loan is made.

If one or more points are being charged by the lender on a new or refinanced mortgage, you want to know how those points affect your overall or *effective* interest rate, i.e., the real cost of the mortgage loan. That calculation is also very important if you have two or more offers from different lenders because you will use it to compare those offers on the basis of their *effective* interest rates.

The Table on the next page illustrates the impact of points on the actual interest rate you are paying on a fixed-rate, 25-year mortgage. It is designed to help borrowers who are wondering whether they should trade a lower number of points for a higher interest rate (or vice versa). The numbers reveal, for example, that a 7% mortgage with a payment of 4 points (effective interest rate of 7.46%) is comparable to a 7.25% mortgage with a payment of 2 points (effective interest rate of 7.48%). Both loans are virtually identical to lenders, but they have quite a

different impact on borrowers.

Points Versus Interest Rate

<u>Contract Interest Rate</u>	<u>Points at Closing</u>			
	<u>One</u>	<u>Two</u>	<u>Three</u>	<u>Four</u>
5	5.10	5.20	5.30	5.40
5.25	5.35	5.45	5.55	5.65
5.50	5.60	5.70	5.81	5.91
5.75	5.85	5.96	6.06	6.16
6	6.11	6.21	6.32	6.43
6.25	6.36	6.47	6.58	6.69
6.50	6.61	6.72	6.83	6.95
6.75	6.86	6.97	7.09	7.20
7	7.11	7.23	7.34	7.46
7.25	7.36	7.48	7.59	7.71
7.50	7.61	7.73	7.85	7.97
7.75	7.87	7.98	8.10	8.23
8	8.12	8.24	8.36	8.48
9	9.12	9.25	9.38	9.51

Fractional points. If the points charged fall between whole numbers (say, between two and three points), you can still obtain the approximate effective cost from this Table. *Example:* If 2½ points are charged on a 7% loan, the effective interest rate is 7.29% (about halfway between the rates for two and three points, i.e., the difference between 7.23% and 7.34%).

Other mortgage maturities. You also can use this Table to evaluate 20-year and 30-year mortgages since the effective interest rates are *not* substantially different. For 20-year mortgages, multiply the effective interest rate in this Table by 101%; for 30-year mortgages, multiply the effective interest rate by 99%.

Reference: For a checklist of questions to ask *before* you refinance an existing mortgage, see *Exhibit 3: Before You Refinance*, page 20.

Another Option: Home Equity Loans

If you want to borrow or cash in on some of the equity in your home without the hassle of negotiating a new mortgage or refinancing, consider a home equity loan. Your current mortgage holder probably can arrange one with little paperwork. But watch the ads; special deals are always being made on home equity loans. Time your loan application to obtain the lowest interest rate.

Added plus: The total administrative and legal costs on home equity loans, as well as the time to obtain the loan, are usually much less than with a regular mortgage. This can be a significant advantage when interest rates are especially low because lenders can get backlogged with loan applications from borrowers who want to take advantage of the low interest rates.

Negative and plus: Most home equity loans have *variable* interest rates. However, the total interest paid each year can be substantially less than with a regular mortgage since you pay interest *only* on the monthly amount outstanding, whereas in a traditional mortgage you pay interest on the full amount borrowed at closing.

Mortgage Terms

□ **Fixed vs. variable interest rate.** Think twice before replacing a relatively low fixed-interest-rate loan with a new variable rate loan, even if the new variable rate is less than the fixed rate. *A low fixed interest rate is a very valuable asset:* It can't be changed by the lender and you have the comfort of knowing the *exact* amount of your monthly mortgage payment today and over the life of your mortgage. For example, if you currently have a 7% fixed interest rate, the loan with a two-percentage-point savings of a 5% variable rate could end up costing you more since interest rates over the next 10 to 30 years are likely to go much higher, taking your variable rate with them. Recognize also that in some variable rate advertisements, the low interest rate may apply only to the first year or two.

□ **Term of mortgage.** If the interest rate is fixed and low, you may want the longest time to repay the mortgage, i.e., 30 years rather than 10 or 15 years.

That's because the fixed mortgage payment becomes less burdensome as time goes by because of inflation. In 15 to 20 years, your salary may be double what it is today, but your fixed mortgage payment will be the same. Be aware that there is usually a one-half point (0.50%) difference in the interest rate between a 15- and 30-year mortgage.

What to do: It's always a good idea to get a few proposals from your lender, e.g., 15-year vs. 30-year mortgage and a fixed vs. variable interest rate for each.

□ **Points versus mortgage term.** The impact of points (see Table on page 7) is even greater if a mortgage is repaid (or prepaid) in the first three to five years after the loan is made. Then the cost of the points is, in effect, amortized (written off) over the shorter period the loan is outstanding, i.e., from the date of the original loan to the date of repayment or refinancing.

For example, if four points (\$4,000) are charged on a 7%, \$100,000, 25-year mortgage on your home, the effective interest rate is 7.46% over the full term of the mortgage. However, if that mortgage is repaid in three years (say you buy another house), the effective interest rate increases to about 8.5%. Basically, you take the \$4,000 in points and divide by three years for an extra annual cost of \$1,333. That's in contrast to a 25-year loan, where the points are spread over 25 years for an annual cost of \$160 — \$4,000 points divided by 25 years.

□ **Prepayment penalties.** Check your lender's policy on *prepayment* penalties for paying off a loan early, particularly if you intend to sell the property in the next five to 10 years. The questions to ask:

- How many percentage points are charged for early payoff of the mortgage?
- Does the penalty decrease every year (e.g., 7 points in year one, 6 in year two, etc.)?
- At what point in time are there no penalties?

Note: If you already have a mortgage, you will find the prepayment penalty in the mortgage agreement or the deed of trust instrument that secures the loan. If a penalty has to be paid, it's fully tax deductible in the year paid.

□ **Late mortgage payments.** You may be unavoidably late in making payment because of illness, poor cash flow, or even oversight. Find out how long the lender gives you after the due date to make payment and what the penalty is if payment is made after that time. Penalties can vary significantly among lenders.

Protect credibility: Plan ahead with your lender if there's a probability you may be late with payments for a period of time (e.g., you're disabled). It may be better to negotiate an extension of the loan by a few months or even a year than to incur continuing late payment penalties and negatively affect your credit rating.

□ **Appraisal and mortgage insurance.** Is a formal appraisal of the property needed before the mortgage financing is approved? If so, what are the costs and the minimum appraised value to obtain the financing? Does the lender require mortgage life insurance? If so, it's usually better in the long run to buy level term life insurance. That's because the face amount of term insurance *doesn't decrease* every month as mortgage life insurance does. *Result:* With level term, you are getting *additional* life insurance coverage in future years when the amount earmarked for the mortgage is lower. This can be particularly important if you are not adequately insured now. *Alert:* If you decide to use level term life insurance, be sure the policy is convertible to permanent insurance, noncancellable, and renewable to at least age 65.

□ **Mortgage contract restrictions.** Is the mortgage assignable to a buyer when you sell the property? If so, this provision will help you sell the property at some future time, particularly if the interest rate on the mortgage is low. Are there any restrictions on your ability to rent the property? The fewer the restrictions, the more marketable the property. In addition, if you can't sell the property at a good price, the interim rental of it may be a good alternative until real estate prices increase.

Second and Vacation Homes

Don't jeopardize the tax deductions you're entitled to on your second or vacation home. Under current law, if your second or vacation home is used for *personal* purposes for no more than 14 days a year (or no more than 10% of the total number of days rented), you may get some tax deductions, but your overall

rental losses are limited by the complex *hobby* and *passive activity loss* rules.

That means you can actually lose valuable tax deductions by renting your second or vacation home even if your personal use is under 14 days a year or less than 10% of the total number of days rented.

An option: Talk to your accountant; it may be tax advantageous *not* to rent out the house and to count it as a *second* personal residence. As a second residence, rather than a real estate investment, you can at least deduct mortgage interest and real estate taxes. *The questions:* What are the tax savings if I rent or don't rent the second home? Will the deductions on the rented home increase the likelihood of an IRS audit?

Another potential problem: Be aware that complications can arise if you own property in two different states because two sets of laws and taxation may apply. Also, if you do own homes in more than one state, make sure it's *absolutely clear* which home is your legal residence, e.g., the same as on your tax return. If it's not clear, your tax deductions could be affected, principally interest expense and real estate taxes.

Business Use of Your Home

Overall rule: You can claim a home office deduction if the home office is used to conduct essential day-to-day administrative or management activities and you don't have another fixed location where you could perform such duties. How difficult that will be to prove depends on the facts and circumstances.

- *Recordkeeping and deductions:* It's very important to keep a *time log* on the time you spend at home and on the road or at another location, and to document the business purpose of that travel and location. Of course, continue to save all home-office-related invoices and receipts for which you will be taking a deduction.

- *State laws and your deductions:* Be aware that state laws may have additional rules and requirements for claiming home office deductions and for taking capital gains when you sell your home. These state laws also may not

conform to the federal tax laws. So carefully analyze your state's laws before claiming home office deductions and in planning the sale of your home.

- *Tax return filing and computations:* If you qualify to deduct home office expenses, you must list your deductions on IRS Form 8829, *Expenses for Business Use of Your Home*, and attach it to Form 1040 when you file your tax return. Form 8829 is also the place where you compute the percentage of your home allocated to business use, e.g., 1,000 square feet of business use divided by 4,000 total square footage equals 25% allocation. That 25% is then used to calculate the share of depreciation, utilities, insurance, etc., attributed to the home office.

- *Sale of home which includes a home office:* When you sell your home, you still can use the \$250,000/\$500,000 exemption. However, if your home office is a *separate* dwelling unit, there is a capital gain tax of 15% on that portion of the profit allocable to the home office space. Furthermore, there is *no exclusion* on any gain resulting from depreciation deductions taken on prior tax returns for periods after May 6, 1997. The tax rate on the accumulated depreciation is 25% and it is payable in the year you sell your home. This depreciation recapture tax of 25% also applies to most rental and investment properties.

Protecting Your Home

Most homes purchased many years ago have doubled or tripled in value with comparable increases in the cost to rebuild or replace that home. Review your overall insurance coverage with these provisions in mind to be sure you are fully protected.

1. *Coinsurance clause:* Some homeowner contracts still have coinsurance requirements that provide full loss protection only if the policyholder increases his coverage as the value of the insured property increases.

An example: Let's assume you have a policy with an 80% coinsurance clause, a house that would cost \$100,000 to replace (not including land and foundation), and an \$80,000 policy covering your home. Note that the policy covers 80% of the replacement value — meeting the minimum coinsurance requirement of 80%. Now, in the event of a partial loss, say \$40,000, the insurance company will pay

the full loss of \$40,000 because you maintained a policy for at least 80% of your home's replacement value.

Why it's important: Assume the cost to replace your home goes to \$150,000, but you fail to increase the amount of your policy coverage to \$120,000 (80% of the current value). You still have an \$80,000 policy with an 80% coinsurance clause. Now if you have a claim for \$40,000, the insurer will send you a check for only \$26,667, which represents 67% of the total claim. **You lose \$13,333** since you insured only 67% of the minimum requirement (\$80,000 divided by \$120,000 equals 67%).

2. Guaranteed replacement cost: Many companies offer a guaranteed (extended) replacement cost endorsement. This modification of the policy not only eliminates the coinsurance provision, but also guarantees that, even if the cost to rebuild the property is more than your policy limit, the higher amount, usually up to 125% of the policy's limit, will be paid. Talk to your agent about adding this provision to your policy and the additional cost. Without this provision, your insurance payment to replace your home is limited by the policy's dollar limit. Any excess replacement cost over that policy limit is your responsibility.

3. Contents insurance: Another big exposure to protect against is damage to both business and residential building contents (everything from equipment to furniture to rugs, etc.). Review the replacement value of the contents in your current policy and add new contents purchased since the policy's last update.

4. Business use: If you use your home for business purposes, you will need additional liability insurance, particularly if you have business people visiting your home office. *Alert:* To obtain liability insurance for business use of a home, as well as business contents, add a separate "endorsement" to your existing home policy or take out a separate business policy. Check with your insurance agent.

5. *Umbrella insurance:* This insurance protects your home and other personal assets against lawsuits and judgements in excess of your *existing* casualty policies. If you already have umbrella insurance, check the dollar limits of the policy to be sure the amounts are sufficient to protect you.

Free Information

The IRS publishes helpful tax and general information brochures on your home. Here are the important ones: 523 (Selling Your Home), 530 (Tax Information for First-Time Homeowners), 551 (Basis of Assets), 587 (Business Use of Your Home), and 936 (Home Mortgage Interest Deduction).

To order any of the above publications, call 800-TAX-FORM or download the information from www.irs.gov.

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As with many other important financial planning areas, the economics of owning a home are much more complex today. Planning in advance and getting good advice from your accountant are the keys to saving taxes, getting valuable deductions, increasing your net cash flow, and structuring the purchase and sale to your maximum advantage.

Keep this important **Resource Report** handy for future reference. □

References —

Exhibit 1 — Home Highlights: Big-Dollar Actions and Cautions, next page

Exhibit 2 — 8 Ways to Lower Property and Casualty Insurance Costs, page 18

Exhibit 3 — Before You Refinance, Ask Yourself These Questions, page 20

Home Highlights: **Big-Dollar Actions and Cautions**

- Don't consider buying a home without having it thoroughly checked out by an independent, licensed inspector. This is particularly important if you're buying the property *as is*. This precaution also applies to other major purchases, such as used business equipment, a second-hand automobile, etc.

- Verify in advance what the home is really costing you and which expenses are tax deductible. Many fees paid in connection with the purchase of a home, such as commissions, transfer taxes, legal and appraisal costs, and recording fees, are *not* currently tax deductible and become part of the cost (tax) basis of the residence when you sell your home down the road.

- Homeowners can exclude up to \$250,000 (single taxpayers) and \$500,000 (married, filing jointly) of profit on the sale of a home. *Caution:* You must meet the residence requirement. The home must be the taxpayer's principal residence for at least two years of the five years preceding the sale. Violation of this requirement could cost you many dollars in additional taxes.

Alert #1: The two years of residence requirement does not have to be consecutive, e.g., a taxpayer can live in the home in the second and fifth years to qualify for the \$250,000/\$500,000 exclusion.

Alert #2: The exclusion applies to *each* sale of a principal residence, but generally not to more than one sale every two years.

Alert #3: The law provides an exception to the two-year rule, principally for job relocation and illness.

- *Splitting an exemption:* You can't split the \$250,000/\$500,000 exclusion to cover the profit from the sale of two different homes. You must wait two years to claim the second exclusion and meet the residence requirement, i.e., it was your principal residence for two of the last five years.

- *Married taxpayers:* To obtain the \$500,000 exclusion, *both* you and your spouse must have lived in the home for at least two of the five years preceding the sale, and *neither* of you can have claimed the exclusion during the previous two years.

- Any capital gain on the sale of a home above the exclusion amount is taxed in the year you sell the home.

- *Capital gain and adjusted cost basis:* The gain or loss on the sale of a home is based on the selling price *less* the home's cost basis (usually the purchase price and capital improvements) *less* all expenses incurred in the purchase and sale of the home (e.g., legal and recording costs, appraisal fees, title insurance, points not previously deducted, selling commissions, etc.).

If you have deferred a capital gain from a previous sale of a home, that capital gain is *subtracted* from your adjusted cost basis on the second sale. This increases your capital gain, but you still can apply your \$250,000/\$500,000 exclusion to reduce or eliminate it. The capital gain tax is 15%.

- If you own a second home, don't rent it without first asking your accountant to calculate the tax deductions *both* with and without rental income. You could lose valuable deductions, e.g., mortgage interest and property taxes, if you elect to treat the second home as rental property.

- Check out your state laws *before* buying a home or using it for business purposes because they may be different from the federal laws in regard to deductible expenses and the taxation of capital gains.

- Always check with your accountant on the tax deductibility of interest *before* financing or refinancing a mortgage. Contrary to what many taxpayers think, there are restrictions and limits, particularly if you extend a personal mortgage beyond its original maturity date.

- If points are charged on a refinancing, check out whether the points apply to the *total* mortgage amount or just the *new money* you receive.

- Before refinancing an *existing* mortgage to obtain a lower interest rate,

compute your breakeven. Usually, you need a new interest rate about two points lower to justify the upfront closing costs you will be charged on a refinancing.

- Check the *coinsurance clause* in your property and casualty policies. Be sure it's based on the current replacement cost of your home. Also talk to your insurance agent about a "guaranteed replacement cost" provision in your policy.

You also want to check your policy on renewal. Many companies are adding more restrictions and lowering coverage.

- It's prudent to update annually your *contents insurance* coverage and to insure your personal properties on a replacement cost basis also.

- Be sure you have an updated *umbrella* insurance policy to protect your personal assets against catastrophic casualty claims and that it's coordinated with your property and casualty insurance policy.

- *Prepaying a loan:* Penalties for prepaying a mortgage loan are fully tax deductible in the year paid.

- *Contract advisory:* Never sign a contract for home improvement expenditures or major repairs that requires full payment *before* completion of the work. Also insert a clause that the work must be satisfactory to you *before* final payment is made and, if *time is of the essence*, add that provision also. □

If your home is used partly for business purposes, either as a rental or home office, you need to keep additional records.

8 Ways to Lower Property and Casualty Insurance Costs

#1. Shop around: The property/casualty insurance industry is very competitive; get quotes from at least two insurers. You could find a premium difference of up to 20% on comparable insurance coverage.

#2. Increase your deductible: This can substantially reduce the cost of your homeowner's insurance and, in many cases, your auto insurance costs too. Increasing a deductible to \$500 (from \$250) usually saves about 5% in annual premium cost. Increase the deductible to \$1,000 and the savings is about 10%.

#3. Use one insurer: Save up to 5% to 10% of your home and auto insurance premiums if you buy two or more policies from one insurer.

#4. Buy only needed coverage: Many individuals use the fair market value of the property as the basis for the amount of insurance coverage. *That's a mistake.* Subtract the value of the land and foundation and your premium could drop as much as 20%. But make sure you have a sufficient policy limit to cover the *replacement value* of your home.

#5. Install security system: Get a discount of at least 5% for installation of a burglar alarm, dead-bolt locks, smoke detector, etc. For a more sophisticated security system, e.g., the fire and burglar alarms ring at the police station, the premium savings could be as high as 20%.

#6. Take advantage of your age: If you're age 55 or over, you may qualify for a discount up to 10% on your annual premium cost. If you recently turned 55, the original policy and premium cost can be adjusted for the discount.

#7. Buy a newer home: Because a new home's electrical, heating, and plumbing systems and overall structure are likely to be in better shape than those

of an older house, you usually can save 10% to 15% of the annual premium cost.

#8. *Periodically review contents coverage:* Two reasons: (a) you want to add assets acquired since you originally took out the policy, and (b) you want to eliminate or reduce the value of older assets which have decreased in value, e.g., appliances purchased years ago.

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What to do: Review these ideas with your insurance agent. If you are currently paying \$2,000 a year for property and casualty coverage, a 15% discount from one or a combination of the above ideas will save you \$300 each year. □

Before You Refinance, Ask Yourself These Questions

It pays to be prudent when effecting a mortgage financing or refinancing. Remember, you probably will be living with its terms for many years.

- Do the points apply to the *total* mortgage amount or just the *new money* you receive?
- Is all of the interest tax deductible? Have I extended the term of the mortgage beyond the maturity date of the original financing? If so, check with your accountant; your interest deductions may be restricted.
- How long will it take for me to recoup the upfront costs of refinancing? Two to four years is excellent.
- Will I be selling the property within the next five years? If so, I may not recapture my upfront refinancing costs.
- Is there a penalty for paying off the mortgage early? If so, how much is it and for how long is it applicable?
- Is the new mortgage assignable to a buyer when I sell the property?
- If I'm electing a variable interest rate, am I willing to live with the possibility that the interest rate could increase substantially? (Remember, the prime rate went to 20.5% in August 1981.)
- Will I need a formal appraisal of the property? If so, how much will it cost and what is the minimum appraised value to obtain the financing?
- Do I want or need more life insurance to cover the mortgage debt? If so, would I be better off with level term insurance rather than mortgage life insurance, which decreases as the mortgage principal decreases?
- Can I rent the property without the lender's consent? This is a valuable option if I can't sell the property at a good price.
- Should I consider a home equity loan? It may be less expensive and easier to effect than a traditional mortgage.

- Rather than just refinance the outstanding amount on my existing mortgage, should I use this opportunity to borrow more money at the lower interest rate to consolidate some debt and/or provide extra cash for other uses?

About *The Business Library*

This **Report** is part of *The Business Library* (TBL), a collection of 90 Reports and Manuals on subjects of critical importance to business owners, executives, their families, and the professionals who advise them. TBL is produced by an editorial and research staff with an *average experience* of **28** years in helping businesses and individuals manage their finances better.

The company was formed in 1974 by Thomas J. Martin. Martin has written more than 900 articles and advisories and presented *hundreds* of workshops and seminars to *thousands* of business owners and executives on many of the subjects covered in *The Business Library*. He is an Investment Banker and an expert witness in Valuation and Succession Court Cases. He has helped *hundreds* of business owners and executives raise capital, refinance debt, prepare for succession, and value and sell their businesses.

The information in *The Business Library* has helped more than 300,000 business owners, executives, entrepreneurs, investors, and individuals manage their companies and finances better, using several million copies of our reports, manuals, advisories, books, seminar workbooks, and newsletters to guide them in their business and family planning.

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