

## Using ARMs...Without Losing an Arm and a Leg!

ARMs – Adjustable Rate Mortgages – have been one of the major engines behind the real estate boom of the last decade. The Mortgage Bankers Association recently reported that ARMs now make up 25 percent of the more than \$8.5 trillion in outstanding mortgage debt.

Yet the headlines about adjustable-rate debt aren't terribly rosy these days as home prices have begun to stall around the country and the Federal Reserve has now raised its federal funds rate 16 times since June 2004. In reality, some ARM borrowers have seen their monthly payments double on loans they got in 2004, when interest rates started to turn upward.

A January 2006 study by the Federal Reserve reported that 35 percent of people with ARMs weren't sure of the maximum rate they could face on their loans. Another 28 percent didn't know what index rate would be used to determine those rates. It's wise to check with a financial planner to see which option might work for you.

For first-time or repeat ARM borrowers who have gotten a rude awakening over these past two years, it might make sense to explain some key facts about adjustable-rate mortgages and how they work.

**What's an ARM?** Fixed-rate mortgages carry an interest rate that stays the same during the life of the loan. But with an ARM, the interest rate changes periodically, usually in relation to a particular financial index. Payments may go up or down depending on where that index is heading.

**What kind of indexes are we talking about?** Lenders may index their ARMs to rates on one-, three-, or five-year Treasury securities, LIBOR (London Inter-Bank Offered Rate) or national or regional average of costs of funds to savings and loans. Before you borrow, you might want to ask your lender to explain what their benchmark is and double check that rate in the paper.

**What's the adjustment period?** With most ARMs, the interest rate and monthly payment change every year, every three years, every five years or possibly longer. The period between one rate change and the next is called the "adjustment period." A loan with an adjustment period of one year is called a one-year ARM, and the interest rate can change once every year. You need to ask your lender how much warning you'll get about an approaching adjustment period and how your current payments may be affected.

**Watch those introductory discounts.** Many home lenders take a cue from credit card companies by offering you a lower rate during the first year of the ARM. Keep in mind that this low initial rate will be temporary and you'll have to adjust to the possibility of significantly higher payments later on, especially if interest rates keep heading up. Make sure you understand the relationship of any introductory rate to a permanent rate.

**What's the cap?** On most conventional ARMs, the lender caps the percentage increase in the interest rate. It's very important to ask your lender about how your rate cap works on your particular loan and, as mentioned above, when the adjustment periods are. Interest caps come in two versions: Periodic caps, which limit the interest-rate increase from one adjustment period to the next; and overall caps, which limit the interest-rate increase over the life of the loan. Ask whether there are any other conditions under which your monthly payment might change.

**What about prepayment and conversion?** Recent events underscore why you should ask whether there are any prepayment restrictions on your ARM, or if there are any obstacles to converting it to a fixed-rate loan whenever you want. For conventional lenders, it's typically not a problem, but as more borrowers consult non-traditional lenders for home loans, it's worth double-checking.

**Think twice about "option" or "flex" ARMs.** Maybe you make a very good income, but you're self-employed and your income isn't steady. It might become very attractive to do a flex or option ARM, which allow you a range between a minimum payment to a full payment that covers interest and principal. Obviously, deferring full payments keeps you from building equity in a flat or slowing market.

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## Fighting High Energy Costs as the Temperature Heads Upward

While fuel prices may inch down and up as weeks pass, most energy experts agree that the days of under-\$2-a-gallon gasoline and heating bills that don't require oxygen before opening are far, far away.

The way you deal with higher costs for transportation and utilities shouldn't be an afterthought. The current energy environment is an opportunity for permanent changes in the way you manage energy spending throughout your life. Some ideas:

**Start thinking about alternative energy vehicles.** There's a healthy debate about whether hybrid vehicles and the coming generation of flex-fuel vehicles (those capable of running on gasoline and ethanol blends) are good investments. The answer comes down to the individual vehicle and your driving habits. Some argue that you're better off going with a sub-compact traditional fuel vehicle than a hybrid on a pure price basis, but this year, the federal government has offered some help in the form of income tax credits for hybrids placed in service in or after 2006. Some state and local governments are doing so as well. Go to [www.irs.gov](http://www.irs.gov) for more information on the federal tax credits (they vary by vehicle model) and check your state or city revenue department Web site for any local information. Beyond that, assess an alternative energy vehicle on the same points you would any other car you've bought. Consult various consumer resources on service records and maintenance costs and check to see how much the vehicle will cost to insure in your area.

**Drive smart in the meantime.** Even in the winter, you don't need to leave a car running for more than a minute to get it ready to drive, according to the U.S. Department of Energy. To be safe, check your owner's manual. Experts advise you to drive slower, use air conditioning only when necessary and yes, consider public transit or carpooling. Other ideas: Clean out the trunk (extra weight cuts gas mileage) and make sure your tire pressure is correct.

**Consider a gasoline budget:** Is every car trip necessary? If you typically spend \$120 a month on gasoline, set a budget of \$100 and see what you can cut to make it. Consider car-pooling, public transportation, walking or even the family bicycle if you get close to the budget amount.

**Consider a budget plan for your utilities:** Most utilities feature some sort of budget plan to help homeowners even out their monthly electric and fuel heating bills through the year. Yet know that the utility is in the driver's seat – it will estimate your usage for the next 12 months and assign you a monthly payment. Talk with a local utilities watchdog group about potential problems with that plan. Other tactics: Try and shift your dishwasher and laundry usage to the off-peak hours in the evening and wait to use them until you have a full load. Also, if you really think bills are going sky-high in the winter but you don't want to do the budget plan, overpay your heating bill during the summer months.

**Turn down the wattage.** If you replace four 75-watt or 100-watt standard light bulbs in your home with 23-watt compact fluorescent bulbs, the Energy Department says you'll get as much light as the higher-wattage bulbs but save 69 percent in electricity costs. Assuming the lights burn more than four hours a day, the savings can add up to roughly \$200 a year.

**Rethink the whole driving vacation thing.** If you still believe that driving to a destination is the cheapest way to run a family vacation, you might want to consider air travel. Don't forget to consider the cost of renting a car at your destination.

**Get a programmable thermostat.** If you're not able to discipline yourself to keep your thermostat low in the winter and high in the summer, you might want to consider a programmable thermostat that automatically adjusts your home temperature based on time of day. It'll cost you roughly \$50 if you install it yourself.

**Get friendly with your water heater.** Some water heaters are preset by manufacturers to about 140 degrees Fahrenheit and very few consumers ever touch that setting. However, the Energy Department considers 120 degrees enough for safe dishwashing and comfortable showers.

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## Getting Your Freshman Off to College the Right Way

Parents struggle to save for college, but some of the biggest money challenges don't have anything to do with paying the tuition bill. What happens if a child gets in an accident or suffers a sudden health emergency? What if a natural disaster – a la Hurricane Katrina – displaces a student without an action plan? What if your child gets in trouble with credit or botches his bank account?

Before junior heads off to college, it makes sense for parents to develop a “worst-case scenario” plan for money disasters that can affect both parent and child. Some ideas:

**Consider an advance medical directive for your child:** If your child becomes sick or is hurt at college, how would you feel about a doctor you've never met administering a course of treatment that could be at odds with previous medical history? If your child contracts a virus, would you be content with overnight treatment at the school's student health center, or would you want your child transported to the closest major hospital? An advance medical directive isn't simply for terminal conditions for older people. The creation of such a document by your attorney can spell out in precise language how you *and* your child want a sudden or chronic medical issue handled. Have a serious discussion with your child to incorporate his or her wishes into this document, and then check with the school to see where it should be filed for reference.

**Make sure your child is insured:** From health insurance to renter's insurance, check with your health and home insurer to find out if there are ways to economically cover your child where he or she is going to school. Also, most schools will offer resources of temporary or short-term health insurance to cover students who are attending schools across state lines from their parents. Talk with a financial planner about these options. A good site for learning about health insurance options *after* graduation is [www.PlanForYourHealth.com](http://www.PlanForYourHealth.com).

**Put plastic on training wheels:** Many experts believe it makes sense for students to handle their first credit or debit card while at home. You might want to introduce them to plastic in their senior year of high school instead of their first year of college. Consider a lower-limit card that allows a parent to be a co-signer but puts the name of the student squarely on the card. Specific agreements should be made on what the card can be used for and what funds need to be set aside to pay the card in full each month.

**Make the student pay his tuition check:** Even if you are fortunate enough to have enough money to completely cover your child's tuition, make sure your child writes the check to the bursar. They need to know what an education really costs and they need to understand the importance of major payments made on time. That will get them ready for mortgages, car payments and hopefully, saving early for their child's education.

**Discuss financial aid:** Make sure you have an ongoing dialogue with your child about financial aid, scholarship and grant renewal.

**Discuss taxes:** Many college students with assets have their parents do their tax forms or have their taxes done by their parents' tax preparer. Even if the parent continues to handle tax preparation, parents and students should discuss tax issues at appropriate intervals so the student isn't clueless about filing when they are finally on their own.

In fact, it might be a good idea for the student to attend the meeting with the tax preparer so they understand how the process works and what important financial documents to keep handy.

**You and your kid should check his credit report – together:** As long as your child is accepting your support, you should have them pull their credit reports annually so you can sit down and review them together. Not only will this teach the child the importance of building a strong credit rating and confirming the accuracy of their credit report on an annual basis, but it provides another level of parental oversight on the use of credit cards. If the student knows he needs to review his credit record with Mom or Dad, they'll know problems won't be easy to hide.

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