



Consumer-Oriented Information & Advice to Save Time and Money

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From My Home To Yours

Spring, 2005

1st edition

A NEWSLETTER - FROM MY HOME TO YOURS

After many years talking about it, I'm finally getting around to doing a newsletter. I've assembled many articles of interest over the years relating to mortgages, financial planning, real estate, home improvements, etc. to better educate myself and the input I give you, my customers. This newsletter provides a great forum in which to convey some helpful and hopefully money-saving information.

My objective is to provide this consumer-friendly information, as always, in an independent, unbiased way. I hope to publish 2 newsletters a year (spring & fall), in addition to my infamously long Christmas letter.

I dislike junk mail as much as anyone, so if you're not interested in receiving future newsletters, please let me know. I'll save you the hassle & I'll save a stamp. If you prefer, I can also send this newsletter via e-mail. You can either call or e-mail me (ostrom@pmc-pa.com). I hope you find the newsletter informative. Take care and enjoy the spring. - Laurence

IT'S TAX TIME AGAIN

From January to April 15th each year, some of you call to ask about the tax deductibility of interest & points.

Is home mortgage interest deductible?

The IRS subdivides mortgage interest into two categories: "acquisition debt" and "home equity debt." Mortgage interest paid as a result of the loan used to buy, build, or improve a primary and/or secondary residence is classified as **acquisition debt** and is fully deductible up to \$1,000,000 per year (\$500,000 if married filing separately). It is important to recognize the difference between interest owed and interest paid. Qualified, deductible interest cannot be deducted if not paid within the calendar year.

Home equity debt is interest incurred for any other purpose (like debt consolidation). This interest is fully deductible up to the lessor of \$100,000 per year (\$50,000 if married filing separately) or the difference between fair market value of the residence and the remaining

acquisition debt. Home equity interest is not deductible as a business-use of home (home office) expense, but if deductible, it would be placed on the Schedule A.

Are points deductible?

Most of my customers in 2004 chose a rate associated with 0 points. The rationale for this choice was 1) didn't have the funds, so the issue was moot, or 2) the "spread" between the various rate vs. point options was small, to the extent that the break-even point was beyond their anticipated time remaining in the home. In other words, it wasn't worth paying. This circumstance will probably change as interest rates begin to climb.

That being said, for those of you who did pay points:

- 1) If you paid points on a refinance transaction, the cost of the points must be deducted "ratably," that is, an equal amount over the term of the loan. For example, if you paid \$1,500 in points, and the term of the loan was 15 years, you deduct \$100/year. When you sell your home or refinance again, the non-deducted remainder of the points is fully deductible in the year the mortgage is paid off.
- 2) If you paid points on a purchase transaction, **OR** paid points on a loan (or portion of a loan) which was used for home improvements, you may opt to deduct the points ratably, **or** all at once, in the year the transaction settled. Even if the seller paid your points, the IRS considers the points paid by the buyer and would be deductible to you. In this scenario, however, you must reduce the cost basis of your home by the amount deducted.
- 3) If you paid points on a second home, the points must be deducted ratably.

Old Time Remedies

- Kill fleas - Add a few drops of Dawn dish washing liquid to your dog's bath & shampoo thoroughly. Rinse well to avoid skin irritations.
- Kill ear mites - Massage a few drops of Wesson corn oil into your cat's ear. Clean with a cotton ball. Repeat daily for 3 days. The oil soothes the cat's skin, smothers the mites, and speeds

WHY ARE MORTGAGE RATES RISING?

Most fixed rate conventional, conforming interest rates usually rise and fall relative to the 10-year bond yield. Federal government-issued bonds are considered the “benchmark” on which other debt instruments are priced, such as mortgage-backed securities (MBS). These MBS are offered for sale by large, quasi-privatized organizations such as FNMA (Federal National Mortgage Association, aka “Fannie Mae”) and FHLMC (Federal Home Loan Mortgage Corporation, aka “Freddie Mac”) in the secondary mortgage market. Given the added risk of mortgage default and prepayment, FNMA et. al. need to add a certain margin/spread above the 10-year bond yield to attract investors who will purchase the MBS. So, as the perceived risk-free government-issued 10-year bond yield increases, so will the yield increase for MBS in the secondary mortgage market. And this, then, translates into higher interest rates in the primary mortgage market (i.e. lender to consumer).

That being said, so why is the Treasury 10-year bond yield increasing? Buyers of bonds fear inflation because it erodes the value of their fixed return investments. If it is perceived that inflation is increasing, investors would want a higher yield on the MBS as an inducement to commit money to the long term investment. Example: assume inflation is running at 3%, and the yield on the treasury bond is at 4%, and the yield on a MBS is at 5%. Now, assume inflation is expected to rise to 4%. Investors then would be less interested in buying the T-bond at 4%; they would want 5% to protect their real, post-inflation return.

So, why is it perceived that inflation is increasing? Economists, stock & bond markets, and nervous mortgage brokers focus on economic indicators released by the government for data and clues to help understand the forces which might cause inflation to rise and fall. Example: in January, ‘05, construction spending increased 0.7% from the previous month, factory orders increased 0.2%, real personal consumption expenditures (includes durable goods, non-durable goods, & services) increased 4.2% in the 4th quarter, ‘04, and the real gross domestic product increased by 4.4% in 2004 (compared with 3.0% in 2003). Source - www.economicindicators.gov

On a regional basis, the 3rd District of the Federal Reserve, which encompasses southern NJ, eastern PA, and Delaware, gathers economic information as well. Their Business Outlook Survey (*) shows that their diffusion index of current manufacturing sector activity increased from 13.2 in January, ‘05 to 23.9 in February, ‘05. This index has remained positive for 21 consecutive months. Their employment index (*) decreased from 17.0 in January, ‘05 to 12.3 in February, ‘05 - its lowest reading in 15 months. (*) Survey description & definitions can be found at www.phil.frb.org.

Of course, there are many, many more economic

indicators describing the national and regional economies. Some indicators may suggest the economy is growing and thus the likelihood of inflation increasing, and some may suggest the opposite.

Thus, the reason mortgage rates are rising right now is the widespread opinion that inflation will be getting worse.

INTERESTING TID-BITS

- As of mid-2004, debit card use accounted for ~ 33% of in-store transactions, versus ~ 20% in 2000.
- Home ownership rates have increased from 64% of all households in 1990 to 68% in 2003, to 69.2% in the 4th quarter, 2004.
- Home prices have risen by 4.3% per year, nationally on average, from 1993 to 2003.
- The average family’s debt (non-mortgage) reached \$79,000 in 2003, up over 46% after adjustment for inflation since 1990.

REMODELING PROJECTS: COST VS. RESALE VALUE

Each year I provide cash-out refinance loans and home equity lines (2nd mortgages) to customers paying for major home improvement projects. It’s always enjoyable to hear their plans and aspirations. As a homeowner myself, and one who has spent countless thousands on a multitude of interior and exterior projects, I too share the customer’s enthusiasm and joy. But ... here’s a bit of cautionary advice.

If your motivation is for long-term enjoyment of the property, go for it if you can afford it. If your motivation is to increase the value of your property for short-term resale, you might investigate the cost vs. value of the project.

Each year *Remodeling Magazine* publishes an annual report based upon regional survey results from remodeling contractors’ and realtors’ estimates. Cost figures include a 40% margin, and are adjusted to account for city-to-city pricing variations.

| <u>Nat’l estimates</u> | <u>2004 cost</u> | <u>2004 resale %</u> |
|---------------------------------------|------------------|----------------------|
| Minor bathroom remodel (mid-range) | \$ 9,861 | 90% |
| Deck | \$ 6,917 | 87% |
| Window replacement | \$15,383 | 84% |
| Family room addition | \$52,562 | 81% |
| Major kitchen remodel (mid-range) | \$42,660 | 79% |
| Basement remodel | \$47,888 | 76% |

Project definitions and survey methods can be found at www.remodeling.hw.net.

By keeping newspaper clippings over the years, I can tell you that while the cost of the various projects has slightly but gradually increased, the % resale value estimates have varied widely. For example, in the 1996 survey, the minor bathroom remodel project recouped 66% of the costs, for the deck, 80%, and for the window replacement, 70%.

SPRINGTIME GARDENING

As many of you know, my wife & I are passionate gardeners. Some of you have toured our property and know how we've been slowly, but surely transforming our landscape.

Spring is the time to clean out the flower beds - the leaves have performed their warming duty through the winter, but now is the time to rake them out. While the ground is still bare, now is the time to visualize your game plan - what to plant, where to plant it. It's an immense task, but there's no time like the present. Is the area shady, part-shade, or sunny? What are the colors which would complement the area? Does the area warrant adding height, or is the area along a walkway/in the foreground, thus requiring smaller plants? Are deer a problem in your yard? If so, be sure to note if your plantings are deer resistant.

Example: we love tulips. We discovered the deer do as well. So, after a disastrous year, we had to dig up ALL of the bulbs we planted and move them into a protected, fenced area of our garden - so much for the original game plan!

Another springtime chore - mulching. Once you've cleaned up your beds, laid out your plan, and positioned your plants, don't forget to add mulch. Ahh, but what type and what color? If you require lots of mulch (I order 7-8 cubic yards per year), where will you have it dumped? Consider some out-of-the way location, so you can dispense it at your convenience.

And what about all of those potted plants you kept indoors throughout the winter? When nighttime temperatures stay reliably above 55 degrees, you can move your plants outside. First, move them outside with a 2 hour exposure in full shade, then gradually increase by 2 hours a day until they are out permanently.

You should change their soil, line the flowerpots & planters to keep the soil from falling out (used dryer sheets are cheap & effective), add material to help with drainage (Danielle uses broken terracotta shards), and add a layer of discarded cuttings or dry leaves - this also helps minimize soil runoff and provides excellent nutrition for the plant as the material decomposes. Finally, add your soil mix and the plant - you're good until fall!

FAIR AND ACCURATE CREDIT TRANSACTIONS ACT

The Fair & Accurate Credit Transaction Act (FACT

Act) was enacted in December 2003 and amends the Fair Credit Reporting Act (FCRA). The Act went into effect December 1, 2004 and is intended to 1) provide additional protection to consumers with respect to identity theft and credit history restoration, 2) improve the use of and consumer access to credit information, 3) enhance the accuracy of consumer report information, and 4) limit the use and sharing of medical information in the financial system.

The FACT Act requires certain mortgage lenders who use credit scores to make or arrange loans secured by a 1-4 unit residential property to provide the "Notice to Home Loan Applicant." This notice must contain the following information for the consumer:

- ***Credit score reported by consumer reporting agency and used by the lender***
- ***Range of possible credit scores for the consumer reporting agency whose score was used***
- ***The four key factors that adversely affected the score, as reported by the consumer reporting agency who provided the score***
- ***If the consumer reporting agency has indicated the "Number of Inquiries" was an adverse factor, this must be disclosed as well, even if it wasn't one of the four "key factors"***
- ***The date the score was provided (e.g. the date of the credit bureau report containing the score)***
- ***The name, address, and telephone number of the consumer reporting agency that provided the score***

The credit score is a computer-generated summary calculated at the time of the request and based on information that a consumer reporting agency or lender has on file. The scores are based on data about your credit history and payment patterns. Credit scores are important because they are used to assist the lender in determining whether you will obtain a loan. They may also be used to determine what interest rate you may be offered on the mortgage. Credit scores can change over time, depending on your conduct, how your credit history and payments patterns change, and how credit scoring technologies change. For further information about credit scores as they relate to the lending process, review the information I have provided at www.pmc-pa.com/credit.html.

The Act also contains provisions requiring the consumer-reporting agencies to provide consumers with a **free copy of their credit report on an annual basis** upon the request of the consumer, regardless of whether they have applied for credit. The implementation date is September 1, 2005 for residents of the East Coast.

Certain customers can also now request that Active Duty and Fraud Alerts be placed on their credit reports. Mortgage lenders are required to take certain steps to verify and document that a request for credit is NOT the result of identity theft when either a "Military or Fraud

Alert” appears on a credit report. The mortgage lender is also under obligation to certify that the mailing address of an applicant for credit is not located in a country or territory appearing of the FATF list of Non-Cooperative Countries or Territories.

GRILLING SEASON - YEAH!

I love to grill. From the time I can physically move the grill back onto the patio in the spring, to the time when I’m shivering, hands over burner in the fall, I’m grilling. So, I tend to collect personal wisdom, articles, & recipes about the subject of grilling. Here’s some great grilling tips I hope you find useful.



- * Trim excess fat from meats to avoid flare-ups
- * Marinades are wonderful to tenderize

& add flavor

- Marinate in the refrigerator in a glass container or resealable plastic bag. Do not reuse marinades. Add fresh marinade if using for basting later.

* Bring meat to a cool room temperature before placing on the grill, as cold meat may burn on the outside before the interior is cooked

* Use tongs to turn meat instead of a meat fork to avoid piercing and losing juices. Also, salting meats after cooking helps retain juices.

* Brush on thick or sweet sauces during the last 10-15 minutes of cooking, basting and turning every few minutes to prevent burning.

Cooking fish on the grill has always been difficult for me, until Danielle bought me a grilling board last year. I was a little skeptical, but it worked better than I expected. It’s specially treated wood that you lay on top of the grill, after you soak it in water for a couple of hours. I like the hickory imbedded board for extra flavor & aroma. Then you lay the fish on top of the board & cook. The fish turned out great, with lots of flavor.

SELECTING THE RIGHT CONTRACTOR

After working with several landscapers, arborists, painters, carpenters, masons, cabinet makers, window replacement companies, power wash companies, etc., I can tell you that finding and selecting good contractors is not an easy chore. I, unfortunately, even had to sue a landscaper who walked off the job with my full payment! So, from the school of hard knocks, here are some tips to help with your selection.

1) **Ask those you trust.** A satisfied customer is the best

form of advertising. Collect vendors’ names from family, friends, neighbors, and co-workers. I like to collect 5 to 10 names, because the list will get whittled down between the lack of response to your phone message, to the no-show appointments, to the lack of follow-up and a written estimate. If I start with 10, I may have 3 good, potential contractors.

2) **Ask for references.** A good, confident contractor should not hesitate in providing references. I like to request specific references, i.e. jobs similar in nature to my project that were completed within 1 year. Call the reference and inquire if you can see the work.

3) **Ask for an estimate in writing.** This may sound burdensome, but it can protect you in the long run. It should be a formal, detailed estimate on the contractor’s letterhead. The letterhead should contain the tradesperson’s full name, business name, address, phone number and professional license number. The more detailed, the better.

Example. I had a tree removal company cut down several trees on my property. The estimate said something like, “cut down 5 trees.” It should have stated, “cut down 5 trees, in 20” sections, moving all wood chunks to the wood pile in the back right-side of the property.” This little mistake cost me plenty of work, after the fact.

Talk through each point and aspect of the job, making sure you’re covered on as much as you & the contractor can foresee. Each aspect of the job should be itemized, both in terms of the exact work that will be performed and the cost. I also like to note the rough time frame when the work will begin. And, once the project is started, a more exact time frame when it will be completed. I’ve been strung along on many a project, waiting and waiting, and being inconvenienced all the while.

4) **Ask for licenses & proof of insurance.** Ask the contractor to see copies of any licenses, if required. Ask for a copy of their workman’s compensation, health, & liability insurance and call the insurance agent - are the coverages, as printed, correct? What do the coverages mean? Is the policy paid up to date? How long has the company been in business? Have they ever defaulted on their payments, or had lapses in coverage?

5) **Make a contract.** Once you’ve selected the contractor, negotiated your best deal, and altered the initial estimate to the level of detail that you want, you & the contractor should sign and date the estimate - now it’s a contract. Make sure there are no blank spaces. Detail the payment arrangements, making sure the final payment is when the work is complete and to your satisfaction. Make sure any guarantees and/or follow-up services are specified. The type and quality of the materials should also be specified.

GOOD LUCK !!

DEBUNKING THE BI-WEEKLY MORTGAGE PAYMENT PLAN

Many of my customers have called me over the years asking my opinion about a solicitation for some sort of great loan.

Equity some other slogan, is the an old concept: mortgage.



“Accelerated Builder,” or super marketing name given to a bi-weekly

By paying a ½ month payment, every other week, you are reducing, say, a 30-year term loan down to about 22 years. You are making 26, half-monthly payments a year, or, said another way, 1 full extra payment per year. As with any prepayment method, you are saving interest by the reduction of the loan term - the lessor the term of the loan, the fewer the payments, the fewer the payments, the less interest paid. Nothing complicated, right?

From the solicitations, it wouldn't seem so however, thus involving extra monthly charges, set-up fees, and the like for providing the bi-weekly service. I, as a mortgage broker, often receive extra compensation for persuading you to establish such an account. If established initially, the interest rate tends to be 1/8 - 1/4 higher than a standard 30-year fixed rate loan. And, once established, there's no going back.

Also, the lender automatically deducts the ½ monthly payment directly from your bank account on a predetermined bi-weekly schedule. Thus, you lose the “float” - the 15 day grace period from the time the payment is due to the time you are assessed a late charge. And, if by chance, you don't have enough funds in your account when the payment is withdrawn, you will be hit with two bounced check charges - one from the lender, and one from your bank. You'll also be hit with a late charge from the lender for each and every payment until the mistake is discovered because future payments will be credited to the previous obligation date.

My opinion is this - yes, the interest saving benefit of the bi-weekly is true, but why pay extra when you can accomplish the same thing, voluntarily? Simply add 1/12th of your monthly principal & interest payment to your required monthly payment. If you like auto-withdrawal, fine, change the payment amount as noted, and have the lender deduct it on the ~ 10th (keep a couple of days buffer from the end of the grace period for safety).

The success of any prepayment plan is predicated on the amount and frequency of the extra payment. My motto is, add what you “feel” comfortable with, and do it routinely. You don't need a fancy plan. Just do it

yourself.

As always, if an unusual mortgage option is intriguing you, please feel free to call me for an analysis.

WORD PLAY

Intoxication: Euphoria at getting a tax refund, which lasts until you realize it was your money to start with.

Cashtration (n.): The act of buying a house, which renders the subject financially impotent for an indefinite period.

RECIPE

RED PEPPER-DILL SWISS FONDUE

~ 6 oz. Swiss cheese, shredded
~ 6 oz. Gruyere cheese, shredded
~ 1 oz. Parmesan cheese, grated
2.5 tbsps cornstarch
1 cup red pepper, diced
2 tbsps butter
1 cup vegetable or chicken broth
1 cup milk
1/4 cup lemon juice
2 tbsps fresh dill, chopped
1/8 tsp. Nutmeg, ground
Salt & ground white pepper to taste

In medium-size bowl, toss the cheese with the cornstarch. In large-size saucepan, cook the red pepper w/butter over medium heat, 2-3 minutes. Add the broth and milk, heat until barely simmering. Stir in lemon juice. Add the cheese, a handful at a time, stirring until the cheese is melted before adding more. When all the cheese has been added, stir in the dill, nutmeg, salt and pepper.

Transfer fondue to an enamel or ceramic fondue pot and keep warm over a fondue burner. Serve immediately. Recommend a good French bread for dipping. ENJOY!

MORE INTERESTING TID-BITS

- ☺ National average purchase price for a single family home was \$264,540 in 10/04
- ☺ 1.2 million new single family homes were sold in 2004, up 9% from 2003, and the 4th consecutive annual record

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