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U C C E S S

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Debt's Role in Your Financial Plan

As nice as it may seem, achieving debt-free status isn't always the best way to reach your financial goals. Take a look, for example, at mortgage debt. Most people can't afford to pay cash for a home, so they borrow some portion of the purchase price.

On the other hand, you don't have to look any further than the recent history of the real estate market to see how too much mortgage debt can cause significant financial problems.

What Is Smart Debt?

Smart debt is the kind that generates more advantages than disadvantages. Here's how to recognize it:

✓ **You already have the free cash flow or liquid assets to cover the required monthly payments.** This means that you aren't counting on additional income from

the asset you acquire to make the payments. While some people might find this advice too conservative, it's important to remember that the income an asset is supposed to generate can be speculative. If it's rental income, you may not find tenants or you might lose the ones already in place. If it's short-term proceeds from flipping a property, the market may not support the higher price you're hoping for. And if it's a new business, the customers might not be there in the numbers you need.

✓ **The payments don't prevent you from addressing important financial objectives.** Debt that reduces the amount you can save for a child's education or your retirement may not be smart debt.

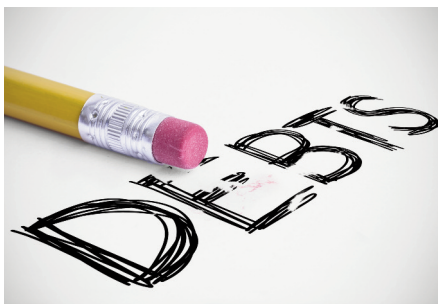
✓ **It's to cover the big-ticket items you need to earn a living.** For most people, this means a reliable car. For the self-employed, it can also mean capital equipment or an addition to your house for your business.

Continued on page 2

Dealing with a Spouse's Credit Issues

Combining your finances with your spouse's may also include combining your credit histories. When you apply jointly for credit, both your credit histories will be evaluated. Some tips to consider when one spouse has a poor credit history include:

- ✓ **Don't apply for joint credit.** If your spouse's credit history is very bad, it may pay to leave him/her off the credit application.
- ✓ **Ask a parent or relative to cosign a major loan, such as a mortgage.** Before asking, keep in mind that you are asking that person to take responsibility for the entire loan.
- ✓ **Instead of applying for joint credit cards, list your spouse as an authorized user of your cards.** While an authorized user can charge on your credit card, you are responsible for paying the bills. If the account is paid promptly, it will be reported on both credit histories. If you make delinquent payments, only your credit history suffers.
- ✓ **Use other strategies to improve your spouse's credit history.** Ensure that your spouse makes all payments on a timely basis. Try to pay down as many of his/her credit balances as possible. ○○○



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Debt's Role

Continued from page 1

✓ **It's tax deductible.** This generally applies only to mortgage interest, but there are limitations. The IRS doesn't let you take a deduction for mortgage debt beyond \$1 million on a first or second home, and that's reduced to \$500,000 if you're married but filing separately. It also disallows taking a deduction for interest on home-equity loans totaling more than \$100,000.

✓ **It preserves or improves the value of your home.** Financing major repairs, remodeling, or making your home more efficient with debt can be a smart move, as long as it doesn't violate the principles suggested above.

✓ **It doesn't push your debt-to-income ratios too high.** Financial experts and banks recommend keeping your total monthly debt payments (including rent or mortgage) at or below 40% of your monthly take-home income, and payments that don't keep a roof over your head to a maximum of 20%. Go beyond these limits, and you may find it hard to be approved for a loan when you need it.

✓ **It doesn't reduce your credit rating.** This comes into play chiefly as a result of credit card borrowing. Your credit rating suffers when your credit card balances come close to your limit. Consumer credit experts say you should aim to keep your balances at less than 35% of your credit limit to keep your FICO scores from being reduced.

Strategies to Reduce Debt

If your debt is out of hand, here are some steps you can take to make it more manageable:

✓ **Refinance your mortgage.** If you haven't missed any payments and have equity in your home (it's worth at least what you owe), you may be able to reduce your mortgage payments by refi-

Draw Down Retirement Funds Carefully

One of the toughest decisions you'll make when retiring is deciding how much to withdraw annually from your retirement investments. Take out too much, and you could spend your later retirement years relying on the help of relatives or enduring a much lower standard of living.

Your withdrawal amount can be calculated based on your life expectancy, expected long-term rate of return, expected inflation rate, and how much principal you want remaining at the end of your life. Yet, your life expectancy, rate of return, and inflation rate are difficult to predict over such a long time. To help ensure you don't run out of retirement assets, consider these strategies:

✓ **Use conservative estimates in your draw-down calculations.** Add a few years to your life expectancy, reduce your expected return a little, and increase your inflation expectations. That will

result in a lower withdrawal amount, but it will also help ensure that your funds don't run out. Take a careful look at any answer that indicates you can take out much more than 3% to 5% of your balance each year. That doesn't mean you can't take out more, but you should be confident of your assumptions before doing so.

✓ **Review your calculations every couple of years.** If you find you're depleting your assets too rapidly, you may be able to go back to work on at least a part-time basis. If you find that out late in life, working may not be an option.

✓ **Place three to five years of living expenses in short-term investments.** That way, if there is a severe market downturn, you won't have to touch your stock investments for at least three to five years, giving them time to recover. ○○○

nancing. Even if you have to finance closing costs, mortgage rates might be so much lower than your current rate that you still come out ahead. You might even be able to cash out some untapped equity in your home and pay off some unsecured debt — replacing high-interest, nondeductible debt with low-interest, tax-deductible debt.

✓ **Reduce your spending on non-essential items.** Cut out as much of your monthly budget as possible, like restaurant meals, entertainment, subscriptions, premium TV packages, and expensive mobile phone data plans. Trade a luxury car you're still making payments on for a less-expensive one.

✓ **Keep a record of every penny you spend.** Incidentals you pay for with cash can add up without you being aware of just how much you're spending. Keeping a diary could help you find more

ways to reduce unnecessary spending.

✓ **Cut up your credit cards.** This makes it nearly impossible to take on any more credit card debt.

✓ **Pay down high-interest debt first.** Keep making the minimum payments on all your debts, but find a way to make the biggest payment possible on your highest-interest card or loan first.

✓ **Negotiate with your lenders.** Call them to request a reduction in your interest rate, a waiver of late fees, or an affordable payment plan.

If your plan hasn't been updated lately to reflect current debt balances or you're not sure whether you're making the best use of borrowed funds to reach your goals, it's time for a thorough review. Please call if you'd like to discuss debt in more detail. ○○○

How Much Is Too Much to Pay for Your House?

While it's often said that you can't put a price on happiness, one thing is certain: you definitely *can* pay too much for the house of your dreams. The question is, how do you recognize when you're crossing the line? There's no easy answer, but here are some guidelines to help you avoid buyer's remorse on the purchase of your next home.

1. Is the house the most expensive on the block? It may be a cliché, but there's wisdom in the advice to buy the cheapest house on any block. The idea is that a good part of the value of a home is its location. That means how physically attractive the area is, how good the schools are, how close it is to good means of transportation, what the crime rate is, and all other factors that make a neighborhood desirable. By paying less for the structure than you might for another in the same location, you're getting a good bargain for the whole package. Go for the most expensive, and you're paying top dollar for location benefits.

2. Pay attention to comparables. This is where a good real estate agent who knows the area you're looking at can really help. Comparables are homes that have been purchased recently and are similar to one another in key ways, like the number of bedrooms and

bathrooms, construction, acreage, and amenities. Comparables will give you a fairly good idea of whether the home you're interested in is appropriately priced.

3. Assess the trends. It's helpful if you can assess the trends in the local real estate market in context with the wider market and the economy. Unless you're a real estate professional or economist, though, this can be difficult to do. Still, there are a number of questions you may ask yourself to guide your evaluation:

✓ Is the community just being discovered by young, upwardly mobile families? If so, the chances may be good that the value of the home you're considering will increase for some time after you buy it.

✓ Are new roads being built in the area or existing highways being expanded?

✓ How's the economy at the local, regional, and national levels? Is it picking up or declining?

✓ Is it a real estate buyers' market — in which more people are desperate to sell than to buy and prices are falling — or the reverse, a sellers' market, where prices are rising?

The most difficult assessment to make is the point at which real estate prices have risen so fast for so long that there's a greater chance of prices falling than continuing to increase. If you can get your hands on a chart of historic prices, you might find a clue.

4. What can you afford? All of the previous considerations have to do with the value of the home. This one has to do with what makes sense for you to pay given your financial situation. Mortgage underwriters have their ratios to determine whether they'll approve you for the mortgage you want, but you need to ask yourself whether you

should bump up against those ratios to get the biggest mortgage they say you can afford.

For example, one ratio bankers look at is your prospective monthly housing payments (including principal, interest, taxes, and insurance) compared to your household gross monthly income. Depending on the lender, the maximum allowed is 28% to 30%. Another ratio looks at your monthly minimum debt payments (including credit cards, car and education loans, and mortgage) to your income. Here, the acceptable range is generally 35% to 41%.

To avoid an uncomfortable budget squeeze once you start making mortgage payments, carefully consider — even before you go house hunting — how the mortgage will affect your budget. Don't forget to make allowances for unforeseen but common expenses like home and car repairs and medical bills.

5. What do you really need? Finally, it pays to put your future mortgage payment in perspective with your other financial objectives. If you buy the most expensive home you can afford, will that keep you from working toward other goals, like saving for your children's educations or retirement? Are you dipping too deeply into your savings to make a big down payment to minimize the size of your mortgage?

It can be risky to rely on your home as a wealth builder. Equity you might be counting on to tap in the future through a home-equity line of credit or second mortgage may not be there when you want it. Settling for a home that is not your dream home but is financially comfortable might be the smarter choice.

Please call if you'd like to discuss this in more detail. ○○○



News Year's Resolutions — From Your Financial Advisors

We would like to help you get off to a good start in 2017 by suggesting some New Year's resolutions. Please pardon our focus on financial issues...we are Financial Advisors, after all.

We are going to give you nine suggestions. Nine because we are located at 99 Wood Avenue, because we want to help get you to cloud 9 (named after the cloud number that represents a state of euphoria), and because "giving it the whole 9 yards" means giving it your all.

1 Get yourself prepared for your accountant. The earlier you get your tax papers together, the less you may have to worry about it, and the more your accountant will like it. Your accountant will want all of your documents showing wage income (like W-2s) and all of your documents showing income from investments (1099s and K-1s). Having deductions documented can save headaches for you and your accountant, and may very well save you money. Gather charitable donation receipts, mortgage interest statement (Form 1098), and substantiation of any other expenses that may be deductible. For a more exhaustive list, please e-mail us, and we will send it to you.

2 Become less emotional about the news — read your news instead of getting it through a broadcast. Broadcast news is harder to absorb without emotion.

3 Prepare a file for your death. No one likes to think about their own demise, but if you can create a folder for your loved ones that includes a will and a list of all of your assets, you will truly be showing your love. Your list of assets, liabilities, and insurance policies should include account numbers, the names of the institutions, contact names, phone numbers, and website addresses.

4 If you want to learn more about finances, we recommend the following books, from most readable to most intense.

✓ *Don't Miss Out – The Ambitious Student's Guide to Financial Aid* (36th Edition), by Anna & Robert Leider

- ✓ *Money*, by Eric Loneragan
- ✓ *Loaded*, by Sarah Newcomb, PhD
- ✓ *Investing for a Lifetime – Managing Wealth for the "New Normal,"* by Richard Marston
- ✓ *The Myth of the Rational Market*, by Justin Fox
- ✓ *Thinking Fast and Slow*, by Daniel Kahneman

5 Interest rates have increased, but mortgage rates remain low by historical standards. Bankrate.com reflects a 4.09% rate on 30-year fixed mortgages as of December 13, 2016, based on their survey of large lenders. Consider refinancing, given that rates may go higher. You can also consider refinancing if you have a variable rate and want to reduce stress by locking in a rate.

6 For those having a hard time saving for retirement, or for retirees having trouble living within a retirement budget, work on monthly budgeting. To get started, you might consider using software or online tools, mobile apps, Excel or a similar program, or even pencil and paper. Start by creating broad categories. Prioritize your expenses. For example, your heating bill may get a higher priority than your entertainment expenses. You can build out from there.

7 Learn everything you can about college funding before your child begins to apply. Learn about the sources of financial aid from schools, the Federal government, and your state. Local and community scholarships can be especially fruitful and more likely, as there are generally fewer applicants. Savings and investment options and potential tax benefits should also be considered. Studentaid.ed.gov provides information on Federal Student Aid and the FAFSA process. Savingforcollege.com provides information on savings programs (mainly 529 plans) and has an informative section on the basics of Financial Aid.

8 Research the charities to which you might donate. Like most businesses, some charities are run more efficiently than others. There are web-based resources that can provide you with

information about charities. Charity Watch (www.charitywatch.org) provides research articles on specific charities. With a membership contribution of \$50 or more, Charity Watch grants access to in-depth information including financials, analyses, and ratings on charities. Charity Navigator (www.charitynavigator.org) is itself a charitable organization. While donations are requested, they are not required in order to access information on charities.

9 Refer a friend to Burke Financial. We are growing and accepting new clients. If unsure whether the friend is a good fit, go ahead and refer them. They may become future clients, or they may merely learn a thing or two about financial planning or investing. As you may remember, we begin educating prospective clients during our first meeting. Even those who do not become clients will certainly have learned something useful and actionable.

If you need more resources on any of these topics, please e-mail or contact us. We have more resources we can pass along.

Have a Happy New Year and a financially successful year.

From your financial advisors at Burke Financial.

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