# A Warning For All Homeowners

**Scott A. T.:** Broadcasting from One Dallas Tower. Welcome to the Financial Rock Star Show. I'm your host, Scott Alan Turner. Ready to help you get out of debt, save more money and retire early. In the studio with me is producer Katie who is becoming a bourbon aficionado. There's a $5 word. Bourbon expert. On the show today I'll be answering your questions about money, business and life. If you have a question you'd like answered on the show visit goaskScott.com and today we are back to our regularly scheduled programming. Not a big rant like last time. Actually it was a response to a rant. Let's get into it though.

Red Alert. All hands to battlestations. This is a warning for you if you own a home or if you know someone that does. That's all of you. Recently here we had a couple big hail storms roll through. Golf ball sized hail. The roof looked okay from the street to me, but lately we've been having all the contractors running around the neighborhood going door-to-door banging on them saying, "Hey, let me go check out your roof. See if you've got any hail damage." One of these guys came to my house, I answered the door, which I don't normally do, but I did. It was one of those 1 out of 20 times that I actually do. Said, "Hey I'll get up on the roof. Do a free inspection for you." I knew immediately he was going to find hail damage. Even before he got on the roof so I knew it was going to happen, but I said, "Yeah, fine. Go ahead. You want to go up on the roof, look around, sure." Of course he gets up, looks around, takes some pictures, come back down, shows me the pictures. Here's the hail damage. You should have your roof replaced. Of course I should and you should get the contract so you can make a bunch of money right? Oh yeah. Oh yeah.

I don't know who this guy is. I call my insurance company and say, "Hey, what should I do? We had some significant hail storms. I don't know if I've got hail damage or not. I want someone who's going to come out here and give me an honest opinion one way or the other." I had to file a claim with the home insurance company. The claim adjuster comes out the next day with their preferred roofer company. One of the preferred roofer companies. Then they both go up on the roof, look around. Same deal. They come around, take some pictures, and says, "Yes you actually have hail damage. You should have your roof replaced." That I was a little more comfortable with because my claims adjuster was there up on the roof at the same time. Even though I was not looking forward to getting the roof replaced. There are two warnings here. One is when something happens in the neighborhood, a storm or something, there are people going to be coming around knocking on doors, offering you services. You need to call your insurance company and get one of their preferred people first. Then get the claims adjuster out there. Don't just believe what somebody says when they show up.

Here is a different story. The people that are usually targeted by this particular scam are older people and aging parents. It has to do with a roaming group of people, this is a worldwide problem too. It's not limited to the US. Known as gypsies. May or may not have heard about them before. In dealing with groups of people, I'm not implying that all people of the gypsy culture are involved in crime, but generally gypsies they are a crime family population. It's estimated that each year they cause $15 billion, with a B, billion dollars in various times of fraud and con-artistry annually. $15 billion dollars a year. What they do is they travel place to place and they have these home repair cons. They will show up on your doorstep and say, "Hey, I noticed you've got some roof damage up there. Would you like me to go up there and fix it?" Of course they'll go up there and it sounds like they're banging on stuff with hammers. Then they'll say, "Couple hundred bucks cash for whatever we did on the roof." Which is nothing.

Or they have this driveway coating and sealing scam. Where your driveway might have some cracks and they go out there with a can of spray paint or something. Some oil-based compound and put it on there. $50-100. We're going to seal driveway. Looks great. Until it rains. Then it just washes away. House painting scam is another one. Roofing I talked about. They'll show up in a pickup truck. They might say, "We were working at your friend's down the street and we did some work for him. We've got some leftover materials. Would you like your house repaired?" This is how the scam goes. They get the kids involved too. Knock on the door, "Hey my son needs to use your bathroom. Can he come in?" You let him in the house, use the bathroom, couple days later realize your watch is missing. Your jewelry's missing. Don't let people in your house. How do you protect yourself from this?

Number one, don't answer the door if a stranger's outside. I ignore most of the knocks on my door. 90% of the time. I don't even look to see who's there because I don't really care. I don't want to be bothered. Number two, never let anyone inside your home. Someone needs a drink? Bring them a glass of water. Bathroom? No. You're not running a public restroom. You have hail damage? You're worried about your roof? You call your insurance company. Forget what the guy at the door's telling you. If you're in a car accident. Another one. Never agree to settle on the spot for cash. You don't know if you're being scammed. You don't. There are scammers out there that'll target people who have nice looking cars. They may bump into you in the parking lot or something or try to back out. Been known to cause issues on the road in moving vehicles. They try to get a cash settlement out of you. Don't do it.

Jeff in Tokyo, Japan has a rental home and wonders if he should pay down the mortgage or invest.

**Jeff:** My wife and I are currently 36 years old, we have a $240,000 mortgage on a condo and rent it out so the monthly payments are covered. It is a 25 year term mortgage. Our company covers the rental costs of the house that we live in right now. We currently invest $4,000 a month in index funds as we prepare for retirement down the road. I'm wondering if we should reduce the amount that we invest and put more towards the principle of the mortgage, or just keep things as they are?

**Scott A. T.:** Katie is heading to Tokyo soon with some friends because our friend Nick loves sushi and he has his heart set on the world's greatest sushi restaurant which has something like a six month waiting list. You know who doesn't like sushi? Me. That's why I'm not going to Japan. I won't be able to meet up with you Jeff. Eating plenty of sushi, I'm not a fan of any food that you eat and 30 minutes later you're hungry again. I would rather stuff myself with cookies.

You've got a free place to live now because your company picks up the tab while you're living in Tokyo, which is a sweet deal. $4,000 a month in investments. That is huge. Congrats on that number. That is $48,000 a year in investments. Let's just call it $50, so you could have the condo paid off in five years if you just cut off the investments. What happens if you do nothing for five years but pay down the house? Then start investing the exact same amount afterwards? I'm going to use my handy investing calculator on scottalanturner.com. Let's run the numbers. $4,000 a month. We'll be conservative; 9%, because you're age 34. You invest that for 15 years you're going to end up with about $1.5 million dollars if you invest smartly. What if the renters pay the mortgage? Well, if you do $4,000 a month starting now for 20 years, meaning you're not going to pay it down, that comes out to $2.6 million. Or $1.1 million more by investing instead of paying off the house. That is the power of compound interest. That extra five years of investing where you're putting money each month away and it compounding is an extra $1 million if you let off your renters ... Let the renters pay off your mortgage.

You also got to keep in mind the house in five years. You have that as a $250,000 asset plus the increase in the home's value, but real estate doesn't appreciate at 9% a year or anywhere near that. It's closer to 3-5% depending on what yardstick you use to measure. The location, economic climate, all kinds of other factors. Some years it might be 8% for awhile. Other years it might go down 15%. Mathematically it shows you're better off investing assuming you select the right investments. Index funds, which you're in, they're the right option. 100% Apple stock, that would be a terrible, terrible decision. As would high commission mutual funds; but what math does not take into consideration is your risk tolerance or how you feel about debt or the unknown. That's what risk is. I don't like debt, so we paid off the house. I like the feeling. It's more important to me than the money, but I also had a lot of investments when I paid off my house. Much more than the value of my home. I was not, as they say, house-rich and cash-poor. Some people they sleep fine with $20,000 in savings, $500,000 in rental property and $1 million and a half in rental mortgages. I don't think I would go that extreme as an example.

You have to ask yourself, what is it you and your wife want? Do you want to be 100% debt free to enjoy the feeling and the freedom? If that's what you want then you get to pay down the rental faster. Do you want to have as much money as you can in retirement? Then you let the renter pay the mortgage for the next 25 years. You take on more risk with that choice, because if you can't find a renter you're stuck paying the mortgage. If things get bad, you've got to sell the place, how quickly can you sell it? You lose your job, what's going to happen? Will you lose money? Can you cover the difference on the place if the market tanks and you need to sell it? There's risk there. If you lose your income and you lose a renter for an extended period of time. I mean that's the worse case scenario you have to prepare for. If the condo is paid for, if you own it outright, the problem of finding a renter quickly - it just goes away. It goes away. Much, much less stress on your life. Which has value for some people.

If I'm in your shoes, probably going to hybrid. I'm going to go hybrid. I'm going to invest heavily because of the power of compound interest and you're young, but I'm also going to pay down extra on the condo to get it paid off sooner. I'm not going to investment zero to pay down the rental house. Maybe you shoot for a 15-year payoff instead of 25. That's the approach I took with my first house. I maxed out my retirement plans and then I threw extra at the mortgage to get it paid down and it felt good for me. Kicker is I want a big emergency fund in case I can't find a renter at some point along the way. Or I get bounced from my job. You lose part of your income. I want 12 months at least siting aside just to cover that mortgage. That's not my normal income. My normal expenditures. That's just the mortgage. That's going to make me feel good. That covers my bases pretty well. Let's me sleep like a baby most nights. Thanks Jeff for the question. Enjoy some sushi.

Several episodes ago, I don't remember the number, a listener asked if peer-to-peer lending was a good investment choice. I thought ... I did a little research on it and I thought, "Yeah, something I'm going to check out in the future." I explained the different ratings for a company called Lending Club, I think it was, where you can pick which type of return you want to get based on the risk level of the borrowers. An article on Think Adviser came out just last week on this topic of peer-to-peer lending and I'll read from the article. It gives a good explanation.

"P-to-p lending is essentially crowdsourcing for debt. Borrowers with credit scores near a 640 and above, considered prime borrowers, are unable to secure a bank loan or who would prefer a loan charging a lower rate can apply for a loan at one of the growing number of online America places like Lending Club or Prosper. Those are the two leading companies. The application accepted; the loan is posted on the website for investors to review. Once enough investors agree to fund the loan, which is divided into pieces, the borrower receives the money and begins to make monthly payments to the marketplace. Which are then divvied up among the lenders who financed the loan. There are usually many lenders per loan, because the minimum investment per loan is usually only $25. The loan rate is fixed and the term usually ranges between 24 and 60 months. Investors finance multiple loans increasing diversification and reducing their credit risk. They receive monthly payments from each borrower that can be reinvested or withdrawn."

The peer-to-peer lending market's about ten years old. In this article what was interesting it says it's dominated by institutional investors. What that means is the big, large companies. The institutional investors, not the individuals like you or I. They come in and swoop in and get all the good loans before you and I would even have a chance to have that opportunity to get in on them. Basically the little guy is getting blocked out. You can still get in and get on loans but the good ones, for the most part, are taken by the big companies. Article says the most popular loans are now funded in five seconds. Unless you've got a pretty quick mouse reflexes and you can get in on a new loan in under five seconds, you get the second tier loans; but an option is available is this other service called Lendingrobot and you can tie it to your Prosper and Lending Club. There was one other account you can tie it to. Set up different things and it'll do the investing for you on your behalf. I haven't checked out Lendingrobot. Don't know a lot about it, but it is an option available if you want to do your research on that.

Lending Club fired their CEO and their stock tanked. Company might be in trouble, but even if it weren't these type of investments, I put them in the fringe investment category. You got to spend your time on them. You've got to become a part-time expert on it and treat it as a second job if you want to get onto these and get on the good deals so that you understand them. Never invest in something that you don't understand. You want to become an expert in it. Most of you boring old index funds and spending your free time at the swimming pool or at the ski resort depending on the time of year, better way to go. Now back to your questions.

Dolores writes,

**Dolores:** Can you cover PMI? Private mortgage insurance. This seems like such a swindle from what I understand. PMI is an insurance for borrowers who owe more than 80% of their home's value. I believe this mortgage is protection for lenders against borrowers who default on their loans so does the PMI company cover the balance of the loan that is defaulted? Know that the borrower is definitely not absolved of responsibility for the balance remaining on the loan. Does the lender get paid twice then? Once from the PMI company and again from the borrower? Why do we have to pay this and what exactly is it for?

**Scott A. T.:** On my first home I put 5% down as the down payment. 80% first mortgage and I believe I had a second mortgage of 15%. Then something called PMI. Private mortgage insurance. Which cost me $130 per month. It doesn't go towards principal. It doesn't go towards interest. There is no benefit to the homeowner financially. It covers the bank in case you default on your mortgage. It doesn't cover you as the borrower. It's basically a junk fee required by the bank if you don't put a big enough down payment on a home. If your down payment is less than 20% you usually have to pay PMI. It protects the lender in case you don't make your house payments. They have to come in and repossess your house or they have to come in and sell it for less than what is owed on the loan. PMI it is an insurance policy. It comes from an insurance company that benefits whoever is lending the money. Again, if the home goes into foreclosure, the lender can't make back the money from the sale of that foreclosure. Insurance company will come in and make up the difference for the lender.

Called private mortgage insurance because it's through private companies, not government agencies like FHA or VA mortgage programs. They have their own little mortgage insurance thing. It's run differently than those programs. Generally, PMI's going to cost .3% up to 1.5% of the original loan amount per year. You can get rid of it when the loan balance drops to 78% of the home's original value. Best illustrated with an example. Take $100,000 house. You put $10,000 down. Your loan balance is 90% of the original value. You've got a $90,000 loan. Once you pay the mortgage from 90% to 80%, pay down $10,000, meaning you have 20% equity in the house. That's just assuming the value of the home doesn't go anywhere. Your loan balance is 805 of the original value. Now according to Bank Rate, lenders must automatically cancel PMI when the outstanding balance of the loan drops to 70% of the home's original value. That can take several years. You can ask for it to be removed when there is an 80% ratio, but you've got to keep track with your payments in order to figure that out. How do you avoid paying PMI?

Number one, you put 20% down on a home. That's an option. Which is a good idea anyway, because you'll have lower mortgage payments. Another option is called piggy-backing mortgages. You have a first mortgage of 80% down and then you might have a second mortgage, 5%, 10%, 15% on the balance depending on how much you put down. I'm at ... Using my own past here. I know I had PMI on my first home, but I think maybe Katie's townhouse was the one that had two mortgages. Maybe not my house. Either way, I had PMI. Some lenders might have that option with the piggy-backing and still require PMI. Another way to get rid of PMI, you don't hear about it as much, is you build up equity in your home due to rising real estate prices and refinance it. Example, $100,000 house. You have a $90,000 loan. You're at the 10% loan ratio. If the house price goes up to $110,000 in a couple years and you pay the mortgage down to just $87,000, meaning you paid $3,000 down on the principle over those two years. Your loan-to-value ratio is 80%. You didn't have to go from 90% to 80% to get that 20%. You only had to go from 90% to 87%. That's a big difference.

To do that you have to have the house appraisal done and pull that off. Then there's closing costs associated with a new mortgage. You get to decide if the closing costs are worth it depending on how long you want to stay in the house. That's a different story. There's some math to do there if you go that way, but it will wipe out the PMI if you can do it. I did that on my first house. It was a financial win. I came out way ahead despite the $4,000 in closing costs or whatever it was. You can also ask your lender if they'll just accept an appraisal only without doing a refinance. Have somebody come in, if you're looking at the values of the homes in your neighborhood and you see that they're going up by everybody based on recent house sales. Make a phone call, check with the lender, see if they'll accept it. You pay somebody a few hundred bucks for an appraisal. They come in. If you're $100,000 house that you moved into is now worth $120,000 the lender may accept that and cancel the PMI because of your greater loan-to-value ratio.

Is PMI a swindle? Well, it's a necessary evil if you want to get into a house with less than 20% down. It's a junk fee, but it's there to cover the banks in these situations and it's there for homeowners if you wanted to get into a house with less money. Some people, they might find, yeah it is worth the wasted expense to get into a house sooner rather than saving for a 20% down payment. Just have a plan in place to get rid of PMI as soon as possible. Thanks Dolores for the question. Quick break then we'll be back. You're listening to Scott Alan Turner.

Hi folks. Scott Alan Turner here. For those of you that are my long-time listeners. You know I'm not one of those guys on the radio who promotes every product that shows up on their desk. You're never going to hear me trying to get you to buy crochet needles because I don't sew. Or recommending a pool cleaning service from someone that's never cleaned my pool. If I had a pool. No. I have a name to uphold to you, my Rock Star listeners. If I were to recommend something to you, I would tell you about milk. It's delicious. It's nutritious. I have milk every day in the form of yogurt that I make myself from milk. If I feel like a bowl of Cheerios, I don't add water or soda. I have milk. Once a week I'll have a bowl of Ben & Jerry's ice cream. Which is made with, you guessed it, cream. Which is a form of milk. Next time you're buying groceries and you're at the checkout counter, when they ring up the milk tell them Scott Alan Turner sent you. If you see a black and white cow out in a field, stop and give it a little pat on the head say, "Thanks for the milk, buddy." No, better not do that. You might get arrested for trespassing.

Andy wants an investment with a 10% return. He asks,

**Andy:** "Are there any safe stocks or mutual funds where I can get 10% plus a year?" Stocks, no. Single stocks have the greatest risk and while you can look at the short-term performance of several stocks, I could probably name a few, but I won't; over the course of year or three years or even five years, you may see that they get over 10% return per year. When they go down, that's when you get into trouble. If you're into single stocks. You want to diversify and have a much broader spreading around of the money so that you reduce your risk when those dips occur. What about mutual funds? Or index funds? The S&P 500 Index Fund, that's one that you see on the nightly news every night, that is the benchmark for the stock market returns on average 10% a year. When you look at the past 80 years it's been measured. Over that period of time, you can get 10%. You can go out to a place like Vanguard and buy their S&P 500 Index Fund which is a fund that mirrors that stock market benchmark and you can get that 10% a year return.

**Scott A. T.:** Now the question is, should you? Should you? What's wrong if you're just in that fund? Successful investing comes from proper asset allocation and good diversification. Let me explain that. While I can go out and buy that one fund which gives me that 10%, if there is a really down year where that fund goes down a lot, or the whole stock market goes down a lot, I lose of money. I lose a lot of money. It takes that much longer to make that money back. That's what happened in 2008, 2009. When the stock market lost half it's value. If I had 100% of my money in that one fund, I got clobbered. If I had a proper asset allocation, meaning I put not all of my money in just a single stock fund, but I put a little bit in bonds, well then I didn't do so bad. I didn't get clobbered as much. In fact, if you look between the period of, I want to say roughly, 2002, 2003 maybe up through 2010 that people who were in stocks and bonds ended up doing better than those people who were just in mutual funds; because as the stock market went down, the people who were in bonds didn't go down as much and bonds actually did pretty good during that period.

Now we're probably getting a little bit deep for some people so I'll leave you with this. If you want to do a little more research. It's called Modern Portfolio Theory. It's been a bunch of research done on this particular topic as to should you go 100% in stocks or should you do some mix of stocks and bonds? If you look at Modern Portfolio Theory, where they've done mathematical equations and a bunch of research on this, those people that are in a portion of stocks and a portion of bonds in their portfolio they do as well, maybe slightly less, than those people that are just in fully stocks over time; but they don't have the wild swings. The massive ups and downs. They don't lose 50% of their portfolio like the people did in '08-'09 who were just in 100% stocks. You get the same great returns with less risk. If you're looking for safety and the 10% a year then you want to make sure you have the proper asset allocation between stocks and bonds and that you're in low-cost index funds that don't eat up your returns over time. That will get you to where you want to go. Now where can you get that? A Vanguard Target Date Retirement Fund is a great place to start. Easy way to get started. They do all of your asset allocation for you. Your diversification, low fees, it's got it all. Thanks Andy for the question.

If you've been to the moon, the one that orbits the earth, how do you describe it to someone? Okay you haven't been there. Neither have I. How about travelling to the edge of space? Probably haven't done that either. Still too expensive. What about climbing Everest? Virtual reality headsets, they're finally coming into the mainstream. They're going to be very common in a few years. The drawback of some of the virtual reality experiences is when you have the headset on, it's covering up your face, you can't see anything. You are isolated. You're alone. You're physically isolated and you cannot describe the experience to someone who's never worn a virtual reality headset. How do you describe flying through the clouds like Superman? You can't. Being debt free is like that. Most people aren't aware you can be out of debt. Car loans are normal, they're part of life, kind of like cell phones. Some people are aware, but they don't have a plan to get there or they don't do enough to make it a priority. The few who achieve it can't generally explain it to someone who's not familiar with it. It's like trying to explain what the earth looks like from the International Space Station. A picture doesn't do it justice. Or if you have seen the Grand Canyon in person compared to a picture. It's much different.

The only way to know is to go there, stand on the rim of the Grand Canyon, one mile up, look at all of the colors and the size of it all and take it in. Then you can get it and experience it. You find, once you're up there, this is a pretty good view. I could look at this forever. Or a long time. You check out all the brochures at the Grand Canyon, plan the trip, set the sails, stay the course, you'll get to the rim of the Grand Canyon. When you see it in person for yourself, you realize what everybody else has been talking about. This is amazing. It's beautiful. Until then, you have to believe the pictures of being debt free and having financial freedom are real. Those are the words. If you're enjoying the show, please take 30 seconds. Text the link and get fr.com to three friends and help spread the word. I would appreciate it. That's it for this episode. I'm your host, Scott Alan Turner. Rock star Katie is my producer. All of the links mentioned in this show are available in the show notes at Scottalanturner.com. If you have a question you would like answered on the show visit goaskscott.com. Thank you for listening.

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