



The “Kiddie Condo” Loan

Hedging college expenses through real-estate investment

By Sarah Tingen

Students, parents of students, and even blood relatives of students, listen up. This investment strategy might save you thousands of dollars over the course of a college career, and pay off the rest of the debt in the years after.

The name “kiddie condo loan” was coined by mortgage lenders and is in reference to the U.S. Federal Housing Administration loans which are often distributed through the FHA 203(b) loan program. Despite the name “kiddie,” there are no age restrictions on this loan nor does the “co-borrower” have to be a student.

The concept is rather straightforward. Two people who are related by blood (in this example a parent and a college student), can act as “co-borrowers” and get a loan together. The two co-borrowers’ names are put on the title of the property and they both get a better credit score by making the timely mortgage payments.

The benefits of this investment include free or reduced housing for the student, tax breaks, potential appreciation and/or cashflow, and an increasing credit score (good for young people who usually have little or no credit exposure, but more on that later in this newsletter).

This type of loan allows for a very low (usually 3% or less) down payment and allows a student (who usually has little or no credit), to use the financial backing of a relative to qualify them for a loan.

The deal gets even sweeter if you rent out any of the bedrooms in the property you bought.

If you rent out any of the bedrooms in the home you can deduct advertising and maintenance costs, utilities, insurance, taxes, the interest on the mortgage payment, points, commissions, tax return preparation fees, travel expenses, rental payments, and local

See KIDDIE on page 2

INSIDE THIS ISSUE

1	The “Kiddie Condo” Loan
1	Lessons Learned or Foretold Disaster?
3	Q&A
3	Tip of the Month
4	An Introduction to Credit
5	Reader Response

Lessons Learned or Foretold Disaster?

The Sub-Prime Meltdown

vs.

The Great Depression

By Chris Grubbs

You don’t have to be a history or financial scholar to know the Great Depression was one of the worst, if not the worst, event in American financial history. The stock market crashed, banks failed, and many people were unemployed. After the Depression, the U.S. Government put measures in place to prevent such a catastrophe from happening again. While there were multiple causes of the Great Depression, one large contributing factor was the Stock Market crash of 1929.

Not only did the market crash of 1929 cause a large amount of people to lose money, it caused a large amount of people to lose *borrowed* money. You see, the stock market was doing so well in the years prior to 1929 people actually borrowed money to invest. Now, borrowing money to invest is called buying on margin,

See ECON on page 3

transportation expenses.

We recommend you see a competent CPA who has real estate tax experience for specific advice on tax returns, but there's a ton of tax shelter savings potential.

The possibilities of deductions are virtually endless, and usually the loss you incur from these deductions is enough to offset the positive rental income that you've received from the other roommates. This translates to untaxed income.

Keep in mind, this property needs to be conveniently located to school, in structurally sound condition, and the student has to be responsible enough to maintain the facilities, or at least hire someone who can. You also want your student to be happy there and have enough pride of ownership to make sure his friends do their share of taking care of the house as well.

As is the case with all potential investments, there is some inherent risk. A lot of naysayers find reasons that this strategy won't work, so let's address 4 common objections.

Objection 1: My student may drop out.

Solution: Have you spent all of your time and efforts planning for your student's education only to have them drop out? If your student is financially responsible and academically motivated (you should know this), then chances are they will stay in college for at least four years. In fact, the average time of completion for students is increasing due to major changes (literally), and graduate program possibilities.

Objection 2: I don't want to be fixing broken down toilets/making repairs in the middle of the night.

Solution: First of all, get a thorough home inspection...always...and get it done by a certified home inspector. The upfront knowledge about the structural integrity of the plumbing, electrical systems, roof, major appliances, and foundation can help you to estimate the future cost and take the necessary preventative action to avoid major expenses. Your real-estate agent can recommend both a competent home-inspector and, hopefully, a local handy-man. Also consider joining a local landlord/property owner network. They usually have online resources (if you aren't local to the property),

and have 24/7 access to hotlines with landlord maintenance and/or legal advice.

Objection 3: What if the roommates don't pay rent on time?

Solution: Evictions can be costly, and need to be implemented in a timely manner in order to get the property ready for rental again. Often times a lawsuit to get the remaining balance of the rental contract is not worth the effort or money. Don't base all of your finance planning on the reliability of tenants. Always have a cash allocation for at least two to three months of vacancy if one of the rooms happens to go unoccupied.

Having multiple rooms rented to multiple individuals can hedge a potential vacancy. Often times, a quick clean and an advertisement on Craigslist.com can find a suitable replacement.

Another solution is to hire a property manager. They charge anywhere from 6-12% of total rent collected and will arrange for maintenance, evictions, and rent collections on your behalf. This becomes increasingly useful if/when your student-turned-graduate lands that dream job in another city.

Objection 4: What if I incur a major expense due to lawsuits, vandalism, or a natural disaster?

Solution: Consider obtaining an umbrella insurance policy. This extra protection bolsters your existing insurance covers and will protect you from many common major financial disasters. This policy can be added to your existing homeowners insurance policy and can cost a few hundred dollars a year (depending on the amount of coverage), but the small investment into your families security and peace of mind is well worth it.

This smart investment will help you save a lot of money in the long run, whether it's through tax benefits, the reduced housing cost, or, most likely, both.

Please see your financial planner for more details. This financial strategy was tailored to buffer out college education expenses and is a great tool for the beginning investor or savvy professional.

Creative Flux

Creative Solutions to Common Problems

Q & A

Q. As the stock market declines, so does my retirement fund. Is there anything I can do to limit my losses until the market turns around?

A. Besides “shorting” various stocks and indexes, (betting that their stock price will go down) investing in gold, silver and oil are good ways to hedge common investment portfolios. Thanks to ETFs, you can buy shares of funds that track these commodity prices almost exactly, with the liquidity of a stock. They all generally increase as the market decreases and vice versa, so a portion of your portfolio allocated to these assets would limit your losses as the general market declines.



Tip of the Month

A sales rep, an administration clerk and their manager are walking to lunch when they find an antique oil lamp. They rub it and a Genie pops out. The Genie says, “I’ll give each of you just one wish”.

“Me first! Me first!” says the admin clerk. “I want to be in the Bahamas driving a speedboat, without a care in the world”.
Puff! She’s gone.

“Me next! Me next!” says the sales rep. “I want to be in Hawaii relaxing on the beach with my personal masseuse, an endless supply of Pina Coladas and the love of my life.”
Puff! He’s gone.

“OK, you’re up,” the Genie says to the manager.

The manager says, “I want those two back in the office after lunch”.

Moral of the story:

Always let your boss have the first say.

and even today anyone who is willing to invest an initial \$2000 dollars (or more to open a margin account) can buy stocks on margin. Margin trading is however, heavily regulated by the Federal Reserve. But the point of this article is not to have a lengthy discussion about trading on margin, nor am it about the Great Depression. The point of this article is to provide a comparison between what is happening in the economy today and what happened in 1929.

If we take a look at the causes of the market crash of ’29 and the real estate sub-prime collapse of today, there are some striking similarities. In both cases people were borrowing money assuming their investment would increase in value. In the sub-prime market many banks lent money to people who would not necessarily qualify for a standard loan. These types of loans are known as sub-prime loans, and this practice was fine until 2007.

As interest rates increased those with sub-prime or adjustable rate mortgages found it harder and harder to make monthly payments. Finally, the bubble burst, and quite a large number of home owners found they could no longer make the monthly mortgage payment. Banks were forced to foreclose and lost millions of dollars. Larger banks and lenders like Freddie Mac and Fannie Mae took a hit and barely survived. Other banks like Indy Mac, Countrywide, and Bear Stearns were not so lucky.

Now that the real estate bubble has burst it is time for investors, banks, and the government to take a look at what went wrong. While I am certain most banks that made a large number of sub-prime loans were honest, there were banks that took on less than honorable practices. Sadly it may be years before we see exactly what went wrong.

Over the next few months I will be taking a closer look at several banks to analyze what went wrong, and speculate which ones will be able to dig themselves out of this hole, and which might be the next casualty of the real estate collapse.

See you in the market place,

Chris

An Introduction to Credit

By Michael Hersbkowitz

Until relatively recently, I had no interest in getting a credit card. Sure, I'd "apply" at Quizno's and get a free sandwich every so often, but I was perfectly happy with my debit card. I could purchase anything a credit card could purchase from stores to cyberspace and always knew how much money I had. I had heard too many horror stories about people getting into credit card debt and having it destroy their lives, and I didn't want the temptation to buy things I couldn't afford. It just seemed like a more responsible way of managing my finances.

My, how I've grown.

Granted, there's nothing irresponsible about always knowing how much money is in your account and never having consumer debt. But you'd be missing out on the easiest way to build a credit profile. What many people don't realize is that having no credit is just as bad as having bad credit. Never having any debt might impress your mother, but it won't improve your financial profile one bit. Saying you can handle your finances won't convince a lender to give you a loan; you need to be able to back it up. That's what a credit score is for. This is one of life's great catch-22's: in order to borrow money, you have to have borrowed money. Fortunately there is a relatively easy way to get your foot in the door: credit cards.

All it takes is a card with no outstanding balance. You don't even have to buy anything! If you get a card as a freshman with no minimum spending limit, buy something a couple of times a year and pay the bill the same month, its impact on your credit score at graduation will be extremely positive. Not only will a good credit score save you thousands in interest on a home or car loan, without credit you'd be unlikely to get a loan at all. In addition, it's not uncommon for employers to check credit scores a part of their hiring process. If you haven't demonstrated financial responsibility, including the proactive action of building a credit score, an employer might be hesitant to hire you. Plan on being self-employed? There are a ton of great ways to get loans and even *grants* to start a business, (another article for another issue, perhaps), but again, no credit usually means no

loan.

Remember, while credit can be a useful tool, it must be used responsibly. Once you build credit, you'll get tons of offers for new credit cards from credit companies and the stores you frequently shop at. Banks and other lenders will want to lend you money because you've proven you can pay it back. Only take up offers that benefit you, and never bite off more debt than you can chew. It is possible to have too many credit cards and have it bring *down* your credit score. Nevertheless, borrowing a little money and paying off your bills will pay big dividends for yourself in the future, and it is highly recommended as a great way to a financially successful adulthood.



Reader Response

Rethinking “Rethinking:”

Dear S&M,

Regarding the article Rethinking The Mortgage (June, 2008):

The example with the 20% increase is quite extreme considering the current market (as well as the 50k down payment). I understand you are trying to make a point, but being a newsletter you should reflect examples of a more current nature; say perhaps, a decrease in property values.

The down payment's affect on monthly payments topic was sorely neglected. In this example (at default rates according to <http://www.mortgagecalculator.org/> on 7-11-08) the monthly payment for Brian would be around 390 and Jose's would be 755. I didn't see where the \$365/month advantage (\$13,140 over 3 years) was considered. –Kyle M.

Our response: Thanks for the great comment Kyle, and the difference in monthly payments was an oversight on my part.

Let's run the example again with the 20% appreciation and Brian's reduced housing cost (principal and interest), due to his large down payment.

Jose and Brian are brothers. They buy a \$100,000 house each and have \$50,000 to invest. Brian wants to have as small of a mortgage as possible, so he puts down \$50,000. Jose understands the leverage of mortgages and gets a 97% FHA loan. He puts \$3,000 down. Though Jose would actually get a better interest rate because his loan is bigger, let's assume they both got a 6% interest rate on the loan.

Over the next three years, Jose and Brian both see growth in their area. There are new shopping malls, restaurants, schools and apartment complexes. Their investment has increased by a whopping 20%! Jose and Brian's houses are now worth \$120,000.

Jose has paid a total of \$21,584 in house payments, \$17,668 which is mortgage interest and \$3,916 on principal.

Brian has paid a total of \$10,792 in house payments,

\$8,834 which is mortgage interest and \$1,958 is principal.

If you consider the % return on investment, (ROI), Brian, who put down \$50,000 made a 40% return. Jose who put down \$3,000 and still saw \$20,000 in growth made a 667% return on his money! 40% vs. 667%. Jose used the bank's loaned money as leverage for the appreciative growth of his property. Brian used his own money.

Now let's consider the return on investment including the house payments.

Brian put down a total of 50,000\$ + 10,792\$ total P+I (principal and interest) = 60,792\$

Jose put down 3,000\$ + 21,584\$ total P+I = 24,584\$

Brian made 32.9% ROI and Jose made 81.3%.

While it's not the 667% ROI which we had mentioned earlier, it still shows significantly more profitability when you leverage your funds.

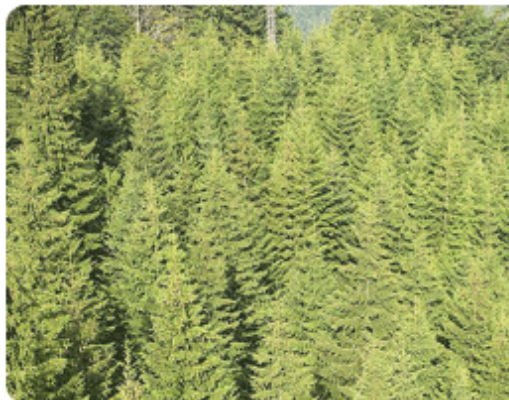
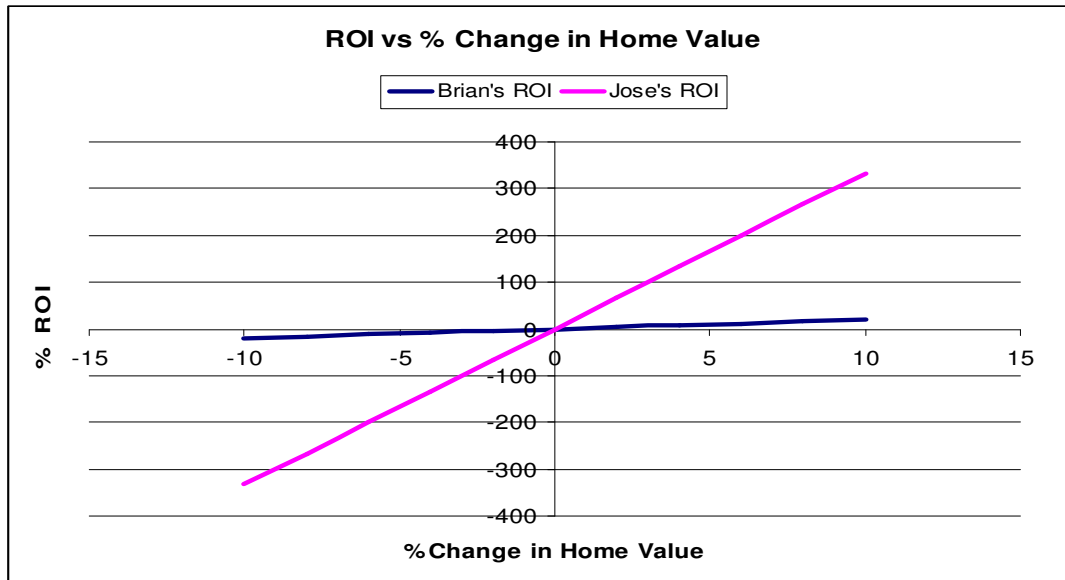
Thanks a lot for your comments, Kyle, and I hope this scenario represented the true facts a bit better than the previous simulation, which did not account for the P+I difference.

To discuss a situation where the houses might have actually lost value let's consider this example.

Brian still put down \$50,000 and Jose still put down \$3,000. Their homes have lost 10% of their original value both are forced to sell at a loss for \$90,000.

Brian still has a \$50,000 mortgage, but his \$50,000 down payment is now only \$40,000 in equity. Jose lost his entire down payment of \$3,000 and still has a \$97,000 mortgage on a house worth \$90,000. Clearly, Jose is in more trouble than Brian.

The following chart depicts the ROIs for the two different down payments. There clearly is more risk for the lesser down payment, along with more potential gain. The general sentiment here is that while some real estate has decreased in value in recent months, the time horizon for a real estate investment is measured in years, and it is assumed (safely, I might add) that as demand for housing increases, real estate valuations trend upwards over time.



The Nature Conservancy
 Billion Trees Campaign

**We Support the Planting of a Billion Trees in the Brazilian Rainforest
by Donating Monthly to This Cause**

www.plantabillion.org

Disclaimer: We're not accountants or lawyers and the advice we give is speculative. We tell you stories from our previous experience and recommend that you do your own research or hire functional team members before investing. We're not responsible for any actions taken or consequences incurred by our subscribers from reading this newsletter. We cannot be held liable for the information contained in this newsletter as it represents fictitious situations and personal experience. That being said, we're out to help people, so we'll keep telling our stories.