SUMMER 2021

FINANCIAL PLANNING NEWSLETTER

WOULD YOU ORDER THE SAME FLAVOR OF ICE CREAM FOR 30 YEARS?

By Tim Harvey

After an exhaustive and exhausting home search this spring, my wife and I moved to the Lafayette area in May with our young son. While there were countless factors to consider in finding the house we wanted—the number of bedrooms and bathrooms, the location of the neighborhood, the quality of the school district, etc.—the type of mortgage to select seemed straightforward. We are two professionals in our early 40s with a long runway of productive working years ahead, and interest rates seemed sure to climb as the economy recovered from the pandemic. As a result, we locked in a 30-year fixed-rate loan through our trusted mortgage team and focused our attention elsewhere, like on assembling our new patio furniture.

The 30-year fixed-rate mortgage is the vanilla ice cream of home loans: it is a great, easily understood structure that allows borrowers to lock in the same monthly payment for the entire loan term. This can work well for those who like simplicity and expect to stay in their homes a long time. Very often, however, it is not the most cost-effective option. The reality is that the average home loan in the U.S. lasts about seven years. Why? Well, life happens. Owners move, they upgrade or downsize as circumstances change, they get different jobs, relocate to be closer to family, or in many cases, switch flavors of loans—refinancing as lower interest rates become available.

In our case, we figured interest rates and inflation would pick up as the effects of the pandemic subsided, so we wanted to lock in our mortgage,

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but only the first part of that equation has played out. Rates are now lower than they had been in the spring.

Aside from the fixed-rate vanilla option, two other types of loans include adjustable-rate mortgages (ARMs) and interest-only mortgages. These may offer a lower interest rate for a period of seven or 10 years with little or no mortgage principal due. Many borrowers find these attractive to reduce their monthly payments and keep more capital invested, which historically can grow at a higher rate. If borrowers sell their home or refinance before the initial seven or 10 years is up, savings can be had. The main drawback is that if the loan stays in place beyond that point, the rates may climb with ARMs or interest-only mortgages.

From the lender's perspective, they want to charge more when they commit to a 30-year contract and cannot raise the interest rate during that time frame. Even if a borrower starts with a 30-year mortgage and wants to pay off their home, refinancing halfway through to a 15-year fixed can lead to savings since the principal outstanding is now lower and the risk for the lender has fallen, particularly if home values have risen over that time. Rather than sticking with the same 30-year fixed mortgage, looking at a 15-year option at that stage could sweeten the deal, like adding toppings to turn your basic cone into a sundae.

To be sure, refinancing requires some paperwork and transaction costs. You can't just trade in a half-eaten scoop of ice cream for free. But considering all these factors, borrowers might receive very different loan offers from various lenders, just like Ben & Jerry's and Baskin-Robbins sell a variety of unique flavors and their versions of vanilla don't taste the same. Lenders determine the rates they charge clients based on several factors, including the perceived risk that the borrower won't be able to make the payments, the amount of principal outstanding, the length of the term, and the prevailing interest rates in the market. They also want to create a balanced portfolio of loans, so it is worthwhile to get taste tests from several shops.

At HC, we are happy to run projections for our clients to help them think through the implications of refinancing scenarios and connect them with potential lenders or mortgage brokers to put these plans in action. With interest rates back down near historic lows as temperatures rise this summer, looking around for a new flavor of mortgage could result in some delicious savings and extra cash in your pockets.

TYPE OF MORTGAGE	ADVANTAGES	DRAWBACKS
30-year fixed rate	▪ Spreads principal repayment out over long period ▪ Provides certainty against rate fluctuation	▪ Rate can be higher than shorter term loans ▪ May end up paying more interest than needed as home equity rises
15-year fixed rate	▪ Provides certainty against rate fluctuation ▪ Lower interest cost than 30-year term generally	▪ Higher payments than 30-year term with principal repaid over half as many years
Adjustable-rate (ARM)—usually 5-, 7-, and 10-year terms	▪ Typically, lower rate and smaller monthly payment than fixed mortgages during the initial period	▪ Susceptible to rate increases after the initial term expires ▪ Payment amounts will vary as rates fluctuate
Interest-only—usually 7- or 10-year terms	▪ Lowest monthly outflow with no principal payments being made ▪ Maximizes amount of capital to be invested elsewhere	▪ Susceptible to rate increases after the initial term expires ▪ Likely to require more equity to be built up than other structures

BOOMING HOME SALES

From Bob Veres, bobveres.com

Arguably the wildest consequence of the recent pandemic is the remarkable price boom in the U.S. housing market—which, some might remember, went spectacularly bust in the 2008-9 Great Recession collapse. Today, half of all houses put on the market are purchased in less than a week, often for more than the asking price. One recent poll found that most buyers admitted to bidding on homes they'd never seen in person. Home prices are at record highs; inventories are at record lows. More than half of homes on the market have been selling above the asking price—which is so far above the previous record that the statistic is simply offered in isolation. The average home price, as measured by the S&P CoreLogic Case-Shiller 20-city index, rose 13.3% in a single month, following a 12% jump the previous month.

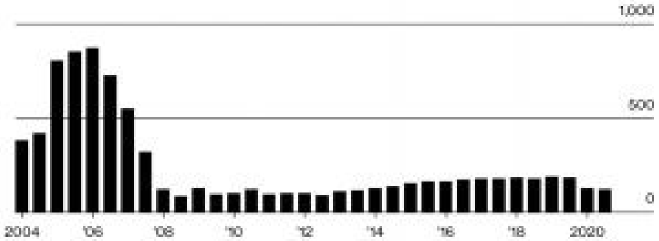
One driving factor is historically low mortgage rates, around and sometimes below 3% currently. Investors have also stepped in; they bought 17% of all homes in April, and some might relabel them speculators who believe (as many did in the run-up to 2008) that prices have nowhere to go but up—forever.

But beyond that, prices have been driven up by simple economics and the laws of supply and demand. The number of homes for sale fell 21% recently, near a record low that dates back to 1982. New home construction has been slow due to a severe lumber shortage, and we are still feeling the effects from 12 years ago, when the Great Recession knocked the construction industry back on its heels. At the same time, millennials—many of them too financially constrained to have bought houses at normal interest rates—are storming into the housing market, ending forever the trope of boomerang kids living in their parents' basement.

Does all this signal another housing bubble? Are we now destined to live through another Great Recession when a housing bubble bursts? Fortunately, there are a few checks and balances on the current boom that were not in place back in 2006-7 when the seeds of the Great Recession were planted. For one thing, lenders are no longer handing out mortgage loans like candy, with zero documentation. Today's lending standards are higher even than the requirements of the Dodd-Frank Act of 2010, which was passed in response to the financial crisis. Loans today are generally smaller in proportion to house values, and leverage is down on owners' balance sheets. You can see the difference in the accompanying table; today's mortgage credit availability looks nothing like it did during the previous residential housing boom years.

MORTGAGE CREDIT AVAILABILITY INDEX

Semiannual



Data: Mortgage Bankers Association.

That doesn't mean that housing prices won't collapse at some point in the future. One possible trigger would be a sudden rise in mortgage rates, which would cool demand significantly. But even that wouldn't trigger defaults; according to the Mortgage Bankers Association, just 0.1% of mortgage loans issued this year are tied to adjustable rates. That's compared to about 60% during the bubble years of the mid-2000s.

Sources:

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https://abcnews.go.com/US/wireStory/us-home-prices-soar-march-late-2013-77891830

https://www.bloomberg.com/news/articles/2021-06-10/real-estate-prices-are-soaring-but-there-s-no-sign-of-a-housing-bubble

WHAT ARE WE READING THIS SUMMER?

By Jean Brusher and Jane Lang

Just for fun, we asked the team what they are reading this summer. Here is a summary of the responses:

Steve Biggs: *The Premonition: A Pandemic Story,* by Michael Lewis. It's topical and I enjoy the way Michael Lewis finds the human stories behind the news events. Also, *The Myth of Capitalism: Monopolies and the Death of Competition,* by Jonathan Tepper. Although this book was released in November of 2018, the content is extremely relevant given the renewed focus by the Biden administration on restoring competitive balance.

Karla McAvoy: *The Premonition* and I love it. I'm also reading *The Price You Pay for College: An Entirely New Road Map for the Biggest Financial Decision Your Family Will Ever Make,* by *New York Times* columnist Ron Lieber. It is a thoughtful look at what a family can really expect to pay for college, considers whether or not a pricey, "name" school is worth the cost, and gives a path to navigate the various forms of aid available. I highly recommend it for those looking to send a child off to college in the coming years.

Andy Byron: That makes three of us reading Michael Lewis's *The Premonition.* After that, I'll be reading either *The Fifth Risk,* also by Michael Lewis, or *The Psychology of Money: Timeless Lessons on Wealth, Greed, and Happiness,* by Morgan Housel.

Lili Lam: *Where the Crawdads Sing,* by Delia Owens. I'm very excited to read this book—it's gotten lots of great reviews and many recommendations.

Jane Lang: *America Day by Day,* by Simone De Beauvoir. A friend loaned this book to me, and it is great summer reading! It's about a French woman traveling across America in the 1940s. It is a great adventure/escape novel, perfect for me right now as my last several COVID-era "getaways" have all been road trips.

Tim Harvey: *Ham 'n' Egg on Golf: Why Won't This Game Just Leave Us Alone?* by Brad Nelson and Dan Miller. This is an insightful, humorous perspective on golf and life written by two Bay Area locals in a format of conversational banter. With a two-year-old in the house, I spend a lot more time playing with toys than golfing, but both are fulfilling and I'm using the scorecard from my last good round as a bookmark, which unfortunately was in December.

Jean Brusher: *L'Appart: The Delights and Disasters of Making My Paris Home,* written by David Lebovitz. Lebovitz is a cookbook author and former Chez Panisse pastry chef who moved to Paris many years ago. He writes about searching for, purchasing, and renovating his Parisian apartment. For everything that's familiar about the process—such as cabinet shopping at Ikea—there are surprises, such as needing to pass a medical exam to receive a home loan.

Abby Hasling: *Think Again: The Power of Knowing What You Don't Know,* by Adam Grant. As humans, when we become comfortable in our own beliefs and convictions, we seek out what we want to hear and see those with opposing views as our enemy. In *Think Again*, Grant uses storytelling and research to show the power of rethinking and unlearning what you already know. This book discusses not only how to look inward and evaluate your own opinions and beliefs, but also how to use those skills to have constructive and meaningful conversations with those whose opinions differ from your own.

AROUND THE OFFICE

JANE LANG, CFP®, MBA

We are proud to announce that Jane Lang has earned her CERTIFIED FINANCIAL PLANNER™ certification, which is the standard of excellence for financial planners. CFP® professionals have met extensive education and experience requirements and commit to the CFP Board's ethical standards that require them to put their clients' interests first. Well done, Jane!

TIM HARVEY, CFA, CFP®

We have recently hired Timothy (Tim) W. Harvey as a senior financial advisor. Tim earned both his Chartered Financial Analyst (CFA) designation and CFP® certification and has worked in the financial advisory industry for nearly two decades as both a financial planner and investment advisor. He has recently relocated from the Peninsula to the East Bay with his wife and young son. Welcome, Tim!

ABOUT HC FINANCIAL ADVISORS, INC.

HC Financial Advisors, Inc. is a fee-only registered investment advisory firm offering full financial management services to individuals and their families. We offer ongoing investment management and financial planning services for an annual fee based on assets managed.

Our current minimum annual fee is $10,000 ($1,000,000 under management). This fee includes the investment management of all assets as well as our comprehensive financial planning services.

We welcome your referrals to our firm. There is no charge for a preliminary, 30-minute meeting to learn more about our services, investment philosophy, and backgrounds.

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