# Getting the Credit You Deserve

# Intro

In this letter, we'd like to highlight a few frequent questions we hear from clients about consumer credit. We will cover what to consider when:

Applying for a new credit card

Financing or refinancing a home

Buying or leasing a car

# You Have it in the Cards

As most of us are aware, there appear to be limitless options when it comes to the benefits offered by credit card companies.

Cash-back, discounts, free travel, gift cards and store credits to name just a few. Add to this interest rates and the reputation and service levels of different card issuers and we have a complicated decision to make. How should we go about deciding which cards are best?

The first question is: do you plan to pay off the balance each month? If you do, then your focus should be on rewards. Here are few common rewards:

***Cash Back:*** There are currently two major types of cash back rewards. The simplest are referred to as Flat Rate cards and usually give you a credit on your statement equal to 1.5% of your purchases, without limitations (Chase Freedom Unlimited and Capital One Quicksilver Cash Rewards cards). There may also be a one-time sign up cash bonus as well, typically $150 if you charge at least $500 on the card in the first three months.

The second type of cash back card generates credits on rotating categories through the year. For example, the Chase Freedom card credits 5% on up to $1,500 of purchases ( or a credit of $75) each quarter from certain businesses, such as grocery stores in one calendar quarter, gas stations and restaurants in another quarter, etc. Or, the US Bank Cash+ card credits 5% on up to

$2,000 of purchases ($100) each quarter on any two categories you select.

***Travel:*** Travel cards typically provide lots of “miles” (or “points”) when you open a card account and then accrue miles at some multiple of what you charge. They may also reimburse you for some travel charges such as luggage fees. Typical offers available now are for 50,000 points at sign up as long as a few thousand dollars are charged within the first three months the card account is open (just about any major airline card offers this through big banks like Chase and Citibank). In addition, cardholders accrue points based on their spending.

***Charitable:*** Many credit card companies allow you to donate your points or miles. But, here is the rub: IRS considers credit card rewards to be discounts rather than money in our pockets, so giving away your points is not tax deductible. That said, there are cards that will automatically give to the charity of your choice based on your spending.

Note that credit card companies change their programs and perks frequently, so the examples we’ve given here may change by the time you read this and we aren’t promoting any of the cards we mentioned. Also note that rewards cards have some the highest interest rates if balances are carried on them month-to-month, so let’s now take a look at what to expect from credit cards designed to carry balances.

***Lower Interest Rates:*** Many card companies offer introductory periods where they won’t charge interest for periods up to about 18 months. After that time period, some companies offer lower rates than others. Currently, the lowest rates available from major card companies are around 13% per year, which is considered low in the credit card world (lower rates may also be available on cards issued by credit unions). Generally, if there is something that needs to be financed, you are better off not using a credit card, but instead getting a personal line of credit at a bank or credit union.

***Fees:*** There is another consideration: some card companies charge annual fees for having their cards. American Express is probably the company that has been doing this the longest, and their fees range from $95 per year for their Preferred card up to $7,500 for the Centurion “Black” card.

***Service Levels****:* The last variable we’ll discuss is the service level of card companies. They vary widely and some have good reputations (American Express and Discover) and some have had service issues (Capital One and Wells Fargo). Service levels can be important, especially if you travel a lot and need to reach them immediately to replace a card or reject a charge.

The moral of this story is to carefully compare the total fees versus perks and services for all credit cards you’re carrying or considering. There are many websites that can assist as well (which are typically supported by the card companies) like thepointsguy.com, Creditkarma.com, and nerdwallet.com. Of course, we’re always happy to assist you with this process.

# Financing Your Own Little Piece of Heaven

Homes often represent some of our largest assets, and their associated mortgages are often our largest debts.

Focusing on the terms of these loans is critical to our long-term financial health. There are many ways that interest rates are set or vary over time for various loans. Add the fact that interest rates change over time, and the complexities multiply.

The primary decision as to which type of mortgage you choose is usually based on how long you plan to stay in the house. Here are few different scenarios:

- If you plan to stay in a house for more than 10 years and mortgage rates are low, you should typically take a 30-year fixed mortgage. With a long-term, fixed-rate mortgage you know what your payments will be for as long as you own your home and most of our clients put a high priority on certainty when it comes to their home.

- If you plan to keep the home for under 10 years then you can typically get a loan at a lower rate because the issuing bank doesn't have to commit for such a long period of time, like 30 years. The lower rates of these loans make them more affordable, so some home buyers use them to qualify for more expensive homes than they would if they were getting a 30-year fixed-rate mortgage. How much lower are the interest rates? At the time of this writing, a 30-year fixed-rate mortgage could be had at 3.75%. A loan with a fixed rate for 10 years would be 3.5% and loan with a fixed rate for seven years would be 3.125%. Assuming a $750,000 loan, the difference in payments from 3.75% to 3.125% works out to about $260 per month.
- Most Vista clients don't mind having mortgages throughout most of their lives, but we do have clients who are interested in, and have the resources to pay off a mortgage very quickly. Our typical recommendation for those clients is to use a 15-year fixed-rate mortgage, with current interest rates of about 3.625%. Fifteen year fixed rate mortgages typically have the most beneficial interest rates.
- Note that most clients who are retired, or close to retirement, are better off maintaining their mortgages because it gives them flexibility with their liquid assets and cash flow.
- When taking out a new or refinanced mortgage, one of the larger expenses is usually title insurance. Depending on the location of the property, the cost of title insurance can vary widely from one title company to another. Rather than just going with the recommendation of the bank or escrow company, it can make sense to do some shopping around to reduce the cost and we're always happy to assist.

When our clients have been in their homes for a while, and have no plans to sell, we help by keeping track of their current mortgage rates. If interest rates drop, we will often suggest refinancing to get a new mortgage at a better rate. We're always happy to assist with this decision which depends on your current mortgage rate, the new mortgage rate, the costs of putting the new mortgage in place, your goals, and other variables.

Besides assisting with mortgages, we are also asked from time-to-time about financing for solar panels. As with other large purchases, there are usually a few variables with these loans where we can provide advice.

# A New Lease on Life (of a car)

Along with housing, our next largest purchase is generally on transportation, be it a car, a truck or something in between.

Whether you buy or lease primarily depends on how long you plan to keep the vehicle and how much you plan to drive it.

There are basically three ways to own a car. Usually, the least expensive way to own a car is to negotiate the best price, pay for it all at once, and drive it until its repair costs are higher than the eventual value of the car. Leasing is generally the most expensive way to "own" a car, but for the added cost you get to drive a new car every few years. Borrowing to purchase a car usually works out to cost something in between these two.

## When to Buy

If you typically buy a car infrequently and hold it for long periods of time (typically greater than four years), or if you drive more than 15,000 miles per year, your best decision is usually to either pay cash or finance it. The deciding factor is the cost of financing. Car manufacturers often "buy down" interest rates on loans in order to make it easier for buyers to make these large purchases so the car companies can sell more units. If the vehicle you're considering isn't one of the more popular models, or is close to or past its model year, you may get such a favorable interest rate on a loan that paying over time is a better decision than paying for the entire purchase price all at once.

What would be a favorable interest rate? Generally, any rate that is lower than what you're planning to receive on money invested over the long-term. So, if your investments are projected to return 5% after-tax and the interest rate on a car loan is quoted at 5.5%, then you're better off paying cash for the car. If the interest rate offered is 4% you would be better off financing the purchase.

## When to Lease

Leasing can sound complicated because leasing companies use terms and numbers that are specific to their industry and, to be honest, a bit opaque by design. We are always happy to help you with this decision. In a car lease, you are basically financing part of the price as a purchase over time, and part as an interest only loan.

An example would be best to help describe the transaction. Let's say you're in the market for a new sedan, like a BMW 530i (we aren't partial to BMW's, it is just an example we have at hand). Here are the details:

- The list price of the car is $56,495.
- BMW will lease you that car for $3,500 down (not including license), plus a $925 acquisition fee and $519 per month for 36 months. If we assume a 9% sales tax, the total monthly payment would be $566 per month.
- At the end of the 36 months, as long as you've taken good care of the car and haven't exceeded 30,000 miles, you can return it to the car dealer and walk away without any additional costs.
- If you would rather buy the car at the end of the lease, BMW will sell it to you at the preset price of $39,841.

How much is it costing you to lease the car? Your total monthly payments would be $20,376 and the cost of the car is reduced during that time period by $13,154 (the purchase price of $56,495 minus the $3,500 down, minus $39,841). That works out to a finance rate of about 4.8%.

The difference can be large when comparing a lease to a purchase. Let's say that instead of leasing the BMW you buy it, financing the purchase over five years. Assuming you could get the same 4.8% interest rate, your payments would be about twice as high at $1,156 per month (which includes sales tax on the entire purchase price instead of just the monthly payments). After three years of making those payments, you would owe about $35,165. When compared to the lease, you would have equity in the car of $4,676 (BMW's estimated value of $39,841 minus your remaining loan amount of $35,165).

Three additional items to note:

- An advantage of leasing is paying the sales tax over time without financing it because you pay it each month based on the lease payment amount. Plus, if you don't buy the car at the end of the lease, you never pay sales tax on the full value of the car as you would if you purchase it.
- As in purchasing a car outright, there are a number of negotiation points in a car lease. These include the purchase price of the car, the amount you put down, and sometimes the fees. At the end of lease, you can often negotiate the price of the car again if you decide to purchase it.
- If you drive a lot, generally more than 15,000 miles per year, leasing doesn't usually make sense because of the way the lease calculation works and the effect high mileage can have on used cars.

## Car Pricing

A point of frustration for most thrifty car buyers is figuring out how much to pay for the car we want. We can get the Manufacturer's Suggested Retail Price

(MSRP) easily, but that is generally just a starting point for the negotiation.

Being armed with more information is always good, and there is a wealth of information on the internet, starting with Edmunds.com. Here you can find MSRP and the dealer's invoice price from the factory. Although the invoice isn't necessarily what the dealer paid for the car it can be another valuable piece of information (dealers often have factory incentives that further reduce their costs for vehicles they sell).

Knowing the value of your car is also important if you want to trade it in. To find that, nadaguides.com (for NADA Guides) or kbb.com (for Kelley Blue Book) can be helpful.

Finally, if you want some general tips on how to negotiate a car purchase, this article is interesting, and a little entertaining: https://www.edmunds.com/car-buying/confessions-of-...

Again, we're always happy to help in any way that we can, and we have been known to help our clients negotiate the purchase of a car. Please do not hesitate to ask us.

# Thanks

At Vista, we spend a lot of time looking at ways to finance all kinds of items for our clients. We're always happy to dissect the numbers and help in any way we can.

We hope this finds your 2019 off to a prosperous start, and we always look forward to hearing from you.

## Your Vista Wealth Management Team