

**Mitochondria Learns to Invest #05**  
**by Klarise Yahya, Commercial Loan Broker**

*Continued from last month ...*

Mrs. Langerhorn looked at me a long moment, as though she was trying to understand what I said. I was glad I talked loudly and slowly. She'd done so much for me I thought it was only fair that I did something for her. Then Mrs. Langerhorn seemed to slump in her chair. "I forgot", she said as though to herself, but loud enough to be sure I heard, "how difficult it must be for the young ones to be permitted to have opinions before they are taught to think!"

**Continued ...**

"Do you know the difference between tax credits and tax write-offs?" She asked. Then she added, "Most people don't".

I had to admit that I'd never really thought of it.

"It depends on where you plug the item into your tax return. A tax credit goes at the bottom. After you compute your taxes you then deduct any tax credits and write a check for the balance.

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your means, and you are totally out of debt,  
you will be ready to learn what an investment is.

"You see, a tax credit pre-pays a portion of your taxes. Let's say you do your taxes and find you owe \$3,500. But you have a tax credit for \$1,000. You subtract the full amount of your tax credit from the taxes owed and you only have to write a check to the government for \$2,500.

"A write-off is different", she continued. "You plug write-offs into your tax return towards the top as deductions from your gross income. So if you made (and I'll just make up some numbers) \$50,000 for the year and you had a write-off of \$10,000 then you only have to pay taxes on \$40,000.

"Here is the effect. To put it simply, if you are in the 30% bracket and your gross income was \$50,000 your tax would be \$15,000 (30% of \$50,000).

"If you made \$50,000 but had \$10,000 of write-offs, you would pay 30% taxes on only \$40,000. Your tax would be \$12,000. You had \$10,000 in write-offs, but your net savings was only \$3,000.

"Do you see that tax write-offs don't have the same effect on your final tax bill as tax credits? Tax credits are worth 100 cents on the dollar in terms of tax savings. Write-offs have varying worth depending on your tax bracket. If you are in the 30% bracket, your dollar savings will only save 30% of the write-off. If you are in the 20% bracket, your dollar savings will be 20% of the write-off"

Then she looked at me and asked, "Now that that's clear, might I be allowed to comment on mortgage interest write-off?" She didn't even have the courtesy to wait for my answer. She just went right ahead.

"You know that a portion of every payment is interest, which may be a write-off, depending on the whims of the government. The rest of the payment is principal, which is not a write-off. So, in reality, you can only write off a portion of your mortgage payment.

"But let's assume that you could write off the entire amount, both the principal and the interest. That would mean that you could write-off, in this example, \$966 a month.

"Now, you're in the 30% tax bracket. That means that only 30% of any write-off actually turns into tax savings. If you were in the 20% tax bracket, only 20% of any write off benefits you. If you were in the 40% bracket, you would save 40% of what you actually paid towards any write-off. Isn't it wonderful how the taxing authorities make it so convenient to estimate your savings from any deduction?

"Let's go back to your personal situation. In your case, 30% of \$966 would be saved from taxes. Seventy percent of that \$966 would be a non-tax advantaged cost. Are you with me so far?"

I nodded. I didn't think I liked where this was going.

"So by not paying off your mortgage, you are writing a \$966 check each month to save \$290. That doesn't sound very smart, does it?"

"The sanctity of the mortgage interest deduction is so ingrained that, even after I've gone through it with them, I've had people that still don't get it. So you know what I do? I ask them, 'Then why do people refinance whenever they can get a lower mortgage rate? If the mortgage interest deduction is so precious, why do they actively seek to minimize the interest they pay?'"

I was embarrassed. I'd never looked at it quite like that. When she explained it, it seemed like the famous mortgage interest deduction was actually a pretty stupid thing to be married to.

"Ok", I said. "Let's get back to paying off my mortgage!" I could see Mrs. Langerhorn smile, although she tried to hide it by taking a sip of tea. "I've got \$1,156 in accumulated monthly payments I'm no longer making, and if I add that to the \$966 mortgage payment, I'll be paying \$2,122 a month on a \$120,000 debt. I'll have it paid off in ... 56.55 months."

I asked Mrs. Langerhorn, "Should I round that off to an even 57 months?"

She nodded agreement, then said "Now add all the individual months it will take for you to get entirely out of debt, including your hypothetical mortgage".

I pulled the calculator closer to the legal pad and began punching the numbers. I started with five months, then added four months, then five (again), then another five months, then the 17 months to pay off my student loan, and finally the 57 months to retire my mortgage.

"It comes to 93 months", I said.

Mrs. Langerhorn asked me how many years that would be. I turned to my calculator, divided by 12, and told her it came to seven years and nine months.

"Let's review. If you were a good puppy and made minimum bank payments, it would require 30 years just to pay off your mortgage. Your credit cards would still have outstanding balances. But if you begin with just the 15% of your paycheck you pay yourself, you can make additional principal payments on one debt at a time, beginning with the smallest debt. Every time you pay off a debt, you add the payment you used to pay to your *pay-off-your-next-debt* money and roll it over to pay off your next highest debt, ranked in terms of monthly payments.

*"You will be totally out of debt, including owning your own home free and clear, in less than eight years,"* she said. She italicized and underlined the words with the tone of her voice.

I had to admit, it was pretty amazing. But I had two big questions. "How did you come up with this? And why don't I invest instead of paying off my debts?"

I could see that Mrs. Langerhorn was pleased by my enthusiasm. She shifted to a slightly more comfortable position, crossed her right knee over her left, and began to answer my questions.

"First of all, this is not my idea. The concept of making principal payments on debts to pay them off early has been around a long, long time. This particular method came to me from a man I met on a plane flight. He had the seat next to me and we began talking. In any event, if you search the internet, you will probably find several sources that suggest you accumulate prior payments and apply them to your next debt. They may phrase it differently, but the elements of everything I've taught you tonight are in the public domain. Once again, I make no claim to being the originator. I'm simply transmitting to you data gathered from various sources.

"Let's review what we've learned. The first rule was ***Live Beneath Your Means***. Once you've learned that, then you can proceed to the next level.

"The second rule was ***Get Out of Debt***. After you have learned to live beneath your means, and you are totally out of debt, you will be ready to learn what an investment is."

It was hard for me to sleep that night. I kept thinking how nice it would be to be totally out of debt. I don't set the alarm on Saturday mornings, of course, but I was nevertheless up and showered while the sky was still grey.

The first thing I did was to turn on my computer and run a web search for "time to pay off credit cards". I found a page that let me plug in the balances on my three credit cards, their interest rates and minimum payments. It turned out that Mrs. Langerhorn was right. After 30 years of payments I'd still owe \$2,000. That was certainly not very good.

Then I turned to a fresh sheet on the legal tablet and started drafting a plan to get out of debt using what Mrs. Langerhorn taught me.

I listed my debts on the left side of the page, with the minimum payments just to the right. It looked like this:

<b>Debt</b>	<b>Amount Owed</b>	<b>Minimum Payment</b>
Student Loan	\$20,000	\$200
Automobile	\$ 5,000	\$156
Visa #01	\$ 4,000	\$ 80
MasterCard	\$ 3,000	\$ 60
Visa #02	\$ 3,000	\$ 60
<b>Total</b>	<b>\$35,000</b>	<b>\$556</b>

As I'd been saving 15% of my paycheck, I thought it might be interesting to see what would happen if I applied that \$600 a month to my debts. On paper, then, I started paying \$660 towards Visa #02. That was the normal minimum payment of \$60 plus my monthly savings. It turned out that I'd have that debt paid off in less than five months.

Then I just rolled that \$660 up into the MasterCard debt, added the \$60 minimum payment that was due in any event, and found that if I paid \$720 towards that obligation every month I could pay it off in about four months.

Now I had (remember, I was doing all this on paper to see how it might work out) \$800 – that's the \$720 plus the \$80 payment – to apply towards Visa #02. I could pay that one off in another five months.

I would then have \$956 to apply to my car loan, which would retire it in five months.

Now the entire \$1,156 could be directed at the \$20,000 I owed on my student loan, which would get rid of it in 17 months.

When I added up the time, I figured that I could be out of debt in 36 months. Totally out of debt in three years! I can't tell you how good that made me feel!

Well, that was the plan. In fact, I got a couple of small raises during this period and applied them to my debt payoff plan. And I put my tax refunds towards paying off my debts, so it took a little less than three years to do the job. I was 29 years old and totally out of debt! *Continued next month ...*

*Klarise Yahya is a Commercial Loan Broker. If you are thinking of refinancing or purchasing five units or more anywhere in the U.S.A., Klarise Yahya can help. Find out how much you can borrow! For a complimentary mortgage analysis, please call her at (818) 500-9966.*