

Mortgaging Futures

Super-jumbo mortgage providers are catering to those seeking to leverage their housing assets.

By Kris Frieswick

GROWING UP IN A PENNSYLVANIA coal-mining town as the child of lower-middle-class parents, George Matz learned early that life can be tough and that security is often elusive. When he was 19, Matz's father died, and he was forced to put himself through college. Today, as a 55-year-old private investor and professional board member for not-for-profit companies, Matz is happily investing the fruits of his former career as an executive in the high-tech industry. One might expect someone with his background and financial wherewithal to own his home outright, because the ability to buy a house with cash is often seen as the ultimate security blanket by those who have triumphed over adversity.

Yet Matz, who bought his Pinellas Park, Fla., home in 2000, has chosen to fund part of the house with debt. "I could have written a check for the house," he says, "but I feel comfortable with the mortgage." He financed 70 percent of the purchase price with an interest-only, seven-year, Libor-pegged loan that charges about 3 percent interest. He then used the money he would have otherwise spent on the home and invested it in tax-free municipal bonds that paid between 5 and 6 percent. "I am using other people's money to make money," he says.

A mortgage, even for those who, like Matz, can afford to pay cash for a multimillion dollar home, can be a winning investment technique in the current economic climate. Many people who could afford to pay cash use mortgages to free up investment income.

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Boutique and concierge mortgage divisions offering super-jumbo mortgages—which generally start at approximately \$650,000 and may go higher than \$5 million—are springing up at financial firms across the country to service this demand. Bank of America recently announced plans to increase its jumbo mortgage offerings, and small boutiques that have long functioned as financial advisors or as stock brokerages are getting into the game. Mellon Private Wealth Management Group has been servicing the mortgage needs of its affluent clients since the mid-1980s. It lays claim to developing the interest-only loan specifically to serve the needs of this demographic, which, due to variations in cash flow (from bonuses, dividend payments and similar income streams), prefers to make principal payments at irregular intervals.

According to Mark Langille, vice president of mortgage lending for Mellon Private Wealth Management, homeowners generally cite four reasons why someone who could pay cash for a home would opt for a mortgage. The first is the desire to retain the mortgage interest deduction, one of the few deductions still available to wealthy people. Individuals can deduct the interest on up to \$1 million of mortgage debt as long as it is used for acquiring, developing or substantially improving a property. Individuals can also deduct the interest on up to \$100,000 of home equity debt. Adjustable rate mortgages are especially popular for the super-jumbo set because even a slightly lower interest rate can result in big cash savings on a \$1 million loan over a short period of time.

Some investors mortgage their homes because they want to maintain liquidity for other investments that require cash—and the flexibility to move quickly on those investments. Larry Lipa, cofounder of Corvus International, a real estate development

TOP VIEW | Although private investors can afford to pay cash for their homes, some find advantages in securing super-jumbo mortgages. Designed specifically for those investing in top-tier housing, these loans provide payment flexibility and tax advantages. They also free up cash for other investments and deliver a hedge against inflation. But these loans often carry slightly higher interest rates than standard mortgages and can complicate estate planning strategies.

company based in Birmingham, Mich., often comes across deals that must be sealed quickly in order to get the best terms—and that means having large sums of cash available. This is why he has mortgaged both his primary and secondary homes in Michigan, even though he could afford to pay cash for both. “Sometimes an opportunity comes along that you only have a couple of days to grab,” Lipa says, “and you want to be able to just put the money down.” Having cash also makes him a more attractive customer for lenders. “For every dollar you have in your hand,” he notes, “you can borrow four dollars.”

Mortgages can also eliminate the need for borrowers to liquidate investments that may result in capital gains taxes. Finally, long-term mortgages of all sizes provide a valuable hedge against inflation.

NICHE FINANCING

Various lenders have created a raft of mortgage products geared toward the specific needs of the affluent borrower. For example, First Financial Equities in Englewood, N.J., will loan up to 65 percent of the purchase price of a home, and the firm has practically no upper loan limit, explains Ari Sorotzkin, the company’s vice president. Sorotzkin’s firm is one of those now starting a separate

mortgage banking division to take advantage of increased activity in the \$1 million-plus market. It arranges pledged asset loans that allow customers to pledge the assets in an investment account as collateral for a down payment loan. By not having to liquidate other investments, they avoid paying capital gains taxes. The remainder of the purchase is financed through a mortgage, resulting in 100 percent financing that leaves the buyer’s other investments intact. Other financial services companies, such as Fidelity and Morgan Stanley, also allow their clients to take out loans against their accounts for this purpose. Borrowers should be aware, however, that these loans require that the value of the underlying securities remains sufficient to cover the loan obligations, and may result in margin calls if those securities fall in value.

Some companies, such as First Financial, also offer loan modification programs that allow clients to refinance for a nominal fee—usually about \$1,000 per \$1 million—without having to complete additional paperwork or pay mortgage recording tax and title fees, which can be as much as 2 percent of the loan—the amount New York state levies.

Another recent entrant to this field is Concierge Luxury Finance, a financial services firm in Heathrow, Fla., that



ILLUSTRATION BY BILL PFEIFFER

conducts one-third of its business in the super-jumbo mortgage market. According to the firm's president, Carl Hendrix, super-jumbo loans usually carry a slightly higher interest rate than smaller mortgages. Most lenders feel that multimillion dollar homes carry more inherent risk because they are much slower to sell, so they price the loans accordingly. "Some lenders say, 'We'll go as high as you want,' but that's not really true," he says. "Lenders want to have security that the house isn't going to be walked away from. The marketing time on a \$30 million home can be years." Many will limit their exposure by capping the loan-to-value ratio at about 50 percent of the home's value beyond a certain size, which varies by lender.

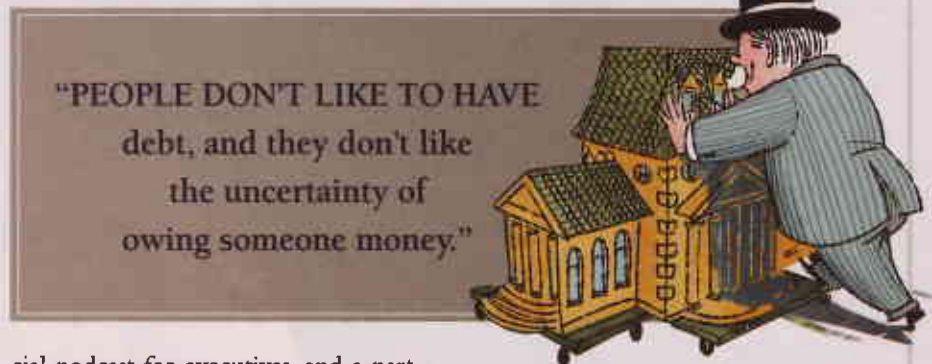
DEBT BE NOT PROUD

Ironically, given the numerous financial benefits of a jumbo mortgage, often the biggest impediment to convincing wealthy buyers to use one is the emotional barriers that many people erect around mortgages and debt. Although David Avital has mortgages on his roughly \$5 million worth of homes, he initially bought them outright with cash. Only after some prodding by Sorotzkin did Avital agree to mortgage them, and the note is for only \$400,000, just over one-third of the amount on which he could claim mortgage interest deductions.

"I don't want a sword hanging over my neck," says Avital, founder of MTP Investment Group, which owns New York parking garages and invests in real estate, bridge financing and private equity. "It's a primitive philosophy, I know, because obviously I could make more money by taking a mortgage and investing that cash somewhere else. But my house is my house; I don't want to mortgage it. I worry about what will happen when I leave this world. I don't want to put too much thinking into my house. Emotionally, I want my home minimally exposed to debt."

This reaction, however irrational, is not uncommon, experts suggest. "What I've learned in this business is that emotions definitely come into play," says Jason Papier, the producer and co-host of *Pro Money Talk*, a finan-

interest deduction does not apply to the purchases of third or subsequent homes, so for the affluent buyers of multiple homes, it may be smarter to pay cash for these additional properties, unless they are prepared to arbitrage



cial podcast for executives, and a partner in PW Johnson Wealth Management, a fee-only financial planning firm in Sunnyvale, Calif. "People don't like to have debt, and they don't like the uncertainty of owing someone money. There are some people who will always feel more comfortable paying cash."

Gibran Nicholas, the founder of Nicholas & Co., a mortgage business in Ann Arbor, Mich., claims that most people inherit their aversion to mortgages from their parents and grandparents. "Our grandparents grew up in a time when mortgages were callable," Nicholas points out. "The bank could call you up at any time and ask for its money back immediately. They could take your home. Today, there are safeguards against that." Yet many individuals still retain the lessons told to them as children.

Even those who see the financial benefits of mortgages acknowledge a break point at which they will decide to pay cash. For Matz, Lipa and Avital, that point is when the mortgage rates creep up into the high 6 percent or low 7 percent range. The consensus is that in this event, cash may become the more attractive option because market returns fail to outperform the cost of the loans. Moreover, the mortgage

the money they would have spent on each home.

For many people this type of arbitrage is just too much trouble. "For the ultra-wealthy, avoiding a monthly payment is their modus operandi," Hendrix explains. "These people would generally rather pay cash or find some alternative source of financing."

Yet, even with interest rates creeping up and the ominous whispers of bursting bubbles growing louder, the jumbo mortgage financial strategy remains, for many, both viable and enticing. According to Ron Chicaferro, executive vice president of Thornburg Mortgage, a Santa Fe, N.M., lender that focuses on the super-jumbo market, about half of those who can pay cash for a luxury home will decide to take that route. "I really haven't seen much of a change in those percentages over time," he adds. "However, if you define the market based on the cost of the properties, there are a lot more people financing higher-end homes than ever before. People are making a lot more money than they have in the past, and there are more people becoming higher-end borrowers as a result." ■

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