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# At the Margin

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## "Kick It Up a Notch"

### The Doctor Is In!


Hey folks, in the words of a famous chef, let's "KICK IT UP A NOTCH"! I'm referring to your competitive response to the economic brain freeze going on in the financial world today. This is the perfect time to innovate new products that give the consumer of financial services something surprising...... STUFF THEY WANT!

I'm not belittling the confusion surrounding new financial regulations from debit and credit card charges and point-of-sale transaction fees, all the way to tougher capital requirements. But some of you feel that you can't do anything until the dust settles. Phooey! Watch me. Or rather, watch our clients. All of the following ideas are being done right now as we speak by community financial institutions around the country.

**"Debt-Free Mortgage"**

Let's go after the "Dave Ramsey" crowd. You know, those older than 45, worried about "carrying debt into their retirement years" people. At a time when longer term savings rates aren't even seeing 5%, you can deliver a product that guarantees a 6 to 8 percent return through

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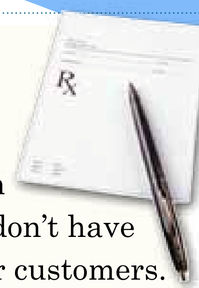
### Prescriptions for Success!



The products Dr.Tom discussed work! They don't have to be offered to all your customers. Segment your market and get a greater share-of-wallet.

The Debt-Free Mortgage can help you offer higher rates of return to your debt-free/target saver segment. Let's look at an example.

**Current Situation**

Your "A" credit customer has 15 years (180 months) <u>remaining</u> on a 5.50% fixed rate mortgage. The <u>remaining</u> balance is $100,000. The monthly payment is $817.08. If they keep this loan for the remaining maturity, they will pay an additional $47,075.02 of interest.

**Debt-Free Mortgage (DFM) Alternative**

On the other hand, your "A" credit customer would like to be

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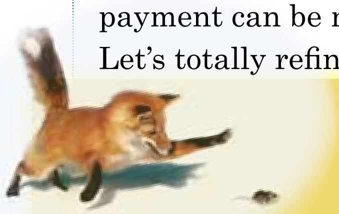
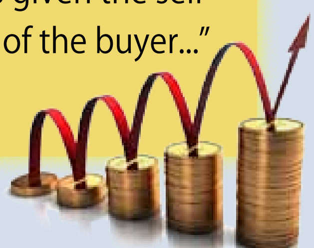
the faster pay-down of the mortgage. But let's package this puppy, not just suggest that an extra mortgage principal payment can be made and therefore will save interest costs. Let's totally refinance an existing outstanding mortgage into 6, 8, or 10 year fixed rate mortgages at interest rates commensurate with their duration, say 3.99 to 4.50 percent. By the way, you will also accelerate cash flows in a certain-to-happen rising rate environment… your CFO will love you.



"Crazy you say? Like a fox I say!" The duration extension on such a loan is a marginal one to two years given the self selection of the buyer..."



*Or how about….*

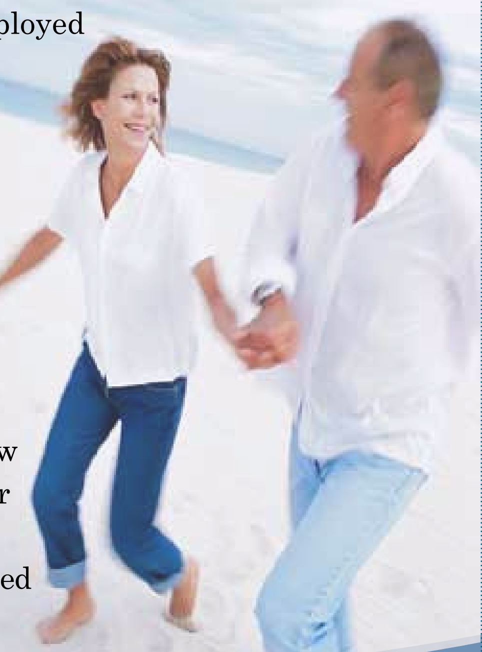
**"Assumable Mortgage"**

At a time when mortgage rates are at record lows, how about offering a mortgage to a current buyer that would be assumable to a qualified buyer in the future for a slightly higher rate and/or fee! Crazy you say? Like a fox I say! The duration extension on such a loan is a marginal one to two years given the self selection of the buyer who would purchase such an option. This is a portfolio lender's product to secure point-of-sale with a relationship banking package.

*Or how about….*

**"Special Purpose Funding of SEP Plans"**

The best kept secret of self-employed people in our economy is just how many fail to fully fund their SEP (Self Employment Plan) retirement plan annually. Self-employed people get up to approximately $57,000 in retirement contributions per year (depending on their level of compensation) that are exempt from taxation. But often cash flow is not there at the end of the year when they need it to fund their contribution. I know; it's happened to me. Whatever portion of the



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debt-free sooner than 15 years. What if your financial institution offers this customer a 4.25% fixed rate mortgage for 10 years (120 months)?

At 4.25% for 120 months and a balance of $100,000, the monthly payment is $1,024.38. That is $207.29 more than the current payment of $817.08. However, at the end of the 120 months, the customer will be debt free (vs. a balance of $42,776.64 if they keep their current loan for 180 months). They will have paid a total of $22,925.04 of interest payments (vs. $40,826.65 if they keep the current loan for another 180 months). The pre-tax internal rate of return for the customer is a whomping, stomping 8.76%! Where else could they receive that high a return for 10 years?

"A CEO of a $1 billion client in New England has quoted that Debt-Free Mortgages have stimulated $80 million of these shorter duration loans during the past year. He is extremely pleased as a large percentage of these originations are new money for his institution."

Not only have you helped your customer, but you have helped your financial institution. Let's look at the cash flows of this loan. A 10-year loan has a duration (economic value of the cash flows) of approximately 3 years. How do I know this? Well, the average life of a 10-year loan is 5 years. Now factor in amortization, prepayment and the present value of the

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contribution that you don't take advantage of is gone…. FOREVER! What a crime! Why would any financial institution allow its good small business customers, existing or potential, to miss the opportunity to make the best investment they could ever make… fully funding their retirement plan.

*Or how about…*

**"The Broker Buster"**

At a time when money market mutual funds, the stock broker's best friend, is barely paying positive yields, why don't you aggressively go after this high balance, high net worth segment of the market? Give them Internet access and complete self-driven ACH transferability along with full checking and debit transaction capability… for a current rate of 1.25%. Why lose out to ING Direct or Citi Direct? Why shouldn't your best or most coveted commercial customers get such an account for their personal balances? WHY NOT?

*Or how about…*

Well, you get the idea. Maybe your financial institution should turn your planning session into a *real product development think-tank* session. All these ideas and more… really work! Call us!

***-Tom Parliment***

Parliment Consulting Services focuses on Strategic Financial Planning to help community financial institutions gain and maintain sustainable superior earnings growth. ***We specialize in retail loan and deposit strategies.***

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think smart

cash flows, and the duration is close to 3 years. Where can you earn 4.25% for a 3-year duration investment?

In summary, DFMs should be marketed to your "A" credit customers who can afford the higher monthly payments. You can target new loan customers and refi them away from your competition. Keep in mind that these loans are low LTVs, 50% risk-based, and excellent collateral for FHLB advances.

**Innovative RETAIL PRODUCTS to Attack Point-of-Sale**

| | |
|---|---|
| **Debt-Free Mortgage** | Attacking risk-averse individuals through fast amortizing structures |
| **Assumable Mortgage** | Attacking self-selected market segment that seeks to turn over home in 2 to 5 years; attack through Realtors |
| **SEP Plan Funding** | Attacking small business owners that fail to fully fund their retirement plan; attack through small business Accountants |
| **Broker Buster** | Attacking through commercial business lines to obtain personal balances of clients |

**The time is right to be innovative with your retail product development. We can help. Call us for your own retail product development think-tank session customized to your markets and your financial institution. Contact us at 508-881-7002 or jflockwood@parlimentconsulting.com to get started!**

***–Janet Frankl-Lockwood***