Investor Insights & Outlook

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A Quick Guide to Home Equity Loans

If you as a consumer need an additional line of credit, a home equity loan, also known as a second mortgage where your home serves as collateral, is one of several options that you can choose from. There are two major advantages of home equity loans. First, the interest rate on home equity loans is usually lower than credit cards and other consumer loans. Second, you can usually deduct the interest on home equity loans, unlike other loans. There are two types of home equity loans—fixed-rate loans and lines of credit.

A fixed-rate loan provides a single, lump-sum payment to the borrower, and is repaid over a fixed period of time at a pre-determined interest rate. This is useful if you know how much you would need and when you would be able to pay off the loan.

A home equity line of credit (HELOC) is a variable rate loan that works like a credit card. Borrowers are pre-approved for a specific spending limit and can withdraw money when needed via a credit card or special checks. Similar to a fixed-rate loan, the outstanding loan amount must be repaid in full at the end of the term. However, unlike a fixed-rate loan, HELOC interest rates float up or down, generally adjusted based on the current prime rate. A HELOC is a convenient way to cover short-term, recurring costs, such as quarterly tuition for a four-year college degree.

Although home equity loans do provide attractive rates of financing, we caution consumers to think twice about the reasons why one would need an additional line of credit. If you are thinking about using a home equity loan for day-to-day expenses, one should examine whether you are overspending and possibly sinking deeper into debt. If you end up taking out more money than your house is worth, the interest paid on the loan above the value of the home is not tax deductible.

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Bill Roller is experienced in financial planning and investment analysis. He focuses his consulting practice on estate, retirement, and financial planning for businesses and individuals. Bill started BR Capital Inc. in 2003. Before that he worked for a large Wall Street firm for over nine years. He served for seven years as a U.S. Army officer in Infantry and Special Forces (Green Beret) units. Bill is a Chartered Financial Analyst as well as a Certified Financial Planner. He is the VP of the Estate Planning Council of Southwest Washington. He earned a Bachelor of Science degree from the United States Military Academy at West Point in 1982, and a MBA from the Wharton School of Business in 1991. He provides the morning and afternoon market reports and financial commentary for AM 1360 KUIK. A link to Bill's articles and interviews is available at www.brcapitalinc.com/newsletter.

Government Health-Care Spending: Medicaid

It is a well-known fact that the United States spends much more than other developed countries on health care, both in absolute dollars and as a percentage of GDP. Two enormous, complicated programs, Medicare and Medicaid, account for the majority of govern¬ment health-care spending in the U.S. Both programs have been growing rapidly, which is expected to continue in the coming years. As illustrated in the image, Medicare and Medicaid are expected to account for 39% of U.S. health-care spending in 2019, up from 37% in 2010.

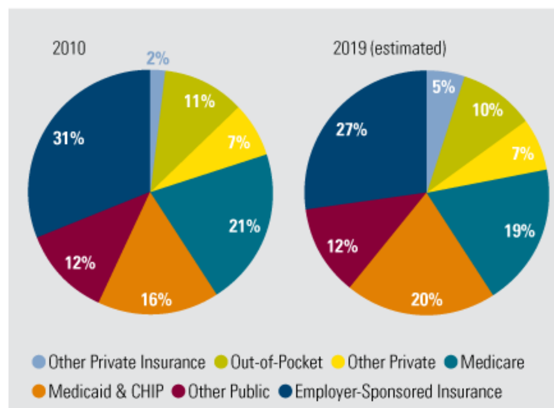
Medicaid is a joint federal-state program that provides health insurance to low-income people. Each state runs its own program and has discretion over benefits and eligibility within federal guidelines. A related program, the State Children's Health Insurance Program (SCHIP or CHIP), covers children from families who make too much to qualify for Medicaid but not enough to afford private insurance.

In 2007, on average 49.1 million people received health benefits from Medicaid. However, 61.9 million people received benefits at some point during the year, as varying economic circumstances led people to transition into or out of Medicaid. Medicaid cost $390 billion in 2009, with about two-thirds of that money coming from the federal government and the remainder from the states. The federal share of costs—called the Federal Medical Assistance Percentage (FMAP)—de¬pends on income levels in the states but is at least 50%. As part of the 2009 stimulus package (the American Recovery and Reinvestment Act), the FMAP was temporarily increased on condition that states accepting the increase could not reduce their Medicaid eligibility levels.

Medicaid beneficiaries are very diverse with widely varying health-care needs. Although children, their parents, and pregnant women accounted for around 75% of Medicaid enrollees in 2007, they only accounted for 32% of Medicaid spending. Aged, blind, and disabled members are gener¬ally much more expensive. Approximately eight million Medicaid enrollees also receive Medicare benefits, and are known as "dual eligibles." Medicaid does not require beneficiaries to pay premiums, and cost sharing is generally very limited, making Medicaid the nation's most important payer of long-term care services.

Medicaid will experience some of the most radical changes under the Patient Protection and Afford¬able Care Act. Starting in 2014, the program will be expanded to cover nearly anyone under age 65 with income up to 133% of the federal poverty level, including adults without dependent children. This is expected to result in 16 million new Medicaid beneficiaries, representing half of the health-reform-related increase in the number of people with insurance. The federal government will pay for 100% of the costs of newly-eligible Medicaid beneficiaries from 2014-2016, phasing down to 90% by 2020.

U.S. Health-care Spending by Source in 2010 and 2019



Source: CMS National Health Expenditure Data

Government Health-Care Spending: Medicare

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Medicare and Medicaid were both created in the mid-1960's as part of Lyndon Johnson's Great Society agenda. As of 1970, 62% of total health-care spending was still private, with out-of-pocket spending the single most significant source. During the subsequent forty years, however, Medicare and Medicaid each expanded by more than 11% annually due to benefit expansions and demographic change, pushing public-sector spending up to nearly 50% of total health-care expenditures. During the same time, private-sector spending also grew at a robust 8.7% annually, as employer-sponsored insurance became the predominant conduit of health-care spending.

Looking forward, the Centers for Medicare & Medicaid Services (CMS) project 6.5% annual health-care spending growth over the next decade. Public sector growth is again expected to outpace private spending growth, with a 6.9% growth rate compared to 6% for the private sector. Combined, Medicare and Medicaid are expected to account for 39% of U.S. health-care spending in 2019, up from 37% in 2010 and 17% in 1970.

Medicare is a federal government program that provides health insurance to people over age 65, and people with certain disabilities. In 2009, more than 43 million people received health insurance benefits through Medicare at a total cost of approximately $510 billion. Medicare benefits are divided into three parts: Part A Hospital Insurance, Part B Medical Insurance, and Part D Prescription Drug Insurance. Part C created a private version of Medicare, now called Medicare Advantage. More details about these benefits can be found in the attached table.

Original Medicare's relatively high cost-sharing provisions and lack of a limit on out-of-pocket spending can leave beneficiaries exposed to potentially devastating expenses in the case of a serious adverse health event. For this reason, most Medicare beneficiaries also carry supplemental insurance. Employer-sponsored retiree health plans, though becoming less common, still cover approximately 30% of the Medicare population. 20% of Medicare beneficiaries purchase individual supplemental policies, also called Medigap policies. Medicaid helps pay Medicare's premiums and cost-sharing for another 20% of the Medicare population. Only about 10% of Medicare beneficiaries are estimated to be completely without supplemental coverage.

Medicare Benefits Breakdown

Benefit	Approx. % of Spending	What Does It Cover?	What Does It Cost Beneficiaries?
Part A	39	Inpatient hospital care, skilled nursing facilities, and in some cases hospice or home care.	Generally no monthly premium as long as the beneficiary paid sufficient payroll taxes while working. Deductible and co-insurance for hospital stays exceeding 60 days.
Part B	26	Physician services, outpatient care, and in some cases physical or occupational therapy and home health care.	Monthly premium, deductible, and 20% co-insurance after the deductible is met.
Part C	23	Same benefits as Part A, Part B, and often Part D. Medicare Advantage plans are offered by private insurance companies as an alternative to original government-run Medicare.	Monthly premium, deductibles, co-pays, and co-insurance.
Part D	11	Prescription drugs.	Part D benefits are only offered through private insurance companies, which charge a premium in addition to deductibles, co-pays, and co-insurance.

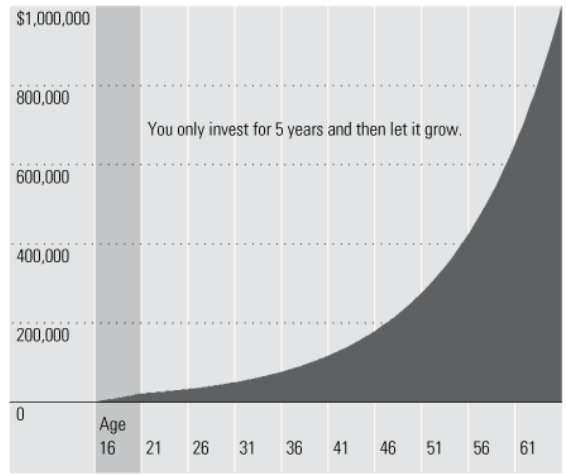
Source: Kaiser Family Foundation and Medicare.gov

Retirement: The Next Generation

If you had a dollar for every time you heard the phrase “Start investing early,” you could retire with a million. If you actually acted on that phrase, you are probably retiring with more. Now is the time to encourage your children and grandchildren to start saving as soon as they get their first job.

Let’s assume that your teenage child or grandchild is employed for five years from age 16 to age 21. During this time, he or she saves $277 per month and invests the money in a Roth IRA (paying taxes, but at a low tax bracket). This may be a serious sacrifice for a teenager, so any contribution from you would be of great help. Assuming the money returns the historical equivalent of a diversified 60% stock/40% bond portfolio, your child can retire at 65 with $1 million tax-free, without having to invest another dollar after age 21.

Retiring With $1 Million



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds.

Source: Stocks in this example are represented by the Standard & Poor’s 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds are represented by the 20-year U.S. government bond. An investment cannot be made directly in an index. The data assumes reinvestment of all income and does not account for taxes or transaction costs. The diversified portfolio was rebalanced every 12 months. The return used for calculations was the average of 50-year rolling returns for 1926–2010.

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