March 10 - March 16, 2006 issue

Del Mar Times

Determining a person's net worth

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Most people have never figured out their net worth. Maybe they've eyeballed assets; added up the house, the 401(k) retirement plan, the brokerage account and the cars, and then subtracted the mortgage, the car loan and a few other things and come up with a roundabout figure. But, this can be done better than that.

Net worth is total assets minus total liabilities. A person might be living in a modest house and driving an economy car and have a higher net worth than a cousin who lives in a big house and has two BMWs in the garage. It's the difference between ownership and what is owed.

We advise calculating net worth at least twice a year. It can be a bit of a hassle the first time pulling together all the information, but it should be easier in succeeding years. Having a financial plan should get it done.

Assuming that a person wants to retire at some point; he, or she, needs to be able to live off of savings and whatever income they may have — a pension, for example. Current retirees can count on their Social Security checks, but if retirement is 25, or 30, years in the future, it's best not to include that in calculating net worth.

Net worth statements are like cheesecake: different everywhere one goes. Some are too simple and too broad, while others may be so detailed that a person is not likely to complete it. The following goes into determining net worth:

• Liquid assets: Something of significant value that can be sold in a matter of days. Include personal bank accounts — checking, savings and money market —

certificates of deposit, bonds, mutual funds, stocks and exchange traded funds. Use values as of the end of the last year so that all the amounts will be on the same day.

• Non-liquid assets: Something of significant value that can't be quickly sold without penalty. This would include retirement accounts, IRA, 401(k), 403b, Keogh, profit sharing plans and pension plans. Also include any real estate investments, including one's home market value.

Other non-liquid assets can include interests in proprietorships, partnerships or company stock in a firm that is not publicly traded. Also include the cash value of any life insurance that is not term insurance.

• Immediate liabilities: What is owed to creditors, credit card debt, car loan, student loan and any other debt one has to repay within two years.

• Long-term debt: For most people, this would be their home mortgage, but it may include other real estate or business loans.

To determine your net worth, do these three calculations: Liquid assets plus non-liquid assets equals total assets. Immediate liabilities plus long-term debt equals total liabilities. Total assets minus total liabilities equals your net worth.

I recommend a complete financial plan done by a professional to make sure net worth is calculated correctly. A professional also will help make sure a person is covered from unforeseen risks such as long-term care costs or an untimely death.

A person needs to protect net worth from the federal government consuming an estate in the probate process. Knowing net worth is important to determine a number of factors in the financial journey.

A few weeks ago, I wrote an article about reverse mortgages. I called a good friend of mine who is my mortgage planner, Eric Union, for a comment.

"Reverse mortgages are easy, simple and provide cash flow for retirees to live on," Union said. "They are also very expensive. There are other more cost affective options to consider that allow retirees to access equity in their real estate, such as lump sum cash out refinance or a negative amortization adjustable rate mortgage."

Consulting a qualified debt expert can save tens of thousands in costs.

It's tragic when people spend their entire working lives trying to pay off their mortgage thinking it's the best strategy for retirement and then find out in retirement that their mortgage payment is only a small portion of their monthly budget, and that they don't have enough investments to live on.

Integrating a qualified investment adviser with a qualified debt/mortgage adviser during the working years will help people avoid this tragic situation.

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