

Effective Percentage Rate

The Net Cost of Borrowing Now

Issue 1

Reviewing and managing cash flow is critical in helping you achieve your financial planning goals and objectives. By working with your Ameriprise financial advisor, you can better understand how to structure your debt in a smart way to potentially increase cash flow, which could ultimately impact your long-term goals and the lifestyle you want tomorrow. On an annual basis, you should discuss your debt structure and ask your financial advisor to calculate your Effective Percentage Rate™ (EPR) of debt.

Next Steps

- > Talk to your financial advisor about your liabilities and structuring your debt in a smart way
- > Calculate your EPR
- > Understand the impact of your borrowing decisions on your net worth

Consider EPR

EPR is the net cost of borrowing now. While most of us understand that there may be tax benefits that reduce our cost of borrowing, we typically don't have a specific number that we can use to better determine various borrowing decisions.

The EPR represents the tax-free return that you earn when you repay your mortgage or your after-tax cost of borrowing when you choose to borrow. In order to help you make smart debt decisions, ask your financial advisor to help you calculate your EPR and consider whether cash coming in is earning at least the EPR and cash going out is costing no more than the EPR.

For example, if you are pre-paying your mortgage but your EPR is less than what you would make by investing that extra cash elsewhere, you could make some wiser decisions about where to put that money. The opposite might be true if you have a lot of credit card debt at 18%, which calculates out to be much higher than the EPR of your mortgage, you may want to consider taking a home equity loan to pay off that credit card debt and repay it at a much lower rate.

Calculating the EPR

To calculate your clients' EPR, enter their Current Rate and multiply it by their Marginal Tax Rate to get their Tax Reduction. Subtract the Tax Reduction from the Current Rate to get the EPR. See the detailed example below and then try calculating your own EPR.

		Sample Calculation	Your Calculation
Current Rate	If you have an existing mortgage today, enter your current interest rate. If you are purchasing a house, or have a house with no current mortgage, enter the rate that you could borrow money today. [7% is used in this example]	7	
X Marginal Tax Rate	This is your combined state and federal tax rate. Tax savings comes off the highest bracket you reach. Use the chart below to calculate your federal tax rate, and then add your state tax rate. [25% federal and 5% state is used in this example]	x .30	
= Tax Reduction	This is the portion of your interest that could be refunded to you on your tax return. To receive these deductions you must typically itemize your return. Consult a tax advisor about your specific situation.	= 2.1	
Subtract Tax Reduction from Current Rate to calculate the: Effective Percentage Rate	This is the current net cost of your borrowing expressed as an interest rate.	7 - 2.1 = 4.9%	

2008 Federal Tax Brackets

Tax Rate	Single	Married Filing Jointly or Qualified Widow(er)	Married Filing Separately	Head of Household
10%	\$0 – \$8,025	\$0 – \$16,050	\$0 – \$8,025	\$0 – \$11,450
15%	\$8,026 – \$32,550	\$16,051 – \$65,100	\$8,026 – \$32,550	\$11,451 – \$43,650
25%	\$32,551 – \$78,850	\$65,101 – \$131,450	\$32,551 – \$65,725	\$43,651 – \$112,650
28%	\$78,851 – \$164,550	\$131,451 – \$200,300	\$65,726 – \$100,150	\$112,651 – \$182,400
33%	\$164,551 – \$357,700	\$200,301 – \$357,700	\$100,151 – \$178,850	\$182,401 – \$357,700
35%	\$357,701+	\$357,701+	\$178,851+	\$357,701+



Financial Planning > Retirement > Investments > Insurance > Banking

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