

## ***Two asset households have an unexpected method to increase their retirement income.***

Many baby boomers' who are at or near retirement have most, if not all of their wealth in two assets, their IRA or 401(k) and their home. Some of these folks will enjoy pensions to supplement their income and others will use their IRA's and social security exclusively.

For example, a sixty five year old couple has \$300,000 in an IRA and a \$300,000 home, which has five years left of payments. They receive \$25,000 per year in social security and have no pension. They plan to start withdrawing six percent of their IRA per year in the hopes it will maintain it's principal balance for as long as they live. They know that if they live too long, the tax code says they will eventually have to take out more than six percent per year, but they have decided to keep living anyway. They have two kids and six grandkids and would hope to leave them as much as is possible in the most efficient manner as possible.

This couple will receive in this scenario a total of \$43,000 per year in retirement. They have concluded they could live on this, if nothing goes wrong, but would have to live without the travel and lifestyle they had hoped for.

What could we do to substantially enhance their situation?

Let's spend down the IRA over the next ten years. Assuming the six percent rate of return, this would create \$40,700 per year from the IRA, bringing their income to \$65,700 per year in retirement, \$23,700 more than they would enjoy currently. However, the huge problem was their intention to continue living. The IRA would be exhausted and their social security income, if increasing by three percent per year would only have grown to \$33,600 by the time they reach seventy-five. At this point they should start looking at their home as an income generator. The couple will have many options to choose from at that time. They could use a reverse mortgage to access the equity in their home. They could set up an equity line of credit of a series of small mortgages, they could sell their home and downsize, or rent.

A reverse mortgage is essentially, what its name implies. You put up the equity in your home as collateral and the bank makes payments to you based on the homes value, your age and the current interest rates. You have the ability to live in the home for the rest of your life and in some cases have the power to leave a remainder interest to your kids. In this case the couple would be seventy-five years old. If their home had appreciated to five hundred thousand dollars in that time (5.25% growth), they could expect a reverse mortgage payment of around fifteen thousand dollars per year for life.

If the interest rates at the time are right, you may consider borrowing money from your home and purchasing a commercial annuity, guaranteeing more income than the reverse mortgage would afford. You could set up a line of credit, with the home as collateral. You could go a step further and sell the home and create a conservative spend down of the proceeds. Under current law the sale of the home would be free of capital gains tax if both of the spouses are living at the time of the sale and may be even if they are not. If the property sold for \$500,000 net of fees and

you invested at 4%, you could spend down the \$500,000 over thirty years (taking you out to age 105) and receive over \$30,000 per year in income. The total increase in income could be as much as \$597,000 over your lifetime.

What is the magic “investment” tool that might allow a client to do this? Life Insurance. Life Insurance is considered to be a lousy investment and how I usually see it used, it is, but it can be a great facilitator of other plans. Normally you think of insurance leverage in the form of death benefit, in this case the couple wants to leave something to their children and would not generally consider spending down all of their assets, but the insurance policy allows them to have their cake and eat it too. If you already own the insurance policy you just found another use for it. If, at sixty-five you were in good health you could purchase a five hundred thousand dollar, second to die insurance policy for around \$6000.00 per year. At the peak of the policies accumulation it would have around \$200,000 in cash value, giving you still more options. The total premium paid (you get to stop at 100) would be \$6,000 per year for 35 years or \$210,000 while your income would increase by \$597,000 and the \$210,000 would purchase a five hundred thousand dollar tax free death benefit. If you died before you sold the home or spent the proceeds from the sale if you had sold it, your heirs will receive both, substantially increasing their inheritance. You would increase your income by twenty three thousand per year for ten years, and send six to the insurance company. Years eleven and beyond you could increase your income by as much as twelve thousand dollars and pay six to the insurance company. Stop me when it’s a bad deal. Oh, and as a side benefit, the proceeds will be income tax free to the children, unlike the IRA, which would be subject to income taxes in the hands of the kids.

This strategy certainly is not for everyone and is fairly non typical in my practice, but it is good example where a person needs to look toward what they already own and determine what would be the best method to leverage it for the benefit of themselves, the people and causes they love. In short they, like most folks these days need to learn and apply creative wealth strategies to their financial lives and often should work with an experienced, quality financial planner to guide them in the process. This is an example of a defensive tax reduction method increasing it’s value while being applied to income and lifestyle planning.