

# Financial Foresight

Dempsey Investment Management, LLC

Fall 2011 Edition



## Pension Maximization Strategies for Retirement

If you are reaching retirement age, you may agonize over your pension distribution choices. In addition, more long-time corporate employees are being offered early-out packages and they want to know how to plan. Should you take the larger monthly payout for as long as you live and ignore the possibility that benefits would cease for your surviving spouse, or should you take a reduced income and guarantee those payments as long as you both live?

### Defining the Pre-Retirement Problem

Please consider the case of Happy Retiree and his wife Susie. Happy will be 62 in

December and he's been offered an early retirement program from his company. Susie is also 62. The Retiree-Life-Only option for Happy has a guaranteed payout of \$5,000 per month. The Joint and 100% Survivor monthly benefit is \$3,535. Their current budget requires \$4,200 per month, so they really liked the idea of the \$5,000 monthly benefit.

The only life insurance Happy owns is the term provided by his company and that ends when his employment ends. If they take the \$5,000 pay-out, Susie would be left without income if Happy dies first. But the \$3,535 Joint Survivor option isn't enough income for both of them and they are relying primarily on their pension for their retirement funds. What could the advisor recommend to maximize Happy's pension?

The advisor asked LLIS to research the following:

1. How much life insurance does Happy need to insure a lifetime income for Susie,
2. How much will that coverage cost, and
3. How does that compare with taking the joint life option?

Since the difference between the Life Only option and the Joint Life option is \$1,465 (\$5000 minus \$3,535), if life insurance in an amount that meets their needs can be purchased for less than \$1,465 per month, then buying life insurance is sound.

### Calculating the Life Insurance Need

We solved for Single Premium Immediate Annuity amounts that would be needed today at different ages to guarantee Susie's income if Happy died. At age 62, Susie would need \$630,000 to guarantee an income for

life. But as times passes and her life expectancy shortens, that amount decreases. At age 72, she needs \$500,000. At age 82, she needs \$320,000. How much will this coverage cost?

### Funding Layered Coverage

The LLIS solution to this pension max problem was to recommend 3 Layered Life Insurance policies. We assumed that Happy is Preferred for underwriting, but not Preferred Plus. Using varying time durations allows the client to buy the needed coverage in layers to reduce the cost. In this case we recommended 3 layered policies. (see inset)

After the 10 year term policy ends, the monthly premium drops to \$575 and after 20 years, the monthly premium drops to \$440. Each time their monthly outlay decreases, their spendable income goes up. Layering the coverage with both term and permanent insurance matches their decreasing need for coverage with the decreasing monthly costs.

This plan would allow Happy and Susie to get the entire \$5,000 to live on. Yes, they'd have to pay \$635 per month for the first 10 years, but that still gives them a net of \$4365 per month. This is \$830 per month more than the alternative available with a Joint Life option.

### What If Susie Dies First?

If they'd opted for the Joint Life plan, Happy would still get only \$3,535 per month. If he no longer has any reason to use

## 4th Quarter Considerations

### ROTH Conversions & Contributions:

Now might be a good time to consider converting part or all of your IRA to a ROTH. This is especially true if your income tax bracket is low or you have individual positions you believe will recover in price. Also consider a contribution before April 15, 2012. The tax benefits of a ROTH are too generous to pass up.

### Health Savings Account (HSA):

If eligible, have you fully funded your HSA for 2011? The limit is \$3050 for individuals and \$6150 for families. If you are over age 55 you can contribute an extra \$1,000. You receive a tax deduction when funding your HSA, and tax-free withdrawals for health care expenses.

Refinancing: A recent check of mortgage rates show 15 year rates as low as 3.25%. Even factoring in an estimated \$2,000 of closing costs, refinancing can still be a great deal.

Duration	Face	Monthly Amount Premium
10-Year Term	\$130,000	\$ 60
20-Year Term	\$180,000	\$135
Guaranteed Lifetime	\$320,000	\$440
<b>Total Insurance</b>	<b>\$630,000</b>	<b>\$635 for first 10 yrs.</b>

life insurance to maximize his pension, then he can simply stop paying premiums and spend the entire \$5,000 monthly amount. The permanent policy may even have some cash surrender values that would return part of the premium he's already paid or Happy might choose to keep the permanent policy to leave a legacy for his children or

his favorite charity.

Consider the Health Insurability Issues First! If Happy, or you are healthy, this solution works great. But what if Happy isn't healthy, how can you find out if this plan might work? The first place to start is with a Preliminary Underwriting review. Do this

as soon as possible before you need to make a decision and you'll know for sure. The younger and healthier you are, the better.

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## Your Home as a Source of Dollars in Retirement

If you own a home, you may be wealthier than you think. The equity in your home could be one of your largest assets, especially if your mortgage has been paid down over the years or paid off. This home equity can be a valuable source of extra income during your retirement years.

### How do you tap your home equity?

There are two ways to tap your home equity if you're approaching retirement (or already retired) and don't want to make mortgage payments: You can trade down, or you can use a reverse mortgage. Trading down involves selling your present home and replacing it with a smaller, less expensive home. A reverse mortgage is a home mortgage in which the lender makes monthly payments to you, rather than you making monthly payments to the lender. Both of these strategies can give you substantial additional income during retirement.

*Note: You could get money from your home by taking a home equity loan, where you place a regular mortgage on your home. But you must repay the home equity loan, with interest, like other regular home mortgages.*

### Trading down can give you increased income

If your home is larger than you need, trading down to a smaller place may be a good way to increase your retirement income. The difference between the price that you receive for your present home and the cost of a smaller new home can be added to your retirement funds to provide you with additional investment income. The amount of cash that you can get by trading down

depends on the value of your present home, the cost of purchasing a new home, and the incidental costs involved in the trade (e.g., brokerage commissions, legal fees, closing costs, and moving expenses). You should estimate these amounts to get some idea of the net amount that you will receive. To check the present value of your home, you should get an estimate of its selling price from two or three real estate agents. You should also get an estimate of the cost of your replacement home by shopping around for the type of home that you think you'll want.

*Note: If you think that the tax consequences of trading down are a drawback, think again. You may be able to exclude from federal taxation up to \$250,000 (\$500,000 if you're married and file a joint return) of any resulting capital gain, regardless of your age. To qualify for this exclusion, you generally must have owned and used the home as your principal residence for a total of two out of the five years before the sale. An individual, or either spouse in a married couple, can generally use this exemption only once every two years. However, even if you don't meet these tests, a partial exemption may be available. (For sales and exchanges made after December 31, 2008, this homesale exclusion won't apply to the extent the gain is allocated to periods (not including any period before January 1, 2009) during which the property was not used as your, or your spouse's, principal residence.)*

### Trading down can reduce your housing costs

The other important financial benefit of trading down is that it reduces housing costs--often substantially. A smaller home usually means lower real estate taxes and smaller bills for heating, cooling, insurance, and maintenance costs. If your move is from a single-family house to a condominium, your costs will be reduced

even more because outside painting, roof repair, landscaping, and similar costs disappear into lower monthly condo fees. You should carefully estimate the amount of the cost savings that you'll get from trading down. Compare the annual cost of maintaining your present home with the expected annual cost of maintaining your new home. Be sure to prorate expenses that do not occur regularly, such as indoor and outdoor painting and roof repairs.

### But trading down may have disadvantages

Consider the possible drawbacks of trading down. For instance, you may not want to reduce your living space by moving to a smaller home. Or, you may not be able to find a smaller home as attractive as your present home. Another common problem with trading down occurs if you are strongly attached to your present home. You may not want to be uprooted from your home and the social network around it. Still, you may also be troubled by worries that afflict many older homeowners, such as rising property taxes, the threat of escalating insurance, and the unexpected cost of major repairs. You may decide that trading down is warranted to lighten these worries as well as your financial burden.

*Note: If you sell your home at a gain and aren't eligible for the capital gain homesale exclusion, you'll have to pay federal income taxes on the difference between the selling price and your adjusted basis (the initial cost of your home, plus amounts you've paid for capital improvements, less any depreciation and casualty losses claimed for tax purposes) in the home.*

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