Cashing in on Congress' $350,000 Retirement Shocker

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Bob Carlson, Editor – Retirement Watch

This special report contains information on two changes in the pipeline to current tax laws that could result in you adding another $350,000 total to your retirement savings. The first is

Reverse Mortgages

The first of these two proposed taxes pertains to using the largest asset at your disposal to create as much as $150,000 more income: your home.

Perhaps one of the most misunderstood and under-utilized financial strategies available today is the **Reverse Mortgage** (also known as a **home equity conversion mortgage**, or HECM).

Since 1980, more than a million Americans have used this strategy to:

- Pay for living expenses from an (optional) lump sum, instead of their retirement nest egg…
- Pay off their home mortgages, or even purchase second homes…
- Fund their golden years and have the retirement they deserve…

However, one million Americans who know about this strategy doesn't seem like nearly enough, especially when you consider that the current population of the U.S.A. is more than 300 million…

That there are tens of millions of homeowners in the country that might qualify for it....

And that coming tax law changes in this area alone could put another $150,000 in your retirement savings.

The sad part is…

Most folks who have heard of reverse mortgages probably have a lot of preconceptions about them – and how they work. I'm also going to bet that most of them are dead wrong.

What Exactly Is a Reverse Mortgage?

In short, a reverse mortgage is a type of home loan that allows homeowners to convert a portion of the equity in their home into cash, which they can then withdraw and use for whatever purpose they desire.

Available through an FHA-approved lender, reverse mortgages are increasingly used by seniors to supplement Social Security, or to pay for unexpected medical expenses and home improvements.

Because this type of loan is often misunderstood, though, it's important to first sort through the clutter and distinguish fact from fiction.

Here's how HUD (the agency that regulates and guarantees the loans) describes reverse mortgages:

> *"The equity that you built up over years of making mortgage payments can be paid to you. However, unlike a traditional home equity loan or second mortgage, reverse mortgage borrowers do not have to repay the loan until the borrowers no longer use the home as their principal residence or fail to meet the obligations of the mortgage."*

In a reverse mortgage, a lender makes a loan to the homeowner. Neither principal nor interest on the loan needs to be paid until the homeowner dies, moves, or sells the home. The loan and interest are paid off from proceeds of the sale of the home. The loan proceeds are tax free and do not affect eligibility for other benefits.

Here's an example to help you picture this better. The median home price in America today is about $200,000. For the sake of this argument, let's assume your home's value is at least 25% higher than that – $250,000.

Even if you haven't entirely paid off the mortgage on your current house, you could get a reverse mortgage loan equal to 50% of the home's value, or $125,000. Actually, that estimate may be on the conservative side.

Note: Before you go thinking about getting a 50% loan on your multi-million-dollar mansion, know that the government put a cap on how big a reverse mortgage could be. The maximum loan amount is now $636,150 (which increased from $625,000 on January 1, 2017).

Reverse mortgage proceeds can be received in a lump sum, fixed monthly payments (for your lifetime or a set number of years), or a line of credit to be tapped as needed. Taken as a line of credit, interest accrues only on the amount actually borrowed, not on the entire amount authorized.

In general, reverse mortgages are guaranteed by the Federal Housing Administration. That means the lender is guaranteed to receive payment of the principal and interest, even if they exceed the final value of the home.

Disadvantages of Reverse Mortgages

So far, I've explained briefly how a reverse mortgage works and what to expect. Doesn't sound so dangerous, right? Here are some more things you should know about them, though:

1) You cannot borrow the entire value of the home. The lender for a reverse mortgage wants to make a profit on the loan, so the eventual sale price of the home must cover the loan principal, accrued interest, and perhaps the upfront costs of the loan.

As a result, you will only be able to borrow a portion of your home's value.

2) The amount of the loan can vary. The amount depends on current interest rates, the borrower's age, and the value of the home in question.

Lower interest rates mean a potential increase in the value of the loan, whereas higher rates can possibly lower the value. Also, be aware of your age, as the older you are, the higher the maximum loan amount can be.

3) Associated costs. This is the major disadvantage of a reverse mortgages, especially when the upfront costs and fees are factored in.

Associated costs can include:

- An origination fee. FHA-guaranteed loans can charge up to the greater of $2,500 or 2% of the first $200,000 of the home's value, plus 1% of the value over $200,000 up to a maximum fee of $6,000.
- An initial mortgage insurance premium, which is a flat 2% of the loan amount.
- Closing costs and costs associated with other mortgages (such as appraisal fees and surveys), which can be 1% to 2% of the loan amount. The closing costs depend on the lender and the prevailing practices in your area.
- Monthly loan servicing fee. After the loan closes, most lenders charge a monthly servicing fee of about $35. There can also be an annual mortgage insurance premium of 0.5% to the interest rate

If you factor all these costs together, they amount to about 6%, or more, of the total FHA loan amount. That's potentially tens of thousands of dollars in fees.

Thankfully, these upfront costs don't have to be paid in cash and can become part of the loan, but again, doing that will reduce the amount of cash you can borrow, and you will be accruing interest on those costs since they become part of the loan.

Alternatives to Reverse Mortgages

Because of the pricey additional costs, and other factors, a potential reverse mortgage borrower should **first** consider other alternatives. For example:

- Many areas allow senior citizens either to reduce real estate taxes or defer payment until the home is sold. Taking advantage of this break can increase cash flow.
- Consider other loans. Regular home equity loans usually have much lower upfront costs and lower interest rates. The disadvantage is that repayment must begin right after the loan is made.
- Consider selling the current home and move into a lower-cost home. The excess proceeds from the sale of the first home can be used to pay bills or be invested, with the income used to pay for living expenses.

Also, consider that some lenders offer reverse mortgages that are not FHA-guaranteed. These loans have no maximum amount, so they are appropriate for those whose homes exceed the FHA lending limits. Additionally, they might have lower costs because borrowers aren't paying for the FHA insurance.

My bottom line: Do your research. The benefits and risks of a reverse mortgage should be carefully weighed against each other and viewed in light of your own situation.

Advantages to Reverse Mortgages

Okay, now let's cover why reverse mortgages are something more people need to learn about. We've covered the basics of a reverse mortgage and covered some reasons to stay away from them, but it's time to leave the negativity behind.

1) A homeowner can be allowed to "age in place." This is the single biggest benefit of reverse mortgages.

More specifically, a reverse mortgages lets the person who took out the loan remain in their family home for as long as they wish. As the loan money can be used for whatever purpose the homeowner desires, this can be for house repairs or upgrades to the existing structure, such handicap access. Older generations are often quite attached to the spot they lived in, often for decades, and the ability to repair and upgrade the house as one ages can go a long ways in providing peace of mind and a sense of belonging.

2) The homeowner can meet the soaring costs of getting older. We already mentioned the ability to conduct major repairs and upgrades to the house, but the cash from the reverse mortgage can also help cover medical expenses, vehicle costs, and other related things.

To put it simply, the extra income you receive from this solution could mean the difference between living out your golden years to the full and working until you're 80 to make ends meet.

3) Reduce risk while maximizing income. A reverse mortgage moves more of your tax-advantaged dollars into your later years, which is when you need it.

These days, there are ways, but also more laws, to take into account when planning for retirement. While this strategy isn't right for everyone, there is clear demand among U.S. homeowners approaching or at retirement age.

For example, many widows and divorcees can benefit financially from a reverse mortgage if they have lower Social Security, 401(k) or IRA benefits.

Again, **do your research**. Carefully consider your own present (and future) situation to see if a reverse mortgage could help you.

What Are the Qualifications to Take out a Reverse Mortgage?

To take on a reverse mortgage, you must:

- Be at least 62 years of age.
- Own your home outright, or have a low mortgage balance that can be paid off at closing with proceeds from the loan.
- Live in the home (primary residence).
- Have the financial resources to pay ongoing property charges (including taxes and insurance).
- Receive free or low-cost consumer information from an approved counselor before obtaining the reverse mortgage loan.

That's it for the first set of changes that could help you put another $350,000 into your retirement plan. Here's the second…

The Ultimate 844 LTC Plan

The second change that could affect your retirement and hand you up to $200,000 comes from what I refer to as *the single best retirement savings plan.*

It's called the Ultimate 844 LTC Plan. It's a new asset class that can multiply your investment up to 10x to create tax-free cash for your care. This lesser-known Long Term Care plan reduces your LTC expenses by up to 90%.

Don't feel bad if you haven't heard of "844 LTC Plans," because most investors haven't. "844 LTC Plans" are largely an unknown IRS-approved financial instrument that allows you to pre-pay for long term care expenses at a highly discounted rate.

The ratios vary, based on your health and age, but every dollar that you deposit into an "844 LTC Plan" will immediately explode by 300%, 400%, 500%, or even more into long term care dollars.

- $25,000 becomes $75,000 to $250,000
- $50,000 become $150,000 to $500,000

- $100,000 becomes $300,000 to $1,000,000

Not only do you pre-pay for care — in either your home, an assisted living facility, or a luxury nursing home — for merely a fraction of normal costs, your spouse or your heirs will receive up to 200% of your money back as a life insurance benefit if you don't require any long term care in your lifetime.

Moreover, both the dollars used to pay for your long term care OR the dollars that are passed on to your heirs are 100% income tax free!

Sounds great, doesn't it? Well, it is, and with changes on the way to this law, you could put another $200,000 your account. To understand how much better the 844 LTC plan is, you have to first understand that…

The premise behind long term care insurance is like any other insurance. In exchange for an annual premium payment, an insurance company promises to pay a pre-specified amount in long term care benefits.

Long term care insurance is expensive. Very expensive. A typical premium for a 65-year old couple would be more than $4,500 a year for a 5-year, $5,000 a month long term care benefit with a 90-day waiting period. Add in inflation riders and the premium could easily shoot past $11,000 a year.

Qualifying for coverage isn't easy. It is estimated that only 25% of the people who apply for long term care insurance are accepted. Anyone with pre-existing health issues, like high cholesterol or hypertension, would faint at the sky-high cost of coverage or be denied from the get-go.

Those already expensive premiums can go even higher. That $4,500 annual premium that our 65 year old couple is paying isn't guaranteed. In fact, long term care premiums are skyrocketing.

Why?

Long term care insurance companies have two sources of revenues: premiums and returns on the investments those premiums are invested in.

Insurance companies typically invest only in super-safe bonds, and thanks to today's lower interest rates, their investment returns are less than satisfactory. Moreover, insurance companies have grossly underestimated the cost of claims and are paying out more in benefits than they anticipated.

The result is that 90% of long term care insurers have abandoned the business. Those that have stuck around have raised premiums on older policies.

In 2016, some long term care policy holders were hit with enormous premium increases. For example, the largest seller of long term care policies to U.S. residents raised premiums by 80% to 130% depending on various factors .

No wonder consumers are steering clear of traditional long term care insurance. In 2000, 700,000 Americans purchased long term care insurance. By 2015, new purchases had dropped to only 100,000.

Use It or Lose It

Not only is there zero guarantee that the cost of a standalone long term care policy won't increase, don't forget that it is a "use it or lose it" contract.

Just like homeowners insurance; if your house doesn't burn down… you don't get paid. Likewise, if you're lucky enough to make it through life without needing long term care, all those tens of thousands of dollars of premiums you paid will be for nothing.

If you are one of the fortunate 28% that don't experience a long term medical event, the insurance company doesn't send back the premiums you've paid over the years after your death. Heck, the insurance company is delighted that you died before they had to pay.

Now, here's why the better option, by far, is an 844 LTC Plan.

A better option is the "Ultimate 844 LTC Plan", in which you reposition your self-funded dollars from your left pocket to your right pocket, creating an account that grows up to 3,4,5, even 10 times the investment should you experience a long term care event.

If we assume the max of 10x growth, $100,000 of cash can increase up to $1 million of long term care coverage!

Moreover, if you have the good fortune of dodging the long term care bullet, a tax-free life insurance benefit valued equal to your deposit, or more will be paid to your beneficiaries at your passing.

Here's how it works:

The “Ultimate 844 LTC Plan” is an insurance contract that includes an IRS-approved long term care benefit that allows you to access the contract value to pay for qualifying long term care expenses.

Example #1: Two 65 year old sisters, Jane and Joan, have each set aside $100,000 to cover future long term care expenses.

Jane puts her money into a CD, while Joan deposits her $100,000 in the “844 LTC Plan.”

Ten years later while on a cruise, their boat is struck by lightning and the sisters sustain injuries that prevent them from performing 2 of the 6 Activities of Daily Living.

The CDs that Jane invested in grew (assuming a 1.4% net return) to $115,370, after taxes, and would pay for roughly 24 months of long term care at $4,750 a month. After 24 months, Jane would have exhausted all her capital.

Joan also needs long term care, but her “844 LTC Plan” provides $5,739 a month for 72 months or $448,872 of total benefits, (4 ½ times her initial transfer deposit) all tax free.

After exhausting all her money, Jane was forced to shed her assets, go on Medicaid, and finish out her days in a crowded, no-frills nursing home. Meanwhile, Joan was able to enjoy bingo night at her resort-esque care facility for the next six years, and was even able to stash away some leftover cash for her grandchildren’s birthdays.

If you have dollars sitting in low-yielding certificates of deposit (CDs), Treasuries, or money market funds, the “Ultimate 844 LTC Plan” could be an ideal place to park your dollars.

Should you be unable to perform two of the six Activities of Daily Living (Bathing, Continence, Dressing, Eating, Toileting and Transferring), or have a cognitive impairment such as dementia or Alzheimers, the “Ultimate 844 LTC Plan” could provide you with a monthly *tax free* long term care benefit with the potential to multiply in value

Indemnity versus Reimbursement

Corporate lawyers are notorious for making things more complicated than they need to, but look for one crucial clause that could make all the difference: cash indemnity benefits versus reimbursement benefits.

Cash Indemnity is when the dollars are paid to YOU for YOU to use as you see fit. For example, if you need in-home care and are eligible for a payout of $5,000 per month but only incur $1,000 of care, you can pocket the extra $4,000 and use it for anything you wish.

On the other hand, reimbursement is exactly like it sounds like. If you incur $1,000 of care costs, you need to submit the receipts to the insurance company and wait for them to reimburse you!

My father had a traditional long term care insurance policy that operated on a reimbursement basis. He needed in-home care, but the insurance company refused to pay any benefits because it didn't cover in-home care.

What Could Go Wrong?

An 844 LTC Plan isn't perfect – there are always risk factors, just like with any investment. Thankfully, the risk with any "844 LTC Plan," like any insurance policy, is quite small. However, I still advice you to make sure that the company you are dealing with has the ability to pay the claims.

In the case of all "844 Plans", insurance companies are required by state law to keep cash and securities liquid to pay benefits on their policies. Thus, the risk with companies in this business is quite low.

Second, you can check out the claims-paying abilities of any insurance company by looking at their financial ratings provided by rating agencies such as Standard & Poor's or A.M. Best. I recommend you stick with only the highest-rated insurance companies, at least A- or better with A.M. Best, and a COMDEX Score of at least 90!

For more information on the 844 LTC Plan, contact David Phillips, at Estate Planning Specialists, LLC by calling 888.892.1102 or by fax at 480.899.6723.

About Bob Carlson

Bob Carlson is editor of the monthly newsletter *Retirement Watch,* the monthly video series *Retirement Watch Spotlight,* and a weekly free e-letter, *Retirement Watch Weekly***.** In these, he provides independent, objective research covering all the financial issues of retirement and retirement planning, with more than two decades of experience in the field.

Carlson also is Chairman of the Board of Trustees of the Fairfax County Employees' Retirement System, which has over $2.8 billion in assets, and has served on the board since 1992. He was a member of the Board of Trustees of the Virginia Retirement System, which oversaw $42 billion in assets, from 2001-2005.

His latest book is Invest Like a Fox…Not Like a Hedgehog, published by John Wiley & Co. in 2007. His previous book was, The New Rules of Retirement, as published by John Wiley & Co. in the fall of 2004.

Bob Carlson received his J.D. and an M.S. in Accounting from the University of Virginia. He received his B.S. in Financial Management from Clemson University.

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