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 to the current tax laws. While they are still currently in the legislative pipeline, they could result in you being able to add another $350,000 total to your retirement savings. The first one is:

Reverse Mortgages

The first of these two proposed tax laws pertain to using the largest asset that is at your disposal to create as much as $150,000 more income: your home.

Perhaps one of the most misunderstood and underutilized 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 from 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, the fact that only one million Americans know about this strategy doesn't seem like nearly enough. This is especially true when you consider that the current population of the United States is a little more than 327 million…

Furthermore, there are tens of millions of homeowners in the country who might qualify for HECMs...

And the 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.

As they are available through an FHA-approved lender, reverse mortgages have become 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, it's important to first sort through the clutter and distinguish fact from fiction.

Here's how the Department of Housing and Urban Development (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 a second mortgage, reverse mortgage borrowers do not have to repay the loan until the borrowers either no longer use the home as their principal residence or if they fail to meet the obligations of the mortgage."*

In a reverse mortgage, a lender makes a loan to the homeowner. Neither the principal nor the interest on the loan needs to be paid until the homeowner dies, moves or sells the home. The loan and any interest are paid off from the proceeds that are accrued when the house is sold. Furthermore, 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 can 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 has put a cap on how big a reverse mortgage can be. The maximum loan amount is now $636,150 (which was increased from $625,000 on January 1, 2017).

Reverse mortgage proceeds can be received as a lump sum, in the form of fixed monthly payments (for either your lifetime or a set number of years) or as a line of credit that can be tapped as needed. When taken as a line of credit, interest only

accrues on the amount that was actually borrowed, not on the entire amount that was authorized.

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

Disadvantages of Reverse Mortgages

So far, I've briefly explained 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:

1) You cannot borrow the entire value of the home. As the lender for a reverse mortgage wants to make a profit on the loan, 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 the current interest rate, the borrower's age and the value of the home in question.

Lower interest rates can lead to 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 mortgage, especially when the upfront costs and fees are factored in.

Associated costs can include:

- An origination fee. FHA-guaranteed loans can charge up to $2,500 or 2% of the first $200,000 of the home's value, whichever is greater. Furthermore, these loans charge 1% of the value of the home (up to a maximum fee of $6,000) when the value of the home is over $200,000.
- 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) 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 be an annual mortgage insurance premium of 0.5% attached to the interest rate as well…

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. On the other hand, they will reduce the amount of cash you can borrow, and you will be accruing interest on those costs since they will 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 to either reduce their real estate taxes or defer their 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 their repayment must begin right after the loan is made.
- Consider selling your current home and moving into a lower-cost home. The excess proceeds from the sale of the first home can either be used to pay bills or even be invested. Alternatively, this income can be 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 and are appropriate for those whose homes exceed the FHA lending limits. Additionally, these loans might have lower costs because these borrowers don't pay 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

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

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

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

2) The homeowner can meet the soaring costs of getting older. I have 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 fullest 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 them the most.

These days, there are more things (and also more laws) to take into account when planning for retirement. While this strategy isn't right for everyone, there is a clear demand for such a strategy among U.S. homeowners who are either approaching or are at retirement age.

For example, many widows and divorcees can financially benefit 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.
- Either 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 (and it must serve as your 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 ever created.*

This plan is called the "Ultimate 844 LTC Plan". It's a new asset class that can multiply your investment up to ten-fold and create tax-free cash for your personal 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 which allows you to prepay your long-term care expenses at a highly discounted rate.

The ratios vary, as they are 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 long-term care dollars. For instance:

- $25,000 can become anywhere from $75,000 to $250,000
- $50,000 can become anywhere from $150,000 to $500,000
- $100,000 can become anywhere from $300,000 to $1,000,000

Not only do you prepay for care — in either your home, an assisted living facility or a luxury nursing home — for merely a fraction of their normal cost, 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 over the course of your life.

Moreover, either the dollars that are 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 to this law on the way, you might be able to 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. That is, in exchange for an annual premium payment, an insurance company promises to pay a prespecified amount in long-term care benefits.

Long term care insurance is expensive. Actually, it's very expensive. A typical premium for a 65-year-old couple would be more than $4,500 a year for a five 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 has been estimated that only 25% of the people who apply for long-term care insurance are accepted. Furthermore, anyone with preexisting health issues, like high cholesterol or hypertension, will either faint at the sky-high cost of coverage or be denied from the get-go.

Since 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 revenue: insurance premiums and the returns on the investments that those premiums are invested in.

Since insurance companies typically invest only in super-safe bonds, their investment returns have been less than satisfactory thanks to today's low interest rates. Moreover, insurance companies found out that they had grossly underestimated the cost of claims. Now, they are currently paying out more in benefits than they had anticipated.

The result is that 90% of long-term care insurers have abandoned the business. The insurers that have stuck around were forced to raise the 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 had purchased long term care insurance. By 2015, the number of new purchases had dropped to only 100,000.

Use It or Lose It

Not only is there no guarantee that the cost of a standalone long-term care policy won't increase, but you also cannot forget that insurance is a "use it or lose it" contract.

With 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 that you had paid will be for nothing.

If you are one of the fortunate 28% who don't experience a long-term medical event, the insurance company, upon your death, won't send back the premiums that you paid over the years. Heck, the insurance company will be 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." This is because it allows you to reposition your self-funded dollars from your left pocket to your right pocket. This creates an account that can grow up to three, four, five or even 10 times the initial investment if you were to experience a long-term care event.

If we assume 10x growth, $100,000 of cash can increase up to $1 million!

Moreover, if you have the good fortune of dodging the long-term care bullet, the plan can provide a tax-free life insurance benefit.

Here's how it works:

The "Ultimate 844 LTC Plan" is an insurance contract which includes an IRS-approved long-term care benefit. This benefit allows you to access the contract's value in order to pay for qualifying long-term care expenses.

Example: 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 which prevent them from performing two of the six "Activities of Daily Living".

The CDs which 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 will 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, (four-and-a-half times her initial transfer deposit) all tax-free.

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

If you have dollars sitting in low-yielding certificates of deposit (CDs), U.S. Treasury notes 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 Alzheimer's, the "Ultimate 844 LTC Plan" might be able to provide you with a monthly *tax free* long-term care benefit with the potential to multiply in value.

Indemnity Versus Reimbursement

While corporate lawyers are notorious for making things more complicated than they need to, they still look for one crucial clause which can make all the difference. That is the question of 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 which operated on a reimbursement basis. While he needed in-home care, the insurance company refused to pay any benefits because its policy didn't cover in-home care.

What Could Go Wrong?

An "844 LTC Plan" isn't perfect as there are always risk factors, just like with any investment. Thankfully, the risk with regards to any "844 LTC Plan," like with 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 your claims.

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

Secondly, you can check out the claims-paying abilities of any insurance company by looking at the financial ratings that are provided by rating agencies such as Standard & Poor's or A.M. Best. I recommend you stick with only the highest-rated insurance companies. These have either at least an A- or better with A.M. Best or have 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.

Biography

Bob Carlson is editor of the monthly newsletter and website, *Retirement Watch.* He has served on the Board of Trustees of the Fairfax County Employees' Retirement System since 1992 and been chairman since 1995. The system has more than $4 billion in assets. Carlson was a member of the Board of Trustees of the Virginia Retirement System, which oversaw $42 billion in assets, from 2001-2005. He was appointed to the Virginia Retirement System Deferred Compensation Plans Advisory Committee in 2011.

His latest book is the revised edition of "The New Rules of Retirement" (Wiley, 2016; first edition 2004). He also co-authored "Personal Finance after 50 for Dummies" (with Eric Tyson; Wiley, 2015) and wrote "Invest Like a Fox…Not Like a Hedgehog" (Wiley, 2007).

He has written numerous other books and reports, including "The New Rules of Estate Planning," "Securing Your Lifetime Stream of Income," "Tax Wise Money Strategies, Retirement Tax Guide," "How to Slash Your Mutual Fund Taxes," "Bob Carlson's Estate Planning Files" and "199 Loopholes That Survived Tax Reform." He also has been interviewed by or quoted in numerous publications, including *The Wall Street Journal*, *Reader's Digest*, *Barron's*, *AARP Bulletin*, *Money*, *Worth*, *Kiplinger's Personal Finance*, the *Washington Post* and many others. He has appeared on national television and on a number of radio programs. He is past editor of *Tax Wise Money*.

Carlson also was a Commissioner of the Fairfax County Redevelopment and Housing Authority. Carlson is an attorney and passed the CPA Exam. He received his J.D. and an M.S. (Accounting) from the University of Virginia and received his B.S. (Financial Management) from Clemson University. He also is an instrument rated private pilot. He is listed in many editions of *Who's Who in America* and *Who's Who in the World*.

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