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Retirement InSight and Trends is the quarterly newsletter from the Retirement Resource Center that helps committed professionals with the practical application of new concepts in the field of retirement planning and income management.

The articles below comprise this retirement-specific newsletter. Click on the links below to read each article online separately, or **click here to view and print the issue in its entirety**.

1. *"Using Housing Wealth and Qualified Retirement Benefits to Facilitate Asset Division in Silver Divorce"* by Barry Sacks, PhD, JD. Silver divorce is on the rise. Almost ten years ago, in October 2014, a study showed that since 1990, the divorce rate for Americans over age 50 has doubled and more than doubled for those over age 65. It is still increasing even today, so for those of you who are financial planners or family law attorneys, whatever your contact with the financial world, be aware that many older people are getting divorced.
2. *"5 Critical Social Security Concepts You Should Know to Elevate Your Credibility'"* by Heather L. Schreiber, RICP®, HLS Retirement Consulting, LLC. Advisors generally don't want to become Social Security experts. I always look at how I can help you add more value because your clients want you to. They expect you to be able to talk about it; it is part of their retirement income plan. You need to know the basic concepts and, more importantly, how to weave those conversations into what you are already doing well.
3. *"Maximizing Retirement Success: Beyond Assets and Liabilities"* by Chia-Li Chien, PhD, CFP®, PMP®, CPBC. Many years ago, I was working with a client who we'd categorize as house-rich but cash-poor when planning for retirement. In a nutshell, they did not have enough to sustain their current lifestyle into retirement.

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Using Housing Wealth and Qualified Retirement Benefits to Facilitate Asset Division in Silver Divorce

Barry Sacks, PhD, JD

Editor's note: This article is an adaptation of the live webinar delivered by Barry Sacks in 2024. His comments have been edited for clarity and length.

You can read the summary article here as part of the April 2024 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)

You may also choose to take the full length course Using Housing Wealth and Qualified Retirement Benefits to Facilitate Asset Division in Silver Divorce for 1.0 hour continuing education (CE) credit.

By Barry Sacks, PhD, JD

Silver divorce is on the rise. Almost ten years ago, in October 2014, a study showed that since 1990, the divorce rate for Americans over age 50 has doubled and more than doubled for those over age 65. It is still increasing even today, so for those of you who are financial planners or family law attorneys, whatever your contact with the financial world, be aware that many older people are getting divorced.

Dividing the Retirement Benefits

It is important to realize the importance of silver divorce in two economic factors. By age 50 or more, or even by age 65, many people have accumulated some wealth, typically in the form of a home and retirement savings. Therefore, the division of these assets has enhanced significance in divorce compared to younger couples divorcing.

Again, people are approaching or have retired by age 50 or even more by age 65. Therefore, financial considerations relating to retirement are particularly important. What do we mean by financial considerations relating to retirement? Primarily cash flow sustainability. There is nothing worse one can imagine than running out of money at ages 80 or 85 and certainly having no way at that point to find cash inflow.

So, what do we have? Qualified retirement plans are the most common kind of retirement savings. Typically, they are in defined contribution plans like 401(k)s and IRAs. These are assets to be managed and provide a source of income during retirement.

For some retirees, the value of their retirement benefits is comparable to or greater than the value of their home. For most others, the value of their home equity is greater than that of their retirement benefits. The point is that these are the significant assets for most people who are seniors.

Some people have other assets like rental property or life insurance policies. But for most people who have anything, it is their home equity and retirement savings.

Accessing Housing Wealth Through Reverse Mortgages

Let's first discuss a reverse mortgage because that is how housing wealth can be accessed in the most useful and beneficial way.

In simplest terms, a reverse mortgage, as most of you know, is just a loan. It is not a transfer of wealth to the bank. It is not anything but a loan but has this unique feature. Unlike any other loan, repayment is only required once the borrower ceases permanently to use the home as their principal residence. That is crucial to our considerations because the loan provides cash inflow when needed, but without increasing their later cash outflow. Remember, that is the crucial point in retirement. In retirement, cash must be managed with great discipline.

The reverse mortgage loan is a loan that does not increase. It is not a taxable event and does not increase your income. It can be repaid once the home is sold, when the borrower permanently leaves the home, or, for that matter, when it is refinanced by the borrower's heirs if they choose to keep it. That happens occasionally, although it is not a widespread occurrence.

A reverse mortgage provides liquidity, that is, cash, for the following purposes, and it can be highly beneficial. One situation is if one ex-spouse wants to keep the home. If one ex-spouse keeps the home, the cash from the reverse mortgage enables that ex-spouse to buy out the interest of the other ex-spouse. If the couple sells the home and the net proceeds are divided, then the cash from reverse mortgages can enable each to buy a new house.

These are called HECM for Purchase reverse mortgages. HECM is the acronym for Home Equity Conversion Mortgage, which is the most prevalent kind of reverse mortgage. Using a reverse mortgage as a purchasing tool for people is becoming increasingly popular as retirees, and their advisors become aware of it.

How can you divide retirement savings if it leaves each ex-spouse with insufficient money for a comfortable retirement? Reverse mortgage cash in the form of a line of credit can serve as an external source of money that offsets the inherent volatility of investments in the portfolio. Think about it. A 401(k) account or a rollover IRA is typically invested in securities. One must accept the inevitable pair that if one expects long-term growth, one must expect short-term volatility. It goes up and down on the way up.

If one draws from a portfolio when it is down, that increases the likelihood that the portfolio will run out of money. Again, that is the thing to watch out for. You want to avoid running out of money in later years. More generally, reverse mortgage cash can enhance retirement for ex-spouses in many ways, including as I have just described.

Professionals who advise people in the context of divorce must understand this flexible financial tool and how it works so they can feel comfortable advising their clients about using it. Unfortunately, people unfamiliar with reverse mortgages might have a negative, almost instinctive reaction. However, it is a very useful tool, and it is important to dispel some of the widely held misunderstandings about reverse mortgages.

First Example: Buyout Scenario with No Existing Mortgage

This is the simplest example: Joe and Laura are divorcing. They own a home valued at $800,000, free and clear. Let's say they also own a classic car worth $50,000.

In this case, Laura wants to keep the home. As a result, she'll keep the home, and Joe will leave and get his own house. Dividing the assets equally means $850,000 divided by 2, so each party is entitled to $425,000.

The first step is for Laura to obtain a reverse mortgage for $375,000 and purchase Joe's interest in the home. She will also give him the classic car worth $50,000. With the $375,000, this comes up to the $425,000 he is entitled to.

In this step, Laura keeps the home, and all mortgage repayments are deferred until she permanently vacates. That is the whole point of a reverse mortgage: no cash outflow. She also keeps the current property tax rate, as happens in California.

What about Joe? Joe gets a loan, also. He uses the $375,000 that he got in cash from Laura, and he gets a HECM for purchase, a reverse mortgage as a purchase loan

to purchase a new home worth $700,000. It is smaller than the $800,000 home that he and Laura shared. That is okay because he is now by himself. The $800,000 house might have been where they raised kids. Typically, the kids are grown up and gone in a silver divorce.

Generally, reverse mortgages are between 40% and 60% of the house's value up to the current home value limit of $1,149,825, depending on the borrower's age and loan rate.

The most important thing to remember is that both parties remain homeowners, not renters. Think about that. The age at which civil divorce occurs and years after that, the last thing one wants to be is a renter subject to the whims of a landlord. It is hard enough to move at any age, but at a later age, when one has gotten used to where one lives or neighborhood or community, one does not want to be at risk of having to move or having an unexpected incursion made into cash outflow.

As a result of this scenario, neither party incurs any monthly mortgage payment obligations, and no rent is ever due. Neither party had to draw upon income-producing assets, such as their securities portfolio. Again, no capital gain tax or sales fees were incurred. These are all very favorable results for both parties.

Now, there are the tax considerations. The purchase and sale between spouses or ex-spouses' of a marital home incident to divorce do not give rise to the recognition of capital gain. This is good news, set out specifically in Internal Revenue Code section 1041(a). Now, here comes the bad news. There is a carryover basis. That is the ex-spouse who retains the home; in this case, Laura has generally paid the current value of the departing ex-spouse's portion. Typically, we know that over the years, the values of homes have increased substantially despite some volatility.

The remaining spouse retains the departing ex-spouse's tax basis, meaning what they have paid. So upon the later sale of the home by, in this case, Laura, who retained the home, tax is calculated on the original cost basis of the home. In other words, if they bought this house for $200,000, then Joe sold his half for $400,000, and Laura is deemed only to have paid $200,000 for the entire house. That is $100,000 for her and $100,000 for Joe. Therefore, when she sells it, that gain will be recognized. That is the other part of Section 1041.

Second Example: Asset Division Scenario

This is a different couple. Neither party wants to retain the house, so they sell it. Their house is worth $1,650,000, much more expensive than the one that Joe and Laura had in the example above. They had an existing mortgage when they sold it for $600,000. Because they sold it on the market, presumably using a real estate agent, there is a sales fee, and we estimate $95,000. That is a reasonable number for a house that size.

There is a capital gain tax to pay because it is sold to an unrelated party. There is $800,000 left over, and they divide the cash 50/50, or $400,000 for each.

Each party uses their share of the net cash as part or all of the down payment on a new home. Each party then obtains a HECM for the remainder of the home purchase valued in the $700,000 range.

Using the HECM proceeds of $300,000 and the $400,000 cash, each of a couple ends up owning a house free and clear in the sense that no debt service must be paid as long as they live in the house. Again, favorable results for both parties. As I said before, they become homeowners, not renters, which is particularly important as people age. Neither party incurs any monthly mortgage payment obligations. Neither party has had to draw upon any income-producing assets. Both parties participate equally in the sales fees and capital-gaining taxes.

Again, let's look at the tax considerations. In this one, a capital gain is recognized. However, an exclusion is set out in Internal Revenue Code Section 121, and the regulations say the amount of gain that can be excluded is $250,000 for each individual or $500,000 for a couple filing a joint return. Now, it is important to note, because now we get into some of the weedy stuff about tax law, a joint return cannot be filed for the year when the divorce becomes final, even if they still need to divide up all the assets.

In California, we have what is called bifurcated divorce, where people can become single from the standpoint of their marital status and still argue, fight, pay lawyers, and have a terrible time dividing up the assets or the financial part. Marital status can be resolved relatively quickly. When there are assets to be divided, that might take much

longer, but it does not delay the marital status change.

Here is one of the considerations for this exclusion. If the couple has been living apart for some time before the divorce becomes final, the home sold may be treated as the principal residence of only the party living there. However, the rule is complicated because it says that one is entitled to that $250,000 exclusion if one has lived there two out of the last five years. But you must measure this in months. What does it mean to be living there? Can visiting there to pick up your stuff or does cleaning up the place count? I am currently involved in a case where the people are fighting precisely that. It is a $2 million house in Berkeley Hills, and the argument is how much time he spends there. During which months can he get his two years of residence during the last five years? I am looking forward to seeing how that case comes out.

Third Example: Buyout Scenario Involving a 401(k) Account

Jack and Jill are divorcing. They own a home worth $800,000, free and clear. Jill wants to keep the house, and Jack wants to travel. Jack may later rent a house. Jack also has $1.2 million in a 401(k) account.

Under the agreement, Jill keeps the house and $200,000 in the 401(k) account, which she can roll over to an IRA. Jack gets the rest of the 401(k), valued at $1 million, and rolls it into an IRA.

Using the four percent retirement income rule, Jack will be able to draw $40,000 per year from the $1 million IRA. Added to a typical Social Security amount of $25,000, he'll have an annual income of $65,000. That is reasonable, acceptable, and manageable. It is not colossal.

Using the same rule, Jill can also draw four percent from the $200,000 for $8,000 a year. Even with Social Security, assuming that she gets some of Jack's Social Security upon divorce, though it is not very much. The question is, is there a better way?

Here are the tax considerations. Jack's and Jill's income will come from IRAs and Social Security. The IRAs will be taxed as ordinary income. Jill's Social Security piece will be taxed at a low rate. About 50% of it will be taxed at whatever her bracket is. As a result, her income, which is already too little to maintain the house and provide living expenses, is further reduced by some income tax. Obviously, with her small income, her tax rates will be relatively low. Indeed, the Social Security tax may be zero because the other income is so low. Determining how much Social Security income is taxed is a complicated procedure. It is always less than ordinary income, but how much less depends on the other income.

We've got a second way to examine this situation. Again, the home is valued at $800,000. Jack wants to travel and later rent a home. Jill keeps the house and obtains a reverse mortgage for $300,000.

To accomplish equal division, Jack will get $300,000 of cash under the agreement and QDRO as before and an IRA valued at $ 700,000. This leaves $500,000 in Jill's 401k account or IRA. In Jack's retirement, he'll be able to draw $28,000. That is four percent of the IRA annually, again, adjusted for inflation in subsequent years and another $12,000 from having invested the $300,000 he had. He is getting a total income of $40,000. Again, added to his Social Security of $25,000, he'll have the same income he had before. Different tax rates apply to different sources of investment capital.

Jill now has a $500,000 IRA that gives her $20,000 a year. This is much better than the $8,000 that she would have had from the $200,000 401(k) or IRA. However, the amount is still taxable as ordinary income.

The favorable result is that Jack will have less tax to pay than under the first way because some of it is capital gain. The lower income may result in the Social Security piece being taxed less. Jill gets much more cash flow and more money invested with greater long-term potential wealth but also, of course, greater risk.

Another way a reverse mortgage could benefit both members of the divorcing couple, for both the asset division and the provision of returned income, is when the home value is greater than the securities portfolio value. This is shown in an article that Pete Neuwirth and I wrote, along with my brother Steve Sacks, the brilliant computer programmer in the family. We published "Integrating Home Equity and Retirement Savings through the 'Rule of 30'" in the October edition of the 2017 *Journal of Retirement of Financial Planning*.

This research shows that when you have a high ratio of home value to portfolio value, you get so much buffer and more help that you can withstand a lot more draw from the portfolio. We showed that even with an initial draw of eight percent of the portfolio, when there is a house that is close to twice as much value as the portfolio, you can get an eight percent initial draw rate and keep drawing that for 30 years with a 90% probability that the portfolio will last 30 years, inflation-adjusted, so it is constant purchasing.

Reverse Mortgage Overview

This is the third stop on our travels. Now that we've given you some examples of how reverse mortgages can be used, both as a buffer asset to help the draws from the securities portfolio and as a way of making it much easier to divide up a home, let's learn a little bit more about reverse mortgages.

Who's eligible? It must be the primary residence of the borrower or borrower. Typically, the borrowers must be older than age 62. Some so-called proprietary reverse mortgages, not HECMs, have an earlier eligibility age. The loan amount is lower if there is a younger than age 62, so-called eligible non-borrowing spouse. Interestingly, that protects a younger spouse, such as if the couple's wife is 62 or 63 and the husband is 56 or 57, which is an actual case that I am working on now.

Only the older spouse can be the borrower if a couple gets the reverse mortgage. The eligible non-borrowing spouse is protected if the older spouse dies while the couple is living in the house. This is not a divorce situation. I do not know how that would be carried out if divorce were to occur.

The residences themselves can be single-family homes or condos approved by HUD. They can be one- to four-unit buildings where the borrower occupies one unit and rents out the others. In some states, co-ops are also allowed. The amount typically available is a function of the borrower's age and the value of the home. That goes up to a maximum value of $1,149,825. They're raising this number often now, once every year. It used to be every few years.

Obviously, the older the borrower, the higher the amount available because the amounts are based on actuarial calculations. Typical numbers are that borrowers in their 60s can get 40 to 50% of the home value, and borrowers in their 70s can get approximately 50 to 60% of the home's value.

Here are some features and limitations. The most important feature is that a reverse mortgage is a loan with no monthly repayments. If no repayments are due, they're only due when the borrower permanently leaves the home. As I often say, that can be either vertically or horizontally.

It is for primary residences. If it is one to four units, then the borrower must live in one of the four units or one of the three or two if it is multi-units. It cannot be used as a hotel or for Airbnb. They have minimal income and credit requirements to ensure people can pay their property taxes and insurance. You must keep these things insured.

The borrower retains title and can sell or refinance it at any time. That is crucial to understand. It is not anything but a loan. The heirs inherit the total value of the home subject to the mortgage debt. That is standard and would be the same if there were a conventional forward mortgage. It is the same as a conventional mortgage or HELOC debt, except that no repayment is required during residency.

HECMs are insured and regulated by HUD. It is also nonrecourse. One of the calculations I am doing right now in working is using a reverse mortgage for Roth conversion. A large chunk of a reverse mortgage loan is taken early in the game and runs up several years. It is a variable rate and property values can go down as well as up. If the debt exceeds the home's value when the borrower leaves, there is no additional recourse against the borrower if they are still alive or if the borrower dies. Only the property is liable for the debt.

The money can be drawn in any of four ways or any combination. It can be drawn as a lump sum, a line of credit, an annuity, or a tenure payment, which is a series of payments for a predetermined number of years. Tenure payments are very flexible and can be changed once one starts. If a small lump sum is taken, a line of credit can be obtained for the rest.

This is the interest rate. It is generally variable, but a fixed interest rate can apply to a lump sum that is drawn. There are fees, but they're not out of the borrower's pocket. The critical consideration is that the significant fee, the initial mortgage insurance premium (IMIP), is a one-time

charge and should be viewed in the context of the long-term benefits.

That means that one should not get a reverse mortgage on a place that one plans to leave in a relatively short time, as little as a year or two or even as much as four or five years, because those fees are gone. But if one plans to stay in the home for several years beyond five, six, or seven or permanently, then it will be amortized over that time. It is a small amount per year. People do tend to stay put. Many people like to, as they say, "Age in place." For what it is worth, is that I am talking to you from the very same place I have been living in for 45 years. I am 85 now, so I plan to stay. People tend to stay, particularly older people who do not like a change of scene.

One more extraordinary feature is that when a reverse mortgage is taken, in whole or in part, as a line of credit, the portion not yet borrowed grows at the same rate as the portion borrowed accrues interest. That means it grows and grows if one gets a line of credit early on and does not use it for a while. If interest rates are relatively high, remember that it is variable, and the amount available grows.

That becomes extremely important as time goes on. As inflation causes that to grow, the amount available also grows, which helps sustain one's portfolio.

Myths to clear up.

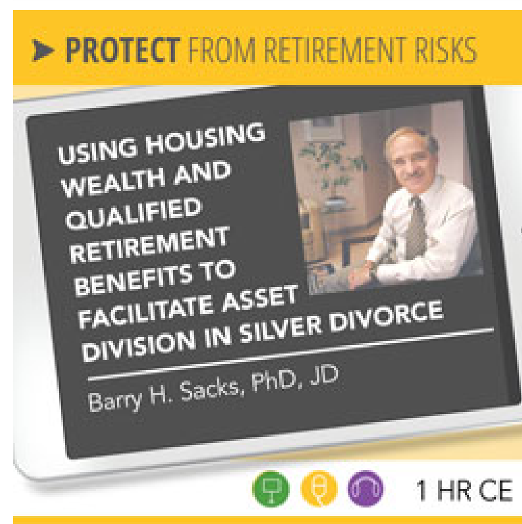
- The bank does not own the house.
- The heirs do not lose their inheritance.
- The setup fees are low, and incidentally, mortgage insurance premiums are on any regular forward FHA loan.
- It is not true that there is no way out. It can always be paid off or refinanced.
- There are no prepayment penalties.
- There is no equity sharing.
- There are no required annuity purchases.
- The high interest is similar to HELOCs, but HECMs have a lower cap. HELOCs rates are often not capped at all. When inflation and interest rates jump, HELOCs will follow, whereas there is a cap on HECMs.

Concluding Thoughts

A reverse mortgage can constructively divide assets and provide retirement income for people involved in a silver divorce.

In particular, by using a reverse mortgage, both divorcing parties can emerge from the divorce as homeowners with no debt service to erode and constrain their cash outflow for everyday living expenses.

By using a reverse mortgage, divorcing parties can retain a more significant portion of retirement accounts to provide retirement income instead of being drawn down for the division of assets. That is crucial. We are talking about people no longer working, so they cannot refill their retirement funds. A reverse mortgage credit line can serve as a buffer asset to augment and sustain a securities portfolio invested to provide retirement income.



Using Housing Wealth and Qualified Retirement Benefits to Facilitate Asset Division in Silver Divorce – Barry Sacks

About [Barry Sacks, PhD, JD]

Barry Sacks, Ph.D. earned his Ph.D. in semi-conductor physics from M.I.T., and then taught at U.C. Berkeley. He earned a J.D. Harvard Law School, and is a Certified Specialist, Taxation Law, from the California Board of Legal Specialization. Barry spent 35 years as an ERISA attorney, specializing in qualified retirement plans. He then used his breadth of skills to discover a role for a reverse mortgage to help make a retirement portfolio last longer. Barry now has a law practice providing special services to tax professionals in the area of "Offers in

Compromise" for retirees living on 401(k) accounts or other securities portfolios.

Barry and his brother, Stephen Sacks, Ph.D. shared their analysis of the reverse mortgage credit line in the February, 2012 Journal of Financial Planning. They revealed that if a reverse mortgage credit line was drawn on before drawing on investments when values had declined, a retiree's residual net worth (portfolio plus home equity) after 30 years is about twice as likely to be greater than using home equity as a last resort. Evensky, Salter and Pfieffer then published their paper in the Journal of Financial Planning the following year on how to increase the sustainable withdrawal rate using the reverse mortgage line of credit.

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5 Critical Social Security Concepts You Should Know to Elevate Your Credibility

Heather Schreiber, RICP®, Founder and President, HLS Retirement Consulting, LLC

Editor's note: This article is an adaptation of the live webinar delivered by Heather L. Schreiber, RICP®, in 2024. Her comments have been edited for clarity and length.

You can read the summary article here as part of the April 2024 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)

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By Heather L. Schreiber, RICP®, HLS Retirement Consulting, LLC

Advisors generally don't want to become Social Security experts. I always look at how I can help you add more value because your clients want you to. They expect you to be able to talk about it; it is part of their retirement income plan. You need to know the basic concepts and, more importantly, how to weave those conversations into what you are already doing well.

Believe it or not, the Bipartisan Budget Act of 2015 changed all the rules, and all the claiming strategies were thrown on their heads. Some nine years later, I still get questions about spousal eligibility.

Concept #1: Calculating the Social Security Benefit

Let us discuss how to calculate the Social Security benefit. Some of this might be basic to you, but I will review it for those who need help understanding how it works.

To become eligible for a retirement benefit, you have to earn credits, or the old terminology used to be cores of coverage. You need 40 credits or cores of coverage to become eligible for retirement benefits. Once you have earned 40 credits, you can stop counting. It is, on average, ten years of work. You can earn four credits in a calendar year; each year, a credit is worth something different and is inflation-adjusted.

This year, one credit is $1,730. So, if you work throughout the year, you must earn $6,920 to earn four credits. You can earn them at the beginning of the year, and once you have earned your four credits, you have earned the maximum four for the year. You can stop counting once you have done this over the past ten years and earned 40 credits.

That leads us to a very significant term, which is called PIA, or Primary Insurance Amount. That is the basis on which your Social Security benefit revolves. You will see the term "Survivor PIA," you will see PIA as it relates to retirement benefits, and you will even see PIA when we are talking about spousal or ex-spousal benefits because

someone's PIA is how a spouse or ex-spouse will benefit as calculated. You need your ten years on average, but the PIA is based upon your highest 35 years of earnings indexed for inflation, and it is based upon a three-tiered bend-point formula.

Concept #1: Calculating the Benefit

Earning "credits" or "quarters of coverage"

- 40 credits needed for retirement benefit eligibility
- 10 years of work, on average
- 1 credit = $1,730 (2024) of FICA earnings or $6,920 in a year; max of 4 credits may be earned per year

Primary Insurance Amount (PIA)

- Applies the highest 35 years of a worker's earnings, indexed to inflation, to a three-tiered bend-point formula.
- The year of initial eligibility (age 62) is the year the bend points are applied to average indexed monthly earnings (AIME).
- Full Retirement Age = 100% of PIA. An early or later claim will reduce or increase the amount of PIA received.

https://www.ssa.gov/oact/cola/Benefits.html
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The bend-point formula is indexed to or based upon the year someone reaches initial eligibility or turns 62. Their highest 35 years of earnings as of the year they turn 60 are indexed, and then all years after that are taken at face value. If the Primary Insurance Amount is equivalent to what someone would collect at full retirement age, you get 100% of your Primary Insurance Amount.

Whether or not you collect that is based upon the timing of your claim. So, if you file early, it is reduced monthly. If you file later, as late as age 70, it is increased by delayed retirement credits. The PIA is an important number.

How do you calculate 100% of the benefit at full retirement age? You first look at someone's entire earnings history under Social Security and adjust all of those numbers for inflation. Remember that age 60 and beyond are not adjusted.

A common question is, "Well, once I claim the benefit, do they still look at my earnings? Absolutely. If those most recent earnings continue, if it bumps out one what was counted for the highest 35, it will be used. So, every year someone earns something, Social Security will recalculate the PIA. Once those highest years have been selected and indexed, those are used in the recalculation of the PIA.

Now, what if someone has a zero in some of those years? Well, guess what? They do not just say, "Well, we will just use the 20 you have;" they will substitute zeros. This is where this becomes a valuable conversation. Zeros are added from missing years in that 35-year calculation.

Once you have 35 years, or if you do not, zeros are substituted for the highest 35 years where you had no earnings. You divide that by 420, the number of months in 35 years, and that becomes your average indexed monthly earnings.

You apply a bend-point formula to this. I do not want you to get into the weeds about the bend-point formula; know it is used when someone turns 62. I want you to focus on the ties. The first tier pays 90% of the income in that tier, the second tier pays 32%, and the third tier pays 15%.

I'm sure you've heard that Social Security is designed to replace a higher percentage of lower-wage earners' income. For example, someone whose average indexed monthly earnings is $1,000 a month will get 90% of their pre-retirement earnings replaced, while someone who has higher earnings will have less replaced. Social Security is intended to replace about 30 to 40% of pre-retirement income.

Let's say someone has an average annual income of around $24,000 throughout their career. Per the bend-point formula, Social Security will replace 65% of their earnings. For someone with an average monthly income of $10,250, Social Security will only replace 33% of their income. So, how do we take all of this mumbo-jumbo about the PIA and the bend-point formula and use it with clients?

Remember, zeros are substituted for any missing years in this calculation. So when clients want to know how to increase their Social Security because they might have been in and out of the workforce taking care of children or aging parents (the sandwich generation), tell them that even part-time work can increase their PIA. These are the honest conversations you have by understanding this. Encourage them to work at any level. Any level is going to be better than a zero.

Sometimes, a dependent spouse says, "It is not worth it for me to work, so I will just wait. I will get the spousal benefit, which can be as much as 50% of the higher earner's PIA." The problem with that is it can be a competing interest because now the rules have shifted, and I will get to that later, in that the higher wage earner has to file for benefits before the dependent spouse can file.

The higher wage earner should consider waiting longer so that it produces a higher cash flow while they are both alive and a higher cash flow for the survivor. However, for the dependent spouse to file, the higher wager must have filed. So, encourage a dependent spouse who might be either very low earning or shy of the credits needed to collect their independent retirement benefit to work enough to earn those credits. If they have earned at least some benefits, let them file and have the higher wage earner file later. So that is something to consider.

However, make sure they understand that for any year that they work, Social Security will be recalculated, and if that presents a higher PIA because that most recent year increased their PIA, they will see that benefit increase the following year. It takes a whole year to come into effect, but they will see it. People ask how accurate a Social Security statement's benefit estimates are. First of all, they are in today's dollars. Secondly, they are most accurate the closer you get to the benefit projection date. It is assumed that someone will earn the most recent year of earnings for the rest of their career until Social Security is informed otherwise.

Business owners generally report very low W-2 earnings. If they are an S corporation, they generally report lower W-2 earnings to avoid employment taxes. Then they come to you later and say, "Uh-oh, I barely have any Social Security." So, you always want to be mindful of that, especially when they are in their 50s. If you discover they have negligible Social Security benefits, how can you test how much they should consider putting in to bolster that retirement benefit?

A little-known tool I recommend is the "Plan for Retirement Tool," available through your online Social Security record. If you have a business owner who says, "Well, what if I report higher or lower earnings?" You can put all those scenarios into modeling potential benefits. So, if I just went in and said, "What if this person makes zero for the rest of their career, how does their benefit change?" "What if they make $75,000 or $50,000 a year?" Then, you can download the results.

This is a good way to test scenarios for business owners who want options. What if they say, "Well, how about if I shift income to my spouse, who also works for the business?" Or someone can say, "Well, what if I go to work full-time to earn my credits?" These are valuable ways to work with clients to help them see what different amounts of earnings will do for their benefit.

Concept #2: (Living) Spousal/Ex-Spousal Benefit Eligibility

Let's now discuss spousal and ex-spousal benefit eligibility compared to survivor benefits, two things people need clarification on.

Often, people ask, "Can I file for spousal or ex-spousal benefits and let mine roll up?" That is called a restricted application. It rode off into the sunset on January 1, 2024.

Why? Because the people that were eligible for that had to have been born before January 2, 1954. Why? Because the Bipartisan Budget Act of 2015 gave that a shelf life until this year, those individuals had to have been born before January 1, '54, and they all turned 70 by January 1 of this year. The flip side of that strategy was the file and suspend strategy. The file and suspend strategy has a very short shelf life. It expired on April 16, 2016, after the Bipartisan Budget Act came out in 2015.

These strategies allowed the higher wage earner at full retirement age to file and immediately suspend their benefit, allowing a dependent spouse or even dependent children to collect benefits during that suspension period while the higher wage earner was earning delayed retirement credits. That went out of the window in 2016, but people are still confused. So, the first thing to know is that the restricted application is no longer a thing. How are benefits payable now that these strategies are gone?

Since the file-and-suspend strategy is gone, the higher-earning spouse has to file, period, for the spouse to collect spousal benefits. For currently married spouses, that is the deal.

Now that the restricted application is gone, it is not that someone who has earned a retirement benefit can never collect a spousal benefit. Still, it means that everyone falls into a "deemed" filing category. If you file for a retirement or a spousal benefit, you are deemed to file for both simultaneously. To simplify, that means that if I am entitled to a Social Security retirement benefit, it will always be paid before an auxiliary benefit under my spouse's or my ex-spouse's record.

In other words, Social Security always wants to pay workers' own benefits before they pay benefits under their spouse or ex-spouse. Makes sense. We are not talking about survivor benefits here (but will later on); we are only talking about living. Social Security will compare the two benefits and say, "Okay, you have a retirement benefit, but this produces a higher benefit under your spouse, so we are going to go ahead and pay you the spousal excess on top of your benefit."

What is the maximum spousal benefit? For a living spouse or ex-spouse, it is 50% of the higher wage earner's PIA. Remember that the PIA is the crux of everything. That is 100% of the benefit at full retirement age. That is what you need to know. So, you need to know the full retirement age benefit of the higher wage earner. You take half of that. That is the maximum amount a spouse or ex-spouse can get, so you should compare that with their own full retirement age benefit. So, it is reduced if the dependent spouse takes the benefit before their full retirement age. People get confused by that.

People ask, "Well, what if the higher wage earner takes it at 70? Is it 50% of that?" I hope you're saying, "No, it is not 50% of that." Or "What if the higher wage earner files at 62? Is it 50% of that? No, it isn't. It is always 50% of the higher wager's primary insurance amount. Whether or not the dependent spouse gets that much depends on when the dependent spouse files for it. The reduction always follows the claimant, regardless of whether it is their own or a dependent benefit. There is a big difference; if you can get that, you are light years ahead of many people because it is confusing.

What is the required length of marriage to receive benefits on the higher earner's record? Currently married spouses have to be married for one year for spousal benefits to be considered for living spousal benefits. For survivors, it is nine months.

If divorced, you must have been married for at least ten years to access living and survivor benefits. In the case of living ex-spousal benefits, you also have to be unmarried. So, you could have been married in between, but you have to be unmarried to be eligible for living ex-spousal benefits while your ex is alive. So, you could have gotten married, but if you get divorced again, you can claim those benefits again if the benefit is higher than your own retirement benefit.

The other slightly different requirement for ex-spousal benefits is if the ex-spouse still needs to file for benefits. However, there is still potentially a way to get ex-spousal benefits, which is called an "independently entitled ex-spouse."

That means I do not have to go knocking on my ex's door to find out if they filed if I know that the divorce occurred two years before my claim and my ex is at least 62. That way, without finding out if they have filed, I can say, "Well, I know those things to be the case, so then I can still file for an ex-spousal benefit." Again, provided that it is more significant than any benefit I may have earned under my own record.

So, let us look at an example so that you get this deemed filing thing under your belt. Say Seth has a PIA of $3,600, and wife June has a PIA of $2,000. So, the maximum spousal benefit under Seth's record is 50% of $3,600. That is pretty simple. June will forfeit the spousal benefit. Why is that? Because the spousal benefit of $1,800 is less than her benefit of $2,000, so in no circumstance will she collect a spousal benefit because her own PIA is greater than half of Seth's. But what if Seth waits until age 70 to file and collects $4,464? Can June collect 50% of that amount, or $2,232?

June's benefit is capped at 50% of his PIA. So, the fact that Seth waits until 70 to file does not give her 50% of that. However, it does give her the right to inherit it. If he dies before her, then she does benefit from him waiting until 70 to file, and that is why the claiming age decision of the higher earner is incredibly important. So, inherit it at death, but not during lifetime.

Let us look at another one. Susan is 65, has a PIA of $3,300, and is waiting until 70 to file. Husband Jake just reached his full retirement age with a PIA of $1,000. So, we know that the maximum spousal benefit is 50% of Susan's PIA, or $1,650. We know in this case that Jake's PIA is less than the spousal benefit, so we know there is an opportunity here for him to collect a spousal benefit. So, if he files now, what is he entitled to collect?

I hope you are thinking, "Well, because Susan has not filed yet, he is only entitled to his benefit of $1,000." But a few years from now, he will get a spousal boost or spousal excess when she files for her benefit. So, he will continue to receive his $1,000, and then he will get the additional

$650 when Susan files for her benefit, representing the sum of the two that is bringing him to the greater spousal benefit amount. Remember, she has to file for her benefit before he is entitled to that extra amount.

Concept #3: The Annual Earnings Test

Help your clients avoid withheld benefits or overpayments by asking one simple question. Every time you deal with someone who says, "Well, I am considering filing before I reach full retirement age." Your very first question should be, "Are you working?" because right now, Social Security, if you have read anything in the media, has a massive overpayment problem to the tune of $23 billion outstanding in overpayments, a lot of which is based on applicant's, or recipient's or beneficiary's changes in their income.

They do not know what they do not know, so they file for benefits. They either do not report that they are working, or their circumstances change while claiming benefits early, and they need to tell Social Security. Then it catches up with them. The IRS communicates with Social Security and then they are in overpayment status. It is not fun. So, you want to make sure you ask if they are working, and if so, you need to ask them how much they are making.

Every year, the limitation on earned income changes. You only need to be concerned about this until they reach full retirement age, at which time in the month that they reach full retirement age. Let's say someone is working and also collecting Social Security and is under full retirement age for the entire year. The 2024 earnings limit is $22,320. Let's say they exceed the earnings limit by $10,000. Social Security divides that excess by two and then divides their monthly payment into the excess amount. Social Security will then say, "We will not pay you benefits for x months until the excess is paid back." That is if they hear about it beforehand. If they do not hear about it, they will return to you later and say, "Well, it took us two years to find you. We have paid you ten months of excess benefits, so now you owe us $20,000." So, you want to be very careful about that.

Once someone hits the year they are going to reach full retirement age, they have a higher earnings limit, and they only have to worry about it from January until the month of their birthday. The earnings limit for the year you reach full retirement age is $59,520 in 2024, and then the excess withholding is only a third of the excess. Remember, starting the month you reach full retirement, and beyond, we do not have to worry about this.

A common question I get is, "What earnings count?" It is only the applicant's earned income; it is not the spouse's earned income. You do not have to worry about pension income, IRA income, rental income, or dividends. W-2 income, self-employment income, and benefits are withheld up front. They need to understand that when they go into this. Now, it is not that the benefits are lost. Once they reach full retirement age, if they have had benefits withheld, the benefits are restored in the manner of taking those missed months and recalculating their benefit as if they had applied for benefits that many months later.

If someone had missed out on ten months of benefits over time, at full retirement age, their benefit would be recalculated as if they had claimed ten months later. They do not get a lump sum back; they get it added to their benefit in a monthly way at full retirement age as if they had claimed ten months later. If Social Security is not informed of the excess earnings, they will come looking for you and present an overpayment notice, which is not fun. I have worked with many clients who have gotten them, unsuspecting people who needed help understanding, and it can be an overpayment for many reasons. It is usually an earnings problem. It could be that they had a non-covered pension and received benefits they should not, but often it is an earning issue.

Always ask about working when people are claiming benefits or considering claiming benefits before full retirement age. Some say, "Well, I have made $100,000 this year. I am going to retire in September. Does that mean Social Security will not let me file until the following year?" That is not the case. A special rule exists called the monthly earnings test for situations like this.

Social Security will say, "Okay, if you plan on retiring mid-year, then we will disregard all of your earnings from January through August if you are going to retire in September. You can get your full monthly benefit in September, provided you do not earn more than the monthly equivalent of the annual number for the rest of the year." So, if the 2024 earnings limit is $22,320, you divide that by 12 for a monthly amount of $1,860, and you cannot

earn more than that per month for the rest of the year.

Any benefits due to excess earnings are withheld in the first months of the year. For example, Jim is 64 and expects to earn $35,000 in 2024. If he files for benefits now, he will get a permanently reduced benefit because he is filing at 64, but he has $12,680 of excess income over the $22,320. When we divide that by two, he received $6,340 of excess benefits, which he is not entitled to because of his excess income.

So, Social Security will withhold the $6,340 excess in the following year's first four months. They take that $6,340 and divide it by his monthly income benefit. Say it comes to 3.38 months. They rounded it up so they would not have to pay him for four months, and his Social Security benefits would start again in month five. Every year, he needs to report to them what he thinks his earnings will be so that they do it proactively instead of reactively. You do not want your clients to get overpayment notices. The other thing is that if someone relies on Social Security for a steady income stream, it is not a good idea because they will not get benefits for part of the year.

As said earlier, benefits previously withheld will be repaid at full retirement age. Even if the filer is under the earnings cap or retired and their spouse continues to work, you need to make them understand that "Yes, you are under the earnings cap, but if you have a spouse who is working, it is likely that you are going to pay taxes on a portion of your Social Security benefits."

There are alternate ways to bridge income so we can avoid that, and because you are taking a permanent reduction in addition to the fact that taxes will probably take a bite out of it on some level, too. I did mention already that in the fiscal year 2023, there are $23 billion in outstanding overpayments, so this is a critical issue that you need to make sure that your clients are aware of when they are considering filing early.

Concept #4 – Widow(er) Benefit Eligibility and the Survivor Switch Technique

Let's discuss widow and widower benefit eligibility and the survivor switch technique.

The earliest age at which retirement benefits are available for spousal and ex-spousal benefits is age 62.

A widow or widower collecting survivor benefits can remarry at age 60, so it does not prohibit a survivor benefit from being paid. That is important. When talking about ex-spousal living benefits, if that ex is collecting benefits under an ex's record and gets remarried at any time, those benefits will stop. Still, survivor benefits will be payable to a surviving spouse or surviving ex-spouse of the deceased as long as that remarriage does not occur until age 60 or later.

I tell advisors they need to be mindful of the fact that age 60 is critical for the remarriage of widows and widowers. Why is that? Well, a survivor benefit can be as much as 100% of what the deceased was receiving, whereas a spousal benefit is capped at 50% of PIA. That is a big difference, and you need to be mindful of this in your planning and your discussions with them.

The age widow benefits are as much as 100% of what the deceased was collecting at the time of death or entitled to collect at the time of death, so the claiming age decision of the higher-earning spouse is critical to survivor cash flow. Suppose that higher wage earner waits until age 70 to collect their benefits. In that case, the lower-earning spouse, if they are the survivor, will benefit from that decision at death because the 24 to 32% in delayed retirement credits that the higher-earning spouse earned by waiting is inherited by that surviving spouse.

Now, I say as much as 100%. Benefits might be reduced by as much as 28½% % if the survivor files at 60. If they are eligible between 50 and 60 because of a disability, it is not reduced any further; it is only reduced by 28.5%.

How is it reduced? Remember, the survivor benefit, like every other benefit, is reduced based on when the claimant, in this case, the survivor, takes it. The benefit is always based on when the survivor takes it. What happens if the deceased dies before they ever claim a benefit? You will get different answers if you call Social Security. From experience, they are in dire straits and trying to train new people. They have a hiring freeze, and they have a bunch of attrition. Make sure you are aware of this.

If they die before full retirement age and never claim, the survivor PIA is equivalent to their full retirement age as of

the date of death. If they die after full retirement age but before 70—say they were planning on waiting, and they never got there, and they pass away—their survivor PIA is what their date of death benefit would have been had they claimed. So, the survivor benefits from the delayed retirement credits they earned or never had the opportunity to claim.

What is the survivor switch technique? This is something that Social Security usually will never tell a widow or widower who comes into file for survivor benefits. (You cannot file for survivor entries online, by the way. You must either make a phone appointment or go into the office.) The survivor switch technique is for an individual entitled to both a survivor benefit and a retirement benefit. They do have a choice. They can choose to file for the lower benefit first and switch to the higher benefit later, regardless of their age. It is essentially a restricted application strategy that they can do at any age.

For example, I could be a survivor and say, "Well, I am going to take the widow's benefit at age 60 and hold out and take my retirement benefit at age 70 since my retirement benefit can continue to increase." Social Security generally does not inform a widow or widower that they can do this. They essentially deem the person without the person even knowing. (See this link to this information on the Social Security website.)

Let's look at an example. Mary turned 66 in February. Her husband Ryan passed recently. At the time of his death, he was collecting $2,000 a month in Social Security benefits. Mary had not yet filed. Her full benefit at her full retirement age is $1,800. What are her options?

If you look at this at face value, his benefit is higher, so she could file in June, which would be her survivor's full retirement age, and collect 100% of Ryan's benefit. Social Security would say, "Well, Ryan's benefit was higher than yours. In June, you have reached survivor full retirement age, so take his." What that "just take his" means is that they have deemed her. They pay her own $1,800 full retirement age benefit plus the additional $200, and then she goes on her merry way, not knowing the difference.

What is her other option? She could have said, "No, I want to file for Ryan's now. I want to hold my own application for my benefit out of the scope of this application because I know, without any cost-of-living adjustment, that if I do that and wait more or less four more years, my benefit will outpace it. So, I will take my benefit of $1,800 a month plus 40 months of delayed retirement credits at age 70, and it will be worth $2,280 a month." These are the things your clients don't know they are entitled to unless we advocate for them and educate them.

Here is another example. Edward is 62. He recently filed for his $ 1,610-a-month retirement benefit. His PIA was $2,300. Margaret, five years his senior and a physician (this is based on a real case), was collecting $3,200 at the time of her death. She was obviously the breadwinner in this situation. What are his options? If he went in right now, Social Security would say, "Well, you are going to lose your lower benefit, but hers is higher, so you can go ahead and file. We will file now, but you are under your full retirement age. You are only 62, so you will continue to collect your $1,610, but we will pay you the reduced amount of the survivor benefit, which is $755, for a total of $2,365."

Or he could do nothing. This is an option. If he is properly advised and says, "Well, can I wait until I reach my full retirement age and take 100% of her $3,200 for the rest of my life?" That is an option, too. He is not forced to take it right when she dies. The only time he is forced to do that is if he is already a dependent spouse.

If he were taking a dependent spousal benefit, then yes, Social Security automatically switches him. But if he is not, he does not have to do it right away. So, if there is another way to bridge income between now and when he turns full retirement age, then absolutely do it because by waiting, he can collect $3,200 for the rest of his life.

The point is that there are options that Social Security generally will not offer. They are not in the business of providing advice of any kind, so your client has to know their options before reaching out to Social Security.

Be aware that survivor benefits are subject to the annual earnings test if claimed prior to FRA. For some reason, people often think they are not, but they are. Even mother's and father's ben fits taken before full retirement age are subject to it. It is generally not advisable to collect Social Security benefits if some will be withheld, especially if someone is counting on those benefits for monthly income. However, this is the one time when I say, "Hey, take it while you can," if the idea is to take survivor benefits for a

finite period of time.

Say I am a widow at 62, or even 60, but I am earning not so much that it totally wipes out my ability to take a survivor benefit but let us say it does withhold benefits for a few months of the year. I say take it anyway. Why? Because I will only get it for, let us say, eight or ten years, depending on how old I am, before I switch to my retirement benefit. Take it because you are not going to get it for very long. Then remember, when you hit full retirement age, they will recalculate it, and you will get a little bit more until you reach age 70. So, take it. It is better than nothing.

Again, if the survivor benefit is taken before full retirement age, the benefit will be reduced because it is taken for a longer period of time. You always want to seek solutions to bridge income while the lower benefit is claimed. If they do that survivor switch thing, you must say, “Okay, we will hold out for a higher benefit.” So, think of solutions to bridge income to preserve the ability to do that. Some people may need help to do that, but if they can, always look for bridge solutions.

Remember, you want to compare the survivor benefit at full retirement age because it cannot increase. Once someone dies, that survivor’s PIA number is not going to increase. You want to compare the survivor benefit to their own benefit at age 70 because theirs can increase, but the survivor PIA will not after full retirement age. Which one is higher? That is the one you want to hold out to take. For the lower one, take it earlier.

Concept #5: Minimizing Taxes and IRMAA Surcharges

Many people are surprised to learn that they might have to pay taxes on a portion of their Social Security benefits, which were established as part of the 1983 Social Security amendments. These tiers have never been inflation-adjusted, so more people are pushed into a situation where their Social Security benefits are at least partially taxable.

The way to determine whether or not someone is subject to tax on a portion of their benefits is to take their Modified Adjusted Gross Income (modified means we are not counting the taxable portion of Social Security yet). So, MAGI plus half of their Social Security benefits for the household and dividing it by two, plus nontaxable interest such as tax-exempt interest, is what is called your combined or provisional income.

Once you know that figure, then you compare it to the threshold. So, if your client is a married couple and their MAGI comes to $32,000 or less, there is no tax hit for them. If their MAGI is somewhere between $32,000 and $44,000, then as much as 50% of their Social Security benefits are exposed to taxes. Now, this is not a cliff regime, but as much as 50% can be exposed, and if they are over $44,000 in income as a couple, as much as 85% is exposed to taxation.

Only so many retirement income sources do not hit the line of provisional income. According to Social Security, roughly 40% of income beneficiaries pay federal income tax. That number will continue to rise, especially as these numbers never change and as all of these proposals hit on how they will fix the insolvency issue. Unlike the earnings test, a spouse’s earnings and other income sources hit MAGI, such as pensions and your IRA distributions. All those things go into the taxation of benefits, unlike the earnings test, which only looks at earned income.

What are the sources of income that do not increase provisional income?

- If they can start putting money into a Roth, qualified Roth distributions do not hit the bottom line.
- Health savings accounts. I am a big advocate of health savings accounts. If they have a high-deductible healthcare plan, start max funding that thing early. It has a trifecta benefit: It comes in pre-tax, it grows tax-deferred, and monies can be withdrawn tax-free for qualified expenses. Since it comes out tax-free, do not use it while they are working; hold on to it to offset medical expenses in retirement.
- Loans from a cash-value life insurance policy come out tax-free.
- Qualified charitable distributions (QCD) from IRAs. If you do not know about them, you should know about them. When someone turns 70, you must start talking about QCDs because they become available at 70½. Up to $105,000 this year could be transferred directly to a qualifying charity. For each person who has an IRA—only IRAs at this point—and when they hit RMD age at

73, they can also use it to offset a portion or all of their RMD.

- Reverse mortgages are another way to access cash that is not taxed.

Minimizing IRMAA Surcharges

IRMAA is the Income-Related Monthly Adjustment Amount for Medicare premiums. Start being mindful of this when someone turns 63. Why? For those who enroll in Medicare, usually at age 65, their Medicare premiums are based upon their MAGI two years before at age 63. So, we have to make sure that any strategies we are using to diversify income from a tax standpoint are mindful of what that looks like at 63.

The MAGI situation with these IRMAA brackets is a cliff regime. For 2024, the standard monthly Medicare premium is $174.70, but if a married couple's income tops a MAGI of $206,000, they are pushed into the next premium band, and they would instead pay $244.60 per month per person. When someone turns 63, ask, "Are you going to enroll at 65?"

So, if someone finds themselves in a higher premium band, know they will only feel the pain for 12 months. Are higher premiums for one year worth the reward of getting this into a more tax-efficient bucket?

There are exceptions for life-changing events like divorce, marriage, work stoppage, loss of income, and loss of income-producing property that can be appealed. They would have to file a form SS-44, submit it, and they will get a new determination. If it hits a married couple, they must fill out the form.

Social Security and Your Value Proposition

You do not need to be an expert to incorporate Social Security optimization services into your suite of services. I hope that these five things we covered here have given you enough to say, "Okay, now I understand why I need to know how the benefit is calculated."

Have an educated conversation with clients about why it is important to substitute zeros during your highest 35 earnings years with at least something to increase benefits, why it might be beneficial for a lower-earning spouse to pump up their primary insurance amount by taking on some full-time work, or why the business owner might want to consider paying themselves a little bit more to boost their benefits long term. You need to understand the basics, and you need to understand how to convert that into meaningful conversation.

Remember, Social Security is experiencing a crisis of infinite proportions. There are many points of misinformation coming out of the local field offices and over the phone. It is frightening, and it concerns me because consumers need guidance. They need accurate guidance, and they need you. You are desperately needed.

I have read studies that say people are willing to leave their advisors if they are not willing or able to help them with their Social Security claiming decisions. Eighty-two percent of respondents want to talk to their financial professional about how to maximize benefits, and 78% want to discuss how to leverage other sources of income to delay filing. Seize this opportunity. Do not let it pass you up. Learn about Social Security.

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5 Critical Social Security Concepts You Need to Know to Elevate Your Credibility – Heather Schreiber

About Heather L. Schreiber, RICP®, Founder and President, HLS Retirement Consulting, LLC, Retirement Income Strategist, Speaker, Writer, and Trainer to Financial Professionals

Heather Schreiber, RICP®, is Founder and President of **HLS Retirement Consulting, LLC**, Heather partners with financial, legal, and tax professionals to build holistic client solutions for retirement.

Heather prides herself in her ability to customize potential solutions to meet the needs of each client or prospect as well as her ability to turn complex strategies into easy to understand terms. In her 20th year in the industry, Heather has worked within the finest organizations including Franklin Templeton Group of Funds, AXA Advisors, SunTrust Bank and one of the largest FMOs in the country. She is frequently asked to speak at industry events, radio programs, recruiting webinars and created and led a series of bi-annual 2 ½ day intensive training events for elite advisors on effectively weaving Social Security planning into their sales process.

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Maximizing Retirement Success: Beyond Assets and Liabilities

Chia-Li Chien, PhD, CFP®, PMP®, CPBC

Editor's note: This article is an adaptation of the live webinar delivered by Chia-Li Chen in 2024. Her comments have been edited for clarity and length.

You can read the summary article here as part of the [April 2024 Retirement InSight and Trends Newsletter], worth 1.0 CE when read in its entirety (after passing the online quiz.)

You may also choose to take the full length course [Maximizing Retirement Success: Beyond Assets and Liabilitiess] for 1.0 hour continuing education (CE) credit.

By Chia-Li Chien, PhD, CFP®, PMP®, CPBC

Many years ago, I was working with a client who we'd categorize as house-rich but cash-poor when planning for retirement. In a nutshell, they did not have enough to sustain their current lifestyle into retirement.

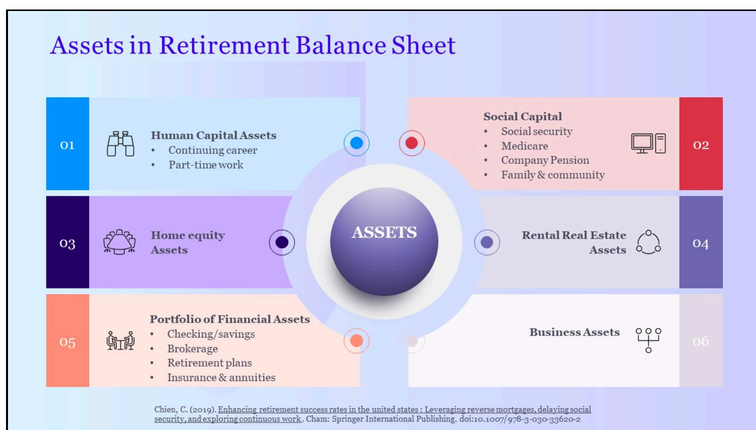
Back then, advisors like me probably jumped right into potential retirement strategies. However, in today's environment, considering a client's financial psychology first is the best way to find out if the clients are eligible for various retirement strategies and if they have the capacity and the capability to implement them before we jump into providing advice.

The Retirement Balance Sheet for Crafting Tailored Deaccumulation Strategies

Retirement is a universal goal for every person on this planet. Financial advisors often approach retirement planning from very different lenses compared to individuals. They look for how many liquid assets a client has and whether their assets are taxable, tax-advantaged, or after-tax. They might also potentially look for illiquid assets such as a home, second home, business, and so on.

However, a typical balance sheet has three components: you have your assets, you have your liabilities, and at the end of the day, you will have your equity. This is a very traditional accounting type of balance sheet. However, there are only two components when we speak about retirement, specifically from a retirement balance sheet perspective. We will be looking at, first, the assets and then second, the liabilities. The liabilities will be calculated to represent future expenses, such as your retirement income, that you will need for the next 30, 40, or 50 years.

So, what do we mean by assets in the retirement balance sheet?



First, let's look at what we call human capital assets. Human capital assets mean someone may continue to work full-time or part-time. Take my husband as an example. He is 60 years old, although he wants to retire like yesterday. But I encourage him to continue to work full-time. His goal is to work for another five years before he retires from his current job.

We expect him to continue to work part-time after he retires from his full-time job. He is not going to do completely nothing, and doing nothing during retirement may or may not be good for his mental and physical health.

Discuss human capital assets with your clients. Your clients must also be physically and mentally able to continue working full-time or part-time. Remember to explore these options, and remember that it is a blessing and a privilege to continue working full-time or part-time in retirement.

Home equity is the most overlooked asset in retirement income planning. What do I mean by that? Americans are very good at building their housing assets. Most people desire to purchase their home at a very early age and stay in their home for retirement. Therefore, home equity assets ought to be explored with clients as well.

Portfolio financial assets are probably the most familiar area that practitioners typically discuss. This includes checking, savings, brokerage, and retirement accounts such as Roth, IRA, 401k, you name it, and even insurance annuities accounts.

Social capital includes Social Security, retirement benefits, Medicare, company pensions, and potentially family and community supports. In some cases, people may not have sufficient Social Security retirement benefits or a company pension. They might need to rely on family or communities for support. For example, many of you probably are familiar with the sitcom Golden Girls, in which older women cohabitate with other women in the same household complex.

Rental real estate assets are one of those assets that clients often talk about, but financial planning practitioners need help with what to do with them. Many of my clients have rental real estate assets, so we talk about it, but I do not recommend that they take specific actions. I recommend that they explore other alternatives with their CPAs and realtors to make sure some things are considered. Therefore, take inventory of your client's real estate assets because often, it could be a lot, especially for those who do not necessarily know how to invest in a portfolio of financial assets as they tend to invest in what they know, such as real estate.

For those not specializing in succession or exit planning, business assets are likely assets the most missed on the retirement balance sheet. First off, it isn't easy to pinpoint the value. Many of the advisors I know use rough estimates. However, the rule of thumb is to ask your clients how much they think their business is worth and suggest that they do an appraisal. For example, several years ago, I was working with a client who happened to be a four-partner financial planning firm. I asked them when the last time they had their business appraised was. Let me repeat this question again. Instead of asking clients, "How much do you think your business is worth?" ask, "When was the last time you had your business appraised?" This question will get them thinking about not only doing an appraisal of their business but also how much it is worth.

The Liability Side of the Retirement Balance Sheet

The liability side of the retirement balance sheet is different from the traditional balance sheet. With today's advanced medical treatment, people can live 20, 30, 40, or even 50 years in retirement.

You want to help your client identify their current spending, collecting data such as fixed expenses, discretionary expenses, contingency expenses, and legacy goals. You also want to ask your clients how long they

think their retirement will last. Is it age 90, age 95, or age 120? The Social Security Administration estimates people living up to 120 years old. My father-in-law passed away late last year. He was 96. People do live a very long time.

Ask your clients about their family health history. Several life insurance companies have their policy set at a certain age, which means that if your clients did not die before that age, they will not pay death benefits and will potentially pay out the cash value. Check for those critical ages in the life insurance and how long the client thinks they might live.

Here is the entire retirement balance sheet. On the left-hand side, you will see human capital assets, home equity assets, a portfolio of financial assets, social capital assets, rental real estate assets, and business assets.

Retirement Balance Sheet

Assets	Liabilities
Human Capital Assets	**Fixed Expenses**
Continuing career	Essential Living needs
Part-time work	Taxes
	Debt repayment
Home equity Assets	
	Discretionary expenses
Portfolio of Financial Assets	Travel & leisure
Checking/savings	Lifestyle improvements
Brokerage	
Retirement plans	**Contingencies**
Insurance & annuities	LTC
	Health Care
Social Capital	Other spending shocks
Social security	
Medicare	**Legacy Goals**
Company Pension	Family
Family & community	Community & Society
Rental Real Estate Assets	
Business Assets	

Chien, C. (2019). Enhancing retirement success rates in the united states : Leveraging reverse mortgages, delaying social security, and exploring continuous work. Cham: Springer International Publishing. doi:10.1007/978-3-030-33620-2

On the right side, you will see estimated future fixed and discretionary expenses. Contingency expenses are also calculated for the future, as well as their future legacy goals. Together, these components complete the picture of a retirement balance sheet. Please take stock of your client's information and place it into a retirement balance sheet so you will have a better understanding of which assets need to be matched to which liabilities.

Home Equity, Reverse Mortgages, and the Retirement Balance Sheet

There is a critical correlation between scaling factors (to be defined), financial assets, and home equity in retirement planning. The use of a reverse mortgage can potentially bolster retirement spending and success. In this section, we'll explore how home equity assets could potentially help with retirement income planning.

Home equity is your home's market value minus any outstanding loan balance. Many retirees or pre-retirees have their homes paid for, so their home equity becomes an asset that is just sitting there and not generating any income supplementation.

I do not necessarily directly advocate that people consider home equity conversion mortgages or HECMs. However, I encourage clients to evaluate if it is necessary to tap into their home equity. For example, home equity could be a line of credit used for contingencies, especially for those who did not necessarily get a chance to invest in long-term care insurance. If your client's home is paid for, it is also worthwhile to consider a Home Equity Conversion Mortgage (HECM) Line of Credit as a potential source for long-term care.

Below is a high-level summary of the requirements for obtaining an HECM line of credit.

Reverse Mortgage	Home Equity Loan	HELOC
Must be 62 or older	No age requirement	No age requirement
Borrow lump sum or annuity-like payment from home equity	Receive loan in single lump sum payment	Draw on your line of credit as needed
Must own home or have a small mortgage balance	Must have at least 20% equity	Must have at least 20% equity
Balance plus interest due upon moving, selling, or dying	Repay in regular installments to cover principal and interest	Pay interest only on what you withdraw

Investopedia

Investopedia / Sabrina Jiang

https://www.investopedia.com/mortgage/reverse-mortgage/reverse-mortgage-or-home-equity-loan/

How much you'll be able to access home equity depends upon the interest rate. The current interest rate is relatively high, meaning that the HECM portion will be much smaller compared to a lower interest rate environment.

It is important to remember that default with a reverse mortgage is not the same as with a typical mortgage. The default in a HECM or reverse mortgage is typically past due on homeowner association or property taxes. If your clients want to consider a HECM, just make sure that they pay for their homeowner association and property taxes and keep the home maintained.

The key point to remember is that with the reverse

mortgage, nothing is repaid until you die. If anything is left, it will go to your heirs.

Many advisors think reverse mortgages are unique to the U.S., which is incorrect. Reverse mortgages are available worldwide in selected countries. Why do I want you to know about that as a planner? Your clients might own real estate outside of the U.S. If they do, they can take a reverse mortgage on the home they own outside the U.S. The United Kingdom, Canada, and France are a few other countries that I listed in my published research in 2022.

The reverse mortgage was established in the 1980s in the U.S., but the HECM began in 1961 in the private sector and became federally backed in the early 1980s. Canada started its reverse mortgage in 1961, and the U.K. started it in 1965. I absolutely love France's approach. Why? One option in France is that you can sell the reverse mortgage to desirable investors and live in that home as long as you survive.

Of course, there is government oversight regarding reverse mortgages. The Department of

Housing and Urban Development (HUD) is the oversight authority in the U.S. In Canada, it is the Franchise Consumer Agency of Canada. The U.K. is an investors' compensation scheme. France is under the Ministry of Economic Finance and Recovery. Unlike the U.S., you can use a selected list of approved vendors or lenders. Canada has two banks you can use. In the U.K., like the U.S., you can use any approved lenders. In France, it is just willing investors. When doing this research, I had to find someone who read French to verify the information accordingly.

The reverse mortgage market in Asia is more significant than you'd imagine. Most Asian countries have higher homeownership percentages than the U.S. Here is a list of countries with reverse mortgages: Australia, Singapore, China, Taiwan, New Zealand, South Korea, China, Hong Kong, and India.

You will only know if a client owns homes in other countries if you ask. A client may be thinking about buying a villa in Italy or somewhere else for retirement. You can also help them with this option if they need additional retirement income.

The Critical Correlation Between Scaling Factors, Financial Assets, and Home Equity in Retirement Planning.

How do you know who the best candidates are for a reverse mortgage? I have conducted research to determine benchmarks to better identify the most qualified candidates.

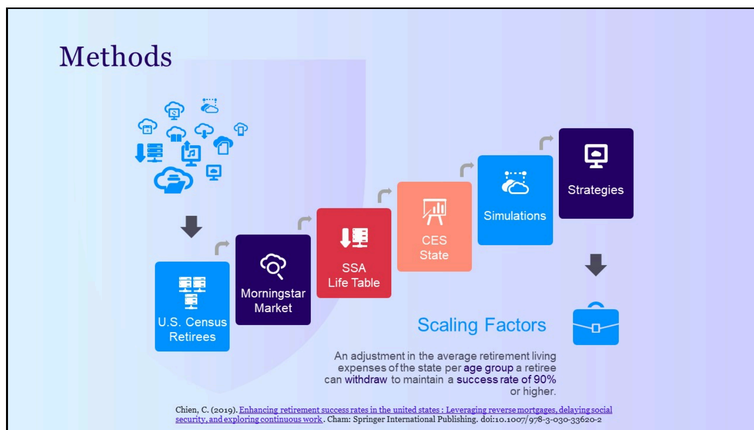
In my 2019 research, I wanted to understand how well U.S. retirees were doing regarding retirement success. I used U.S. census data to calculate the assets retirees had left in the previous year, subtract what they needed this year, and estimate their potential balance at the end of the year.

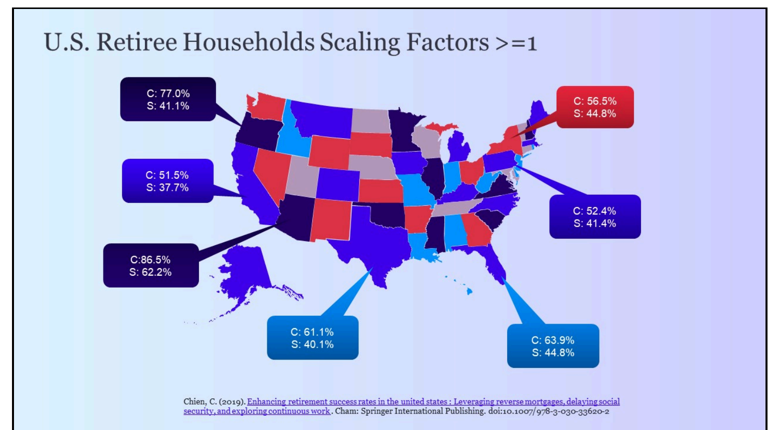
There are so many assumptions to make, just as you must make assumptions in your commercial financial planning software. Every little change will make a big difference in the simulation. For example, how do you know how long your client will live? Are you going to be using age 120? (This is what I used in my research.) What assumed return should I use? I did not use an average return; instead, I used rolling returns from the historical record, starting from 1927 and continuing until 2018.

We've had a significant increase in inflation in the last two years. Because every year is different, I used rolling inflation based on CPI coming through the government data. I also further estimated inflation based on healthcare, housing, etc. The calculation is far more in-depth than just one inflation number.

Retirement success depends on how much a retiree spends. The U.S. Census Data does not necessarily ask each household how much they spend in retirement, so I used the Consumer Expenditures data set. I took a number based on each state's average and broke it into different age groups. For example, you spend more when you retire between ages 50 and 60 than when you are 70 and 80. Over age 80, you are likely to spend more on healthcare. None of these assumptions are fixed. Everything is dynamic, and in the simulation, everything was based on a rolling schedule, rolling returns, rolling spending, and rolling inflation.

To perform the simulation, I used four different major datasets.





The U.S. Census dataset has retiree household asset information, including their Social Security retirement benefits, which tie directly to the Social Security Administration. I also used the Social Security Administration live table, which means that the mortality rate is calculated up to age 120 because I do not know when they are going to die.

I calculated the rolling market return using the Morningstar historical record, including equities and bonds.

The important thing I created was the Scaling Factor, which you can see in the graph below. The Scaling Factor is based on how much retirement will cost on average in a particular state. Every state's average spending is different. Retirees in my state and age group typically spend $1,000 a month. If I have a higher income and net worth and want to spend $3,000 monthly, my scaling factor is 300%, or 3x my state's spending average. This is what the scaling factor is for. Either you spend 100% of the state average or more than that average in terms of the calculation.

The research aimed to determine at what point scaling factors will always achieve at least 90% retirement success, meaning that no one runs out of money from their financial portfolio assets. If the scaling factor is less than 100, the retiree generally needs more retirement assets to maintain their standard of living at the state average and will eventually need help making ends meet.

Let's look at the following graph.

For households with couples in California, only 51% of the population will be successful in retirement. Only 37% of single households in California will be successful. Now, California has such a high cost of living. Look at Texas, where couples have a 61% success rate and single households 40%. Pennsylvania has a 52% success rate for couples and 41% for single households. Florida has a 63% rate for couples and a 44% success rate for single households. In New York, 56% for couples and 44% for single households. Arizona does better: 86% for couples and 62% for single households.

This tells you that most U.S. retiree households will not be successful in retirement. What does this mean? They will run out of money, and somebody must pick up those costs. That means you and I, the taxpayer, will always subsidize those who cannot make it.

When I talk about single households, I would like you to think about not just someone single because it could be divorcees, widows, and widowers. Think about that. We always want to help our clients plan for the last survivor. If you do not plan well, the last survivor will have a higher chance of failure when the other spouse dies.

How Might a Home Equity Conversion Mortgage (HECM) Improve Retirement Success?

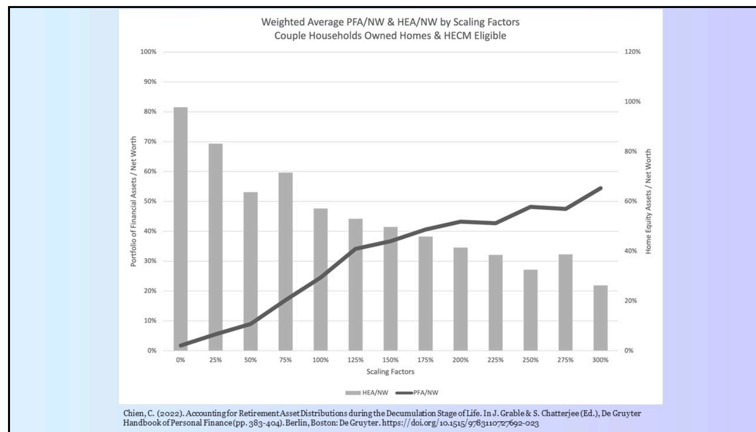
What if we introduce an HECM as a strategy for the same data set of U.S. households who qualify to use HECM? For example, in California, by introducing a HECM into the equation, couples become 10% more retirement successful. The single household success rate improves by roughly

nine percent. This is huge when it is considered appropriate to use a HECM.

In Texas, about six percent of couples will be more retirement successful; singles become about eight percent more successful by adding an HECM to support retirement spending. Pennsylvania improves about five percent in the couple population and eight percent in the single households. Florida moved from 63% to 72% for married households and 4 percent more for single households using an HECM. New York improved a whopping 10% in the married population, and singles improved by roughly 7 percent as well.

In sum, the research found that using a HECM for eligible families can make a huge difference in experiencing a successful retirement.

In my 2022 published research, I used the same dataset to determine how to spot clients who can be helped most by introducing home equity or an HECM into the conversation. On the left side of the graph below, which models couple households, you will see a percentage that takes the liquid assets divided by net worth for real household data in the U.S. population.



Chien, C. (2022). Accounting for Retirement Asset Distributions during the Decumulation Stage of Life. In J. Grable & S. Chatterjee (Ed.), De Gruyter Handbook of Personal Finance (pp. 383-404). Berlin, Boston: De Gruyter. https://doi.org/10.1515/9783110727692-023

On the right-hand side, I use the percentage of their home equity divided by net worth. That will give us a percentage for comparison. I use the scaling factor in the horizontal area or the bottom of the chart, which is how much they want to spend. This can range anywhere between zero percent of the state's average retiree spending and more than 300%, based on every state's different average and different age group.

The more you want to spend (i.e., 300% of the state average), the more liquid assets you will need to be successful in retirement. And the more you want to spend, the less home equity assets (which are illiquid) you want as a percentage of total net worth.

It is more expensive for single households, such as singles, divorcees, widows, and widowers, to survive through retirement. Lower net-worth families tend to be house-rich and cash-poor. Higher net worth families tend to have lower home equity and higher liquid assets as a percent of total worth.

Identifying Clients Who Can Increase Retirement Success by Utilizing a HECM

So, how do we identify clients who can benefit from this strategy?

I had a client who lived in California, so let us look at the California benchmark. Lifestyle spending in California is typically 300% on average, which means liquid assets divided by net worth should be more than 54%, and home equity divided by net worth should be less than 26%.

This client's net worth was $6,000,000. Sounds great, right? However, their lifestyle is 300% of California's average retiree's spending. Still, they only have 28% of their net worth in liquid assets, far lower than the liquidity benchmark to support their spending. Their home equity is at 71%, higher than California's average home equity benchmark. This is a classic house-rich, cash-poor family, a prime candidate for a HECM.

If they do not want an HECM, you can discuss potentially downsizing or moving to a place with a lower cost of living. Luckily for this client, we devised a plan for them to migrate to Mexico or Hawaii to meet their lifestyle outside of California.

Another client lived in North Carolina. The North Carolina benchmark says that most people will spend about 125% of the state's average. Their liquid assets divided by net worth should be around 34%, and their home equity should be around 53%.

This client's net worth is more than $2,000,000. Their lifestyle spending is at 125%. Their liquid assets are 82%,

or way above the benchmark, and their home equity is only 18%, or way below the benchmark, so they are not a good prospect for a HECM. There is no need to discuss incorporating home equity into their retirement income plan.

For clients who are house-rich and cash-poor, we recommend that they relocate, downsize, or adjust their lifestyle. All of these could potentially help their retirement success at some point, even if they do not want to consider home equity or HECM.

Consider using a retirement balance sheet to lead your retirement discussions with your clients. A house-rich, cash-poor might be a good candidate for HECM, but you may want to skip HECM for those not in the house-rich and cash-poor category.

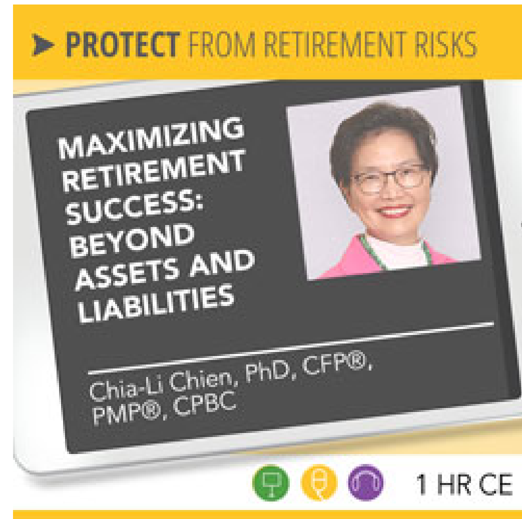
In sum:

- Advisors can use retirement balance sheets to lead discussions about using home equity to improve retirement success.
- Reverse mortgages are available worldwide.
- Consider using benchmarks to spot if home equity is a viable option to introduce.

About Chia-Li Chien, PhD, CFP®, PMP®, CPBC

As the Associate Provost of Undergraduate & Graduate programs at The American College of Financial Services, Chia-Li Chien, PhD, CFP®, PMP®, CPBC, has held several senior management positions in Fortune 500 companies, including Diageo, ABB, CIGNA, and RSA Insurance Group.

Dr. Chien also serves on the boards of various national financial service associations and holds a doctorate in financial planning. She is a Certified Financial Planner (CFP®), Project Management Professional (PMP®), Certified Professional Business Coach (CPBC), and Extended DISC Certified Professional.



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A sought-after, frequent speaker about succession planning at national conferences, Dr. Chien has published three award-winning books along with research on succession and retirement topics in a variety of academic and practitioner research journals.

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