American Advisors Group

CASE STUDY:

Strategic Use of the Home Equity Conversion Mortgage (HECM) Loan

Avoiding the realization of capital gains in highly appreciated stock positions.

Problem
Retirees using their dividends and occasionally selling stock positions as supplemental income.

Challenge
Retirees are facing a hefty tax bill.

Solution
Refinance their 30-year mortgage with a Home Equity Conversion Mortgage (HECM) loan.

Result
Action reduced the need for liquidating capital gains-sensitive stock positions.

Problem

In addition to William and Lorraine's pension, social security income, and required distributions from their IRAs, they have been using their dividends and occasional selling of stock positions to supplement income.

Due to the low-cost basis of these positions, they are often stuck paying significant capital gains taxes each time they sell, putting alarming cracks in their retirement nest egg.

They are also concerned about the risks associated with the concentration of their current assets, leading them to look for ways to reduce this exposure and become more diversified.

Challenge

William and Lorraine own a home worth $1.15 million with an outstanding loan balance of $183,000. They would like to complete a few home-renovation projects but have been reluctant, due to their capital gains exposure from selling some of their stocks.

The challenge that William and Lorraine face is not uncommon. Advisors are solving these issues using various strategies including liquidating and spreading the gains over time, using a securitized line of credit, or perhaps implementing charitable strategies to offset income gains elsewhere. In any case, the retirees are facing a hefty tax bill.

Solution

Refinance their 30-year mortgage with a Home Equity Conversion Mortgage (HECM) loan.

Result

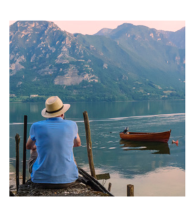
The couple was able to refinance their existing 30-year mortgage with a government-insured Home Equity Conversion Mortgage (HECM) with a line of credit feature. In doing so, they created the option of if, when, and how much to apply toward their mortgage payments.

+  This action reduced the need for liquidating their capital gains-sensitive stock positions. In addition, they were able to use the line of credit for home renovations without incurring any tax liability.

+  Looking down the road, their line of credit will grow at the same rate being charged on any outstanding balance, creating a pool of resources should they need additional liquidity for future expenses, such as travel to visit their kids, in-home care, or any other expenses.

+  With this added flexibility, William and Lorraine don't expect to liquidate any more stock, allowing it to grow as a future inheritance for their children.

+  Under current law, upon their passing, they will receive a step-up in basis, eliminating what otherwise would have likely been a sizeable and taxable capital gain. This will provide savings to the surviving spouse or heirs, valued well beyond the expense of the line of credit.

+  Perhaps most importantly, William and Lorraine are relieved of the stress of having to write checks to the IRS to meet their ongoing income needs.

The Full Story

William and Lorraine, ages 78 and 79, have been working with their advisor for over 20 years. One of their primary assets is a portfolio of three stock positions valued in excess of $1.2 million with a cost basis under $120,000. In addition to their pension, social security income, and required distributions from their IRAs, they have been using the dividends and occasional selling of positions to supplement income. Due to the low-cost basis of the positions, they are stuck paying significant capital gains taxes each time they sell, diminishing the size of their retirement portfolio. They are also concerned about the risks associated with the lack of diversification in their portfolio. They own a home worth $1.15 million with an outstanding loan balance of $183,000. They would like to complete a few home-renovation projects but have been reluctant, due to the sizable capital gains expense they would incur if they sell some of their low-basis stocks.

The challenge that William and Lorraine face is not uncommon. Advisors are solving these issues using various strategies including selling and spreading their stock gains over time, using a securitized line of credit, or perhaps implementing charitable strategies to offset income streams elsewhere. In any case, they are facing a hefty tax bill.

It was after hearing about the HECM Line of Credit and engaging our advisory team that the ideal solution was designed. The client was able to refinance their existing 30-year mortgage with a government-insured Home Equity Conversion Mortgage (HECM) with a line of credit feature. In doing so, they created the option of if, when, and how much money, if any, to apply toward their mortgage payments. This one strategy alone reduced the need for liquidation of their stock positions. In addition, they were able to use the line of credit for key home renovations without incurring any tax liability.

Looking down the road, their line of credit will grow at the same rate being charged on any outstanding balance, creating a pool of resources should they need additional liquidity for future expenses, such as travel to visit their kids, in-home care, or any other expenses. With this added flexibility, they don't expect to liquidate any more stock. Under current law, upon the passing of William and Lorraine, they will receive a step-up in basis, eliminating what otherwise would have likely been a sizeable and taxable capital gain. This strategic use of a reverse mortgage line of credit will provide a significant savings to the surviving spouse or heirs, valued well beyond the expense of the line of credit. Perhaps most importantly, William and Lorraine are relieved of the stress of having to write checks to the IRS to meet their ongoing income needs.