



KNOWLEDGE BASE

Harvest Equity to Increase Family Wealth!

Case Study I

The concept of Equity Harvesting seems to be white hot right now in the insurance and mortgage community. While there are sales books in the marketplace that make it sound like a can't miss topic, caution needs to be taken so you can determine if using the plan is prudent given your situation and set one up in the "correct" manner.

DEFINING EQUITY HARVESTING (EH)

Equity Harvesting is defined as follows:

EH is removing equity from a personal residence through refinancing (or a home equity loan) where the money borrowed is placed in cash value life insurance.

The tool of choice to help clients build wealth in a tax favorable through Equity Harvesting is cash value life insurance.

Why cash value life insurance? Because if properly structured, cash in a policy can grow tax free (income, capital gains and dividend taxes) and be removed tax free (policy loans). To properly structure the policy, it must be over funded with cash using the minimum allowable death benefit that still allows the client to borrow from the policy tax free.

While fundamentally Equity Harvesting is simple to understand, this martial starts out with a common person example so you can understand the mechanics the plan.

Example Number 1

Mr. Smith ("Joe lunchbox") is married and has a home with a fair market value (FMV) today of \$235,000. He has 2 children and a spouse where their combined household income is \$78,000 a year. Assume the Smith's purchased the home for \$185,000 seven years ago and that the current debt on the home is \$135,000. Assume the current home loan is 6.5% with mortgage payment of \$935 a month.

IMPLEMENTING EQUITY HARVESTING

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Let's assume Mr. Smith will use a home equity line of credit (not a refinance) and will remove \$76,500 of equity from the home over a five year period (which creates a 90% debt to value ratio on the property).

Equity Harvesting is removing equity from a home to reposition it into cash value life insurance. Therefore, Mr. Smith will access his new line of credit in the amount of \$15,300 every year for five years to fund an over funded/low expense cash value life insurance policy.

It is assumed that the life insurance policy used is an equity indexed life insurance policy that has a 1% guarantee rate of return on the cash value, has its growth pegged to the S&P 500 index and locks in the gains annually. It is also assumed that the policy will return 7.5% annually (which is conservative since the S&P 500 has averaged over 11% for the last 20+ years).

Let's assume that Mr. Smith will retire when he is 65 years old and will withdraw money **tax-free** through policy loans from his cash value policy from age 66-90 (25-years).

How much could Mr. Smith borrow tax free from his life insurance policy starting at age 66?

\$23,000 each year for 25 years for a total amount of **\$575,000**.

While \$23,000 is a lot of money tax free in retirement for a couple who's annual taxable income is \$78,000 a year; the question becomes: what would Mr. Smith have done if he did not implement an Equity Harvesting plan?

Mr. Smith probably would have **done nothing**. Therefore, \$23,000 a year is a significant improvement to Mr. Smith's retirement income.

The next question is: what is the cost to Mr. Smith for having an interest-only loan on \$76,500 of new debt? If the home equity line of credit is at 7.5%, the costs to Mr. Smith would be \$478 a month or \$5,736 a year.

Therefore, when **trying to compare** using Equity Harvesting to doing nothing (which in this example means funding a post-tax brokerage account with the money that would have been allocated to the interest expense), Mr. Smith needs to invest \$5,737 every year into the stock market and let it grow. When Mr. Smith reaches age 66, he needs to compare how much money he could remove from that account for 25 years to how much could be removed from this cash value life insurance policy. When investing money in the stock market there are annual expenses. I will assume a conservative 20% blended tax rate (capital gains/dividend tax which is very conservative) on the growth (the industry standard is 30%) and only a .6% annual mutual fund expense (the average is over 1.2%).

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For this example, it is assumed that the money will grow in a brokerage account at a gross rate of 7.5% annually (the same rate as the funds will grow in the life policy).

If Mr. Smith invested \$5,737 every year in the stock market, he could remove **\$19,038** a year every year after tax from ages 66-90.

Remember how much Mr. Smith could remove from his cash value life insurance after tax? **\$23,000** every year for from ages 66-90.

How much better did Mr. Smith do by using Equity Harvesting to build wealth vs. doing nothing and simply investing money after-tax in the stock market?

\$3,962 a year or \$99,050 over the entire withdrawal period.

Therefore, Equity Harvesting would be a viable financial tool to help Mr. Smith build wealth for retirement.

However, the above numbers do not create a fair example as the client who does nothing has no loan to pay off whereas the client who uses Equity Harvesting has a \$76,500 loan still to pay off. In our example, Mr. Smith will have a \$114,399 death benefit from the Equity Harvesting life insurance policy that will pay income-tax free if he were to die at age 90. That will more than pay off the \$76,500 debt on the home.

Example Number 2

Let's see how the Smiths can grow their wealth with Equity Harvesting assuming they had a home where they could harvest \$200,000 of equity to reposition into a cash value life insurance policy. Using the same assumptions from Example 1, how much could Mr. Smith borrow **tax free** from his life insurance policy starting at age 66?

\$61,000 each year for 25 years for a total amount of **\$1,520,000.**

Question: What is the cost to the Smiths to create this retirement nest egg?

The new home loan amount will be \$400,000. At a 7% interest only rate, that creates an annual mortgage payment of \$28,000. However, remember that the debt caused by Equity Harvesting is only \$200,000, and, therefore, the costs of Equity Harvesting for this example would be \$200,000 worth of debt not \$400,000.

What is the cost to borrow \$200,000 for the Smiths? \$14,000 a year.

Question: If you could have an expense where the costs is \$14,000 a year and where the "tax-free" retirement income is **\$61,000 a year for 25 years**, would you incur the expense? Their answer should be all day long.

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If the Smiths funded \$14,000 a year into a typical brokerage account, the Smiths would be able to remove approximately **\$46,500** from the brokerage account from ages 66-90 vs. the **\$61,000** after tax that could be removed from the life insurance policy (for a total of **\$1,525,000** over the 25-year period).

With a fairly conservative life insurance illustration, the Smiths ended up doing approximately **31% better** with Equity Harvesting vs. doing nothing (if we assumed they could **NOT** write off the interest).

Summary

As you can see, Equity Harvesting (whether the interest on the loan is deductible or not) is very powerful.

If you would like more information on Equity Harvesting for your specific situation and how it can be used to grow your wealth, please contact me by clicking [HERE](#).

For a complete, meaningful, and full disclosure look at the concept of Equity Harvesting, you should consider reading the new book [The Home Equity Management Guidebook](#) (by Rocco DeFrancesco), or [Last Chance Millionaire](#) or [Missed Forturn 101](#) (by Douglas Andrew).

And to better understand how to protect your IRA's and 401(K)'s from near annihilation by the TAXMAN, you absolutely need to read [The Retirement Savings Time Bond...and how to defuse it](#) (by Ed Slott).

If you need help in securing a copy of any of these outstanding wealth preservation books, please contact me at (847) 456-2700, or click [HERE](#) and indicate your preference.

Having been exposed to a number of financial planners and wealth building strategies, I have come to see how beneficial Equity Harvesting can be when trying to build the maximum amount of wealth for retirement. Given the rise and fall of home values in our area, as well as the apparent difficulty of being able to put meaningful resources away for retirement, you would do well to contact me to learn more about these important strategies. To do so click [HERE](#), and indicate **"Harvesting Equity"** in the comment section. Or, simply call me at **(847) 456-2700**.

To examine another of Harvesting Equity, return to the "Your Situation" page and click on >> **Case Study II** <<.