

CREATIVE

Wealth Maximization Strategies

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**A feast is made for laughter, and wine makes merry,
but money answers all things.**

- Ecclesiastes 10:19



“CAN WE ‘MONETIZE IT?’”

In the Internet age, it's easy for everyone to have a voice, but only a few people have figured out how to get paid for speaking. Those brilliant postings on politics, incisive critiques of entertainment, passionate rants about your favorite sports teams, or hilarious links to stupid human tricks may be great outlets for your creativity, but how much time can you devote to these activities if you're not getting paid?

This process of converting something (in this case, one's blog content) into money is called **monetization**. Monetization strategies are an essential part of financial decision-making for both businesses and individuals because monetization makes valuable assets spendable. The writer of Ecclesiastes stated that “money answers all things,” because even ancient societies understood that money has a superlative advantage over all other assets because it could be used to buy almost anything. Thus, anytime value is created, a follow-up question almost immediately follows: “Can we monetize it?”

Monetization can be accomplished in an almost infinite number of ways, but all monetization is a variation on two basic transactions: **selling** or **borrowing**. Several examples:

- An individual monetizes his time and abilities by selling them to an employer or customer.
- A property owner could monetize a property by charging a fee for a parking space.
- Businesses can monetize their value by selling bonds to provide cash for new opportunities.
- A shareholder monetizes her investment when she sells her stock certificates.
- A homeowner monetizes a residence by taking a home equity loan.

More creative instances of monetization might be: a recording artist recycling previously released material as a “greatest hits” album, or railroad companies selling their right-of-way privileges to fiber optic cable companies. (In regard to Internet blogs, there are a surprising number of ways to monetize a website venture, including charging members a fee for content or services, establishing a referral/partner network, selling e-mail lists and attracting advertisers.)

Consequences of Non-Monetized Assets

The concept of monetization is simple, and this simplicity may lead us to overlook its importance. But when we have valuable assets that are not monetized, we begin to see how crucial monetization is to financial success. For example, retirement – the most prominent issue for many Americans – is really a monetization issue: i.e., “How do I turn the assets I have into an ongoing income?” Consider the following instances where non-monetized assets may severely impact one's financial options:

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The Non-Monetized Business Owner

A business owner has invested a lifetime of work to develop a going concern to provide wealth and security for his family. Suppose that in addition to delivering a high six-figure annual income, the business owns real assets such as land, buildings, equipment, and licenses valued at \$5 million.

As age 70 approaches, the business owner realizes he may not want to continue working, or that his declining health may not allow him to. Yet, if he simply stops working tomorrow and closes the business, what happens to all the value he has created? The annual income stops, and although he still owns the real assets, they aren't money – they aren't liquid, they can't be spent. It might be possible to sell the business assets piecemeal, but the money received will probably be far less than the value of the assets if the business were still in operation. If the owner doesn't find a way to profitably monetize his business, he may be forced to continue working, or forfeit much of the material value he has developed.

The Non-Monetized Homeowner

Thirty years ago, a couple found a great deal on a beach house in an exclusive area. Over the years, the property has been a sanctuary and gathering place for the couple, their children and grandchildren, a place of great times and wonderful memories. Even with the recent downturn in home prices, the beach home is valued far in excess of the initial purchase price. It is a prized family asset.

But Mom and Dad are looking to retire, and while the beach house looks great on their balance sheet, the couple's primary concern is income. The children would like to keep the property in the family, but don't have the ability to monetize the house (i.e., buy it from the parents), so the prized family asset may have to be sold.



The Non-Monetized Accumulation Plan

Over her working lifetime, a book editor has acquired some interesting assets: The rights to a percentage of ongoing royalties from the works of several authors, as well as stock ownership in a privately held publishing company. While both of these assets provide a modest income stream (from book sales and dividends), the editor wants to relocate and needs a large down payment to invest in a condo development.

Because of the unique nature of these assets, the editor's assets cannot be easily liquidated like a publicly traded stock, bond or mutual fund. Even though they may have a history of profitability and provide some steady income, she faces a challenge in monetizing them for their total value.

Optimal Retirement Planning: Coordinated Selling and Borrowing

As you can see, non-monetized assets can be a detriment to fully maximizing your financial options, both now and in retirement. A conventional response within the financial services industry to this dilemma has been: If you are focused on retirement, *don't hold non-monetizable assets!* Instead, accumulate paper assets like stocks, bonds and mutual funds, ones that can be easily converted to cash. Simplify your planning by segregating your retirement into specific tax-favored vehicles like IRAs, 401(k)s, etc.

But consider the examples above. Would the business owner think he was better off if he had not developed his business? Would the couple rather not have purchased the beach house? Should the editor have refused the royalty and ownership assets? No. These assets, while not fully monetized, are valuable. Rather than abandoning or ignoring these assets, a better approach is to find creative ways to combine and integrate both monetized and non-monetized assets, both now and in the future.

Competent financial professionals can provide concepts and procedures to determine when and how to monetize assets, whether they should be sold, or what type of collateral they could provide if used for borrowing. This paradigm of asset coordination is the basis for business transfer strategies, such as buy-sell agreements and stock purchase plans. It's also a key element in estate planning, determining which assets should be liquidated while others are preserved for heirs. And it's also essential for individuals who want to maximize their lifestyle opportunities in retirement.

Some of these monetization strategies may appear complex; they may require the establishment of separate legal entities (like a trust or corporation), contain special agreements, and include the repositioning of assets into new vehicles (such as annuities or life insurance). Evaluated as individual transactions, some might wonder if these items are necessary, and whether they are worth the cost. But the key is to evaluate the big picture for the benefits, because a coordinated plan is designed to deliver results greater than the sum of the individual pieces.

For example, suppose that distributions from a simple accumulation plan containing \$1 million project an annual income of \$50,000. In comparison, suppose \$100,000 of the \$1 million was allocated to obtain a life insurance policy equal to an amount of \$200,000 received in a reverse mortgage. When combined, the remaining accumulation and home equity can provide a greater retirement income, while the life insurance ensures the home equity due to the bank will be repaid, allowing the heirs to inherit the house. In this instance, coordinating three items (the accumulation account, home equity and life insurance) results in a better monetization of the home and greater income.

Personal discipline is probably the key element in acquiring assets. Anyone who develop their skills, works responsibly and lives within their means can save for retirement. But to fully realize – and enjoy – your efforts, you may want to consider working with professionals to help you fully monetize your financial potential.

AS AN INDIVIDUAL...

DOES YOUR FINANCIAL SITUATION INCLUDE NON-MONETIZED ASSETS? DO YOU HAVE A PLAN TO MONETIZE THEM?

IF YOU ARE A BUSINESS OWNER...

DO YOU KNOW HOW YOU WILL YOU MONETIZE THE VALUE OF YOUR BUSINESS IN THE FUTURE?

A “HIDDEN” MONETIZED ASSET: Your Human Life Value



As a parent, spouse, employee, you have a unique human life value to others. While much of the value you bring into these relationships may not be financial, or even financially quantifiable, a life insurance policy allows you to monetize your human life value when you are no longer there in person. When you obtain life insurance, you have monetized yourself.

The group, **Financial & Tax Fraud Education Associates**, is a non-profit organization that operates a website (www.quatloos.com) devoted to exposing fraudulent business financial and taxation practices. In the middle of a commentary on the potential abuses in life settlements (agreements where a private investor buys an existing life insurance policy from the insured in exchange for becoming the beneficiary), are several interesting comments on the “hidden asset” of insurability.

(W)ealthy people have a hidden asset, which is their insurability. The [homeless person] at the bus station can't qualify for \$5 million in life insurance, but many affluent and nearly affluent Americans can. Whether buying a lot of insurance makes financial sense for a person depends on a lot of factors, including their age, health, and what the internal rate of return will be. But when it does make sense, wealthy people should be taking advantage of their large insurable interest by purchasing as much life insurance as they can reasonably afford so as to either pay estate taxes or to further grow their estate (income tax free) for their children.

This comment reflects the philosophy of coordinating the monetization of assets concept mentioned in the previous article. The author further states that monetizing one's life is even worth borrowing for...

If the wealthy people were really smart, they would simply buy as much life insurance as they could and hold it until their deaths. If they didn't have the cash on hand to buy it, they could always use the services of many lenders who are willing to finance the premiums with the loans being paid out of the policy proceeds at death.

Most people might not think of borrowing to obtain life insurance, but borrowing is certainly a monetization strategy, and for some people, the benefit of monetizing their human life value/insurability may outweigh the cost of borrowing.

HAVE YOU MONETIZED YOUR GREATEST ASSET?

MONETIZING HOME EQUITY WITH A REVERSE MORTGAGE

A typical method of monetizing real estate assets is taking a loan against the equity. But most monetizing strategies that involve conventional borrowing come with the obligation of regular scheduled repayments. A reverse mortgage is a unique monetization-by-borrowing agreement that offers flexible and deferred repayment options. Along with several other unique advantages, a reverse mortgage can be a very attractive asset for older individuals to monetize.



A reverse mortgage is a loan against the equity in a principal residence that provides you cash advances, but requires no mandatory monthly repayments during the life of the loan. Unlike a typical loan agreement, the cash flow is reversed – the bank is sending money to the homeowner, instead of the other way around. Hence, the “reverse” mortgage.

A reverse mortgage loan is not due and payable until the borrower ceases to occupy the home (i.e., the borrower sells, moves out permanently or passes away), at which time the balance of borrowed funds (including the accrued interest) is due. If there is any additional equity in the property, it remains with the homeowner or his/her beneficiaries. But while the house serves as collateral in a reverse mortgage, the lender has no recourse to demand additional repayment from any family member if there is not enough equity in the property to pay the loan in full; i.e., the borrower's estate cannot be forced to pay the difference if the property's value declines during the reverse mortgage.

Because the qualifications for entering into a reverse mortgage agreement are minimal, a reverse mortgage is one of the easiest monetizing strategies to execute. Applicants must be at least 62 years old, and the property in question must be the owner's primary residence. The property does not have to be owned free and clear (although the reverse mortgage must pay off any outstanding liens against your property before you can withdraw additional funds). There are no additional income, asset or credit requirements to qualify for a reverse mortgage.

As a general rule, the older you are and the greater your equity, the larger the reverse mortgage monetization. The amount of reverse mortgage benefit available will depend on your age at the time you apply for the loan, the type of reverse mortgage program you choose, the value of your home, current interest rates, and in some cases, where you live.

The proceeds from a reverse mortgage are tax-free and, depending on the type of agreement, may be received as a lump sum, fixed monthly payments, a line of credit, or a combination of these options.

Coordinating a Reverse Mortgage to Maximize Your Financial “Big Picture”

From this general overview of reverse mortgages, it should be easy to see the attractiveness of reverse mortgages for older

homeowners. For those with limited financial resources, a reverse mortgage monetizes what is often one their largest assets, which can provide either additional income or a greater measure of financial stability. Even those who don't "need" to



tap the equity in their principal residence may find reverse mortgages worthwhile, because of flexible terms, tax advantages, or the capability to maximize other financial objectives.

For example, the National Care Planning Council offers the following commentary on how a reverse mortgage might be used to enhance an estate plan (from www.longtermcarelink.net):

When tax-free monies from a reverse mortgage are used for the purpose of funding insurance products, it gives homeowners, particularly those with substantial equity built up in their homes, the comfort of having more control over their estate and assuring the legacy they leave retains its value. If the senior homeowner uses some of the tax-free equity released from a reverse mortgage to purchase additional life insurance for their heirs, the net result would be larger death benefits for the beneficiaries without affecting the current (and many times, limited) income stream of the borrower. When the insurance policy pays the benefits to the heirs, they receive tax-free dollars. Upon the sale of the property, any equity over the reverse mortgage loan amount will be subject to estate taxes, but ultimately, still revert to the heirs. With the unknown nature of the future real estate markets, the use of a reverse mortgage provides for greater control of the legacy assets by the senior homeowner.

A reverse mortgage can be an excellent monetization strategy for home equity, especially if the decision is part of a coordinated plan to maximize the value of other assets as well. Even if the property in question is considered a valuable inheritance asset, it may be possible to not only monetize the home under favorable terms today, but also ensure that it returns to the estate for future generations.

Note: This type of comprehensive planning is not a one-size-fits-all program. Tax, insurance and legal questions are best addressed by experienced professionals, and it is strongly recommended that you seek expert assistance when considering a reverse mortgage and any other related financial transactions. (In fact, FHA requires reverse mortgage borrowers to participate in a Credit Counseling session with an approved counselor early in the application process. When applicants complete this counseling, they receive a Counseling Certificate in the mail which must be included as part of the reverse mortgage application.)

IF YOU WANT TO MAXIMIZE YOUR ABILITY TO OPTIMIZE A REVERSE MORTGAGE IN THE FUTURE, LAY THE FOUNDATION TODAY BY REASSESSING OR RESTRUCTURING YOUR LONG-TERM PLANS.

"The problem is that no matter what you think of insurance, past problems, future difficulties, etc., risk management still is a mandatory element of financial planning."

- Errold Moody

THE BEST RESOURCE FOR LIFE INSURANCE

An ongoing philosophical debate in the financial services community is how financial professionals should be compensated, either by commissions or advisory fees. Both sides of the discussion raise some interesting issues. Those advocating a fee-based approach argue that the incentive of commissions for brokers and sales agents has the potential to cloud the assessment of any transaction. In contrast, those defending the commission-driven model assert there is greater incentive to actually implement and monitor financial transactions, while fee-based planners have little or no motivation to ensure that the customer actually follows through on the advice given.

Since both sides are fairly well-entrenched on philosophical grounds, it is perhaps surprising to read a practical, real-world perspective on how to obtain reliable financial advice, particularly in regard to life insurance.

Errold F. Moody, Jr., operates and maintains what he claims is "the largest and most comprehensive planning site on the Internet" (www.efmoody.com). For more than two decades, Moody's major interest has been "individual fee financial planning." It is Moody's contention that the best way to retain the services of financial professionals is by paying for their advice as opposed to buying their products – **except when it comes to life insurance.**

Moody's exception is because he observes that many fee-based planners don't seem to know much about life insurance. Besides personal experience, he quotes a 1999 *Journal of Financial Planning* article which stated:

"...many planners were not looking at, or least not emphasizing enough, the entire area of risk management – not just life insurance, but also disability, health, long-term care and liability coverage."

Moody follows with some commentary of his own. (As you read this, keep in mind that for the past 24 years, Moody has been a professor at the University of California, Berkeley and Irvine, taught classes for Professional Designations in Financial Planning, and from 1995-2004, he was an Insurance instructor for various licenses and continuing education programs.)

"Insurance is, in my mind, one of the most difficult of all planning areas. While it is easy to get information about mutual funds and other investments from the likes of Morningstar or Value Line, it is almost nigh on to impossible to obtain objective and intensive analysis of a life insurance

product. Therefore, since the analysis is hard, and since very few planners have the capability to do such analysis, they simply have decided to effectively eliminate planning for that area in total. Therefore, while somebody may have limited the conflict of interest in regards to commission, they simply have paid an hourly or flat fee for an incompetent, unknowledgeable adviser who has effectively breached its [his/her] fiduciary obligation to a client.”

Thus, Moody concludes the only effective way to buy life insurance is from a knowledgeable agent. Setting aside questions of compensation, the real issue is the financial professional’s knowledge of insurance, and ability to accurately transmit that information to the consumer, then deliver the appropriate products. Because of the variety and complexity of life insurance contracts, you need to work with someone who is immersed in the business. And the most likely “expert” is a life insurance agent, whether compensated by commissions or fees.

REQUIRED MINIMUM DISTRIBUTIONS: The distribution may be required, but what if you don’t want to spend it?

When Congress first began writing legislation for tax-favored retirement plans in the 1970s, some of the provisions were likely based more on projections (guesses) than historical precedent or experience. This seems particularly true of the required minimum distribution (RMD) regulations which mandate that a certain percentage of retirement account accumulations must be withdrawn after the account holder reaches age 70½ (unless, in the case of an employer plan, a rank-and-file employee continues to work after that age).

As qualified retirement accounts, IRAs, SEPs, 401(k)s and the like were specifically intended to provide retirement income. And considering the tax-deferral features on deposits and accumulations, the Federal government certainly has an ongoing interest in eventually “recovering” these tax-deferrals during distribution. But why age 70½? As life expectancy continues to increase and general good health extends later in life, many qualified retirement account holders age 70½ or older may still be working, and/or may not want or need to take distributions from their accounts. For these individuals, liquidation from a retirement account will result in additional taxable income, and the funding of a new, non-qualified accumulation vehicle. Both facets of this distribution process could benefit from some forethought and planning.

The first issue to address in required mandatory distributions is the resulting taxable event. The entire distribution from qualified retirement plans (except amount attributable to after-tax contributions) is treated as taxable – there is no distinction between principal and earnings. As



such, this additional income, whether spent or not, is taxed at the individual’s highest marginal tax rate. For individuals who are currently receiving income from other sources (wages, passive income, dividends, etc.), this means distributions from qualified plans **may actually end up being taxed at a rate greater than the tax-deferral that was received when the money was deposited.** While the taxability of qualified plan distributions is unavoidable, some individuals may want to consider ways to either offset the current taxation, or minimize the impact of future taxes on the distributed funds. For example...

Suppose a \$24,000 RMD is required. This means an additional \$24,000 must be reported as income. When making a required mandatory distribution that is not intended to be spent, the individual has to find a new place to hold and/or invest the \$24,000 (or \$24,000 minus the taxes due). Where should the money go?

If the retirement account had been invested in a financial product that delivered good returns over the years, the individual might choose to place the money in a similar product with non-qualified status. But depending on the type of account and the assets held in it, the new account may be subject to taxes on interest earnings, dividends, and short- and long-term capital gains. These annual taxes create an ongoing, compounding opportunity cost for holding the investment. Especially if these assets are intended to be held long-term, and perhaps intended to be part of an inheritance, the compounding opportunity costs may make the non-qualified version of this financial vehicle less attractive.

On the other hand, there are some financial transactions that have tax advantages. If the distribution were used to make mortgage payments on a second home or investment property, some of the reportable income from the distribution might be offset by a deduction for the interest portion of the mortgage payments. Using the \$24,000 cited above to make a mortgage payment of \$2,000 each month might not only reduce the tax on the distribution, but also secure a nice piece of real estate.

If these distributed-but-not-spent retirement account assets are earmarked to be part of an inheritance or estate plan, the annual distributions could be used to fund a tax-deferred annuity or buy life insurance. These insurance products have tax advantages and contractual guarantees that many people find valuable in ensuring a legacy for heirs.

HAVE YOU CONSIDERED A PLAN FOR YOUR DISTRIBUTIONS?

Selected FAQs about RMDs from the IRS

The Internal Revenue Service website (www.irs.gov) has an extensive listing of the regulations for Required Minimum Distributions, as well as additional publications available for download. A brief reading of these regulations - and the penalties for improper distributions – should prompt you to

seek expert assistance. Here are a few Frequently Asked Questions regarding RMDs, direct from the IRS:

What types of retirement plans require minimum distributions?

The RMD rules apply to all employer sponsored retirement plans, including profit-sharing plans, 401(k) plans, 403(b) plans, and 457(b) plans. The RMD rules also apply to traditional IRAs and IRA-based plans such as SEPs, SARSEPs, and SIMPLE IRAs. The RMD rules also apply to Roth 401(k) accounts. However, the RMD rules do not apply to Roth IRAs while the owner is alive.

When is the deadline for receiving a RMD from an IRA?

An account owner must take the first RMD for the year in which he or she turns 70½. However, the first RMD payment can be delayed until April 1st of the year following the year in which he or she turns 70½. For all subsequent years, including the year in which the first RMD was paid by April 1st, the account owner must take the RMD by December 31st of the year.

How is the amount of the RMD calculated?

Generally, a RMD is calculated for each account by dividing the prior December 31st balance of that IRA or retirement plan account by a life expectancy factor that IRS publishes in Tables in Publication 590, Individual Retirement Arrangements (IRAs). There are three separate tables:

- The Joint and Last Survivor Table is used by an account owner whose sole beneficiary of the account is his or her spouse and is more than 10 years younger than the account owner;

- The Uniform Lifetime Table is used by account owners who are unmarried or whose spouse is not the sole beneficiary or whose spouse is not more than 10 years younger; and
- The Single Life Expectancy Table is used by a beneficiary of an account.

Can an account owner just take a RMD from one account instead of separately from each account?

An IRA owner, after calculating the total amount s/he needs to take from the aggregate balances in his/her IRAs, can take that amount in any portions s/he chooses, from any one or more of the accounts. However, RMDs required from other types of retirement plans, such as 401(k), 403(b) and 457(b) plans, have to be taken separately from each account (e.g., if a person has one 401(k) plan which is twice as large as another 401(k) plan, the RMD for the first will be twice that of the second, and if s/he takes less than the required amount from the first, s/he cannot “make up for it” by taking more from the second.

What happens if a person does not take a RMD by the required deadline?

If an account owner fails to withdraw a RMD, fails to withdraw the full amount of the RMD, or fails to withdraw the RMD by the applicable deadline, the amount not withdrawn is taxed at 50%. The account owner should file Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, with his or her federal tax return for the year in which the full amount of the RMD was not taken.

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