The Kelemen, Way & Hanslits

FINANCIAL PERSPECTIVE

Creators of The Planning Vision Process®

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CREATING CLARITY & CONFIDENCE IN A COMPLEX WORLD

Dealing with Boomerangs and KIPPERS

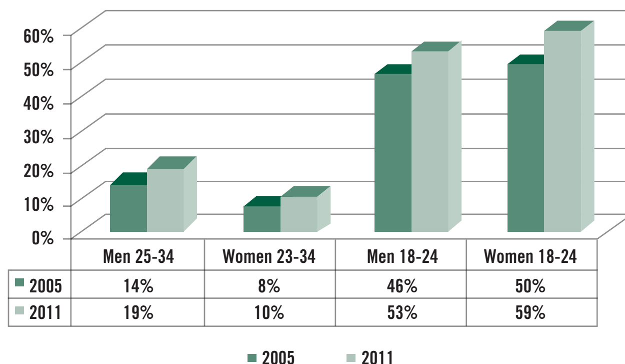
One of the realities of the post-crash economic downturn is that more adult children are expecting their parents to help them out financially. We are seeing this happen with a growing number of clients, and it usually takes two forms: 1) moving back in with Mom and Dad (the "boomerang"). Or 2) outright gifts for home down payments, cars, loan payments, grandchildren tuition, or even cell phone bills.

Either way, they can be described as "KIPPERS"—Kids Invading Parental Pockets and Eroding Retirement Savings. Not many families can withstand a long-term drain on assets that likely already took a blow during the 2008-2009 market meltdown.

The empty nest is quickly becoming the cluttered nest. The August 2011 issue of *Harper's* magazine published data estimating that a stunning 85% of this year's college graduates were planning to head back to live with Mom and Dad for "at least a while."

Percentage of Young Adults Living at Home 2005 & 2011

(Source: U.S. Census Buerau)



	Men 25-34	Women 23-34	Men 18-24	Women 18-24
2005	14%	8%	46%	50%
2011	19%	10%	53%	59%

Although the trend started in the mid-1980s when the Merriam Webster Dictionary first coined the boomerang term, it has clearly accelerated for economic reasons. Having your children return to the safety net of your home can be a wonderful time of family closeness, but it can also create personal, marital, and financial stress.

It's no big deal if your adult children are turning to you for help for the first time because of a financial emergency. Stuff happens, especially in this economy. But it becomes problematic when they don't move out or they repeatedly line up for gifts or a loan (that in most cases end up being gifts). Over the years, many of our clients have taken advantage of the annual gift exclusion, currently at $13,000 per parent per beneficiary. It was a nice way to reduce the size of their taxable estate. Unfortunately some of the adult children and grandchildren now have a sense of entitlement and dependency on those gifts at a time when their parents' real estate values and portfolio values are lower.

We think part of the problem is that for some families, the kids have no clue about their parents' financial situation. They don't grasp how much retirement costs and what it takes to adequately save for it. They grew up with a comfortable lifestyle in an era of plenty, and now their lifestyle isn't as high as it was when living at home before college. They see mom and dad living more comfortably than them and think "Mom and Dad can afford to help me."

So, if you find yourself in this situation, here are five action steps:

1. **Update your retirement planning projections.** Financial advisors with good software can run a series of scenarios showing different annual gift amounts, savings rates, retirement dates, and retirement lifestyle costs. Once you have that, you will be in a better position for suggestions two and three.
2. **Level with your kids.** Share as much of your current situation and planning projections as you feel comfortable. Who knows, it might even motivate them to start investing for their own futures.
3. **Just say "no."** It's hard to say "no" to your child and see them experience some of the hardships you may have experienced. We know, because we are also parents who have always wanted the best for our children. But we also know that many of the challenges and delayed gratification we experienced over the years have helped to make us who we are today. **It's a fine line between needs and wants; between helping and enabling!**

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Is a Reverse Mortgage in Your (or Your Parents') Future?

It's hard to miss the ads on cable TV featuring celebrity spokesmen pitching reverse mortgages. The sheer volumes of the ads raise suspicion that they are better for the promoters than for the ultimate customer. Shady reverse mortgage practices of the past and confusion about them continue to dog the reputation of new and improved reverse mortgages of today. So just what are they, and when might they be appropriate?

The Basics

In a reverse mortgage, (also called a Home Equity Conversion Mortgage—HECM for short) the bank makes payments to the homeowner, instead of the homeowner making payments to the bank. And unlike other loans which may also be based on one's income, existing debt, or ability to repay the loan, the HECM is driven by the equity in the home and the borrowers' ages. The homeowner does not have to pay back the loan until he, she, or they die, vacate the property, sell it or transfer title to it, refinance, or otherwise fail to use the property for 12 consecutive months. However, whatever sums the bank advances accrue interest which is added to the principal amount the bank receives when the home is sold or the loan is repaid.

To qualify, the homeowner must be at least 62 years old (if a married couple, the younger must be at least 62) and have substantial equity in the home. The homeowner can collect that value in a variety of other ways:

1. A lump sum;
2. Tenure: equal monthly payments for as long as the home is the homeowner's principal residence;
3. Term: equal monthly payments for a fixed term;
4. Line of Credit: draws taken as needed; or
5. Various combinations of lump sum and the above options.

As an example, assume a husband and wife, both age 70 living in the 97302 zip code with a home worth $500,000 free and clear. (A mortgage against it can be paid off with the HECM.) According to the FHA, with an adjustable rate loan at today's interest rates, they could receive a lump sum of $312,623, or $1,808 for the rest of their lives, or a $3,570 per month for 10 years. The payments are generally tax free.

As with an annuity, an older couple would receive higher monthly payments for life and lower ones if they were younger. **And as with an annuity, if the couple receives more in payments than the ultimate sales price of the home, the lender eats the difference. And that's what also makes reverse mortgages more expensive than a typical line of credit or a conventional 2nd mortgage.** They have higher origination fees that can range from $2,000 to $6,000, plus an annual mortgage insurance premium equaling 1.25% of the mortgage balance. Those who opt for the popular Saver loan sponsored by the FHA can have that premium reduced to 0.01%, but they can only borrow about 80% to 90% as much as they could with a standard home equity conversion mortgage. And they will also pay a slightly higher interest rate according to reversemortgage.net.

Reverse Mortgages vs. Home Equity Loans

	REVERSE MORTGAGE	HOME EQUITY LOAN
Based on income & credit	No	Yes
Eligibility & loan amount based on age	Yes	No
Eligibility & loan amount based on home value	Yes	Yes
Monthly repayment required	No	Yes
Must live in home	Yes	No
Withdrawals can exceed home and loan value over time	Yes	No
Must attend educational session before obtaining loan	Yes	No
Can have other mortgages against home	No	Yes

Planning Opportunities and Strategies

1. **The "Cavalry to the Rescue" strategy.** Reverse mortgages are often viewed as a last resort, when other sources such as a portfolio, employment, or savings are no longer sufficient. They can supplement income and be helpful with major medical expenses or costly repairs. We've witnessed this cavalry rescue. While it was a welcome relief to have the option available, it was not a happy time for the individuals who had spent their portfolios down to the bone and couldn't make further budget cuts.
2. **The "Piggy Bank" strategy.** In spite of major downturn in housing prices, many people still view their homes as an asset. We generally disagree with this concept because one always needs a place to live and homes are not as liquid as they used to be. However, in cases where the home equity is disproportionally large compared to other retirement assets and income sources, and where the homeowners don't want to downsize for many years to come, a HECM can provide a nice income supplement and source of cash when needed.

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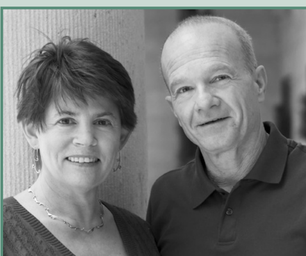
Ron and Kathy Presented with Distinguished Service Award



At the Salem Area Chamber of Commerce 62nd Annual Salem First Citizen's Banquet on March 2, Ron and Kathy Kelemen were honored as Distinguished Service Award recipients. They were recognized for their many years of active volunteer activities and leadership of several charitable and civic organizations, plus working with disadvantaged youth.

"It is quite a humbling experience and an honor, because so many other people in this community deserve it more than we do," commented Ron. "We are so fortunate to live and work in this community, and to be in this space in life where this kind of volunteer service is possible."

The Dow at 13,000—Too High?

On February 28, the Dow closed above 13,000 for the first time since May 19, 2008. And the other major indexes have also either approached or surpassed the pre-September 2008 meltdown levels. So here we are, almost four years later, with many people wondering where we are in the market cycle.

Our position is that in late 2007 the economy was stronger, but it was propped up by too much leverage. That masked fundamental weaknesses of many companies. **Today, by contrast, the fundamentals of most companies are significantly better.** Corporations have used this low interest rate environment to refinance their debt and clean up their balance sheets. Technology—often at the expense of jobs—has made many companies more efficient and profitable. In fact, by many measures, profitability is at an all-time high, which means that shareholders own pieces of profitable businesses in a low-interest rate environment with few other alternatives. This compensates for a weaker economy and gives the stock market somewhat of a buffer if things in Europe don't pan out well.

Taking inflation into account, the Dow remains well below its real value of May 2008, when it last was at 13,000 on a nominal basis. According to the Wall Street Journal, **the Dow would have to exceed 14,000, a further 7.9% gain, to return to its May 2008 level after adjusting for inflation.** And to reach its all-time high of 14,164 on Oct. 9, 2007, it would need to surpass 15,876 on an inflation-adjusted basis.

Can the Dow do that? Probably. We just don't know when.

Reverse Mortgage...*Continued from page 2*

3. **The "Long-Term Care" Scenario.** This could be a fallback position for a couple who did not obtain long-term care insurance while they were still healthy. It could be used for in-home care or for facility care for one of the spouses. ***However, there are some downsides to depending upon this strategy. Care costs could outstrip the HECM payments. Because of the high closing and servicing costs (compared to conventional loans), HECMs may be unappealing for individuals in their 80's or poor health who may soon need to vacate the home for assisted living or skilled nursing care.*** And regular income from an HECM may affect one's ability to qualify for Medicaid or food stamps. Hopefully none of our clients will ever get in that situation!
4. **The "Reverse Mortgage First" strategy.** Generally it is not advisable to take out a HECM early because the amount you receive is actuarially based on your age. Younger people get less; older people get more. But in a paper published in the February 2012 issue of the *Journal of Financial Planning,* Barry Sacks, Ph.D. and Stephen Sacks, Ph.D. make a compelling case to tap into a HECM first, before making heavy withdrawals from a portfolio of stocks and bonds.

   They back-tested a variety of portfolio mixes of an $800,000 portfolio and a $417,000 HECM over the past 30 years and compared the portfolio survival rates when starting a HECM early, rather than later to supplement the so-called 4% "safe" withdrawal rate. Their conclusion showed that using income from a HECM early in retirement provided greater income security, longer-range portfolio survival rates, and a higher net worth at the end of 30 years. The reason for this is that it gave the stocks and bonds time to grow. This was especially true in periods when the market was trending down or flat at the start of retirement, and even truer when the portfolio was mostly a taxable IRA account.

   A recently deceased client of ours used a variation of this. Well into retirement for over 15 years, he applied for a HECM on his upscale home in early 2009 before the housing bust hit the Bend area hard. He stopped making taxable withdrawals from his retirement plan, thus saving taxes and enabling his IRA account to recover.

As you can see, reverse mortgages are complex and somewhat flexible. ***They need to be integrated in with one's total planning and not considered as a stand-alone tool. You need even more info than this summary before charging off to get one.*** In fact, HUD regulations require that you take a brief class and a counseling session about them before you get your loan. Too bad those rules weren't around for sub-prime mortgages a few years ago!

The Team Advantage™

Ron Kelemen, Mary Way, and Larry Hanslits are independent Certified Financial Planner™ certificants. They jointly serve their clients as a team with over 72 years of combined experience. They are members of The National Association of Personal Financial Advisors (NAPFA), and as such work on a fee-only basis and do not accept any third party compensation or finders fees. Their practice focuses on wealth planning and management for professionals, business owners, and retirees. They are advisory associates of The H Group, Inc., one of the largest independent fee-only registered investment advisory firms in the Northwest with 18 professionals and over $550 million under active management.

About Ron Kelemen, CFP®

In practice since 1981, Ron is a contributing author of three financial planning reference books and is frequently quoted in the national press and professional journals. *Medical Economics* lists him as one of the 150 best financial advisors for doctors. He is active in Rotary and several non-profit organizations.

About Mary Way, CPA, CFP®

Mary joined the practice in 1995. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She is a board member of the Salem Rotary Foundation, and like Ron, a past president of the Willamette Valley Estate Planning Council.

About Larry Hanslits, CFP®

In practice since 1985, Larry merged his practice with Ron's and Mary's in 2011. He sits on the investment policy committee of The H Group, Inc., provides advanced estate planning case writing services to attorneys nationwide, and is a teacher and a judge for the financial planning scholarship competition at Oregon State University.

The opinions expressed in this newsletter are those of Ron Kelemen, CFP®, Mary Way, CPA, CFP®, and Larry Hanslits, CFP®. They do not necessarily reflect those of The H Group, Inc. They are general comments that may not be appropriate for every individual. They should not be construed as legal or tax advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. All economic information is historical and not indicative of future results.

TEAM UPDATE

We started off 2012 with excitement and energy that still remains with us. In January we conducted an all-day, off-site team retreat to identify areas where we can streamline processes and improve client services. (That's when Ron and Kathy were pleasantly surprised by a camera-wielding delegation from the Chamber of Commerce announcing their Distinguished Service Award.) We upgraded all of our software to Office 10 and replaced some computers and monitors.

Lani has been updating our data base, getting ready for new software arriving in April. Their 10 chickens (in a fancy "chicken condo") still lay 10 eggs a day!

Debbie took a couple of 3-day weekend trips to Seattle and Sisters. While the rest of us had a fairly seamless transition to new software and computers, she has been spending a lot of time with her new "best friend"—our IT guy.

Larry attended his first Strategic Coach meeting in late December and the Portland Estate Planning Council conference in January. He kicked-off the annual Financial Planning Contest at Oregon State University and is preparing to teach his class on investments in March. He and Laurie are starting to get offers on their house in Florence. Low ones, but at least they are getting them.

Mary participated in the two-day Financial Planning Association conference in Portland, gathering lots of insights and useful information to help our clients. She spent a week in Bend with her newborn grandson, Paxton Marcus Way, and after many diaper changes and bottle feedings claims to be fully "grandma certified." As you read this, she and husband Steve are vacationing for two weeks in Costa Rica. Upon their return, Steve starts an entirely new career in a dream job as the banking specialist with Axiom EPM, a worldwide enterprise software firm located in Tigard.

Ron attended his 66th Strategic Coach workshop in Chicago and the FPA conference with Mary. His spare time was spent completing some Rotary matching grants for projects in India, hanging out with daughter Skyler visiting from Boston, and snowboarding on Fridays—snow conditions and sore knees permitting. Although Kathy and Ron enjoyed the big hoopla in their honor, they are glad to return to their normal and busy lives back under the radar.

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The Kelemen, Way & Hanslits Financial Perspective
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Dealing with Boomerangs and KIPPERS... *Continued from page 1*

4. **Help them restructure debts, rather than simply bail them out.** Then teach them how to avoid new debt. One option is to match debt-reduction payments, with the understanding that they put away credit cards and live within their means.
5. **Make a loan a legitimate loan.** Plenty of websites have samples of promissory notes. Charge a fair interest rate and include reasonable terms that your child can afford.

As far as living with a boomerang?

The most important thing you can do beforehand is to have a serious discussion and come to terms on the following items:

1. **Set a time limit.** Whether the boomerang kid is getting a divorce, returning to school, or saving for a down payment on a house, set a time limit.
2. **Set goals and discuss expectations.** Why is the child returning home? To pay off credit card debt? Recover from a bad relationship? Look for a new job? Talk frankly about the reasons behind this new living arrangement, and lay plans for the transition back to independence.
3. **Discuss rent.** For some parents, the mere mention of charging rent to a family member draws an incredulous reaction. But for other parents, charging rent helps prepare the boomerang for living independently and helps parents keep up with home finances. (Ron remembers that his dad charged his older brother rent 45 years ago.) According to Ask. Com's young adult columnist Jackie Burrell, roughly half the nation's boomerang kids pay rent, ranging anywhere from $200 a month to the going market rate. Some families start at one rate. Then, as an incentive for their child to move out, they raise the monthly rent a predetermined amount as the months tick by. Others charge rent, but set the money aside and present it as a nest egg when junior moves out.
4. **Agree upon rules and chores.** You and your spouse are basically living with another adult, not a child. So, it's unrealistic to set curfews. But you need to have rules about loud music, overnight guests, and alcohol or other substance issues. You also need to agree on a set of household chores, such as laundry, help around the house, cooking, yard work, and other chores. Otherwise, it's too easy to slip back into mom-takes-care-of-everything mode, which does nothing to foster independence and much to breed resentment.
5. **Make a contract.** Whatever the plan, discuss it and spell it out beforehand, and put it in writing. It can be really simple and not any longer than the words used to describe these five points.

It's all about you and your own financial security.

Love your kids, but do not sacrifice your own financial future by enabling KIPPERS. Like all parents, you have sacrificed many times over for your children. Now it's time to take care of you. They will still love you in the long run. Your children have decades to build their financial security, while you do not. Ironically, if you are not careful, you could end up depending on your children for financial help in your old age.