Highlights

from

"Reversing the Conventional Wisdom:
Using Home Equity to Supplement Retirement Income"

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1. **Retirees' Objective.** The overriding objective for many retirees is to maintain cash flow throughout their retirement years, to avoid "running out of money" in their later years.

2. **Maximum "Safe" Withdrawal Rate.** It has long been accepted that the maximum safe (or "safemax") annual withdrawal from a retiree's account (such as a 401(k) account or a rollover IRA) begins with a first year's withdrawal equal to between 4.0 percent and 4.25 percent of the initial account value. Subsequent years' withdrawals then continue at the same dollar amount, adjusted only for inflation (thus maintaining constant purchasing power).

3. **Meaning of "Safe".** In this context, the term "safe" means a 90% or greater probability that the account will have sufficient assets to make such annual payments for at least 30 years.

4. **Taking the "Unsafe" Approach: The Risk.** Many retirees find that the safemax amount is uncomfortably limiting, and therefore tend to withdraw more than that amount. This higher, "unsafe," withdrawal rate significantly increases the risk of these retirees running out of money during retirement, of "outliving their money."

5. **The Conventional Wisdom: Home Equity as the Last Resort.** The conventional wisdom, for retirees who choose to withdraw from their accounts at "unsafe" withdrawal rates and own homes, is to view their home equity as a "last resort." The last resort, a passive strategy, is to draw upon the home equity only if and when the account is exhausted.

6. **The Most Frequent Cause of Account Exhaustion.** Where withdrawals lead to an account's exhaustion, it is most often because the investment performance in the early years of withdrawal has been weak or negative. Thus, the losses or even the weak gains in the early "down" years, coupled with the withdrawals in those years, lead to the account's not having enough assets to recover in the later "up" years.

7. **More Effective Way to Insure Cash Flow Continuity: The "Active Strategy."** Our article demonstrates a much more effective way to use home equity (in the form of a reverse mortgage credit line) than to use it as a last resort. Establishing the reverse mortgage credit line early in retirement, and using it in the Active Strategy described in the next paragraph, and described more fully in the article, greatly increases the likelihood that the retiree's cash flow will continue for the retiree's entire life in retirement, as compared with the likelihood of cash flow continuation if the Last Resort Strategy is used.

8. **The Operation of the Active Strategy.** The Active Strategy allows the account to grow during the early years of retirement by taking no withdrawals from it in the early years that follow years in which the account's performance was weak or negative. This greatly facilitates the account's recovery in years when its performance is stronger.

9. **Demonstration of Effectiveness of the Strategy.** Monte Carlo simulations run with 4%, 5% and even 6.5% initial withdrawal rates, using a 60-40 asset allocation and investment return data and inflation data from the 1973 through 2009 time period, show that the Active Strategy gives substantially greater cash flow survival probabilities than the Last Resort Strategy. And, incidentally, the Active Strategy results in a significantly higher median residual net worth (at the end of retirement) than the Last Resort Strategy.

See other side --------->