Maximize Retirement Income

by L. Jake Carpenter, VP Investor Relations

I have seen the following scenario play out time and time again. I want to offer you some valuable nuggets that can help you avoid common mistakes in retirement planning. I meet good people, who have worked hard for many years. Now they are ready to slow down and try to exit their business, farm, or rental property, but they find themselves backed into a corner. For instance, consider the farmer who has been working the farm for the last 40 years. Though the kids and grandkids work on the farm, they have no desire to take it over for Mom and Dad. The farm is worth $5 million and it's generating a gross income stream of $100,000 a year. Another way to say it is their $5 million dollar farm asset is generating a 2% gross return.

Dad and Mom at age 65, have reached a stage in life where they are either no longer able or no longer desire to work the farm. If they were to lease the farm ground, the return on the asset is even lower, then if they work the farm themselves. And a 1031 Exchange isn't suitable since they don't want to sell the farm and buy another one. So, they decide to just sell the farm.

Using our scenario as an example, here are some points to consider. First, Dad and Mom purchased the farm 40 years ago for $350,000, now it is worth $5 million. Second, since they've owned the farm for so many years, their depreciation schedule has been exhausted. This means the income from the farm is no longer tax-advantaged, so 100% of the farm income is subject to ordinary income tax. This also means that all of the $5 million dollar sales proceeds are unfortunately subject to capital gains tax and potentially depreciation recapture which together equals about 40% of the sale. In this case it equates to a $2 million dollar tax bill.

Dad and Mom sell the farm, and put the net sales proceeds, $3,000,000, in their checking account. Then they initiate their plan to take out $100,000/year to live on. Now here's another point to consider. When factoring in inflation, at a very conservative rate of 4%, Dad and Mom will run out of money in 20 years. So, if they live past 85 years of age, they will have exhausted their income. How many people do you know that are older then 85? Did you know the fastest growing population in America are those turning 100?

Here is a better plan. Before you sell the farm, work with someone who has the tools, like Equilus Capital Partners, to build a strategy that will allow you to sell the farm and put the tax bill back in your pocket. There are strategies that defer capital gains tax, like using a 1031 Exchange, only they allow you to diversify the sales proceeds into a passive position in income-producing real estate, as well as into conservative stocks, bonds, and mutual funds. One of the benefits of being in a passive position in real estate is that you don't have to deal with the trash, toilets, and tenants. Your funds should be managed to produce a target income that outlives you. Utilizing this strategy, you can take a portion of the interest income every year and put more spendable income in your pocket. Our proactive strategy takes inflation into consideration and allows for your income to increase every year at 4%.

If Dad and Mom had taken this route, by the time they are 95 years old, they could potentially be taking over $580,000 a year in income and still have an investment account balance of approximately $5 million after 30 years.

This is a great illustration of the possibilities, depending on your individual situation. Our goal is to come along side of you to build and implement strategies that will maximize your after-tax spendable income and allow you to do the things that maybe you were not even aware that you could do. Set up your consultation today and become equipped to make optimal decisions by knowing all of your options. Avoid common mistakes, call today: (509) 665-8349.