Two JFP articles you shouldn't miss

By Editor Test *Sat, Aug 11, 2012*

In the August issue of the Journal of Financial Planning, there's an article by Harold Evensky et al about using home equity instead of a cash bucket in retirement, and one by Manish Malhotra about weighing the pros and cons of various decumulation strategies.

The August 2012 issue of the Journal of Financial Planning contains a couple of highly useful articles on retirement income planning. One article involves using a line of credit associated with a reverse mortgage. The other describes a framework for comparing distribution strategies in retirement.

In the reverse mortgage article, entitled "Standby Reverse Mortgages: A Risk Management Tool for Retirement Distributions," authors John Salter, Shaun Pfeiffer and Harold Evensky describe the advantages of leveraging the Home Equity Conversion Mortgage (HECM) Saver.

Under the strategy they suggest, homeowners age 62 and older with small or paid-off mortgages can open a standby home equity line of credit, but borrow from it only during bear markets in order to avoid selling assets at depreciated prices. When the assets recover, the retiree can sell them, pay off the line of credit, and recapture the equity in their home.

The line of credit would, in effect, eliminate or reduce the need to maintain a large and unproductive cash reserve—e.g., the first "bucket" in a bucketing strategy—as a buffer for meeting immediate needs during a downturn. Using the HECM Saver line of credit also offers certain advantages over a standard reverse mortgage as a source of cash or using a conventional home equity line of credit.

The tough question is, how do you optimize the timing of this strategy with regard to market behavior? Much of the article is devoted to providing answers, based on the results of simulations that try to help identify the "trigger for borrowing rebalancing, and paying back the HECM Saver line of credit."

The second article is "A Framework for Finding an Appropriate Retirement Income Strategy." It acknowledges the existence of a wide range of decumulation strategies beyond the traditional systematic withdrawal program (SWP), and tackles the challenge of making apples-to-apples comparisons between them.

The author, Manish Malhotra, has a stake in all this: his company, Income Discovery, makes a software tool that runs simulations that allow advisors to see how different distribution strategies would perform under a variety of hypothetical future scenarios.

Except perhaps for advisors whose clients are deep in what advisor Jim Otar calls the "green zone"—with a very high resources-to-expenses ratio—few will argue with the author when he points out that "The art of building an income plan lies in finding the right balance between SWP and fixed sources of cash flow that provide acceptable confidence and reasonable protection in unfavorable markets with a potential to leave a legacy (if so desired) in favorable markets."

The article appears to break new ground in the breadth of risk factors, capital market assumptions, and types of financial tools and resources—including fixed immediate annuities, variable deferred annuities with living benefits, TIPS ladders, and Social Security—that it embraces in its comparisons.

Decumulation, it is often said, is much more complicated than accumulation—partly because there are no second chances and partly because there are so many different ways to do it. As more boomers retire, and turn to advisors for help with income planning, tools that allow them to test the viability of competing strategies in advance should come in handy.