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Raising Cash From the Less Usual Places

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SUPPORTING a family can be tough in a good economy. Add today's tight credit market, high unemployment and depressed home prices, and there's a good chance many stuck in the generation sandwich are thinking about last resorts for obtaining additional cash to pay for expenses like senior living care.

The good news: Because of new developments from the financial industry, last resorts no longer necessarily mean fire sales of the house and stocks.

"There is a whole raft of new financial products that are designed to help this market," said Troy E. Thompson, founder of Thompson Advisory Services, a financial planning company in Portland, Ore. "We're talking about people with substantial resources even though they are having difficulty making their expenses for various reasons. There still is a great deal of wealth and the financial product market is trying to tap into it."

These relatively new options include opting for do-it-yourself intrafamily reverse mortgages, signing up for bridge loans specifically designed for elder care and selling life insurance policies. But while these options exist, they aren't right for every family. No one wants to use these types of options to support themselves, but to support parents who are running out of money, they may be necessary. Here's a look at various options and their pros and cons.

REVERSE MORTGAGES Taking out a reverse mortgage can enable homeowners to stay in their home while also letting the family tap into the home's equity.

With a reverse mortgage, elderly homeowners receive either a lump sum payment or a monthly amount from the lender. Then, when the homeowner dies, moves or sells the house, the loan, plus interest, is repaid.

Obtaining a reverse mortgage through traditional sources like the Federal Housing Administration's Home Equity Conversion Mortgage program can be costly, even with new lower fee options, and it can have other drawbacks, such as limits on how much can be borrowed against equity.

But another option has increasingly been promoted in recent years: a reverse mortgage financed by family members. With such an intrafamily mortgage, which can be formally set up by a lawyer,

the homeowner could potentially tap into more of the home's value at a lower cost and have more leeway for which properties to use as equity for the loan — a vacation home, for example.

Still, despite these advantages over a traditional reverse mortgage, financial planners and estate planning experts generally aren't fans of this option. "I think a family reverse mortgage adds enormous complexities and I'm very hard pressed to think of a situation where the benefits are big enough to justify them," said Deborah L. Jacobs, author of "Estate Planning Smarts."

Financial planners say those in need of cash would probably be better off selling the house outright and downsizing to something affordable rather than setting up such a loan. "A reverse mortgage is kind of like treating a boil instead of that systematic issue that is causing your financial system to have a problem," said David H. Diesslin, owner of the financial advisory firm Diesslin & Associates in Fort Worth.

But even if the whole family agrees that keeping the house is important, there are other downsides to such loans. A reverse mortgage "puts the borrower at odds with the lender," said Mark M. Gleason, senior financial adviser with the Wescap Group in Burbank, Calif. "When it's a family member, this opens the door to intrafamily tensions." And if the borrower lives longer than expected, he said, the lending family members need to ensure they have enough assets to continue to finance the mortgage. This could be hard if a member of the family loses a job or gets sick.

Plus, if the homeowner dies, the holder of the reverse mortgage won't get certain tax benefits he or she would have received if the house had just been inherited.

Financial planners recommend that families with the means to set up such a mortgage look into other options, like buying the house outright from the homeowner and leasing it back or simply picking up the bill for some of the homeowner's other expenses.

A lawyer's services would be needed to set up such a mortgage, but there could be new offerings on the horizon. National Family Mortgage, which recently opened for business to help families set up intrafamily mortgages, doesn't yet offer the ability to set up intrafamily reverse mortgages. "It's in the pipeline," said the company's founder, Tim Burke, noting that there are particular challenges involved with such loans.

ELDER CARE LOANS There's also the relatively new option of taking out a bridge loan to finance Mom and Dad's move to and stay in housing for elderly people. Elias Papasavvas started Elderlife Financial Services for that purpose. "The concept of taking out a loan for elder care might be novel today, but when the car loan first came out, it was also considered a very strange thought," said Mr. Papasavvas, chief executive of Elderlife, which offers two different products for this purpose.

The first, offered since 2003 and called the Elderlife Line of Credit for Senior Living, is an

unsecured line to cover the gap between the monthly cost of living in one of 3,000 independent communities or assisted-living homes nationwide that Elderlife works with and the amount people can pay until some liquidity-producing event occurs, like the sale of a home. Elderlife offers lines of credit up to $50,000, requires payback in five years and pays the monthly gap amount directly to the living community. "Most families use this as a short-term bridge to selling a home or other benefits," said Mr. Papasavvas, who added that most of the loans were paid back in a year or less. "It is a quick solution that gives families some breathing room."

Approval of the loan and its interest rate, which can range from 8.25 to 12.50 percent, is based on the applicant's credit score, debt-to-income ratio and credit history. The older parent, an adult child or children or some combination can apply for the loan.

In addition, just this year, the company introduced another financial product: bridge loans to finance the entry fees into continuing-care retirement communities. This type of housing requires an upfront payment — from $50,000 to $1 million or more, Elderlife said — and then allows the resident to move through various levels of care as needed. Unlike the basic line of credit, this loan is secured by real estate or securities, and so has a lower interest rate.

For both products, up to six family members can cosign, but by doing so, they become liable. Lauren Locker, a certified financial planner with Locker Financial Services in Little Falls, N.J., said families considering these loans should be sure to read the fine print, especially about the interest rates. They should consider their family situation, she said, and consult with other family members before making a decision. "It's a matter of family dynamics," she said. "Everybody has to go into it feeling good."

LIFE SETTLEMENTS The notion of selling one's life insurance policy for cash originated in the 1980s with the advent of AIDS. Before new treatments were developed, patients who believed they had little time left to live and who needed money for expensive treatment would sell their policies to investors in what are called viatical settlements. The investors' hope was that the cash they put out to buy and keep the policy would be less than the payout of the eventual death benefit.

Gradually, as AIDS patients began to live longer thanks to new treatments, investors expanded from buying the life insurance policies of the terminally ill to buying policies of the elderly, creating the so-called life settlement industry. Still, selling one's policy is not necessarily a good idea, or even an option, for every family that no longer needs the insurance or can't afford it.

First, partly as a result of tight capital markets, fewer investors are willing to buy such policies, so supply now outstrips demand. According to Doug Head, executive director of the Life Insurance Settlement Association in Orlando, the total face value of policies (the amount to be paid when the insured person dies) sold this year is expected to be about $7 billion, the same as last year and down from a peak of about $10 billion in 2007.

As a result, "it's a buyer's market right now," said Stephan Leimberg, editor of the book "Tools and Techniques of Life Settlement Planning." Mr. Head estimated that sellers who could get 20 percent of face value a couple years ago can probably get about 15 percent today.

Even more, buyers in the life settlement market, generally institutional investors, are looking for only certain types of policies. First, they typically want only the policies of those who have reached at least a certain age, most frequently from age 65 to 70.

In addition, life settlement companies seek policies that offer certainty regarding death benefits, low premiums and flexibility to skip premiums, among other characteristics. As a result, life settlement companies prefer to buy universal and certain types of term policies rather than whole life or variable life policies. They also prefer to buy policies from top-rated insurance companies and those that have a death benefit of $500,000 or above. "It's a question of efficiency of capital. Investors don't want to put all that effort into buying the policy if they don't get a big enough return," Mr. Leimberg said.

Experts say a life settlement really makes sense only for policies with little or no cash value. Whether to opt for a life settlement "depends on how much cash value do you have as a percentage of the death benefit," said Michael Brink, a principal at Pelagos Advisors, a life insurance and life settlement advisory firm in Atlanta. Surrendering the policy to the insurance company — turning it in for its cash value — is a sensible alternative if the cash value is large, he said. A life settlement is typically an option for someone with "universal or term insurance, 65 to 70 years old, and where the policy's cash value is not substantial," Mr. Brink said.

Financial planners also recommend considering other factors when deciding whether to sell a life insurance policy. One such factor is taxes. If the policyholder dies with life insurance, the entire death benefit is considered tax-free income. This is not the case if the policyholder surrenders or sells the policy, though the tax treatment for these two approaches differs.

The Internal Revenue Service in 2009 released guidance clarifying the tax treatment for the proceeds of life settlements, and it's not as generous as that for a cash surrender. With the surrender of a policy for cash, the cost of the insurance and the premiums are both included in the calculation of the cost basis. This cost basis is then not considered part of the proceeds taxed as income. With a life settlement, on the other hand, the cost of the insurance is not included as part of the cost basis so more of the proceeds are taxed as income or capital gains. With the new rules, "at the margin if you assume that the price that the insurance company is willing to pay you is the same as the life settlement company, the after-tax result favors the surrender to the insurer," said Mr. Thompson of Thompson Advisory Services.

If one sells a policy, there's the possibly uncomfortable notion that an investor is going to benefit when the former policyholder dies. The sale is likely to take 90 to 180 days and involve extensive

underwriting, with buyers wanting to see medical records. The former policyholder will have no control over what happens to the policy after it's sold, and it could be resold repeatedly, with buyers checking up from time to time on how the former owner of the policy is doing. "This is all kind of the ghoulish factor. A lot of people say 'No, that is not acceptable.' But if you are down to your last dollar and last resort, you may say, 'Who cares?' " said Mr. Brink.

Selling an old policy may make it difficult to get a new one. The proceeds from a life settlement also may make one ineligible for certain need-based government benefits like Medicaid, said Bernard A. Krooks, an elder-law specialist and founding partner of Littman Krooks law firm in New York. Mr. Thompson added: "People should understand what the bottom-line impact is going to be before committing to a sale." Families also should compare selling a policy to other options, like borrowing money from it, restructuring it somehow or exchanging one policy for another.

If after considering all these caveats, a life settlement still sounds like a good idea, experts suggest finding a good broker through the Life Insurance Settlement Association or by asking an agent or insurance company.

Telltale signs of a good broker, and what any potential seller should insist on, include treating the policy as a security; uniform and capped compensation, regardless of the buyer; and disclosure and transparency about how many life settlement companies are being approached for offers (there should be several) and about gross offers and all compensation to all parties.

Mr. Brink said that while the life settlement industry "really used to be the Wild West," unregulated, with a lot of room for abuse, many states have put in place regulations and laws in recent years that require such consumer-focused practices, often updating older laws covering viatical settlements. There's been an effort at the federal level as well to better police the life settlement industry and practices, he said.