

Home Equity Harvesting and Cash-Value Insurance

By Lew Nason

One of the hottest life insurance sales strategies being used today is harvesting home equity to over-fund a life insurance policy up to the MEC guidelines. The goal is to convert the life insurance policy into what is called investment-grade life insurance. The over-funded life insurance policy can then be used as a college funding vehicle, a non-regulated retirement plan or a family bank — the infinite banking concept — while providing families the valuable protection they need.

People have several major questions about this concept. Does it really work? Is it truly in your best interest? Is it just a scam to sell cash-value life insurance and make higher commissions? What happens when the mortgage interest rates rise?

Does equity harvesting really work?

Does harvesting home equity to over-fund a life insurance policy up to the MEC guidelines really work? There are two major aspects of this question:

1. Does removing the built-up equity in a home and then investing it make sense?

The simple answer is yes, it makes sense, as long as you can make more on the money than it's costing you. For example, if you can borrow the equity at 6 percent, invest it and earn more than 6 percent, then you are making money. And, we are not even considering any of the other very valid reasons that *Missed Fortune* and other books give for not leaving built-up equity in your home.

Important Note: Contrary to what most of the books written on this subject tell you, in many situations you will not be able to deduct the mortgage interest on the equity you borrow. According to IRC Section 264a(3) "mortgage interest is not deductible on any amounts of equity you put into life insurance, where the plan is to take out tax-free withdrawals." IRS Publication 550 states that you cannot deduct interest "on money you borrow to buy or carry single premium life insurance, an endowment, or an annuity policy." IRS Publication 936 includes a phase-out of the mortgage interest deduction depending on your income and other limits to what you can deduct.

2. Does it make sense to invest that money into an investment-grade life insurance policy?

Again, the simple answer is yes; if you need the life insurance protection for your family. You are going to pay for the life insurance protection one way or another, so the best way to get the protection you need is with a permanent life insurance plan. The actual cost of the life insurance protection inside of a cash-value life insurance policy is much cheaper than buying a separate term insurance policy. We haven't even taken into account the numerous tax advantages, the flexibility and the safety of cash-value life insurance.

Is equity harvesting truly in your best interest?

While there are many pros and cons — and some debatable mathematics — with this strategy, the undeniable truth is that when left to their own resources, most people are not consistently saving for their future. In many cases, people use their home equity as a revolving charge account. By taking the equity out of the home and putting that money to work for you today, you are forming the habit of saving. By tying the payments to your mortgage, you are ensuring that you will continue to make the payments in the future. Plus, you are creating a liquid safety net or emergency fund. When you have money working for you, you will feel better and more secure about your current situation and your financial future.

Is equity harvesting just a scam to make higher commissions?

There are many people, both in and out of the financial services industry, who believe in the philosophy of “buy term and invest the difference” instead of purchasing a cash-value policy. There are two major problems with that philosophy:

1. The first problem is that it assumes people will buy the term life insurance they need and then invest the difference. When we consider that there was a negative saving rate in the United States for 2005 and 2006, it becomes obvious that most people are not investing the difference.
2. The second problem with this philosophy is that it supposes that an investment that invests the difference will out-perform the investment inside the life insurance policy. Numerous studies over the years, performed by many independent consumer research firms, clearly show that the average stock market investor is only making a two-percent to four-percent return on their investments after fees and taxes, whereas the average internal rate of return for most cash-value life insurance policies is above 5 percent. And this isn't even considering the advantages of tax-deferred growth of life insurance and the ability to take tax-free withdrawals.

What happens when the mortgage interest rates rise?

If you decide to use an adjustable-rate mortgage, there are two primary concerns with regard to rising mortgage interest rates:

1. The first concern is whether it's possible to make more on the amount borrowed than the loan originally cost. Consider that mortgage interest rates are a function of the financial economy and do not rise independently. As mortgage interest rates rise, so does the internal rate of return of cash-value life insurance.

Mortgage interest rates are generally tied to an index and have yearly caps as to the amount of mortgage interest that can be charged, so they tend to rise slowly. Over time, the spread between the mortgage rates and the internal rate of return of cash-value life insurance may be less and, in a few cases, may even go negative for a time. However, the

considerable tax advantages that cash-value life insurance provides will generally allow you to keep a net positive spread — even as interest rates rise.

2. The second concern is that your current income can support increasing mortgage payments. One of the many advantages of using cash-value life insurance is that it's liquid. Unlike most other investments, you can access your money — tax free — and without federal early withdrawal penalties. So, if you need additional money for the increasing mortgage payments, the cash value in the life insurance is available to use.

Summary

Harvesting home equity and investing it into an investment vehicle isn't a new concept. It's a time-tested, proven concept that the wealthy have used for generations to keep their money liquid, so they can take advantage of investment opportunities as they come along. It has enabled the wealthy to accumulate vast fortunes even during the stock market crashes, recessions and the Great Depression.

The key to making equity harvesting work for you is selecting the right type of home mortgage for your situation and comfort zone. You want a mortgage with the lowest interest rates and fees you can find and are comfortable with. Then, focus on selecting a competitive cash-value life insurance policy. Don't choose a life insurance policy based solely on current company illustrations. Instead, find a company that has a solid financial rating and a documented long-term history of above-average product performance.

When done properly, equity harvesting is an invaluable financial concept when it comes to accumulating wealth. However, it doesn't stop there. It can also help use your home equity to reduce and eliminate debt. You'll free up your current income, so you are able to put even more money away, and you'll be on the way to securing the financial future you have always dreamed of for you and your family.

I've been using this concept personally for more than 25 years, and I know it works.