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TAKING CHARGE OF YOUR RETIREMENT – 6 STEPS TO RETIRE RICH

It's no secret that both the public pension plan (Social Security) and a great number of private pension plans are in trouble. Reliance on any of these plans for your future financial security is a bad plan for you, your relatives, and your friends.

I have good friends who have seen their retirement dreams turn to nightmares because the pension they planned on is now only 25% of what they were promised. The plan they have contributed to and counted on for 25 years, is a plan gone bad.

I will post this letter on my website so that many will have access to it. I am giving my subscribers permission to reproduce this letter or to tell your friends to read it on the website (johnschaub.com). Please note that my new email address is john@johnschaub.com

THE PERFECT RETIREMENT STORM

The first of July 2005 is a landmark date. It is the first day that the very oldest members of the baby-boom generation turn 59½. It is the day that they can begin making penalty-free withdrawals from their IRAs and other retirement savings accounts.

In just 2½ years, when they turn 62, most of them will start drawing Social Security. The great majority of these folks are dependent on Social Security or another private pension for their retirement income. They will vote as a block to preserve Social Security at any cost. That means others will pay that cost.

The world of retirement planning has changed. You can no longer count on a third party, the government or anyone else, to provide an acceptable income at your retirement. You have to take charge of your own retirement income.

Employers are eliminating or restructuring retirement plans just to survive. A pension that pays you enough to live on at retirement will only be available to those who start their own retirement plans and then manage them wisely.

Inflation is back. Actually, it never went away, we just have not talked about it in polite company for a couple of decades. House prices have gone up a lot in the

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last 30 years and we feel good about that. But, what has happened to the price of other niceties like food, gasoline and medicine?

You need to make investments that will last as long as you do and will provide an ever-increasing income. In 1975 a first class postage stamp cost a dime, a tank of gasoline cost about five bucks and you could buy a pretty nice car to put it in for about \$3,000. They all cost about 10 times as much today.

If, like me, you plan on living (and living well) another 30 years, you need investments that will allow you to go to the movies when a ticket is \$100, and popcorn and a coke cost another \$100. (I just bought two Broadway tickets for \$160 each – so the future is here if you live in New York).

In the May 23rd, 2005 edition of Newsweek, Jane Bryant Quinn highlights the weaknesses of US pension plans. 192 companies phased out their 401K plans last year. The Pension Benefit Guarantee Corporation (the Federal Government safety net of private pension plans) now owes 23 billion in benefits more than it has assets to pay. President Bush has proposed raising premiums that private companies pay to

support PBGC. This will drive more companies out of the pension business, leaving anyone left with a larger and increasing burden.

As companies face increasing competition abroad (read The World Is Flat, Thomas L. Friedman), they might freeze benefits like Sears did last year or close the plans to new employees like Ford did. Even government-sponsored plans are in trouble. San Diego has a pension deficit so large that it threatens to bankrupt the city.

SIX STEPS TO RETIRE RICH BY TAKING CONTROL TODAY

Step One: Plan To Have More Income Than You Need When You Retire

How much income do you want when you retire? On-line retirement calculators will tell you that you need to plan to live on 70% or even 60% of the income you enjoy during your working years. They claim you will spend less when you retire than when you are working. That's certainly true if you have less income.

I have several happy retired friends who spend more now that they are retired. They have moved into expensive condominiums where someone else does all of the work (for a price). They travel on first class cruise ships, stay in great hotels, and eat in fine restaurants.

How much do you want to have to spend when you retire? Forget about what the average person wants. You are not average, and work hard to be better than average.

My answer is more income than I spend today (adjusted for inflation), not less. I want some left over for big tips or gifts. I want to be able to travel first class and be able to afford the best when I hire someone to do anything for me. An advantage of having plenty of money is that you can afford to hire the best and pay them a fair price.

Jimmy Buffet said that when you reach 50 you shouldn't have to negotiate for everything. My corollary is that when you reach 65, you should have much more than you need, so that you can afford to pay a fair price for the best service. When your days are numbered, you don't want to spend them waiting in line.

Another part of this strategy is to have your house in order (literally) by the time you retire. Think about where you want to live, and put together a plan to own it free and clear so your overhead will be lower.

By the time you retire, you want to be out of all personal debt (including the debt on your house) and be receiving more interest than you pay. You may want to keep some low interest rate loans on your investment properties to give you a leg up on inflation, but that debt should be well covered by your rental income.

Step Two: Start A Corporation And Start Your Own Pension Plan

I incorporated and began operating my own business in 1973. It was a number of years before I began producing any significant income, but I began learning how to operate a corporation, funding it with management fees and profits from the sale of property that the corporation owned. As my income increased and I began paying taxes, I consulted with a tax attorney who advised me to set up a defined benefit pension plan. This plan had several significant benefits to a young, fast-moving real estate operator.

The corporation can make tax-deductible contributions to the plan. This can eliminate the total tax liability of the corporation. These contributions can be made up to nine months after the end of the corporate year end, and still be deductible to the corporation.

The profits that the pension plan makes on its investments were not taxed. Only money paid out of the plan to employees would be taxed.

As trustee, I have complete control of the investments. There are prohibited transactions and investments, but outside of those restrictions, I had the checkbook, and could buy and sell at will without the need for a third part custodian or trustee. Once a year I would hire a CPA to file a plan return for me, and have my attorney make any required amendments to the plan.

The plan is protected from the claims of creditors. This allows me to wheel and deal personally, knowing that the plan assets were safe if I have a personal disaster.

This strategy is as good today, as it was 25 years ago. It is a good strategy for you if you are making money. If you don't know how to make money, Learn! I have taught thousands to buy and sell houses for profit and to buy, hold and manage for long-term gains. Read my book Building Wealth One House at a Time. Read Jimmy Napier's book Invest in Debt. Get the skills you need and get in the game.

If you already have a profitable business, or provide a valuable service for someone else, talk to your CPA about the benefits of incorporating and forming a pension plan that you can control and invest. If you work for someone else, have them contract with your corporation; you can work for your corporation and start your own retirement plan. If they won't do this, consider the alternative, starting your own business, and then offering to work for them as a consultant.

Step Three: Open A Self Directed Roth IRA If You Qualify.

The self-directed Roth IRA is a powerful tool for those who qualify. If you currently have too much income (\$150,000 if you are married, \$95,000 if single) try to lower your income just one year to qualify. Take a sabbatical without pay, or push your bonus off a year. Once you open the account, and make one contribution, you can invest it wisely for the rest of your life. The Roth will not save you any tax dollars today, but it allows you to make an unlimited amount of profit investing inside the Roth, and then all that profit can be distributed to you tax free.

If you make too much money and cannot find a way to have just one year where your income would be lower, then open a Roth for your parents and have them name you as the beneficiary. If you inherit a Roth, you can continue to operate it. If your parents are no longer living, open a Roth for each of your kids - and stay friendly. They can make gifts to you if they like you.

Here are the major advantages of a Roth IRA.

Although the contributions to a Roth IRA are limited and non-deductible, all the distributions come out tax-free. If you want a \$100,000 tax-free income at retirement, get \$1,000,000 in your Roth and invest it at 10%. High quality first mortgages on good houses pay 10% or more today!

If you can make high returns on your investments, then the Roth allows you to accumulate an unlimited amount, and there is no requirement to distribute any of the profits until you want to do so.

Anyone (with earned income) can open a Roth – 1 day old to 199 years old. Many babies have become models for their parents' business cards earning enough to fund their Roth before their first birthday. Make your kids or grandkids a major gift: open a Roth for them this year.

Most importantly - you make the investment decisions. The more you know, the more you can earn. Many have started a Roth within the past four years and set goals to accumulate millions of dollars inside their Roth by their retirement age. They then plan on the Roth being their main source of income – all tax free- during their retirement. That' s a great plan!

Step Four: Buy Appreciating Investments Specifically For Retirement Income

My dad is retired and his income is supplemented by three free and clear houses that produce about \$3,000 a month in spendable income. He bought them

with a small down payment when he was in his 60s. For the first few years, they provided him some tax shelter. The rents increased with inflation (fifteen years ago they were producing about \$500 a month), and the houses are growing in value. The houses are now free and clear. If he needs a large infusion of cash, he can simply borrow against or sell a house. You might ask who would make an 88 year old a loan, and the answer is simple: his son.

If he needs more income today, we can sell one or all of the houses to a first time homebuyer who needs help with financing. Because we are willing to finance the house for them, they will pay a high retail price, take the house in as is condition, and pay a higher than market rate of interest. This is a way to dramatically increase your cash flow, and at the same time help a family who is unable to buy with bank financing to buy their first home.

How many free and clear houses do you want to own when you retire? Start by asking how much income you want them to produce in today' s dollars. A well-managed, free and clear house will probably produce about a 5% return after taxes, insurance and repairs. If you own a \$200,000 house free and clear, it will probably pay you about \$10,000 a year. Compare the house prices and net rents in your town today. House rents will increase with inflation, so you can base your projections on today' s income, knowing that it will pace inflation.

If you acquire a number of houses, but want more, you can better than double your income by simply selling the house and financing the purchase for a seller. When you sell, the buyer will begin paying the taxes, insurance and repairs. If you sold a \$200,000 house for nothing down and financed the entire amount at 10% interest, you would receive \$20,000 in interest the next year, with no expenses except taxes. The taxes would probably be about what they were when you were collecting rent on the free and clear house.

Another option to increase your income is to sell your property to a family member and finance it. A clever financing device is available to knowledgeable

investors called a private annuity. If you sell your houses to your kids using a private annuity, then when you exercise your estate, the house and debt from your kids will not be part of it.

The private annuity is a special tool that allows you to sell a property and receive a series of payments for life. If you die early, the buyer gets a better deal. This transaction is typically done between family members to transfer control of the property to the next generation and to reduce the amount of the estate. The annuity cannot be secured by a mortgage, so you must trust the buyer to make the payments. If you have no heirs, consider using a charitable remainder trust to accomplish the same goal, a lifetime income. There are rules you need to follow to qualify – check with your CPA.

Step Five: Retire Healthy And Mentally Active – Stay Involved In Your Investments As Long As You Are Making Good Decisions.

A great benefit of investing in real estate is that there is no mandatory retirement age. If you like what you are doing, you can keep on making money. Staying active, both physically and mentally is the secret to a long and happy life. I often spend my Saturday mornings helping build Habitat for Humanity homes. I am typically surrounded by men and women in their seventies and even eighties who are enjoying every day, because they are active!

One of my best friends is well into his seventies and has a lifetime's worth of experience making money in all facets of real estate. Today he manages his portfolio of mortgages, a more passive adventure than managing properties. He continues to make loans and collect payments on dozens of notes. If he has a problem, he calls his attorney, who solves the problem. He delegates his problems, but enjoys going to the bank and keeping track of his investments.

He has not turned over the managing of his considerable wealth to a stock broker or financial planner. If you have spent a lifetime accumulating knowledge and money making skills, don't delegate the responsibility for your financial security to

someone with a fraction of your knowledge. Stay in control! Using your mind will keep it working.

Step Six: Identify And Train Someone Who Can Manage Your Finances When You No Longer Can

My same friend has a number of children. Most have other interests, but a couple of his children understand how wise their dad has been with his investments and have paid attention to both his words and examples. They are well positioned to take over the management of his portfolio.

If you are married or have children, help your spouse or child(ren) learn about making and managing money. It's a great gift. Money can be a burden if you don't understand it. Ask any lottery winner. It's sad to watch someone waste millions of dollars because they don't understand money.

If you have no children, make a friend who understands what you do. This may be a professional, a CPA or an attorney whom you trust and who has the skills necessary to manage your investments. It may be another younger investor who you can teach and share deals with, giving them the responsibility for the day to day management.

Take charge of your retirement, and encourage your friends to do the same. It's fun to have friends and family to travel with – especially when you all can afford to go first class!

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