Case Study:
A Teacher Running Out of Money

World Headquarters
955 Benecia Avenue
Sunnyvale, CA 94085

Office: 650-397-9600
hello@uptrex.com
Web: uptrex.com

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BACKGROUND

A former parochial school teacher who had inherited her mother's home, Lynn had no pension and limited savings. Despite managing to live on a very lean budget of $2,000 per month, she had a negative cash flow every month of over $1,000. With just $11,000 remaining in savings, she was quickly depleting her available cash.

At that point, Lynn contacted a Realtor about selling her home. Seeing her precarious financial situation, the Realtor in turn contacted us for a consult. We set up a three-way meeting to discuss Lynn's current situation and understand her future plans.

It was evident that Lynn required additional retirement income. She was then nearly 80 years old. Although she had some concerns about her future health, especially regarding dementia. Lynn's overall health was excellent. Considering that her mother had lived to 101 and she had two aunts still living in their mid-90s. Lynn needed to plan for another two full decades in retirement.

UNSUSTAINABLE CASH FLOW

Lynn's income came from two annuities and her Social Security benefit. But even on a very frugal budget, her expenses still exceeded her monthly income:

$917 income - $2,000 expenses = $1,083 negative every month!

With no emergency fund, rising health care costs were accelerating Lynn's already dangerously low liquidity. In her current situation, she would run out of money in just 10 months.

REVERSE MORTGAGE

Among the possible solutions we discussed with Lynn was a reverse mortgage. However, this would allow her to convert only 40% of her home's value into cash—about $340,000. Investing these proceeds would not generate enough of the long-term income she needed, even using a generous 5% withdrawal rate (which we believe is unsustainable in most cases).

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OUR 4-POINT APPROACH

For Lynn to continue living independently, we had to address her income insecurity. There was no way to increase her Social Security benefit. We realized, however, that her two annuities had incorrectly structured payments and lacked critically important inflation protection. With a potential lifespan of another 20+ years, inflation alone could reduce Lynn's purchasing power by about half. We needed to exchange these annuities into two higher-quality annuities, as soon as possible without incurring penalties.

Our strategy, therefore, focused on productively allocating the proceeds from selling her home – about $740,000 after expenses – while replacing the existing annuities with ones that would serve her better. The result was a 4-point approach that improved Lynn's monthly cash flow while also protecting her against rising expenses and inflation:

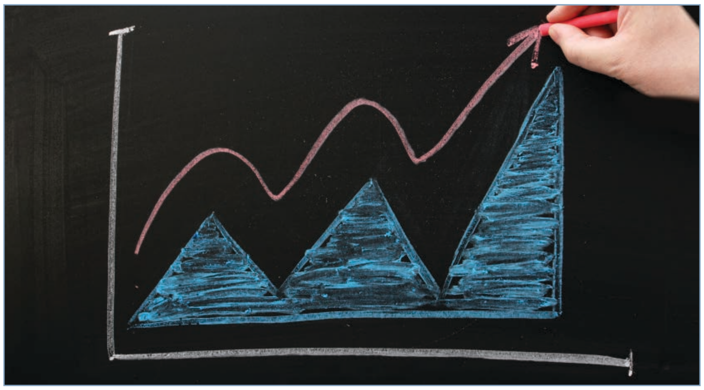
1. **Guaranteed income from two new annuities.** An immediate annuity started paying her nearly $2,600 a month with 4% annual cost of living increases. The other, a variable deferred annuity, provides annual increases of 5% or market growth, whichever is better. Income from this second annuity has been deferred until Lynn needs it.
2. **An emergency fund.** Maintaining $50,000 in a liquid savings account—enough to cover two years of expenses—provides important peace of mind for her.

After allocating about three-fourths of Lynn's assets to provide current income and an emergency fund, we invested the balance of her funds for additional inflation protection:

3. **Tax-advantaged income.** Income from this $100,000 investment, which provides an annual return of approximately 6%, is being reinvested for future use.
4. **A diversified portfolio.** Another $100,000 has been conservatively invested to protect against inflation and any unplanned expenses.

POSITIVE CASH FLOW

Today, Lynn's immediate annuity provides more than $3,400 a month of guaranteed income. Although relocation has increased her monthly expenses to $2,300, this annuity income plus her Social Security provides more than $1,100 in positive cash flow every month. Her income insecurity has been completely eliminated.



GROWING INVESTMENTS

Lynn's tax-advantaged portfolio has grown significantly in four years, from $100,000 to more than $135,000. In addition, her $100,000 annuity with a 5% living benefit now exceeds $140,000. And Lynn's $50,000 emergency fund has grown to over $70,000, enabling her to put $20,000 more toward her future cash flow needs.

FINANCIAL SECURITY

The substantial increase in her monthly income allowed Lynn to relocate to a nearby apartment with none of the maintenance headaches she hated. Despite her initial concerns about transitioning from homeowner to renter, she reminds us often that she enjoys her high-end apartment with its beautiful backyard and garden.

With the stress and worry of dwindling savings and home maintenance now a thing of the past, Lynn is able to enjoy both of her passions: reading and gardening. She also enjoys sleeping well every night.