LateFIRE Chapter 4: A Tale of Two Houses, a 26-Bag, and $1.7M

When you start late on the path to FI, there is URGENCY. There is no margin to make missteps. There is no multi-decade runway to recover from market turbulence, so “time in the market” trumping “timing the market” takes on a different nuance. Ask a person on the cusp on retirement in 2000, or 2008, what happened to that retirement fund left in a stock market account.

Hence, I need to choose my steps carefully. I am in my mid-50s; my husband is 61. However, we also need to take swift and probably dramatic action to catch up and provide for the years ahead. Here is where we are. Any constructive thoughts you, GYFG reader, might offer to help, are very appreciated. Thank you in advance.

The Good, the Bad & the Ugly

The Good:

1. $1 million equity in our primary residence
2. A single stock we purchased pre-IPO via a family relationship that now sits at 26X our initial investment (total value today $86,000 after selling some in 2018 to fully fund our HSA, a spousal IRA, and $14,000 so far in 2019 for IRAs.)
3. $700,000 equity as likely inheritance from an aging parent’s home, to be divided by four siblings (although Alzheimer’s Disease is greedy and expensive, so I don’t really count this)
4. A profitable business that we still enjoy running; just had our best month and quarter ever.
5. Investments totaling $170,000 (includes #2)
6. The intangibles: HEALTh, FAMILy. MARRIAGE, PASSION and vitality for the career my husband still works full time

The Bad and The Ugly:

1. No pension (I am 2.5 years shy of vesting for minimal teacher’s pension).
2. Social Security insufficient to fund our retirement.
3. Mother’s full time care due to AD that could burn up all her assets (retirement

accounts as well as home value, despite $6000/m pension and long-term care insurance that pays $123/day to her limit os $188,000).

4. Business makes minimal profit when we are not there working it (health care practice that we spent the last three years pivoting from insurance-based into 95% cash pay).
5. Investments totaling only $170,000.
6. Health insurance costs spiraling upward yearly.
7. Unbalanced concentration of net worth (our home, by far the lion's share).
8. Various investment funds, some (Putnam) with really high fees. I'm not sure where or how to reallocate these.

So…this is the tale of "what *BEST* to do" now in order to make the best of where we are and what we have, and to get us where we need to go. It's the kind of tale with a "pick your ending" finish…

[GYFG: I thought that I would step in and out of the post to provide some of my thoughts. It would be great to see what other readers have to add to the conversation.

There is a lot of equity tied up in your primary residence. If we ignore the potential inheritance, I get an approximate net worth of about $1,256,000. This doesn't count the value of the business or the income that it produces. From a net worth standpoint, I would argue you and your husband are in a much better position than most American's your age find themselves in – the silver lining. The biggest challenge I see is that ~80% of your net worth is locked up in your home (I'm not telling you anything you don't already know). Depending on your goals in retirement, selling the home might be a viable option to consider. Although Social Security will not be sufficient to fund your retirement, I'm glad you have at least considered it in the bigger picture of your retirement landscape.

The first action I would take in your shoes would be to transfer the investments you have with Putnam over to Vanguard to get rid of the high fees (I believe you once told me that this was running close to 1% in fees). I think a split between a total market fund and bond fund would be appropriate. You should be able to get your fees down to 5-25 bps. I would then continue to sell out of the single stock you own to fund retirement accounts to reduce taxes on your active income. At 59.5 there is no longer a penalty for pulling the funds out if you need them but you will still have to pay taxes when you do pull the funds out. I would even consider speaking to a tax professional on setting up a self-directed IRA or 401K, which would allow you to shelter up to $56,000 per year instead of the $7,000 for each of the IRAs you're funding. This would serve two purposes: (1) you get to harvest more of the gains from the single stock sooner and (2) you get a tax shield against that income.

The benefit of this strategy is that you get to harvest the gains and pay long term capital gains, while at the same time gaining a tax shield for the same amount against ordinary income that is likely taxed at a much higher rate (I'm guessing your household makes at least six-figures with a marginal tax rate of 30%+) than your long term capital gains rate (15% for income under $479,000 for a married couple filing jointly). So, there is some tax arbitrage in this move.]

Our Residence

I love real estate. I thank God for the home we live in, which we purchased in 2011 as a foreclosure sale in a great area. We got stung on the last house we purchased in 2005, sold in 2010, but this one has almost made up for it. Over the years we have bought and sold four residences, plus two vacation rentals in Palm Springs, CA, one of which we flipped for a profit of $45,000 in three months, and one of which we held three years for a profit of nearly 2X our purchase price (sold for $500,000 in 2005; subsequently sold by others in 2009-ish for half that as the desert crashed – yikes). Out of the six, four represented wins (three very big wins).

We love where we live, but there is a lot of opportunity cost tied up here. Should we sell this house we live in, and rent? Sell and purchase something else (less expensive SFR, or potentially more expensive multi-family and live in one unit)? Is selling our home now the correct move? If we did, we could then access ~$1 million to invest elsewhere (including potential cash flow rental real estate), or maybe purchase something less expensive to live in (thereby giving us less to move into investments).

But around here (California, where our business is located), in a still-hot market, something significantly less expensive than our current cost basis is not easy to find, unless it is an extreme fixer, or condominium. Our home is a bit of a "complicated house," with a pool and some idiosyncrasies, so I question it as a good rental (likely to rent @ $4500-5000/month, with PITI + pool + water @ $3500/month, potential profit of $1500/m). Maybe we should sell, but later, so that we can continue to focus our energy and time on growing our business, rather than getting a house ready and then selling, and moving? At that time, we can transfer our tax basis (as over 55-ers) to a home purchased for equal or less than the sales price of this one.

[GYFG: This is a hard one to answer without asking yourself a few questions:

(1) Are you ready to downsize? (I have the benefit of knowing you are empty nesters, so you don't need such a big house.)

(2) What is your time horizon on retiring?

(3) Will you consider relocating once you retire?

I've always been a big believer that no one ever went poor taking a profit. You have $1M in equity, which based on the rule of thumb from the 4% rule, should give you something close to $40,000 a year to fund your retirement lifestyle (assuming index investing in S&P 500). My grandfather used to love telling me that "a bird in the hand is worth two in the bush." If I were in your shoes I would sell, lock in the $1M in equity and rent for a year. Rent something close to the business, something smaller than what you're used to, to figure out if the smaller size fits your lifestyle. Based on the above analysis, it sounds like your monthly burn rate for housing is about $3,500/month, which should be plenty to rent something smaller. Place the $1M in an online saving account like CIT Bank and earn 2.45% interest while you evaluate your options. You will literally be paid $2,042/month in interest while you wait. This leaves you with the ultimate optionality.]

My Mom's House

My mom bought her home for $40,000 in a nearby city in 1975 after her divorce from my dad. 44 years later, it is now worth approximately $800,000 with its remaining balance of $80,000 on a refinanced mortgage ($1027/month), which she took out to finance a sibling's business that failed and pay off a second husband she divorced. Ugh. With Proposition 13, her property taxes remain constant under $850/year ($71/month). As she has moved out of her house into full time care, we siblings are now deciding whether to sell the house or keep it and rent it out. Rent would likely be around $3000/month. Homeowner's insurance is $800/year ($67/month). Gardener, water, trash, probably $150/month. Without accounting for repairs, etc., profit as a rental might be $1600/month.

But…committee-run. My brother is Mom's successor trustee and I get along great with him. My two sisters less smoothly. Sale is cleaner, rental more involved, and probably requiring more dialogue among the siblings. Of course, it is my Mom's, not mine, so this question is about what is best for her, financially. But looking ahead, I wonder if my husband and I should make a move to buy out my siblings and keep it as a rental of our own?

[GYFG: My first piece of advice is to not even count inheritance as part of your plan. I personally think a sale is cleaner as inevitably there will be issues whether you decide to rent it out as a committee or if you bought your siblings out – someone is more than likely going to eventually feel like they got screwed. Additionally, at $1,600/month in free cash flow, that is only about 2.4% on an $800,000 home and that is before accounting for repairs and maintenance. It doesn't leave a lot of room for vacancies or a big repair issue. I would liquidate and put the money into something safe to fund any shortfalls in your mom's care for as long as she is with you. You can figure out what's left for potential inheritance later.]

The Stock

Should we diversify the single stock? When I reached out for advice some time back to another financial blogger (before I knew GYGF), he said to sell it all and reallocate according to my investment plan. My whaaat? Yeah, well…I still don't have one, but at least I now know what one is! Since that time, the stock has risen from 5X to its current 26X, so lucky me that I did not liquidate it. My family member obviously cannot give me advice (hello, insider trading), nor does he know the future, but he is very confident in his company to still grow and prosper (their biotech product lines target a common baby boomers' health concern).

We sold some more when it was pretty high last month, getting ready to move it into the 2019 IRAs.

[GYFG: You have my thoughts on what I would do above. At this point, you need to ask yourself what your tolerance for downside is. How would you feel if it went from 26X back down to 5X? Let the answer to that question guide you in the speed to which to lock in the gains and re-deploy and diversify elsewhere (potentially following the strategy outlined above).]

The Non-Pension

On paper, I think this choice looks obvious: go back to work as a teacher (local jobs are available currently in my two credentialed areas: English and Spanish), collect the $50,000+ salary, save on health insurance, and work at least 2.5 years to secure the pension, of whatever size. However, I do work in our business (without collecting pay) currently. There would be a cost to replace me. And…teaching is very hard work. Doing it at 56 full-time is no small thing. I have doubts about beginning again, and truthfully, I didn't love it before I left it years ago. I had thought to activate substitute teaching by now, and my lagging efforts there seem revealing…

[GYFG: What is the potential pension size? Unless it's game-changing it sounds like your heart isn't in it and you will be miserable for a few years. I would suggest doing the math to at least understand what is at stake. It's the cost of replacing you in your husbands business, the salary you would bring in, the size of the monthly pension. Figure out the net gain/(loss) and then ask yourself if it's worth it or not for 2.5 years. This is one of those art + science questions. Not everything can be solely decided on math, especially when time is our most precious and scarce resource.]

Then What?

If we sell our residence, I get the inheritance, and we liquidate the stock, then where shall we put the money? If in "funds," what is the right one(s)? What is the right ration of stocks/bonds/US/international/large-small cap, etc.?

Income generation for post-work life appears top priority, both my husband's and mine. Dividend funds? Bonds? Rental property either here (although impossible to fit the "rent for 1% of purchase price" parameter locally), or elsewhere in the country?

[GYFG: Don't try to boil the ocean, it is an impossible task. If you sell your house and put the money in an online saving account you buy yourself time to figure out the optimal next steps. We only have so much bandwidth and you also have a business to run. You don't have to have all the answers before you start taking action. If you wait until you have it all figured out you will be stuck in analysis paralysis. Consider selling the house, moving your investments from Putman to Vanguard, and continuing to exit your single stock position as Phase One. Phase Two is income generation once you free up the capital and bandwidth associated with Phase One. You will be in a much better head space to work on Phase Two once Phase One is behind you.]

The Business

It's been an exciting three years as we have worked hard to grow our business, and pivot from insurance- to cash-pay. We have grown while we pivoted, and are tracking for 25% growth this year. Beyond our excitement, there is value building, too, as we see a possibility of (one day) hiring someone else on salary to do the day-to-day my husband does, while we pay all the overhead and keep a profit. He loves what he does, so that is a long way off. In the last year or so, we've also stripped away every single extraneous wasted dollar being spent, and added $12,000/year in subleasing income.

[GYFG: It sounds like teaching may be a distraction for the momentum you've built into the business. You may be answering your own question of what to do with respect to going back to teaching or not. It also sounds like the business will play a critical role in Phase Two of the plan. It may also be worth considering if there is an opportunity to sell the business. It may require a couple years of transition for your husband to phase out and pass off relationships, but it might be worth considering.]

Odds and Ends

Besides the mortgage, our only debt is what we have carried for a few months each year since 2016 as we pay a business consultant in a significant lump sum every February, then dig in hard to pay it off as quickly as possible. We haven't yet had the cash flow to pay it immediately in cash, but we have transferred to a low-interest card. This year, we arbitraged that to get $500 cash back, and companion fares for a year (worth $1200 for the trips we already know we will take) on two new cards, before transferring.

Adult kids are completely independent, except for health insurance we still pay for our 23-year-old recent college grad on our plan, and for the two left on our cell phone plan (as of June they will be kicking in their share: $68/month each or procuring their own plans). No more college tuition and costs as of June 2018!

Cars are old but steady: 2007 Prius, and 2004 slightly-high maintenance Ford truck.

The Universal life policies we should not have purchased way back when will be paid off in six years, with permanent death benefits and long term care components.

Vanity expenditures: $260/month to store a boat, and any other boat-associated costs (I don't ask; he doesn't tell). We probably eat out more than we should, and belong to a more expensive gym than we could, and spend more on quality organic food than many would choose to. But these are in line with our values.

We have given lump sums to help our kids as they have needed it, trying hard to straddle the line of love vs. enabling and stay on the side of love (for example, when our youngest moved to NYC, we joyfully gave the "family car" she'd been driving to our oldest – now expecting our third grandchild – and spent a good chunk on making sure it was mechanically sound first). We have also helped out another family member and regularly give to various charities.

This is Where You Come In. Please.

I could use some real help here! When I first started focusing on our money matters hard a year and a half ago or so, I felt ashamed and hopeless, and thought it was way too late to make any changes that would correct for all the years we'd misspent. But I read a lot of what was freely offered in the FI/RE community, which has been incredibly helpful, and I started taking action. Dom here at GYFG has been hugely impactful; just by dint of spending time in his words and in his friendship, some of his insights, creativity, and proactivity are starting to rub off on me. I'd like to think his intelligence, too, just a tiny bit! I feel more confident and hopeful now, and less like it is a situation completely without redemption. I'm certainly not aiming at GYFG's BHAG of $10 million, but we want to fund a simple life from the point we stop working until the end of our days, and avoid being a burden to our kids.

Now I want to take the best next steps and try to get a game plan laid out for these next 1-5-10-15+ years. It's not a perfect situation, and no one knows the future, but I want to be wise, stepping out both courageously and prudently.

What do you think? Can you see areas I should lean hard into? Others that are murky swamps I need to get out of?

I would be so grateful for any input!

[GYFG: I share this Chinese Proverb a lot but I will share it again – The best time to plant a tree is 20 years ago and the second best time is today!

Shall we take a slight peak into the future after you complete Phase One?

In Phase Two, an important exercise to go through before deploying any capital will be to understand what your desired burn rate is (the cost to maintain your desired lifestyle). You will then need to compare that burn rate to the income generated from Social Security, the business, and then figure out the remaining with the $1.3M in net worth (factoring in your own risk profile). I suggest you execute on Phase One and then come back and seek additional feedback when you’re ready for Phase Two.]

Lin

Lin is the voice of LateFIRE, and our resident copy editor. She believes in the power of the semicolon, and a dash properly placed. Her life mission is world peace: can’t we all “just get along” by using contractions properly, and placing punctuation marks firmly inside quotation marks?