TACONIC VIEWS

Financial Insights for Secure Retirements and Life's Transitions

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Bootstrapping Your Way to Financial Success

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From my experience as serial software entrepreneur, strategic planning consultant, author, and financial advisor, I have learned what it takes for a business to succeed. When it comes to financing a new enterprise, there are a variety of options available, yet the underlying principles are the same. Those who opt to self-finance or bootstrap do so for a variety of reasons. It may be that traditional financing is too costly or not available. Prospective equity investors may demand too large an ownership stake or attach too many strings. It may simply be that a new entrepreneur wants complete control. Regardless of the reason for bootstrapping, the principles laid out here can put a new business on the path to success.

I have worked with a wide range of business owners, from consultants and software developers to retail store owners, to graphic designers, engineers, photographers, therapists, and food distributors, and time and time again—unless you are launching with a pre-established stream of income—it takes three years to get a business off the ground. I want to offer recommendations to help you through these early years and position you for greater success beyond. The general timeline goes as follows:

Year One: Initially, optimism reigns. The product or service is so amazing that everyone needs it, wants it, and will line up at your door to buy it. Actually, it doesn't really work that way. It takes time to develop interest, and it takes interest to develop customers and clients. By the end of the first year, a new business has generally lost money; revenues are less than expenses. This is normal, not a reason to throw in the towel. There are three important steps to take at this point:

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The Truth About Why to Invest in Real Estate

By Bridget Sullivan Mermel, CFP®, CPA, MA
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The trauma is officially over—I'm again seeing articles about real estate with outrageous claims. "While prices fluctuate, over the long run, real estate values have always gone up, always, and there is no reason to think that is going to change," says one blog. Yeah, right. Also coming over the transom are claims about "passive income." That is money you "earn while you're sitting on the couch in your underwear, eating Cheetos." I'm officially skeptical!

All the hype aside, there are great reasons to buy a real estate. Believing that values of real estate always go up just isn't one of them. Here are four good reasons to buy real estate:

Protection Against Inflation
When you buy a principal residence, you lock in your biggest monthly expense. Now, instead of paying rent to a landlord, you're paying mortgage interest. The big plus of owning, though, is at the same time, you're locking in that payment for the life of your mortgage loan. It's like locking in your rent for the next 30 years. That means that no matter what happens with inflation, your biggest expense won't go up. You can spend more money on everything else, but your biggest expense is fixed.

An Investment You Can Enjoy
You get to live in it. When we put money in a savings account or retirement account, we can't actively enjoy the money. We can't sleep in our mutual funds or throw a party in our savings account. Real estate is tangible.

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Financial Planning for Life's Transitions

On the Legacy Letter

By Mike Ryan, CFP® , MBA
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Facing one's mortality, though not especially pleasant, is nonetheless necessary for many reasons—the primary one being that so far, very few people have gotten out of this world alive. You know what they say about death and taxes! Thus, everyone should have a legal will in place to let those who survive them know how they want their assets distributed after they leave this mortal coil. I have stressed the importance of having a will, a power of attorney, and a living will in place to all my clients. These documents codify your wishes for future reference.

Recently, I have come to believe there is another "will" which can also be very important for folks to consider, and this is the "ethical will" or legacy letter. In some cases, this type of will may eventually be valued even more highly than a legal will used to distribute assets. An "ethical will" or legacy letter can serve many functions for a family; it can even be viewed as a "love letter" left to one's family, but it can be so much more.

Many worry about how much and to whom to leave their money after they are gone, but it's perhaps as important to leave your beliefs with those whom you love. An ethical will can accomplish this as you record those things which have been most important to you. You can also share the lessons that life taught you along the way. If relationships have suffered over the years, you can approach those issues with either forgiveness or by asking for forgiveness.

Here are some other issues that can be addressed with "legacy letters":

- It is one way of sharing your values as well as your hopes and dreams for the future of your family.
- You can recount your life story, how you faced hardships or successes, or where you looked for help in times of trouble. If you don't share your story while you are alive it could be lost to future generations.
- Ethical wills offer a wonderful opportunity to share not only personal values but also advice to future generations. You can even offer suggestions about how any money you leave could be spent.
- You can share the important life lessons that you have learned and how you learned them.
- If you are spiritual, it offers you a chance to share some of your spiritual values and beliefs.
- It's another chance to let your loved ones know that you love them and what makes them special to you.

In summary, a legacy letter gives you the opportunity to share what you have found to be of utmost importance in your life with your current family as well as those who will follow. The letter is not easy to write as it forces you to reflect on your life thus far and ask yourself how you would like to be remembered. The exercise of writing one may even prompt you to make some long-delayed changes and refocus on what you believe to be truly important in your life. Writing a legacy letter reminds us once again that though money does matter, it is never the most important thing in our lives.

There are many references to legacy letters online as well as guidance on how to write one. I encourage you to consider whether this type of "will" has a place among your estate planning documents.

Real Estate… *Continued from page one*

You can see it, feel it, and kick it. That's unique in your net worth. It's something that you can really enjoy.

Meaningful Community Connections
People find their lives more meaningful when they are connected to organizations larger than themselves. Getting involved in your local community can help bring more meaning to your life, and it also may increase the value of your investment. For instance, I've seen neighborhood groups across Chicago get together to advocate for better schools. Their efforts pay off. Pretty soon, other families are attracted to the neighborhood because of the good school. This increases the price of the original investment in houses and improves education for local youth.

Solid Component of Net Worth
Don't buy real estate because you think the value is always going to go up. It doesn't. That being said, if you understand the risks when you buy, you can protect yourself against them. With real estate, you get a mortgage, which means that you are taking advantage of leverage. Let's go over a simplified example to illustrate the concept of leverage.

Mary and Jem buy a $200,000 house. They put 20%, or $40,000, down and get a mortgage of $160,000. That means Mary and Jem have spent $40,000 for a $200,000 investment. In year one, the price goes up from $200,000, to $210,000. If they sold, theoretically, they would get that entire $10,000. That means they would get $10,000 on the $40,000 they put into the investment. Mary and Jem are happy. They've made 25% on their $40,000 cash outlay in one year.

As a lot of people learned in the real estate bust, there's a big downside to leverage, too. If the price of the house goes down to $190,000, they'll get $30,000 back when they go to pay off the mortgage. So, they put in $40,000, and got back $30,000. They lost $10,000.

What happened to a lot of people in the 2008 downturn was this: They bought a $200,000 house, but they put 5% down. So, they put in $10,000 and they had a $190,000 mortgage. When they wanted to sell, they could get $170,000 for the house. But they owed the bank $190,000. In other words, they'd have to pay $20,000 to sell their house. To keep things simple, this example doesn't even include closing costs, which make the numbers significantly worse.

That's why you want to protect yourself. Put 20% down and don't buy unless you intend to stay in your house for at least five years. The vast majority of the time, this protects you against the risks involved in leverage. What about buying a house outright? Without leverage, you miss out on the inflation protection. Also, real estate prices in general don't go up enough to make it a great investment without leverage.

Be aware of the potential downsides. To protect yourself against the downsides of real estate, repeat after me: 20% down, five years.

NEWS

Keeping up with Taconic Advisors…

Megan recently joined her husband, Andrew, a professional Motion Designer, on location in Estonia after a few days in Helsinki. Not a small feat, when you have a 14-month old in tow!

Chip and his wife, Karen, returned from their June trip through Burgundy and eastern France, visiting many sites, chateaux, and restaurants along the way. Here they try to beat the heat wave by viewing Mt. Blanc at 12,000 ft..

Jacob's July vacation was spent on Block Island. His Texas-born vegetarian wife, Whitney, shelled her first lobster. The verdict? Surf wins over turf!

Bootstrapping … *Continued from page one*

1. Surround yourself with supportive people. If a business isn't an overnight blockbuster, I've found that many people are quick to disparage it. Stay away from them and spend time with others in similar situations so you can support each other. When someone asks how your business is going, respond that you're putting the profits back in at this point. This is code to fellow entrepreneurs and they'll offer words of encouragement.

2. Keep a tight handle on your spending. It's a tricky balance, but until your revenues rise, your time is not worth as much as your money. Learn how to do things yourself, learn how to do without, and spend wisely. I have seen more than a few businesses not make it past the first year because the owners felt it was important to have staff and office space they couldn't afford. Only add staff who add to bottom line; learn how to do the books and handle clerical tasks yourself. Don't spend what you can't afford. Stay busy.

3. Talk with your financial advisor about tax-saving opportunities available to you in a low-income year. It might be an inexpensive time to make Roth IRA conversions or sell low-basis stock for little to no capital gains tax.

Year Two: You're making headway. Typically, in the second year, businesses generate enough revenue to cover expenses plus a little bit, though you're not making anything close to what you made "before." That's okay. In the second year, make sure you have the following covered:

1. Keep a tight handle on your spending. Sound familiar? Frugality remains a big part of your life and, by this point, you are probably comfortable doing many things yourself to help keep costs down. If you've been subsidizing your business with part-time work of some sort, you'll still need to do this in the second year, but you can begin to scale back.
2. Get feedback from existing customers and clients. What do they like? What don't they like? Why did they choose your product or service? Use this information to develop the most cost-effective marketing plan you can. Build on these successes.

3. Help support those just getting going on their first year; it keeps you humble.

Year Three: This is the breakthrough year. In the third year, business gels. You now pay yourself a decent wage and you finally feel you can exhale a bit. When someone asks how the business is doing, you can tell them sales are up 80% over the previous year and you've got no regrets. Priorities shift:

1. Your time is now worth more than your money. Take a hard look at the responsibilities you have. Identify a few outside your passion and expertise—these are candidates for outsourcing.
2. Talk to your financial advisor about setting up a solo 401(k). You need to save for retirement and you want to minimize your tax bill; this solution tackles both effectively.

3. Update your business plan. You can start by dusting off the one you created three years ago. Odds are good that business today looks quite different than what you initially envisioned. Invest time in developing a new strategic plan. Check in with this quarterly and update annually going forward. Always be open to new opportunities but remember that having a solid foundation and general plan keeps you from chasing the ones that aren't a good fit.

The initial three years of getting a business off the ground are risky, challenging, and oh so rewarding. Survive these and you are well on your way to bootstrapping yourself to financial independence.

How You Can Use Your HSA for Tax-Free Retirement Savings

By Patti Hughes, CFP®, MPA, MS
Chicago, IL

For many people on high-deductible health plans (HDHPs), health savings accounts (HSAs) are a great way to save money on medical expenses. What often gets overlooked is their potential as a retirement savings tool. Anyone who qualifies for an HSA should consider how it can fit into both their short- and long-term financial plan.

An HDHP charges lower premiums but has higher annual out-of-pocket deductibles than other medical insurance plans. An HSA is a tax-advantaged savings vehicle available only to those enrolled in an HDHP. An HSA allows you to put money away on a pre-tax basis to be used to pay for medical expenses (up to an annual limit). The investment growth is tax-free, and it is never taxed if used to pay for medical expenses. Some choose to pay for their annual medical expenses directly now, but also invest money in an HSA, where it can grow tax-free. They save the tax they would have paid on the income that goes into the HSA. They save taxes now and plan to take the money out at a much later date to pay for the medical expenses they paid this year (keep the receipts) and/or for future medical expenses. If they are able to pay medical expenses now, the receipts they save from their current medical expenses can be used to ask for tax-free reimbursements years later.

HSA withdrawals must be used for qualified medical expenses such as doctor visits, medications, dental, and other qualified expenses. You can make a withdrawal at any point in the future for any qualified expenses incurred since you opened the account, but you do have to keep accurate records and receipts for medical expenses in order to withdraw them from your HSA in future years.

To give a simple example, assume you have a gross income of $100,000. After a 25% federal tax, a 5% state tax, and a 7.65% FICA tax, a dollar of marginal income would be worth 62 cents to you after paying taxes. Say you incurred a $2,000 bill for braces—if you paid for this bill now on an after-tax basis, you would need to earn $3,226 of income to net the $2,000 needed to pay for the braces, because $1,226 of that income would go to pay the taxes. If you use your HSA to pay for the braces, you would be paying for it with pre-tax dollars, and would only need $2,000.

The usual approach is to fund your HSA each year and use it to pay current medical expenses. If you are lucky and don't have annual medical expenses as large as the annual limit on HSA contributions, your HSA will grow over the years. However, if you are fortunate enough to 1) be able to pay for current medical expenses with after-tax income, 2) maximize your tax-deferred contributions to your 401(k) account, and 3) fund your HSA in addition each year, you can use the HSA as an additional retirement savings account. You can allow the assets to compound and grow as long as possible while you pay out of pocket medical costs with current funds. In the above example, if you had saved the receipt for the $2,000 braces, you could withdraw this $2,000 thirty years later when the HSA assets have grown, and the withdrawal would be tax-free. Your HSA can also eventually be used to pay for Medicare premiums or long-term care insurance.

When comparing HSAs to ordinary 401(k)s, it's worth noting that contributions to both are made on a pre-tax basis, so they reduce your taxable income in the year you make the contribution (this does not apply to Roth 401(k)s). Both HSAs and 401(k)s grow on a tax-deferred basis, but the main difference is that the HSA distribution is tax-free at the time of the withdrawal (with documentation of qualified medical expenses). The 401(k) distribution is taxable when withdrawn.

What happens if your HSA growth exceeds your reimbursable medical expenses? If you withdraw HSA funds after age 65 without proof of medical expenses, you will pay ordinary income tax (just as you do with 401(k) withdrawals, but there will be no penalty. Before age 65, there is an additional 20% penalty on withdrawals from an HSA not used to pay for medical expenses. Most people just use the HSA to pay for current year medical expenses, but the HSA can also be used as an effective retirement planning strategy. It's worth considering how the HSA can fit into your plans. Your financial advisor can determine if this tax-saving strategy is a fit for you.

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