Investments:

Income is Hard to Find These Days – But Real Estate Can Still Provide

By: Christopher Miller

Income is hard to find among the investment offerings available today. Low interest rates are hurting, and in some cases practically eliminating, the benefits of traditional income providers like Treasury and municipal bonds and life insurance products. This month's article reviews today's options seeking attractive income potential.

U.S. Treasury Bonds.

Note that the products we call "Treasury bonds" are not technically called by that name. Of U.S. government issues; products with maturities of less than one year are called Treasury Bills. Treasury Notes are issued in 2, 3, 5 or 10 year terms, while true "Treasury Bonds" have 30 year terms. (source: Treasurydirect.gov)

U.S. Treasury obligations are considered by many to be the most secure investment vehicles, as they are backed by the (theoretically) unlimited taxing power of the United States government. Current Treasury yields (source – Bloomberg, July 31, 2015) range from 0.06% for the three month note to 0.66% for the 2 year bond, 1.54% for the 5 year, and 2.2% for the 10 year. A $100,000 investment at these rates would pay you income of $60 over three months (!) for the note, and $660, $1,540 or $2,200 annually for the bonds. Considering that interest from these securities is taxable, these vehicles can really no longer be considered something to generate income: They really just preserve capital.

Municipal Bonds.

Muni bonds have historically been attractive to high net worth investors because they offer the opportunity for income that is federal and state income-tax free. Although they vary due to state of issuance, muni yields now are generally around the range of (source – Bloomberg, July 31, 2015) 0.29% for the 1 year, 0.66% for 2 and 1.36%, 2.31% and 3.27% for 5, 10 and 30 year, respectively. These yields have historically been lower than treasury bonds due to their favorable tax treatment: 4% tax-free is higher than 6% taxable if you are in a high tax bracket. Municipal bonds, however, carry greater risk than treasury products; as investors in Stockton, San Bernardino, or Detroit-backed municipal bonds recently learned. (When these municipalities declared bankruptcy, their bondholders lost money.) When considering there is some risk involved, the

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Christopher Miller is a Managing Director with Specialized Wealth Management in Tustin, California and specializes in tax-advantaged investments including 1031 replacement properties. Chris' real estate experience includes work in commercial appraisal, in institutional acquisitions for a national real estate syndicator, and as an advisor helping clients through over two hundred 1031 exchanges. Chris has been featured as an expert in several industry publications, and on television, and earned an MBA emphasizing Real Estate Finance from the University of Southern California. Call him toll-free at (877) 313 – 1868.

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(now very slightly) higher after-tax return of munis is hardly a draw today.

Annuities

Insurance based products such as annuities are also losing some muscle due to low interest rates. In the past, investors seeking either to limit potential investment losses or to ensure a lifetime supply of income could purchase insurance products to pursue such goals. Today, however, low interest rates have affected these companies' ability to offer attractive products.

Some of my investors tell me about "9% annuities" that other advisors are showing them. That sounds exciting – and I can offer those – but they sound less appealing when you look at the numbers behind them. A 75 year-old male can indeed purchase annuities today that will promise to pay lifetime income over 9% - If he waits 5 years to receive distributions. (The rates paid on immediate annuities are lower.) If insurance companies are earning 2% a year on their bonds, and they invest almost 70% of their assets in bonds (source: http://www.naic.org/, 2010 figures), then how can they afford to pay 9%?

The short answer is "they can't." A closer look at this policy proposal will show the company paying income at over 9% per year from year 5 on. If the investor lives to 110, he'll win by collecting this income until then. Since we know he probably won't, and that he'll live a good long life if he passes away 10 years from now at 85, he'll have earned $45,000 in income from his $100,000 investment, and his heirs will receive what's left.

What is left? Well, since the company can't exactly make a living by paying 9% while only earning 2%, the investor's principal will decrease every year he takes distributions. His heirs will usually receive some portion of the remaining equity as a death benefit. Usually, when I show such an arrangement to a client, his reaction is "But they're just paying me back my money and giving my heirs what's left. What kind of investment is that?" I'll tell my client "well – it's not an investment; it's insurance. If you want to buy a lifetime of income as insurance; this is worth considering. If you want to buy investments; then let's talk investments."

Real Estate Still Offers Appealing Income Potential

Real Estate investments at attractive yields are still available today if you shop carefully. Better yet, real estate assets feature growth potential: the ability to grow your principal for your future or for that of your heirs. Given the low income possibilities we see in other places; real estate could be an increasingly attractive option.

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