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LIFE INSURANCE

Don't Let Your Client's Policy Lapse!

It might lead to forced liquidation of his real estate to pay estate taxes.

As agents, we always try to make sure that our clients' life insurance policies do not lapse. If your clients are in the commercial real-estate business, here is one very good reason he must hold on to his policy, no matter how old he is.

A $10 million policy is in its 30-day grace period. Your client is 75 years old. During this grace period, the coverage on his life continues. On a specified date, though, the coverage will stop. Here are some concerns:

Many insurers have, within the past few months, stopped the sale of policies of more than $1 million to people over the age of 75. They are exiting the elderly market because more and more policies are being purchased by people with the intention of reselling their large face amount policies, at a significant profit, in a secondary market funded by deep-pocket investors and hedge funds.

The effect on your client's family could be his inability to obtain new coverage, even if it is for estate-tax needs, in the future. Our firm, like others, is very involved with clients in the commercial real-estate business and we have developed an expertise in helping families avoid forced liquidation of valuable properties to pay estate taxes.

But if investment groups are buying these policies from existing policy owners, think how valuable they are as an investment for your client's family. There always is the option of selling a policy at a profit, but the policy needs to be in effect for a client to do so. Five years from now when that client is age 80, depending on his health, (the poorer the health, the higher the price an investment group would pay for it) a $10 million policy might have a marketable value of $2 million to $4 million. But this is not the only reason to keep it in force.

The policy, most likely, is owned by a special irrevocable trust. Ten million dollars of life insurance will be income tax free, but the trust can make it estate-tax-free as well. Ten million dollars in estate-tax-free money is the equivalent of $20 million of personally owned assets. If the client's estate was valued by the government as being $50 million, the estate tax would be about $22 million. Without insurance, this is what would likely happen to get the $22 million:

- The estate would sell about $24 million worth of real estate.
- The appraisal, brokerage and legal fees would be around 6.5 percent or about $1,500,000.
- The estate would realize about $22,500,000 from the sale.
- $22 million would go to Uncle Sam.
- The family would keep and divide the remaining $26 million of assets.

The price of a lapsed policy

But what has been lost forever is not just $24 million worth of property; it is also the income from and growth of that property. If your client's real-estate portfolio generates 6 percent net cash flow and 3 percent real growth, your client would lose $1,400,000 in income forever and $700,000 of compound capital growth forever.

Life insurance is, in many ways, like a building. A client would buy a new building by putting down a small amount of money and borrowing a large amount. A $10 million building might be bought with $1.5 million in equity. The client hopes to have growth through debt service and appreciation. But if there was a death, cash was needed immediately and the building had to be liquidated, the

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client might not even get his original purchase price back from the building. The estate life insurance, like a building, requires an input of equity. The insurer calls that the premium. The difference is that the $10 million value is there—and guaranteed from day one.

By letting a valuable policy lapse, the client may not be able to obtain it again, and even if he could, the price would be higher because he would be older, and his health may have deteriorated. The disaster insurance a commercial real-estate client carries on his properties may not cost as much as a life insurance policy, but then again, his buildings are not guaranteed to become a total loss.

Unfortunately, some day, hopefully a long time from now, but at some point in time, your client will pass away. Life insurance will create cash flow that will help keep together what he spent so much of his life putting together. To avoid this, advise him to pay his current premium due—it is the best thing you can do for him and his family. Don't let his policy lapse! □

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