

ATHENEUM

[ath-uh-nee-uh m], noun

- An institution for the promotion of learning

PROTECT VOLUME 1

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BALLAST, INC.

The best advice we ever received was to build a team that we would want our family to work with if anything happened to us. That has been our vision since our founding and the backbone of all decisions that we make. As an independent, employee-owned firm, we work tirelessly to make certain our clients receive the best guidance.

Our process begins with understanding the people that we are working with; not only their balance sheets but the client as an individual. We work for insight into their goals, desires, fears, concerns, and opportunities while developing a clear picture of the intricate relationship among all areas of their financial life. Without these conversations and a comprehensive approach as the initial foundation, we do not feel that we can adequately provide sound, objective advice. It is essential.

Our expertise ranges wide and deep. However, we also recognize that the best result is accomplished through coordination and collaboration. We strive to be included in all financial decision-making, and we believe it is imperative to maintain open communication with other professional advisors. Our goal is to proactively monitor and coordinate a continually evolving plan, while standing by our clients to assure they remain steadfast towards their objectives – even in the most challenging environments.

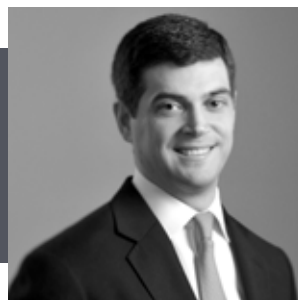
Ballast is a partnership, within our team and with our clients.

“I feel fortunate every day that I sit in the chair that I do. The trust others have in our firm is humbling, and it inspires us to serve them the right way.”

John V. Boardman, III

Founder / CEO / Financial Advocate

CFP®



John worked at a large bank for years. He was on the fast track, but he knew there was a better way to help people. He believed then, as he does now, that he will be sitting across from his clients for thirty years. So he forged his own path.

As the son of a banker, he took an interest in the world of finance from an early age. While attending Centre College, John was active in investment research while working on an endowment study with the school's Director of Finance. After graduating from Centre College, John worked his way up from equity trader to become one of the youngest Vice Presidents in the bank employing over 25,000 people. Although the bank provided great opportunities for John, he decided that his clients would be best served in a different form.

In 2005, he founded Boardman Wealth Planning, now known as Ballast. Ballast was built to act as the “Personal CFO” of its clients, coordinating and managing all aspects of a client's financial life.

John currently serves on the board of the Gilbert Bunnell Foundation and Bluegrass Estate Planning Council. John also serves as a trustee of the Kentucky Teachers Retirement System.

John enjoys golf, running, cooking, and, most importantly, spending time with his wife Ann Wesley, his daughter Kate, his son Henry, and dogs Buddy and Teddy.

“It may be a modest smile, a hug, or a sincere note, but there is a moment in nearly all of our relationships when a client feels a big sense of relief. That motivates me.”



Andy J. Reynolds

Partner / COO / Financial Advocate

CFP®, MBA

Born and raised in Columbus, Indiana, Andy grew up in a family who believed in two things: give to others and be the best version of yourself. He and his wife, Laura, have since gone on to seek to instill those values in their four children, Harper, Emma Kate, Caroline, and Mack. Whether it is family, clients, or colleagues, Andy's greatest sense of achievement is in helping others reach their goals and desires.

Andy attended Centre College, then continued his education at the University of Kentucky, earning a Master of Business Administration (MBA) degree. He then earned his CFP® (CERTIFIED FINANCIAL PLANNER practitioner) a few years later.

In the community, Andy has served on many volunteer boards including the Blue Grass Community Foundation, Life Plan of Kentucky, Bluegrass Estate Planning Council, and OperaLex. In addition, he enjoys coaching his children's soccer and basketball teams and playing with their dog Rosie Cottonball.

For Andy, his work is more than a job. The combination of a service-based yet highly technical field of personal financial decision-making is both rewarding and challenging. As an early Partner in Ballast, Andy continues to help shape the future of the business.

“Helping people achieve peace and comfort in their financial lives is what drives me to be better everyday.”

Brian T. Burton

Partner / Director of Portfolio Strategy / Financial Advocate

CFP®



Born and raised in Lexington, Brian graduated from Georgetown College where he studied Finance and Investment Management. In addition, Brian is a graduate of Kaplan University where he earned his CFP® (CERTIFIED FINANCIAL PLANNER practitioner).

Prior to joining the team at Ballast, Brian served as Vice President and Portfolio Manager for a super-regional bank in Lexington where he managed over \$200 million. With over a decade of experience managing complex investment portfolios, Brian brings a level of expertise that adds significant value to our clients' experience.

Brian has volunteered on numerous local and state boards, including serving as Treasurer for the Kentucky Humanities Council and Bluegrass Crime Stoppers. Aside from his work, Brian enjoys spending time with his wife Megan, and their two children, Harper and Hayes; and maybe an occasional round of golf with friends.

“The people I work with lead complicated lives. I enjoy finding elegant solutions that ease worry in their financial lives so they can live well.”



Cameron K. Hamilton

Partner / Director of Financial Planning / Financial Advocate
CFP®, MBA

Cameron is a problem-solver. His favorite book growing up was “The Way Things Work”, which showed how complicated systems are composed of simple machines. His analytical bent helps him seek out the root of the problem, whether he’s helping a client make a complex decision or perfecting his brisket recipe.

At UK’s Gatton College, Cameron earned a Masters of Business Administration, developing the tools to advise business owners and act as Personal CFO for individuals. He continued his training by becoming a CERTIFIED FINANCIAL PLANNER™ practitioner.

At Ballast, Cameron finds his proudest moments on the job when he sees the look of relief on a family’s faces, easing anxieties with a common sense plan tailored to their needs.

Cameron enjoys cooking, riding with the Bluegrass Cycling Club, fishing, and spending time with his wife, Christie.

“It is truly an honor and a privilege to help our clients achieve their financial goals. At Ballast I am able to help secure the future not only for our clients, but for their families as well, and I take that very seriously.”

Frank E. Yozwiak

Director of Estate Planning & Tax / Financial Advocate

J.D., LL.M. in Taxation



Born and raised in Lexington, Frank earned a B.S. in Business from the Richard T. Farmer School of Business at Miami University in Oxford, OH. Frank earned his J.D. and LL.M. in Taxation from The John Marshall Law School in Chicago, IL.

Frank has passed the Bar Exam and is licensed to practice law in both Illinois and Kentucky. While in Chicago, Frank gained experience and tax knowledge working in the IRS Office of Appeals. Prior to joining the team at Ballast, Frank worked in a boutique Tax and Estate Planning law firm in Lexington where he further expanded his knowledge in those areas.

Frank is a Kentucky Colonel, and a member of the Bluegrass Estate Planning Council. Frank enjoys spending time with his wife Alyssa and volunteering at UK Football and Basketball home games as a Blue Blazer wearing member of the Committee of 101.

BALLAST ATHENEUM TOPICS

PROTECT

- Estate Planning
- Insurance
- Retirement Income
- Debt Analysis

PLAN – COMING EARLY 2019

- Cash Flow
- Monte Carlo
- Retirement Savings
- College Savings

PROSPER – COMING EARLY 2020

- Asset Allocation
- Taxes
- Social Security
- Employee Benefits

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INTRODUCTION

The Ballast Atheneum is an anthology of our thoughts on the twelve most important topics in financial planning. We have organized these topics into three themed years of focus: Protect. Plan. Prosper.

PROTECT

This volume and edition contains Ballast Atheneum articles written and posted between January 2017 and January 2018.

The theme of this volume is Protect. When we become acquainted with a new family, we generally identify several goals that must be implemented over months or even years. However, we often find ourselves focusing in the immediate term on a handful of topics to lay the foundation of a sound plan. These articles discuss four important topics for families either beginning their financial lives, or starting with a fresh focus later on in life: Estate Planning, Insurance, Retirement Income, and Debt Analysis.







ESTATE PLANNING

Estate planning is no longer reserved exclusively for the ultra-wealthy. An estate plan is an integral part of any sound financial plan. Whether it's a last will, a simple testamentary trust, or a multi-generational multi-trust plan, an estate plan is a tool for people from many different financial walks of life.

Among many other things, an estate plan can give you the power to control the disposition of your assets with great detail, provide for tax efficient charitable giving during your life, offer a certain level of risk protection, and help protect your loved ones from creditors and financial predators.

The following articles discuss these and several others of the many benefits of an estate plan.

What Comprises A Sound Estate Plan?

John V. Boardman, III – 10 January 2017

There is no more important aspect to your financial plan than an estate plan. That might seem to be a shocking statement to some and that is likely because of the misconception of what comprises a comprehensive estate plan. While most clients come to us focused on their investment portfolio and cash flow needs, we typically steer the conversation to the estate planning subject. Why do we work, save and invest for the future? Obviously, we do so to achieve financial security. But without a sound estate plan, this financial security will vanish for the most important people around you if something unforeseen occurs. A proper estate plan should be comprehensive in its direction of all financial assets and in coordination with the personal wishes you have. These desires include bequests to family, protecting access to funds for children, and charitable donations, just to name a few. In many ways, an estate plan is a blank canvas that is designed around you.

We pride ourselves in the professional relationships we maintain in the community, so to speak on this subject we reached out to two of our trusted resources: Henry “Tip” Richmond and Jeff Gehring, both members of Dickinson Wright PLLC here in Lexington. Jeff noted, “Your estate plan should take into consideration your current and foreseeable family situation and tax/financial situation to accomplish your non-tax goals in the most tax efficient manner possible.” This points to the idea that people work to construct their plan for different reasons, but at completion, it should accomplish both personal and financial goals simultaneously.

When looking at our clients’ plans, we notice consistency across the key components of the plan: Last Will and Testament, Powers of Attorney, and Healthcare-related documents related to authority and last wishes. After that, there is a wide disparity in the documents that comprise the plan. A younger couple with new children may have more intricate trust planning related to control of insurance, assets, disposition of assets and income specific to age criteria. A successful professional (i.e., doctor) might have more focus on asset protection from “creditors and predators.” While among our client base of retirees, much of the planning revolves around tax, charitable, and family legacy planning. The beauty of a comprehensive, well-designed plan is that it is built around your specific situation and desires.

While most people focus on the disposition of the assets they own, the responsible parties you name must also be diligently considered because they hold a great deal of power. Those individuals must not only be trustworthy but also capable and knowledgeable enough to accomplish your plans. Tip noted the multitude of roles you must consider, including “who will be responsible for the physical care and custody of minor children (the guardian), who will be responsible for administering your estate with the assistance of other advisors (the executor/personal representative), who will be responsible for deciding how trust assets are used for the beneficiaries of the trust and for overseeing the investment of trust assets (the trustee), who will have the legal authority to act for you with respect to financial matters if you are temporarily or permanently incapacitated (your financial power of attorney), who will be responsible for making medical decisions for you if you are incapacitated and death is not imminent (your health care power of attorney), who will be responsible for carrying out end-of-life decisions you have made in the event you have a terminal condition or become permanently unconscious (your health care surrogate), and alternates to all of the preceding positions if the primary named person is unable or unwilling to act.”

As important as the initial construction of the plan, one must always be open and willing to update their plan. Tip recommended “reviewing, and potentially updating, your plan any time there is a significant change in the family or financial situations (e.g., an inheritance), change in the estate tax laws, or if you have concerns about any person you named to a fiduciary position (i.e., guardian, executor, trustee), but in no event less frequently than every 2-3 years.”

The best advice we can offer is to not be overwhelmed by the process. It is, by far, the most neglected area we see in prospective clients. We can simplify the process for you and introduce an appropriate attorney. In most cases, we attend the meetings to make sure the financial goals are compatible with the personal goals discussed. Occasionally, people become paralyzed by indecision with the quantity of decisions listed above; this is a big mistake. We advise making decisions based on what you believe and know today, noting we can always go back and have changes made. It is most important that something is in place for the people you care for.

Demystifying Probate

Andy J. Reynolds – 23 January 2017

To many people the word probate has a negative connotation. Due to the fact that many people only experience the probate process one or two times during their entire lifetime (if that!), it is viewed as confusing, expensive, and undesirable. Many hire an attorney to guide them through the process, and, if done correctly, one can avoid the horror stories of a probate that lasts months or years. In our second Atheneum article, we hope to clarify the probate process and help explain when it can be a positive.

In its simplest terms, probate is a legal process that occurs after someone dies. The probate process includes the following:

- Formal recognition within a Court that a person is deceased
- Identifying a deceased person's last will
- Inventorying a deceased person's assets/liabilities (with proper appraisals, if needed)
- Paying debts and taxes
- Distributing remaining property

Since many of these administrative tasks will need to be completed when a person passes away irrespective of their ability to avoid probate, an “avoid probate at all cost” mentality may not be entirely warranted. Additionally, as a positive, going through the probate process may shorten the period of time during which creditors make a claim on a deceased person's property. In Kentucky, going through probate allows this period to be shortened to only six months instead of two years.

While the probate process may be less daunting than generally recognized, there are certainly reasons to try to avoid probate in several cases. Some clients choose to avoid probate by establishing and funding revocable living trusts, but as a general rule, jointly-owned assets, transfer on death accounts, and accounts/assets which pass by beneficiary designation (e.g., IRAs) also bypass probate.

Attorneys may seek to avoid probate for a few common reasons, which are listed below:

Privacy. The terms of a client's will and the assets included in his or her estate are made public as part of the probate process. Many clients want to avoid this. Thus,

avoiding probate with as many assets as possible provides the client and his or her family with privacy.

Avoiding Probate in Multiple States. If going through the probate process is perceived as bad, going through the probate process in multiple states at one time is much worse. If a client owns real estate in a state in which he or she is not a resident at the time of his or her death, the client's family will have to go through the probate process in the client's state of residence and the state in which the real estate property is located. Many people who own real estate outside their state of residence have the out-of-state real estate owned by a revocable trust or an LLC.

Trust Planning Implemented for Non-Probate Avoidance Reasons. If a client has established a revocable trust in order to implement trust planning at his or her death (for tax or asset protection reasons), utilizing that revocable trust by funding it during the client's lifetime and attempting to avoid probate with respect to many, if not all, of the assets at the client's death can be prudent planning. However, it is generally understood that this planning does not offer any type of asset protection or allow a client to qualify for Medicaid. In many cases, this type of planning (commonly referred to as a Living Trust) may in fact complicate an otherwise simple estate.

In conclusion, while the probate process may appear daunting and overwhelming, the decision to affirmatively plan to avoid probate should be made only after considering your specific circumstances and the potential positive and negative aspects of probate. We always encourage our clients to bring us into these conversations to help review, implement, and monitor an estate plan while working with a trusted estate planning attorney. If you feel that it would be beneficial to review your current estate plan or establish a new estate plan, please do not hesitate to call our office.

Trusts as Estate Planning Tools

Brian T. Burton – 7 February 2017

The topic of estate planning is one that many would like to avoid for as long as possible and the reason is pretty simple: most people are reluctant to discuss what Benjamin Franklin referred to as the only two certainties in this world, death and taxes. This is where a common misconception lies: estate planning is not all about your death. It is more about the level of control you want over your assets, both while you're living and after your death. While there are many ways to gain control over your assets, the most common form is a simple will. A will allows you to arrange for the distribution of your possessions, to name guardians for any dependent children, and to name your executor, the person who will be in charge of your estate. Wills do, however, have limitations and may lack the flexibility and creativity that a *trust* can provide.

A trust in simple terms is a legal agreement between three parties: the *grantor*, the *trustee*, and the *beneficiary or beneficiaries*. A trust allows the grantor to put conditions on how certain assets are distributed upon his or her death. The grantor (also referred to as the trustor or settlor) is responsible for creating the trust agreement; the trustee manages the assets that are titled in the name of the trust; and the beneficiary is the person or entity which receives the benefits of the assets titled in the name of the trust. The trust is considered funded when the grantor transfers legal title of the assets to the trustee, at which time the assets are considered “in trust.”

Trusts are formed to address numerous concerns or reasons and come with varying levels of complexity. For example, trusts are either *living trusts* (established during a person's lifetime) or *testamentary trusts* (set up in a will and established after a person's death). Beyond that, living trusts are considered either revocable (grantor retains control of the assets) or irrevocable (grantor gives up control of the assets). To assist us with a few of these areas we reached out to one of our trusted estate planning resources, Bart Rogers, Member of Frost Brown Todd LLC. Bart mentioned, “Clients need to know the components of a trust and, most importantly, understand the critical distinctions between **revocable** and **irrevocable** trusts.” Bart went into further detail regarding these distinctions and the advantages/ disadvantages of both:

Revocable trust – “The grantor may amend, modify, or revoke a *revocable trust*. Under current Kentucky law, a trust is a revocable trust unless the grantor expressly states in the trust agreement that the trust is irrevocable. In its rudimentary form, the grantor, the trustee, and the beneficiary may be the same person. This is the popular “revocable living trust,” where assets *owned by the grantor* are transferred *to the grantor as trustee*, for the *benefit of the grantor for life*. Additional beneficiaries may be added, such as the grantor’s spouse and/or children. The revocable living trust is often called a “will substitute” because it appoints a successor trustee upon the grantor’s incapacity (to manage the assets for grantor) or death (to manage and/or distribute assets to beneficiaries). The trust agreement is a private document and is not subject to probate. Thus, the assets in trust and the dispositive terms of the trust agreement are not placed in the public records of the probate court. The revocable living trust allows a family to keep *private assets private*.”

Irrevocable trust – “A grantor may expressly state that he or she does not retain power to modify, amend, or revoke, and that the trust is *irrevocable*. The irrevocable trust is the foundation of many high-end estate planning techniques. In addition to the traditional function of asset management by a trustee for beneficiaries over some period of time, the irrevocable trust may be used in gifting or selling assets — usually family-owned, closely-held business assets, and to maximize income tax, gift tax, estate tax and generation-skipping transfer tax savings. Most esoteric planning devices, such as the ILIT (irrevocable life insurance trust), the GRAT (grantor retained annuity trust), the QPRT (qualified personal residence trust), the CRUT (charitable remainder unitrust), and the IDGT (intentionally defective grantor trust), just to name a few, are all irrevocable trusts in their most fundamental form.”

Although trusts are not essential to every person’s estate plan, for many, a trust or combination of trusts may provide important advantages over a will, including having greater flexibility with how assets will be distributed, avoiding the time delay and publicity of probate, and reducing estate taxes just to name a few. With regard to trust planning, we advise speaking with a trusted estate planning attorney and we are always happy to help facilitate that conversation. If you have any questions or concerns with your estate plan, please don’t hesitate to contact us.

Charitable Estate Planning

Cameron K. Hamilton – 6 March 2017

Estate planning can achieve many goals, from simple to complex. The foundations of good estate plans we have discussed thus far in our Atheneum articles make sure that a family has formalized their personal wishes to make for a graceful transition to the next generation. Many families wish to provide not only for their next generation of heirs but also for the causes they hold dear in their communities. Today we will discuss some options for charitable planning that can help achieve this goal.

Charitable estate planning can range from simple annual gifting to complex strategies that involve tax and trust planning which play out over decades. With such a wide scope, it is important to have a firm grasp on your goals for charitable planning. We find a great strategy is to explore these alongside your other financial planning goals, and then partner with an estate planning attorney who can choose the right structure to balance your charitable intent with the other needs and desires of your family. Let's explore two charitable planning options we're seeing estate planners implement today.

Charitable Remainder Trust – Families can transfer property to a charitable remainder trust and receive income generated by those assets during their lives, leaving the remainder to the charitable beneficiary. This deferred charitable strategy works well for appreciated assets such as low-basis stock. Transferring low-basis assets to a trust with a charitable beneficiary lets the owner avoid capital gains tax that would be incurred upon a sale. The owner also receives an income tax deduction based on the discounted value of the transferred property the charity will receive.

An advanced use of this strategy involves pairing with a Wealth Replacement Trust. This option is available if a family would like to make an eventual gift of property to a charity but also restore the estate for eventual family beneficiary. They can use the income generated by the Charitable Remainder Trust to purchase life insurance to benefit the family beneficiary. In this scenario, the life insurance proceeds pass estate-tax free to “replace” the assets transferred to the charitable trust.

Charitable Lead Trust – If a family would rather provide an immediate benefit to their charity, a charitable lead trust can be a good option. With a CLT, the charity leads by receiving trust income during the donor's lifetime, with the eventual remainder

passing to the family or other beneficiary at death or other predetermined date. This is a great option for families that make annual gifts to charitable organizations. The trust can be structured to achieve current charitable contribution deductions or to transfer assets to family heirs with minimal gift tax consequence.

These two strategies are among many great tools for families that want to benefit their favorite charities during and after their lives. We are always excited to learn of our clients' passions and help facilitate the process of translating those passions into an estate plan. If you feel it would be beneficial to explore a charitable component in your estate plan or have a conversation with a trusted estate planning attorney, please do not hesitate to call our office.

The Benefits of a Simplified Estate Plan

Andy J. Reynolds – 14 March 2017

Thus far in the Estate Planning section of the Ballast Atheneum, we have discussed an introduction to estate planning, probate, trust planning, and planning for a legacy. All of these topics can be expanded upon significantly. However, this week we thought it would be important to discuss simplifying an estate plan. Most estate planners, rightfully so, try to create an estate plan that does not need to be amended significantly unless a life event happens. This is a benefit for the client. Sometimes, in a similar mindset, however, clients may desire to add increased parameters to “protect” their beneficiaries.

Often times during these conversations, we hear people desire to have some type of “control from the grave.” This essentially means after the person’s death, they want to put limitations on their beneficiaries regarding how/when they can use/access the assets. In some cases, however, as the client describes what their intentions are, an immediate red flag goes up, indicating that managing their wishes is going to be very difficult and/or expensive. While everyone has the right to do what they want with their assets, many times people are simply not thinking far enough into the future about how the parameters they create may cause an undesired burden (or cost) to their beneficiaries.

Sure, we all agree that it may not be in the best interest of an 18-year-old to inherit millions of dollars. How the plan is designed to protect the 18-year-old – or 60-year-old – is of the utmost importance. To elaborate on potential ways to overdo an estate plan, we asked Kevin Johns, an estate planning attorney and Partner at Wyatt Tarrant & Combs, LLP, to help us understand what his clients may typically find challenging when considering their estate plan.

Kevin stated that “estate planning can be much simpler than most people think. I find that many clients think estate planning is too complicated or is only for the very wealthy and don’t think they need any planning at all. Other clients are overly focused on estate tax savings based upon much lower exemptions from federal estate tax in years past. When the estate tax limits were lower, many couples created complex plans with a bypass trust in order to lower or eliminate estate tax. Given the rise in estate tax exemptions (\$11.2 million per person and \$22.4 million per couple

under the Tax Cuts and Jobs Act of 2017) and the portability of a deceased spouse's unused exemption amount, many of these couples no longer need such elaborate plans. In fact, such plans can actually create future tax problems. Other folks get so involved in the contingencies of the estate plan that they become unable to move forward with their plan and simply do nothing. Others, however, may overlook or forego many of the most important non-tax aspects of their plan in their quest to simplify their estate plan."

We believe, and I would guess most estate planning attorneys would agree, that an estate plan cannot be perfect. A good attorney can draft the plan to be close to perfect, but it is impossible to draft the perfect plan that considers every single possible outcome. We simply do not know what the future will bring. Keeping this in mind can be helpful when completing an estate plan. We always encourage clients to make it as good as possible but to try not to get hung up in the weeds. Sometimes it is best to simply put a plan in action (as best as one can) and then continue to monitor it as time passes. This is especially important with young children or financially-challenged beneficiaries. Remember: a "good" plan is better than no plan at all.

Kevin also mentioned some key best practices when considering how complicated an estate plan and/or estate planning process needs to be.

1. Review current plans, especially when trusts are involved. If you have already established a complex trust for estate tax planning, you should have the trust reviewed. If it is determined that such a trust is no longer needed for estate tax purposes, you may be able to amend it to simplify its provisions for your family. You may also want to amend the trust to avoid negative income tax results.

2. Review beneficiary designations. Specifically consider the titling of assets in conjunction with your estate planning documents. Are such designations outdated? Do such designations need to be revised to be consistent with your updated estate plan?

3. Consider non-tax reasons for trust planning within your estate plan. Some reasons may include (but are not limited to) the following: Desire to avoid probate? Asset protection? Divorce? Remarriage? Second marriages? Children outside the marriage? Protection of assets for multiple generations in the family? A family owned business? Charitable endeavors?

In some cases which may appear rather simple, a more thorough estate plan may be beneficial. Kevin explains that these cases may include areas such as "planning for

a child/loved one with special needs, an elderly parent, or a relative who may require the creation of a comprehensive Special Needs Trust. These trusts are designed to preserve a beneficiary's eligibility for Medicaid and Supplemental Security Income benefits, help with establishing guardianships and conservatorships, assistance with personal injury/medical malpractice settlements, provide advice and support estate/trust administration, and provide guidance with health care decisions and/or creation of Powers of Attorney and Living Will Directives.”

We are encouraging all of our clients to consider their estate plan this year. If you already have one, please pull it out and review it while considering the following: 1) Is it still relevant? 2) Is it too complicated? 3) Do you still understand it? 4) Are there changes that need to be made? If you do not have an estate plan (whether you have a \$200,000 estate or a \$5,000,000 estate), we would encourage you to call our office and let us start the conversation. Finally, and just as important, please take some time this year to review your beneficiaries and ensure that they are titled exactly how you prefer. We are always here to help guide you through what can be an intimidating process.

Risk Management in Estate Planning

John V. Boardman, III – 6 April 2017

When thinking about estate planning, most people think solely about how their assets will be distributed at their death. Obviously, that is of primary concern, but many of our clients' estate plans encompass the often-neglected area of risk management. In each of our lives, there are risks that must be considered and therefore planned around. There are the obvious risks of premature death and disability, and those risks are often covered by insurance (which we will get to in future Atheneum commentaries). However, there are countless other risks to be considered, many of which can be addressed in an effective estate plan structure.

During your life, one of the biggest risks is a lawsuit or litigation. People who work in high risk (or often sued) professions can utilize planning strategies to limit their financial exposure to a settlement or judgement. I asked Greg Hunter, Director at Miller, Griffin, and Marks, P.S.C. about some of the strategies he has used in the past to protect against such risks and Greg noted, "There are numerous types of techniques that we utilize for our clients who are in high risk professions in order to limit such clients' potential liability. These techniques involve the use of limited liability companies, family limited partnerships, living trusts, irrevocable trusts, and ensuring that the proper insurance is in place. Also, ensuring the proper ownership to assets is a key component of asset protection planning." There are obvious high-risk professions like doctors and private pilots but many service industry jobs like accountants and attorneys can be exposed to lawsuit. In addition, people who own rental property can be particularly exposed. It is never a bad idea to consider where you might have exposure, and an effective plan should incorporate risk management strategies where needed.

There are quite a few misconceptions about estate planning, particularly with a commonly-used trust known as a revocable living trust. According to Mr. Hunter, "Typically, a revocable living trust does not protect your assets from creditors. This is because a revocable living trust can be changed or terminated at any time. However, an irrevocable trust can be used to protect assets from creditors because the settlor does not legally own and cannot control the assets of the trust." I asked for his best words of advice for anyone and he said, "Plan ahead. Consider your possible

exposure to litigation and claims. Once a claim has been made, some of the asset protection strategies are subject to attacks and reversal by a judge or jury as such transfers could be deemed as “fraudulent conveyances.”

After one’s passing, risk management should not end. Utilizing proper planning strategies can help protect your beneficiaries from their inherited assets being pulled into a lawsuit. We also advocate trust planning so that assets will “stay within the family” in the event of divorce or the death of a child. Trust planning is most known for restricting and controlling access to assets by heirs but many of our clients implement trust planning for the primary reason of protecting their beneficiaries from risk described above.

Implementing risk management strategies into your estate plan is not difficult. In fact, most modern estate plans incorporate many of the ideas above. If you are unsure if your current plan provides such protections, we hope you will reach out to us to discuss. We can help you think about where risk might exist in your situation and are more than happy to bring in legal professionals to develop a proper solution for you.





INSURANCE

Insurance may be the most common form of financial protection out there. From protecting your loved ones from financial hardship after an untimely loss, to protecting your income stream or business if you become disabled, to protecting your home and property, insurance offers a financial shield that protects you when the going gets tough.

Insurance is definitely a “rather have it and not need it than need it and not have it” item, and we think its various protections mean that everyone could use at least some form of insurance.

The following articles discuss several of the different kinds of insurance and various benefits they can provide.

Life Insurance – Protecting Against the Unexpected

Brian T. Burton – 10 April 2017

Coming in at number two (just behind estate planning) on the list of dreaded-but-necessary financial to-do's is life insurance, because, let's be honest, no one wants to reflect on the circumstances in which life insurance would come in handy. We've heard nearly every reason in the book as to what keeps people from getting the life insurance they need, like, "the insurance I have through my employer is sufficient" or "I just don't have the time." The list goes on and on, but let's face it: there are certain things in our financial lives that need to be brought to the top of the to-do list and life insurance should be one of them.

There are two general categories of life insurance: term and permanent. Often referred to as "pure life insurance," term life provides coverage for a specific period of time, such as 10, 20, or 30 years. At the end of the chosen period, premiums and coverage will typically end and ideally, so too will your need for life insurance. Compared to permanent life insurance, term will generally have lower premiums (because it's temporary and has no cash value) that remain constant throughout the life of the policy. Let's look at a few scenarios where term life insurance can help:

- **Income replacement** – term life can cover your working years so that everyday expenses can continue to be met.
- **Mortgage or other debt** – a term policy can cover the cost of the debt by matching the years of a mortgage or other debt obligation.
- **Business owner** – term life can provide funding for the continuation of a business through a buy-sell agreement.
- **Providing for your family** – a term policy can provide large amounts of cash at death for children's college expenses or other needs.

While term insurance is primarily used for replacing lost income in the event of an early death, permanent insurance is most often used for estate planning purposes and wealth transfer. With permanent life insurance, so long as premium payments are up to date, the policy typically covers you until your death, regardless of your age. There are various kinds of permanent life insurance policies including universal, variable and variable universal, but the simplest and most well-known form is

whole life. Compared with term, whole life premiums tend to be more expensive, but they do provide some additional benefits like a guaranteed death benefit and a cash value component that grows at a guaranteed rate. Here are a few scenarios where permanent insurance may be worth considering:

- **Estate tax concerns** – life insurance (permanent is likely the best option here) can provide funds for heirs to help cover any taxes associated with your estate.
- **Desire to provide an inheritance** – your beneficiaries will receive an inheritance no matter your level of wealth.
- **Special-needs child** – proceeds from a life insurance policy can provide funding for a special needs trust that can provide care for your child after you pass.
- **Charitable giving** — life insurance may allow you to make a substantial gift to charity at relatively little cost while possibly providing an income tax deduction.

Life insurance is certainly not necessary for everyone; however, the vast majority of people do have a need and could ultimately benefit from having coverage. Not only can life insurance help support dependents, but it can also provide immediate cash to assist heirs with paying off any outstanding debts of the deceased, funeral expenses, and/or estate taxes. Here are a few things to consider when assessing whether or not you need life insurance:

- **Does anyone depend on your income, and how much money would they need if you were gone?**
- **What assets would be available to take care of your dependents?**
- **Will your estate owe taxes or other debts at your death?**
- **If you own a business, will there be a cash need upon your death?**
- **Do you have a mortgage or other debt obligation?**

If you answered yes to any of these questions, chances are you need some type of life insurance coverage. If you need help determining whether you need coverage and/or how much coverage, please don't hesitate to reach out to us at Ballast.

Disability Insurance – Protecting Families and Businesses from Disaster

Cameron K. Hamilton – 24 April 2017

According to the Social Security Administration, just over 1 in 4 of today's 20-year-olds will become disabled before reaching retirement age. With such high odds of experiencing a disability for some period of time, it is clear that financial plans should consider ways to limit the financial impact of disability. After all, when someone becomes disabled, their income stops but their expenses continue and even rise. Without income protection, everyday expenses and care can eat through savings and into retirement plans, a financial worst-case scenario. Today's Athenium will discuss disability insurance and its role in limiting these negative outcomes.

Most breadwinners have some special skill or training that helps them earn their income. Although most American workers are covered for disability by Social Security, this program requires you to be disabled from all work for over twelve months. Even then, benefits are based on earnings history and have maximum amounts much lower than privately available disability policies. Thus, any skilled worker who could lose substantial earning potential through disability should consider private disability insurance, either through their employer or individually. These policies will often cover up to 60-70% of earnings. If premiums are paid by the individual, which we recommend, benefits are tax-free, meaning this coverage can come very close to replacing after-tax earnings.

Not all disability policies are created equal. Each insurance company has their own policy language and when it comes to paying benefits, the policy language is king. There are a few features we prioritize (this list is non-exhaustive and features should be chosen on an individual basis). Policies should be *guaranteed renewable*, which means as long as premiums are paid, coverage must continue each year. Ideally they go one step further and are *non-cancellable*, which means premiums cannot rise, even if the company was charging too little to cover claims for an entire age group. Finally, there should be some *own-occupation* language if needed. For example, a surgeon could become disabled from performing cases but could still earn less as a lecturer. This feature comes in different names and forms across carriers and is often the key differentiator in terms of premium cost and potential benefits.

While most seek disability insurance to protect their family from loss of income, it can also be helpful for businesses. If the loss of a key employee would substantially limit the outlook for a business, disability insurance can replace revenue during recovery or help defray the costs of finding and training a replacement. It could also be used to fund a buy-sell agreement in the event of disability of the owner, protecting the survival of the business and therefore the financial interests of the owner's family.

When we speak with our clients, none count becoming disabled as a milepost on their ideal financial map. Nonetheless, planning for the risk of a disability, through personal savings or with insurance, should be part of the conversation. If you are unsure whether your financial plan could sustain a loss of income, we're happy to help analyze your options.

Long Term Care Overview

John V. Boardman, III – 9 May 2017

One of the most intimidating and misunderstood areas in financial planning is Long Term Care Planning. In general, long term care is classified as ongoing health-care needs for the basic activities of daily living such as eating, bathing, dressing, and transferring. In most cases, a person who cannot perform even a few of these activities independently will require some sort of assistance to live comfortably. Understandably, having to hire a nurse or aid to come to your home or living full-time in a nursing facility entails significant cost, so planning around this potential need is vital, particularly for people who want to maintain assets to transfer to survivors.

There is a lot to consider in one's own financial plan to evaluate if insuring your potential long term care need is necessary. No one can predict exactly what their future healthcare needs will be, particularly many decades in advance. However, we do believe understanding the statistics around likely need is important. In 2012, Morningstar gathered a number of statistics and statistical trends from a variety of available "objective" sources (basically, they did not use insurance companies who sell policies). A few of the important highlights were:

- The number of people over age 65 is predicted to grow from 37 million in 2005 to 81 million in 2050 (Pew Research Center)
- 78% of people who need long term care receive it from friends or family (Caregiver.org)
- 40% of people over age 65 will enter a long term care facility at some point during their life (Caregiver.org)
- The average long term care stay is 2.44 years (National Care Planning Council)
- 10% of people admitted to a nursing home stay more than 5 years (Medicare.gov)

The most important conclusion to draw from this data is that the need for care is both varied and unpredictable. The range of care a person might need varies from none to an extensive, long term stay in a skilled nursing facility. Due to the need being impossible to quantify, the best approach is to measure what your personal financial situation can handle. There are four primary methods to cover the cost of long term care; we believe each should be considered before making a decision on long term care.

1. Self-Insurance – For those with significant assets or income, self-insurance is an often followed route. If, for example, we project the annual costs of a stay at \$80,000 per year, we can project that a five-year stay would cost \$400,000.00. Does the client have this or could they afford to spend this? Would spending this amount or more subject his/her family to financial difficulty? Not only would we consider a client's assets, but also their available income to determine if this is a viable option. For those who are unable to qualify for an insurance policy, self-insurance is usually the only remaining option we will advocate by saving a regular amount to cover future potential need. When we are creating a retirement cash flow plan, we always point to the fact that we can redirect cash flow to future health needs. Conceivably, someone admitted into a nursing home is not as active and spending as much on lifestyle expenses as he/she was when retired and healthy.

2. Traditional Long Term Care Coverage – When most people refer to long term care insurance, they are referring to this type of policy. There are a number of policy features that can be added, but the most basic policies involve a daily benefit and a number of months or years the policy will pay. For instance, an example of a policy we might see today would be for \$200 per day and would pay for five years. Other features can include inflation on benefits, home healthcare, or return of premium if the policy goes unused, just to name a few. Adding any of these features increases the cost of the premium. Recently, we have noticed many clients who purchased policies many years ago have been receiving premium increase notices. Most policies allow insurance companies to increase premium on an insured "class" and this can result in significantly higher costs to the insured than originally predicted. One major advantage that we see on some modern policies in this category is what is known as "Partnership." Basically, this feature allows someone to protect on a dollar-for-dollar basis some amount of their net worth and still qualify for Medicaid. For instance, a \$500,000 total benefit policy would allow someone to keep \$500,000 in assets and still qualify for Medicaid.

3. Asset Based Long Term Care – There are a number of insurance companies that now offer this type of policy. In its most basic form, the insured individual makes a deposit into a policy or contract. For doing so, the insured receives some multiple on that deposit in future long term care need. One advantage is typically a death benefit higher than the deposited amount should the insured die prior to needing

long term care. As well, in most policies, the insured can liquidate the account at any time and receive their cash back (in doing so, losing the death benefit and long term care coverage). This has been an attractive option for people who keep high savings and CD balances.

4. Long Term Care Rider – Many of the major life insurance companies now offer a long term care rider on their permanent insurance policies (typically universal and whole life). It has become an attractive option to clients in the last several years as these riders have improved. With the rider, the client purchases a policy on their own life but can receive some of the death benefit in advance of their death if he or she qualifies for a long term care need.

When considering long term care costs and how to pay for those costs, it is important to understand that the primary role of long term coverage, in any of its forms, is estate protection. We have all known or heard of people who have exhausted a great deal of their financial resources through significant end-of-life healthcare expenditures. At the same time, I am often surprised when I see people paying significant premiums for policies when that same person could easily afford to self-insure. We implore anyone to have this discussion with us so we can assess your ability to self-insure or what type of solution would fit your situation. You will note that we waited until the very end of this article to mention Medicaid, and for good reason. Our primary objective would be for you to prepare so Medicaid is not necessary. Qualifying for Medicaid has become more difficult and “giving all of your money away” no longer works so simply. Our advice would be to plan around funding your potential need versus relying on an already financially-strapped Medicaid system that is likely to look far different even just a few years down the road. The entire insurance market around long term care continues to evolve and we expect continued evolution over the coming years. We expect new policy types to be introduced and some traditional carriers to stop offering coverage altogether. Please lean on us to help assess your need and navigate what is a very complex marketplace.

Insurance for Small Businesses

Andy J. Reynolds – 22 May 2017

As an independent, locally-owned firm, we have had the opportunity to learn about insurance needs first hand. While daunting at times, even for us who help advise others on insurance requirements, we can personally attest to the peace of mind that follows once a plan is in place.

Many small business owners wear many hats. While their roles likely started as the producer of their product/service, it evolves to also leading the marketing efforts, sales department, accounting, HR, administration, etc. Some are fortunate to be able to bring on others to support these areas, but many may only have one or two other employees.

To many small business owners, their business is the most valuable asset they have. It is the lifeline for their family and their future income. Due to large insurance companies' marketing efforts, many are very familiar with life insurance but fewer people know about the other insurance coverages that might protect their business and/or family in case of an unforeseen event. Additionally, for many small business owners, their business is their passion and their baby; the last thing they want to see happen is for the business to go away if the unforeseen occurs.

While there are many different types of insurance coverages that might make sense for a small business owner, the coverages below are the most popular and likely affect the most amount of people. This is certainly not an exhaustive list.

- **Buy/Sell Insurance** – This is probably one of the most overlooked insurance policies in place but likely one of the most important. A buy/sell policy likely will include an agreement stating that if a key owner and/or employee dies or becomes disabled, another person will agree to buyout the disabled or deceased person. The payment comes from the insurance policy and allows the owner's family members to likely receive a higher payout. This is potentially achieved by allowing the parties involved to negotiate with rational minds prior to an unforeseen occurrence happening, and it protects against a "fire sale" of the business.
- **Key Man Insurance** – Sometimes a business may have a key non-owner person who is imperative to the success of the business. This may be a COO, key salesman, or other important operator of the business. A key man policy provides assets

if the key person becomes disabled or dies. It allows the business to continue with uninterrupted income while the leadership determines how to move forward after an unforeseen change. This can be incredibly important in businesses where margins are thin and/or it would be difficult to retain staff, make expense payments, etc., if a disruption occurred.

- **Liability Insurance** – If you run a business, there is no way around acknowledging that you may be liable for a future claim. We are all human and even the most genuine humans make mistakes. It is imperative that a business owner have liability insurance for their business. This can look very different per industry, however, most include a general liability insurance policy (including an umbrella policy) and one of the following: product liability, professional liability (errors and omissions), property liability, malpractice, and/or home-based business insurance.
- **Workers' Compensation** – An often overlooked coverage for startup ventures is workers' compensation. This provides insurance to employees who are injured on the job. State laws vary but to our knowledge most states, if not all, require employers to maintain workers' compensation if the business has W2 employees.
- **Cyber Security Insurance** – In the digital age in which we live, cyber threats are one of the most threatening disruptions to businesses. While determining what exactly cyber security insurance covers is difficult, if your business maintains critical information, it would be worth reviewing.
- **Automobile Insurance** – Remember, if you are using your automobile for business use, your personal vehicle insurance likely does NOT cover you while driving for business.

Property and Casualty Insurance

Brian T. Burton – 5 June 2017

We all face the threat of a potentially catastrophic event every day, whether at home or at work, and we need financial protection against these inevitable risks. It's virtually impossible to avoid risk – the good news is we as individuals and/or organizations have the ability to exchange some of these risks for premium payments in the form of insurance policies. In previous Atheneum articles we have discussed life, disability, long term care, and insurance for businesses; today's focus will be on the various personal lines of property and casualty insurance.

Many different coverages fall under the banner of property and casualty insurance, but the two major areas of protection are for physical items (property) and protection against legal liability (casualty). Simply put, property insurance protects the things we own while casualty insurance provides protection against the claims of others. Let's first take a look at some of the different property coverages available for individuals and families:

- **Homeowners Insurance** – a requirement by lenders before funding a mortgage loan, this form of insurance is one of the best things you can buy and hope you'll never have to use. Homeowners insurance covers both damage to property and liability for injuries that occur in your home or on your property. These policies are typically long and can be difficult to understand; however, it is very important to know exactly what you're protected against. A standard homeowners policy should provide coverage for the structure of the home, coverage for personal belongings, liability protection, and additional living expenses for time displaced from your home.
- **Auto Insurance** – a package of different coverages, auto insurance policies may provide collision, comprehensive, liability, medical payments, personal injury protection, and uninsured motorist coverage. It's important to understand what each of these options does and how it would work if you ever needed it. No insurance policy is perfect, but with auto insurance it's prudent to carry "full coverage" – meaning not only liability insurance, but comprehensive and collision, as well.
- **Renters Insurance** – if you are renting your house or apartment, this form of insurance can help replace your valuables in case of a covered incident, such

as a fire or burglary. Renters insurance may also cover personal liability (legal costs) if someone is hurt in your apartment as well as medical payments of the injured party. This type of policy may also cover additional living expenses should your rented home or apartment become damaged by fire, for instance, causing increased costs, such as hotel bills.

Each one of these coverages — homeowners, auto, and renters — should provide some form of liability protection, but we must ask ourselves: is it enough protection? Many homeowners and auto policies will allow an individual to carry up to \$500,000 of liability protection. What sounds like a decent amount of coverage could quickly be eaten up if you are sued and forced to pay defense costs and possibly a legal judgement. This is where the primary form of casualty insurance becomes so important, which is an umbrella liability policy.

- **Umbrella Insurance** – this type of policy provides excess liability protection up to and above what auto and homeowners insurance may provide. For example, if you have \$500,000 in liability coverage under your auto or homeowners policy and a \$1 million umbrella policy, you would have liability coverage totaling \$1.5 million. Umbrella coverage is not only for those with significant assets but it may also be a good idea for anyone with earning years ahead of them – a legal judgement could possibly be tied not only to current assets but also to future earnings.

Having the appropriate protections in place not only provides a financial safety net for the unexpected but also significant peace of mind. If there are any doubts about your coverage, please don't hesitate to reach out to us at Ballast.

Evaluating Old Life Insurance Policies

Cameron K. Hamilton – 19 June 2017

Not all financial decisions are made with a clean slate. Nearly everyone we meet has made both good and bad choices. Our approach has always been to look everything over with a critical but non-judgmental eye and find the most appropriate way forward for the future. Often our first opportunity to practice this approach is with an old life insurance policy. In our final Atheneum commentary about insurance, we'll walk you through our evaluation process.

The first question we try to answer for owners of life insurance is simple but often overlooked – do I have a need for insurance? The answer to this question changes throughout one's life. As debts are eliminated and children become self-sufficient, needs may decrease. However, some may see their need grow over time for business reasons, charitable goals, or even for peace of mind. If you still have a need for insurance today, we want to hold insurance and can move on to the next question.

Does my current life insurance policy fit my needs as well as current alternatives in the marketplace? To answer, we compare both features and price. Pure term-life insurance bought at a younger age usually beats replacement at a later age on price, but replacement can be a good choice if your current policy has features that you no longer need. This situation usually lends itself to an easy apples-to-apples comparison.

Things get more complicated if you own life insurance but don't need to transfer financial risk. At that point, we stop comparing your policy against new policies and instead begin to evaluate opportunity cost. For old whole life policies that pair insurance with investment, we look at two pieces of information – an in-force illustration and the policy features. An in-force illustration, which can be requested from your carrier, shows how your policy has performed to date and provides an updated projection for the future. We use this data to determine guaranteed and projected rates of return, which yield the elusive apples-to-apples comparison. We pair this with an analysis of policy features. Some old policies have guarantees or conversion options so attractive that carriers stopped offering them on new policies. In this happy case we evaluate the policy against alternatives periodically like any financial holding.

It is often the case, especially with whole-life policies that are less than 10-15 years old, that the owner doesn't need the insurance and the policy doesn't have features or performance to justify continued premiums. In this case, you can stop paying premiums and keep your death benefit as long as the cash value lasts. Alternatively, you can surrender the cash value or exchange it into a more suitable insurance policy or annuity. There are several strategies based on the history of the original policy, each with different tax implications that require personalized analysis.

As with all financial conundrums presented to us, we endeavor to use common sense to provide the best advice for your current circumstances. Whether your old policy was a slam dunk or a long-term cash vacuum, it's always a good idea to revisit and determine the best option for the future. We're happy to help with this anytime.



RETIREMENT INCOME

You've planned for it your whole working life. Once you decide to retire, you've got to have the right retirement income to ensure you can enjoy the work-free life you want.

Whether it's Social Security, a pension from your job, Required Minimum Distributions from your retirement accounts, or an annuity you purchased, there are a multitude of different sources of income during your retirement years – so long as you've planned accordingly.

The following articles discuss different sources (and their benefits) of retirement income.

The Importance of Tax Diversification

John V. Boardman, III – 10 July 2017

When most people think of diversification, they primarily focus on a proper mix of portfolio assets. As we have noted in the past, we target an asset mix of non-correlating assets for our clients. This could include stock, exchange traded funds, mutual funds, REITs, etc. However, one area of diversification that is often ignored is tax diversification. As people accumulate all types of assets (retirement, real estate, business, etc.), it is vital to understand how each asset will be treated now and in the future. By owning assets across the varied tax treatments, an investor creates a great deal of flexibility.

As a consistent practice, we analyze how changes in tax rates could affect that person's or family's plan. In the last twenty years, we have witnessed several major tax law changes and it would be irresponsible of us to not consider how future changes in tax laws (even very minor changes) could alter someone's plan. We have found the best solution for a nimble financial plan is the accumulation of financial assets in a wide array of "tax buckets." Looking at the wide array of tax types available, an investor could own tax-deferred (IRA, 401k, etc.), tax-free (Roth), tax-free income (Municipal bonds), non-qualified tax deferred (annuity), non-qualified (Individual or Joint), or life insurance that can sometimes be borrowed from tax-free. For clients drawing an income, it is always best if they have several types of "tax buckets" because that provides us ultimate flexibility in structuring an income stream that optimizes current tax laws. After someone reaches age 70 ½, investors are required to take distributions out of all tax-deferred retirement plans. With proper planning and tax diversification well in advance of this occurrence, we can mitigate income tax liability by structuring income in the most efficient manner possible.

One of the most difficult tax situations to predict is the impact of estate or inheritance taxes on someone at death. Since 2000, we have seen the tax-free amount you can pass to the next generation change from \$1 million to \$3.5 million to unlimited to over \$5 million and now increased to over \$11 million per person. How in the world can you prepare for that kind of change? The estate tax has been a particularly common hot-button issue between Republicans and Democrats. Ironically, the estate tax generates a relatively insignificant portion of tax revenues (only 0.7% of tax collected

in 2013 per the Center on Budget and Policy Priorities). Politicians have continued to fight over the level of the tax because it is, in my opinion, a primarily symbolic tax. The best plans we construct are those that consider how extreme law changes could impact a person's estate plan. We do a lot of "plan for the worst but hope for the best" in this business. Various asset types can be treated very differently when passed to survivors. Some assets receive basis step-up (cost basis for inheritors is value at date of death) while some do not. As well, certain assets like life insurance can be excluded from estate taxes if properly planned.

Proper tax diversification also provides a great deal of flexibility. When people sell their business or retire, they often make major financial decisions soon after. These decisions could include paying off their house, buying a second home, starting a charitable fund, or making major gifts to family. For investors who have solely relied on tax deferred savings (i.e., 401ks), they will face huge tax payments for major distributions as all of these distributions are added to their annual income on their 1040. With non-retirement savings, Roth retirement accounts, or even accumulated cash values in life insurance policies, a person would have many more tax efficient account types to draw from.

The most important theme of this commentary is to not assume that tax rates will remain constant over time. When we look over a time horizon of over 20 or 30 years, we have to assume tax rates will likely change multiple times. It is also never too early to address this area of your plan as accumulation across various "tax buckets" can take a considerable amount of time.

Benefits of Multiple Income Streams at Retirement

Andy J. Reynolds – 25 July 2017

In our second Atheneum article for this quarter's Retirement Income subject, we discuss the benefit of having multiple income streams during retirement. To understand the advantage of having multiple income streams, it is vital to first understand one of the most important factors that affects portfolio longevity when taking income: Sequence of Returns Risk. According to Investopedia, Sequence Risk can be defined as "the risk of receiving lower or negative returns early in a period when withdrawals are made from an individual's underlying investments." A poor market environment early in retirement has negative effects on a portfolio that may influence the overall ability to generate a reasonably expected income stream over time.

For example, suppose a retiree has \$100,000 and requires \$4,000 per year in retirement (4% distribution) adjusted up by 3% per year for inflation. Also assume the retiree makes 5% per year. Holding everything constant, if the client experiences a -20% return in one single year, the results vary considerably based on when the -20% occurs. If the retiree experiences the negative return in year 1, the portfolio runs out of money in year 24. If the retiree experiences the negative return in year 5, the portfolio runs out of money in year 26. If the retiree experiences the negative return in year 10, the portfolio has \$76,000+ left at year 30. The biggest challenge to retirement planning is that we do not know when these negative years will occur and for any one specific scenario, it may be at the worst possible time. Unfortunately, none of us own a crystal ball in our office.

We can combat sequence risk by owning multiple asset classes that provide different sources of income. This may include assets such as stocks, bonds, real estate, annuities, CDs, cash, etc. By owning diverse assets types, a retiree can rely upon one asset over another if a specific area is performing poorly. In the example above, if the retiree owned a real estate property, during the market selloff, the retiree could consider relying more heavily on the real estate income or even possibly consider liquidating the real estate and using that asset for income while the markets rebound.

Additionally, owning multiple assets that provide income streams traditionally will reduce sequence risk by reducing the overall income dependency on a certain asset. Consider a retiree whose income is comprised of 20% rental income, 10%

annuity, 30% stock dividends, 15% bond dividends, and 25% Social Security. The risk of each associated asset (lack of renters, inflation, market correction, lowering bond yield, entitlement reform, etc.) is hedged by the other assets and somewhat contained to a smaller portion of the overall income need. This may not be a viable option for all retirees, but for those who have the ability to own more diversified income, it may be an advantage in the long term.

There is not a perfect way to generate retirement income and each person's individual scenario will dictate what opportunities they are afforded. However, similar to investing in multiple asset classes for an investment portfolio, we believe that retirees who have multiple sources of retirement income generally have more protection against sequence of returns risk and single asset class risk.

Determining a Healthy Withdrawal Rate

Brian T. Burton – 7 August 2017

One of the more arduous tasks facing retirees and soon-to-be retirees is trying to determine how much money can be withdrawn from retirement accounts each year without running out – yet not skimping yourself either. Solving this puzzle has become even more challenging given today's low interest rate environment and tempered expectations for future investment returns, not to mention that on average people are sticking around for a few more years. The old adage suggests you withdraw 4% each year from a diversified portfolio of stocks and bonds, adjust annually for inflation, and you should have enough to last 30 years in retirement. Unfortunately, like most rules of thumb, this one has issues.

First off, the 4% rule was founded in the early 90's when interest rates were significantly higher and equity valuations (as measured by price earnings ratios) were relatively lower. A study on the Social Science Research Network entitled, "The 4% Rule is Not Safe in a Low-Yield World" concludes that in today's low-yield environment the risk of failure for a 4% withdrawal rate may be upwards of 50% if rates stay this low indefinitely.

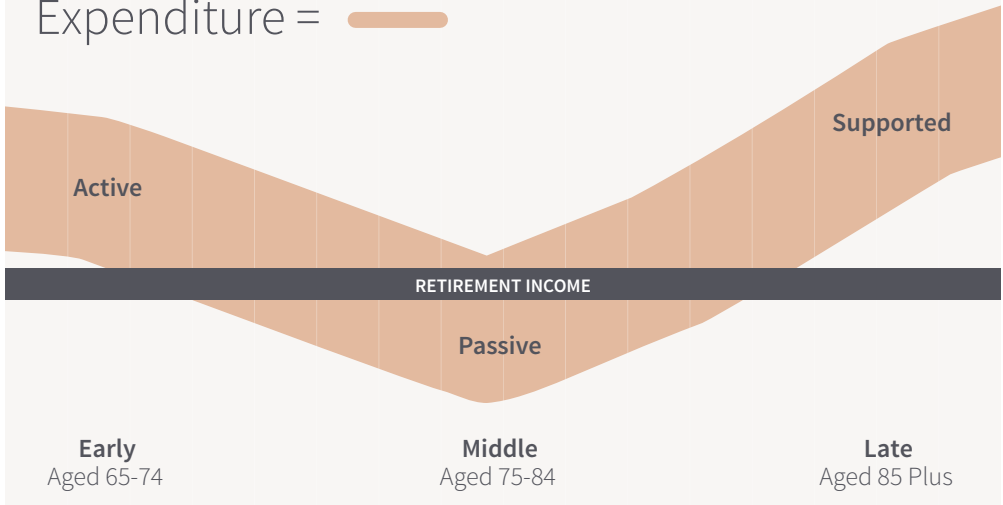
Another problem with blindly withdrawing a fixed percentage from your retirement savings each year is that spending can change greatly depending on what stage of retirement you are in. If we think of retirement in three stages (early, middle, and late), the spending pattern tends to be V-shaped, like the image to the right. What may be sufficient income in the early stage of retirement may not be needed in the middle stage, or what may be sufficient in the middle stage may not be enough in the late stage.

The fact is there is no magic formula or crystal ball that will give us the exact withdrawal rate in advance. There are simply too many uncertainties like investment returns, inflation rates, how long you live, and what your spending turns out to be in retirement. So instead of focusing on an exact percentage or dollar amount we should start with a few other considerations:

- **The early stage of retirement may require a similar level of income as your working years** – many of the activities that fill the void of not working cost money, like traveling and spoiling grandkids. Not to mention the new expenses of health

Spending needs in retirement

Expenditure = 



insurance and unreimbursed medical costs. In addition, more and more people are heading into retirement with mortgages.

- **Start with something reasonable and remain flexible** – given the uncertainty of investment returns and your actual spending need in retirement, it is important to start with a sensible withdrawal rate and make adjustments as you go. For example, if we experience a big market correction, it may be prudent to minimize the amount you withdraw over the next few years in order to give your investments a chance to recover.
- **Use a “Monte Carlo Simulation”** – this important tool provides clear data on the likelihood of success for retirees given changes in spending levels, return expectations, and a multitude of other factors. From these simulations we are able to create an action plan – some may decide to keep working in retirement while others may decide to simply cut back on spending.

Figuring out how much you can spend in retirement is a moving target and everyone has a different view of retirement and spending. Simply setting a withdrawal rate and not making adjustments along the way is probably not wise for most retirees.

Retirement planning is a very personalized matter and should be handled on an individualized basis, not a one-size-fits-all approach.

Evaluating Pension Options

Cameron K. Hamilton – 28 August 2017

Each year we are seeing fewer workers covered by a company pension plan. Overwhelmingly, companies are trending away from the traditional pension, a defined benefit, to a defined contribution plan like a 401k. By and large, employers have decided that guaranteeing a retirement income is too expensive. If you are lucky enough to be in the minority covered by a pension, it's a valuable benefit and can present the most vital decision for your financial future. Determining when and how you access your pension benefit requires a blend of hard math and a softer evaluation of your family's attitude and goals.

Pension plans usually have several options for a retiring employee. You can choose to take a lump sum upon retirement or a series of monthly payments. There are often several different options for payments. Payments can be guaranteed for the worker's life or for a worker and spouse. They can also be guaranteed for some number of years to a beneficiary if the worker passes early in retirement. Each added guarantee reduces the monthly benefit. We can analyze the differences to determine the actuarial assumptions made by your plan and see if one option is "mispriced" in relation to current assumptions.

With the projected payments in hand, the first big decision uses hard math to do a somewhat morbid break-even analysis. When choosing between a lump sum and payments, how long must the payments last to outdo the lump sum? If it takes until age 100 to break even, most would prefer to take their chances investing a lump sum. If the break-even age is closer to life expectancy, the math is less compelling and leads to a personal value judgement.

The value judgement is much more art than science; there is never a perfect answer. The pension must be examined alongside the entire family's picture. If other retirement income like Social Security and real estate income is strong, you might rely less on monthly payments and choose a lump sum. A lump sum is also available for heirs, if that is an unmet priority. However, monthly payments can be right for someone who is risk averse or could benefit from the forced budgeting inherent to fixed payments.

When and how to access a pension is a very personal decision, yet we have some

advice that is perfect for all workers with pensions – learn your options early. Planning a decade out while other opportunities are still available maximizes success. Some pensions escalate in value immediately before retirement, while others see very little change in benefit after peak earning years. Learning the facts early may make you want to change companies or hold on for dear life! As with any other piece of the financial puzzle, it's best to know what you own and plan early and often.

Planning for RMDs

John V. Boardman, III – 11 September 2017

The vast majority of people save the bulk of their retirement funds in qualified retirement accounts (401ks, 403bs, etc.) and IRAs. Through regular saving and long-term growth of the investments inside these accounts, a typical account holder hopes to develop some type of an income stream during their retirement years. According to the US Census Bureau, the average retirement age is 63. Of course, this is just the average and we see many more people working much longer in their careers. A family member of mine just visited a doctor who is still working well into his 90s! Noting that, it is obvious that everyone's "retirement plan" looks very unique. What is not unique is the fact that we are seeing more and more clients living well past 90 and 100. Living longer can potentially complicate your financial and tax planning. One often ignored, yet powerful, planning area is proactively addressing Required Minimum Distributions (RMDs). If planned for properly, efficient planning can result in massive tax savings and additional asset accumulation for you and your beneficiaries.

Generally, you are required to take an annual amount from your IRAs and qualified retirement accounts once you turn 70½. I have included the IRS Uniform Lifetime Table (not the only table used but one that applies to most people) to the right as both a reference and to display the accelerating nature of RMDs. Notice at age 70, the required percentage to withdraw is 3.65%. From a planning standpoint, this is a reasonable withdrawal rate in most plans we construct. However, notice at age 80 and age 90 where the required percentage is up to 5.35% and 8.77% respectively. With people living longer than ever, these higher percentages are becoming a more common reality. In recent years, we have noticed this becoming an unforeseen issue to some clients. The issue arises when the required amount to withdraw far exceeds the amount of income the client otherwise needs. Ordinary income taxes are paid on all distributions from traditional retirement plans. This income is added to the front of your 1040 tax return along with any other income you and your household generate in that year. For people who have aggressively saved for retirement, they could find themselves in a much higher tax bracket than they originally expected.

Required Minimum IRA Distribution

Current Age	Distribution period (years)	Percent	Current Age	Distribution period (years)	Percent
70	27.4	3.65%	93	9.6	10.42%
71	26.5	3.77%	94	9.1	10.99%
72	25.6	3.91%	95	8.6	11.63%
73	24.7	4.05%	96	8.1	12.35%
74	23.8	4.20%	97	7.6	13.16%
75	22.9	4.37%	98	7.1	14.08%
76	22.0	4.55%	99	6.7	14.93%
77	21.2	4.72%	100	6.3	15.87%
78	20.3	4.93%	101	5.9	16.95%
79	19.5	5.13%	102	5.5	18.18%
80	18.7	5.35%	103	5.2	19.23%
81	17.9	5.59%	104	4.9	20.41%
82	17.1	5.85%	105	4.5	22.22%
83	16.3	6.13%	106	4.2	23.81%
84	15.5	6.45%	107	3.9	25.64%
85	14.8	6.76%	108	3.7	27.03%
86	14.1	7.09%	109	3.4	29.41%
87	13.4	7.46%	110	3.1	32.26%
88	12.7	7.87%	111	2.9	34.48%
89	12.0	8.33%	112	2.6	38.46%
90	11.4	8.77%	113	2.4	41.67%
91	10.8	9.26%	114	2.1	47.62%
92	10.2	9.80%	115 & >	1.9	52.63%

SOURCE: IRS.GOV

The primary reason this has turned into an issue is due to the proliferation of the 401k plan. In 1978, a bill was passed allowing employees to defer some of their income and not pay tax on the amount deferred (currently up to 18,500 per year for those under 50, 24,000 for those over 50). As well, many companies match some or all of the employee's deferral. These funds stay invested and are eventually fully taxed as the investor withdraws the funds. The rationale behind this was simple: defer when you are working and your tax bracket is high and then withdraw once you retire and your bracket is much lower. For many people, this works and the au-

tomated nature of this strategy pays off. But for some people, they are finding the opposite to be true: they are finding themselves paying taxes at a rate similar to or even higher than when they were working. I will use a rather extreme, although real, example to illustrate this point. Let's say we have a 30-year-old doctor who makes \$180,000 and plans to work to age 70. She defers the \$18,000 allowed and receives an equivalent match during her entire career. If she attains an average return of 8% annually during her career, her retirement account balance will be \$9,725,412 when she retires at age 70. Based on current RMD schedules, her required distribution at age 70 will be just under \$355,000, putting her in a much higher bracket than her working years. If she was able to maintain her balance at age 80, her required withdrawal would be \$520,000 and at age 90, a staggering sum of \$852,000! This also does not account for higher contribution after age 50 and any adjustment to the tax code that might allow higher contributions in the future. Again, many people would love to have this problem, but I want to display what the impact of long-term DEFERRED savings can be.

Below I have listed a few strategies we have used with clients to combat this issue. Each has to be carefully considered as part of a comprehensive plan, so please involve us when considering your options.

1. Use Roth accounts early and often. Roth IRAs and, since 2006, Roth 401ks are the best way to combat this problem. By paying your taxes BEFORE it is invested, all growth AND distributions are tax free. Fortunately, for higher income households, Roth 401ks have no income limits so this presents an amazing opportunity to defer funds that will never be taxed again.

2. Convert what you can. We have made recommendations to a number of clients to convert some or all of their retirement accounts to Roth accounts. This strategy does require paying ordinary income taxes on converted funds (which can be a very difficult pill to swallow.) but the goal is to pay taxes on a smaller number now versus when it is withdrawn. For example, if a client converts 100,000 in a retirement account and that account grows to 200,000 over time, the 200,000 is now fully tax free at withdrawal. We also have a number of clients pursuing a systematic conversion schedule where they convert some each year to lessen the eventual tax they might owe.

3. Keep working past age 70. If you are not at least a 5% owner in your employer,

you can defer your RMDs by continuing to work. This only affects funds that are in your employer's plan but many plans allow you to roll in outside accounts. In most cases, this prevents you from having to take your RMDs until you stop working.

4. For those over age 59½, consider drawing some of your funds earlier. This has proven to be a worthwhile approach for many of our clients who previously planned to defer all withdrawals until RMD age. The traditional plan for most retirees was to spend down non-qualified accounts (taxable accounts in your name) prior to drawing from retirement accounts. In some cases, this can be counter-productive because the retiree may be just adding to their eventual tax bill.

5. Save some additional funds outside of retirement accounts. Currently, most people pay 15% to 20% on ordinary dividends and long-term capital gains. There is a case to be made that one should plan to save in this type of an account. There is no required time for withdrawal and large distributions will not push you to a higher tax bracket.

6. Consider your estate plan as part of your strategy. Estate planning is one of the most often ignored issues as it relates to retirement plans. Currently, spouses can roll inherited funds into their own accounts while non-spousal beneficiaries can roll into an inherited IRA. This allows the beneficiary to spread the distributions, in most cases, over their lifetime. By passing your assets via a Roth account, your beneficiaries will receive those distributions tax free.

We could go on for pages describing a variety of methods to address current or eventual RMD planning. The most important point to take from this commentary is to not assume what you are currently doing is the best approach. By thinking long-term and creatively, we have helped countless numbers of clients develop a plan that is specific and beneficial to the client and their family.

Planning for “Fixed” Income During Retirement

Andy J. Reynolds – 19 September 2017

Fixed Income in retirement can come from many different sources of assets. It may be a bond/CD ladder, annuity, Social Security, or even an income-yielding individual bond. In all scenarios, using “fixed” income as retirement income comes with many different benefits and risks. While it is very situationally dependent, in most cases we welcome a degree of fixed income payments for retirees. Below are several items to consider when contemplating fixed income for retirement needs.

1. We believe a fully-fixed retirement income structure is a luxury that not all investors can afford or will choose to afford. Take for example the 70-year-old retiree couple who has \$100 million but only needs \$10,000 per month for retirement expenses. If desired, this couple can easily purchase a vehicle that produces a fixed monthly payment, adjusted for inflation, with little risk. Unfortunately, most retirees are not in this scenario and they must take some degree of market risk to accomplish their retirement goals.

2. For most Americans, Social Security is their greatest “fixed” income source in retirement. However, according to an AARP study, only 23% of Americans solely rely upon Social Security for 90%+ of their household income. The remaining 77% must rely upon a combination of investment accounts and other sources.

3. Of those who are relying upon receiving Social Security in the future, changes likely need to occur to maintain the status quo of the program. It is unknown if this will affect retirees, soon-to-be retirees, or the younger generations. However, we must be cognizant that a means-test, across the board cut, reduction to inflation increases, or some other change could occur to this fixed income source in the future.

4. “Fixed” income sources can at times provide a strong backbone for a retiree when creating a retiree’s income structure. The sources can provide required income in early years of retirement should the markets/economy become soft. As most know, these are the most important years of a retiree’s financial life. Stated previously, however, this is a luxury that may not be accessible for all, due to the costs the retiree must give up when purchasing significant fixed income (fees, possible lower yield, possible lack of inflation protection, possible lack of generational inheritance, possible interest rate risk, etc.).

5. Fixed income sources must be considered for the long term, not just the short term. It is important to evaluate how inflation, increased interest rates, longevity, generational planning, etc., may impact all fixed income structures. Remember, at 3.5% annualized inflation, the purchasing power of \$1.00 of income today will be equivalent to ~\$0.70 of purchasing power 10 years from now. As life expectancies continue to increase and Americans continue to retire in their early to mid-60's, income sources may be required to provide income for 30-40 years! In the same scenario as above, a 60-year-old retiree would see their \$1.00 of today's income discounted down to ~\$0.24 of purchasing power at their 100th birthday. Inflation protection would clearly be imperative!

6. When accessing risk, risk of principal is not the only risk to consider. Owning multiple types of assets may help alleviate different types of risks within any one family's financial scenario.

As the markets continue to rise, this is a great time to reevaluate asset allocation, location of assets, and overall risk within one's financial scenario. If there is anything that we can do to help with these conversations, please do not hesitate to contact our office.



DEBT ANALYSIS

Debt. It's a subject that not many people really enjoy talking about, but it's a reality for nearly all of us.

Whether it's "good" debt in the form of a primary home mortgage or a small business loan or "bad" debt in the form of revolving credit card charges, it's something that we must face head on.

The following articles discuss different kinds of debt and strategies for using it to your advantage and paying it off.

When is Debt OK and When is it Not?

Brian T. Burton – 9 October 2017

An amount of money borrowed by one party from another – the basic definition of debt sounds neither good nor bad and leaves many wondering: how do I determine if taking on debt is worth the risk? Although the answer is not always crystal clear, most debts can be defined as either positive or negative for your overall financial situation.

The word “debt” carries a negative connotation and although largely justified, not all debt is bad. When used wisely, debt can actually be a catalyst for building wealth. Here are a few examples where taking on debt, with careful planning and in moderation, may be advantageous:

- **Taking Out a Home Mortgage** – the goal here is to build ownership in an appreciating asset that one day may provide a source of retirement money. A mortgage may also be the single biggest tax break available to you in the form of interest deduction.
- **Funding Higher Education** – in most cases, investing in your future through education is a good decision. Those with college or technical degrees tend to earn higher incomes than those without. Also, the interest paid on student loans is often tax-deductible.
- **Small Business Loan** – while potentially the riskiest of the “good debt” examples, a small business loan can provide the necessary capital to start or expand a business. For example, a business may need to expand its physical location, buy new equipment, or purchase more inventory; a small business loan can help fill these funding needs.

Even “good debts” can get out of hand if not used judiciously, but there are other debts that are simply bad for your financial well-being. While good debt is considered an investment that will grow in value or generate long-term income, bad debt is just the opposite: a debt that is accrued to purchase things that generally depreciate in value and do not generate long-term income. Let’s take a look at some examples of debts that are potentially harmful to your financial goals:

- **Credit Card Debt** – when used for convenience or to earn rewards and not for borrowing, credit cards, when paid off each month, can be beneficial. However,

two-thirds of Americans are known as “revolvers,” meaning they don’t pay off their bills in full so the debt revolves. With the national average APR just north of 16%, it’s easy to see how outstanding credit card debt can lead to trouble.

- **Luxury Items** – these are things that we want rather than things we need (jewelry, expensive clothes, vacations, etc.), thus resulting in bad debt. The rule of thumb here is, if you can’t pay cash for it, don’t buy it.
- **Car Loans** – the ultimate example of a depreciating asset, vehicles begin losing value as soon as they are purchased. While the majority of people need an automobile for everyday life, the way people go about it (buying more car than they need) is what creates the problem.

If you are having trouble differentiating between good and bad debt, try to think like an investor before increasing any debts. Will this purchase return a profit or help my long-term financial well-being? Waiting until you have adequate cash may be the solution if the answer is no.

Everyone’s financial situation is different and each individual views debt differently. Like many disciplines in financial planning, the topic of debt analysis cannot be tackled with a one-size-fits-all approach; rather it should be handled on a personalized level.

Prioritizing Debt Payoff

Cameron K. Hamilton – 23 October 2017

In our first Atheneum article on debt, Brian discussed the difference between good and bad debts. He defined good debts as those that will appreciate or help grow your net worth over time, such as mortgage, education, and business investment. This is great advice for anyone considering taking on new debt. Unfortunately, we don't often get a chance to give our input before someone takes out a loan or swipes the credit card. Today we discuss our ideas on what to do after you've already accrued good or bad debt.

Paying down debt is a lot like losing weight. It doesn't matter how many miles you run if you're eating cheeseburgers every day. You have to address the root cause to make any progress, which means focusing on your diet. First you must eat a reasonable amount, and then additional exercise can accelerate your progress. With debt, your daily diet is your budget. There's simply no way to pay down debt if you are living beyond your means by spending more than you bring in as income. This has to be step one in prioritizing debt payoff: dollars in > dollars out.

Once you have your budget balanced, we can address how to best exercise off that excess debt. Where should debt payoff reside in your ranking of household priorities? This is a personal decision, but there are a few items we believe supersede debt payoff. Health insurance comes first because without it, you are exposed to substantial new debts if you have a health problem. An emergency fund gives the same protection against new debts in case of accidents or property damage. Finally, a company retirement plan match is a rare instance of an opportunity for free money and should be utilized before increasing debt payments. Ideally these items are worked into the budget before we can finally tackle how to prioritize debts.

After tackling these basics, it's time to pay down debt with your excess cash flow. There are two schools of thought on prioritizing different debts. The first is the snowball method, popularized by Dave Ramsey. He says you should pay off your smallest debts first so that you make progress by eliminating individual debts, which helps your financial confidence grow like a snowball rolling down a hill. This strategy makes sense for households new to budgeting or people who emotionally benefit from experiencing achieved success. Just like in our weight loss analogy,

these small, short-term wins motivate you to continue your progress. It's hard to argue against this logic as Dave Ramsey has documented thousands of families becoming debt free with this method.

Nonetheless, there is an alternative method that seeks to maximize your financial well-being. It is often referred to as the avalanche method to provide contrast to the snowball method. This strategy prioritizes paying off the highest interest debts first in order to minimize the total interest paid. It will maximize your household net worth if you stick to the plan, but the progress is less tangible and less immediately gratifying. Since either method requires steady commitment to become debt-free, we prefer you choose the one that best matches your family's personality as it will give you the best odds of success.

Early Mortgage Payoff

John V. Boardman, III – 6 November 2017

Although we spend a large majority of our time planning our clients' investment portfolios, we believe advising on the entire client balance sheet is just as important. On the liability side of the balance sheet, a client's primary mortgage is often a major talking point. The last decade has allowed homeowners ample opportunity to refinance (sometimes multiple times) to lower interest rates. The ultra-low interest rate environment has provided a lift to home values and therefore home equity in existing owners. Because a refinance essentially restarts the clock on a new loan, we have noticed a number of clients who have come to us with loans that are scheduled to be paid off well into the clients' retirement years. For a handful of our clients who have substantial retirement cash flow and also believe in the leverage a mortgage provides (borrow cheap, invest to make more), we have supported the idea of carrying a mortgage into retirement. For the large remainder of our clients, we believe having a paid-off home at retirement (or earlier) creates value and opportunity in a number of other areas.

1. Saves a Lot of Interest

The most obvious reason to pay off a mortgage earlier is that the total interest cost is substantially less. Take a \$300,000 first mortgage at 4% amortized over 30 years. The total interest paid over the life of the loan is just over \$215,000. If that same loan and rate were paid over 15 years, the total interest cost is just over \$99,000. The term was halved but interest savings is well over 50%.

2. Trick Yourself Into Living on Less

For people who have experienced wage increases, shortening your loan is a great way to utilize this improved cash flow. We have advised a number of clients to refinance into 15-year loans from 30-year loans as a reaction to better cash flow. People's lifestyles have a way of naturally absorbing extra income and this is a great method to put that cash flow to good work. The net result is a loan paid off more quickly and a bonus in cash flow when the loan is paid off.

3. Future Goal Funding

Retirement is the primary goal for most investors, but many of our clients have expressed other major goals like funding a child's or grandchild's education, buying

a vacation home, or starting a business. We have found it very helpful to pair the scheduled mortgage payoff before these other goals begin. With extra disposable cash flow created from no longer having a mortgage payment, most goals become much more attainable and less risky to pursue.

4. Peace of Mind

If paying or not paying off a mortgage was all about the math, we would all own fully-mortgaged homes and invest every penny we save by not paying early. We tend to take the opposite approach with our clients. I can unequivocally state that there is no greater financial burden lifted than when someone pays off their home. As well, we have advised countless clients to pay off their home (often well in advance of their original plan) and we have never had someone regret the decision. We live in a world where information (often troubling) and uncertainty circulates quickly and haphazardly, and we have noticed a “peace of mind” that settles over our clients when they can add stability to their own situation through a mortgage payoff. There is no better example of a financial planning tactic where the value is not ever fully represented in the numbers.

5. Future Flexibility

I am always surprised by the number of people who plan to “downsize” when they retire, utilizing the equity they have accumulated in their existing home for their new home. For those people who have not paid off their home, they soon realize that “downsize” doesn’t necessarily mean lower cost. With added amenities or a warm-weather location, retiree home buyers have been discovering that they often end up spending similar amounts, if not more, for their next home.

We do not look at your home as an investment. Although most of our clients have experienced some amount of wealth creation from home ownership, there are far too many expenses and unknowns to treat it as such. We believe the safest approach is paying the home off earlier than scheduled and not depending on the home’s equity for future needs. If handled in this manner, the paid off home and resulting home equity create a “financial cushion” to you and your survivors that cannot be adequately measured on a balance sheet.

Second Mortgage Planning Strategies

Andy J. Reynolds – 21 November 2017

For many households in America, the equity built in their home is one of their largest assets on their balance sheets. Historically, this asset has provided growth in value, as well as an opportunity to obtain a secured loan from a bank for short-term or long-term needs. When a homeowner borrows money secured by their home, the homeowner can establish one of two types of loans: a Home Equity Loan or a Home Equity Line of Credit (HELOC).

Generally, a Home Equity Loan can be thought of in a concept similar to a homeowner's first mortgage. The loan typically distributes a lump sum of assets and the homeowner then makes payments back to the bank based on a fixed rate, a fixed term, and fixed payments.

Alternatively, a HELOC is based on variable payments (with a minimum payment each month), a variable term, and a variable interest rate. Generally, once approved, a homeowner can establish a HELOC, which subsequently functions as if the homeowner has the funds in their bank account. This typically allows the homeowner to use debit card functionalities, write a check, or withdraw funds from an ATM.

Most bankers will advise their clients to access a Home Equity Loan when funding a purchase that may require many years to payback – such as an improvement to the home, a wedding, or perhaps even debt consolidation. Alternatively, a HELOC may be advised when someone needs a small amount of assets to help cover a short-term cost such as a monthly float if emergency funds are exhausted or a short-term project which can be paid for in only a few months of household cash flow.

At Ballast, we try to think outside the box and use tools such as these to help our clients advance in planning for their future. Below is one strategy that we have helped a client implement and it worked well for them. This strategy is not for everyone and we certainly recommend you contact us prior to trying to implement this strategy. There are also outside factors to consider that are not discussed in this article.

A client of our firm was looking to purchase a new home. The new home was valued at \$500,000 and the client currently had \$75,000 in equity in their current home. The client was 45 years old, wanted to be debt-free by 70, and wanted to keep his monthly payment at or below \$3,400 per month. The client had the following

options assuming a new loan is established in November of 2017:

1. \$425,000 – 30-Year Loan: \$2,989 per Month – Paid Off November 2047

- \$500 taxes, \$167 insurance, \$156 PMI, \$2,166 P&I

OR

2. \$425,000 – 15-Year Loan: \$3,788 per Month – Paid Off November 2032

- \$500 taxes, \$167 insurance, \$156 PMI, \$2,966 P&I

OR

3. Total Combined Monthly Payment: \$2,679 per Month

3a) \$340,000 30-Year 1st Mortgage (80% Loan): \$2,249 per Month – Paid Off November 2047

- \$500 taxes, \$167 insurance, \$1,582 P&I

3b) \$85,000 30-Year 2nd Mortgage (20% Loan): \$430 per Month– Paid Off November 2047

- \$430 P&I

For calculation purposes, let's assume all loan options were created in November of 2017. In the scenarios above, if we established a monthly payment of \$3,400 per month with extra payment going to principal, below are the results:

1. The 30-year mortgage would be **paid off in September of 2039**, assuming an extra payment of \$411 per month and a total payment of \$3,400 per month.

2. The 15-year mortgage would be **paid off in November of 2032**. This saves almost seven years of mortgage payments. However, the mortgage payment is \$388 per month above the client's goal, which could create cash flow challenges in the future.

3. The second mortgage would be paid off in February of 2025 (paying an extra \$721 per month). Assuming the full second mortgage payment was then subsequently used to pay down the primary mortgage, the primary mortgage would be **paid off in January of 2038**.

After evaluating all the options, the client chose to obtain both a primary mortgage and a secondary mortgage. The client felt that using this strategy accomplished the following:

First and most importantly, the client made a personal goal to have the second mortgage paid off within three years, even though the strategy shows a five-year payoff. The idea of a second mortgage made the client have a sense of urgency to pay off the second mortgage. Without the "debt-payoff-goal" of the second mortgage, this client in particular would not have actively sought after making extra payments.

Second, this afforded the client future flexibility of a lower payment, if required. Immediately, the two loan payments are \$310 per month cheaper. Once the second mortgage is paid off, the 30-year mortgage payment in option 3 will be \$740 cheaper than the 30-year payment in option 1. If their future personal financial scenario required less outflow to their mortgage, there will be an opportunity to lighten the burden once the second mortgage is paid off.

The client immediately avoided having to pay Private Mortgage Insurance, since their primary mortgage debt was less than 80% Loan-to-Value Ratio. While this may be temporary, it is an immediate benefit.

This strategy is one that helped a client achieve their goals, while providing an opportunity for future flexibility. It may not work for everyone; however, we believe critically thinking outside the box helps clients achieve their goals. We aim to think this way for all clients during every scenario we help consult with.

*This example is for illustrative purposes only. Several additional aspects should be considered when making this analysis. This is not a comprehensive analysis – the numbers are for illustrative purposes only.

The Flexibility of Being Debt-Free

Brian T. Burton – 18 December 2017

In our previous Atheneum commentaries on debt, we've covered a myriad of topics including good vs. bad debt, prioritizing debt payoff, and different mortgage planning strategies. We hope these commentaries have helped shed light on what we consider one of the most important topics in financial planning – debt analysis. Today we discuss what for many is an ideal way to live their financial lives: being debt-free.

Before diving into the benefits, let's first review the differing opinions on what it means to be debt-free. Many "experts" argue that any debt is a shackle, making no distinction between good debt and bad debt, meaning you cannot truly be debt-free until you owe nothing. Others, like Dave Ramsey, do make a distinction between good (debt on an appreciating asset) vs. bad debt and define a debt-free life as one without consumer debt.

We believe both sides make a valid argument; however, everyone's financial situation is unique and being debt-free can mean something different to everyone. The bottom line is that eliminating potentially harmful consumer debts such as car payments and high-interest credit card payments can be a gigantic step toward achieving financial freedom.

Here are a few of the many potential benefits of living without debt:

- **Reduced Stress** – eliminating the fear of how the bills will get paid and how you will ever be able to retire can greatly reduce stress, leading to a healthier and more peaceful life, particularly if debt payments stretch your budget beyond a comfortable level.
- **Increased Savings** – without credit card payments and vehicle loan payments, your increased cash flow will allow you to save both in retirement accounts and after-tax accounts, increasing your net worth and your chances for a long and successful retirement.
- **Financial Security** – chronic, long-term debt can keep us saddled to things we don't particularly enjoy. Cutting out these debts may allow you control over things like expenses, personal savings rate, and living situation.
- **Higher Capacity for Risk** – when large debts are eliminated, a minimal bud-

get of necessities becomes possible. This provides the flexibility to take on risk associated with starting a business, relocating, or holding out for the ideal job.

- **Investment Opportunities** – the best way to grab a great investment opportunity is to always be on the hunt and to always be prepared to act quickly. Without debt payments, you can have the funds available to take advantage of a great opportunity.
- **Possible Early Retirement** – most would agree that retiring early sounds like a dream come true, but that dream for many seems like nothing more than a pipe-dream. It doesn't have to be – with proper planning and hard work, this dream can become reality, and eliminating debt can be a big jump in that direction.

Gaining freedom and control over our finances is something we all desire. By paying off debt and preventing future debt accumulation, we have the ability to achieve these luxuries. If you have any questions about tackling your debts, please don't hesitate to reach out to us at Ballast.

Student Debt Options for Graduates

Cameron K. Hamilton – 29 January 2018

Although a minority of our clients have student debt, those that do not almost always have children or grandchildren planning on attending college. Costs of college attendance have inflated so fast that we discuss it with parents of newborns. We're seeing a steady increase of borrowers with six-figure debt levels, making student debt repayment the most important part of those households' financial plans. What follows is a primer on the options for a student graduating with debt. Obviously, as laws and policies change, this advice may become outdated, but it is up to date as of January 2018.

Federal Loans are Eligible for Income-Driven Repayment Programs and “Forgiveness”

Most student debt we see is federal: Stafford, Perkins, Direct Subsidized/Unsubsidized, and PLUS loans are all government loans that have similar repayment options upon graduation. The default offer is a 10-year payoff calculated like a mortgage: a \$100,000 loan at 6% yields monthly payments of \$1,110. Because the government realizes many new graduates can't afford this plan, they offer several income-driven repayment plans (IBR, ICR, PAYE, REPAYE).

Graduates using these plans report their income annually and make qualifying payments based on a calculation that involves the poverty line. For example, a single borrower earning \$60,000 per year has payments capped at \$332 per month. At low debt levels, this can smooth payments over a few additional years. However, for six-figure debts, interest accumulates and can double the initial debt over a period of twenty years.

If using an income-driven plan, any remaining debt after 20 years is forgiven. However, this forgiveness creates taxable income. This means 20-year forgiveness is NOT usually a good strategy; it generates a tax bill in year 21 that will put the borrower in a high tax bracket.

Public Service Loan Forgiveness IS a Good Strategy...Today

Public Service Loan Forgiveness (PSLF) is an income-driven strategy for borrowers that work for a non-profit, including public universities. Any remaining debt is forgiven after 10 years of income-driven payments. Congress made a special

exemption for this program and forgiveness is not taxable. This means borrowers could purposefully keep income low (say, by maxing out retirement contributions) and let their loans run up knowing they'll be forgiven. We've run this projection for new doctors, who have low income for several years as residents, and it can result in six-figure savings. Once the public hears about doctors being forgiven \$500,000 debts tax-free

using a program designed for social workers, this program could very well become a legislative target on both sides of the political aisle. This program was created in 2007, so the first borrowers only became eligible for forgiveness in the fall of 2017. Borrowers planning to begin using this strategy today should understand the risk of reform. If determined to use this strategy, they would be best served by saving the difference between their income-based payments and a traditional 10-year payment in case they lose their special tax treatment.

Without a Special Repayment Plan, Look at Refinancing Privately

Income-driven repayment plans are only beneficial for a very narrow range of borrowers. Public Service Loan Forgiveness may be politically risky. If a borrower isn't utilizing these options, or some other special option like Teacher Loan Forgiveness, they should look to refinance high-interest loans. Federal loans have been as high as 6.8%, while borrowers with good earnings have refinanced below 5%. This option does eliminate the ability to use hardship forbearance if you become unemployed, but it can substantially reduce the lifetime cost of repayment.

Most Borrowers with Six-Figure Debt Need Help

Most borrowers will ultimately have to repay their student debt unless they become insolvent. With the national average debt of roughly \$25,000, payments amount to about the same as a car loan. However, borrowers with large debts will have mortgage-sized payments that will severely hinder their economic opportunities. Imagine a 25-year-old with a master's level history degree who wants to start a business; it will be financially impossible.

Three Ways to Help a Child or Grandchild

1. Save Early – To send a newborn to a state university, based on the current rate of tuition inflation, would require about \$600 per month in savings. Any amount a parent/grandparent can save will put the same compound interest that hurts debt-holding graduates to work in their favor.

2. Pay Tuition Directly – If you have a graduate with student debt, anything over \$15,000 (\$30,000 for couples) in 2018 is a taxable gift. However, you can pay tuition directly to the university without limit. If you know they will graduate with a mountain of debt and you will want to help, simply pay the tuition directly while they are in school.

3. Educate – Schools are competing for students with dorms that more closely resemble luxury condos than what most baby boomers remember inhabiting. Recruiters focus on these amenities rather than costs or value in terms of enhanced career potential. You'll need to educate your student on the long-term weight of debt and the benefits of taking on as little student debt as needed. We are happy to help you educate family members and discuss personal college scenarios by request.

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