Accredited Wealth Management

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The biggest concern for most retirees is whether they will outlive their money. This often causes investor's "measure of success" to shift from am I beating the market to will I have enough income during retirement. Choosing the right withdrawal rate that allows your assets to last for life is one of the most important decisions retirees can make.

Since every individual's retirement goals are different it is essential a withdrawal rate be tailored to your unique needs. To help clients select the proper withdrawal rate we use a multi-scenario approach, considering alternative outcomes and varied financial market conditions. At a minimum, we review a conservative "base-case" retirement scenario; a potential "bear-market" scenario; and a "Monte-Carlo" scenario that shows many potential outcomes.

By "stress-testing" different scenarios before retirement, we greatly increase the chances our clients select a withdrawal rate that leads to a long and successful retirement!

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Choosing The Right Withdrawal Rate

Retirement Withdrawal Rates

During your working years, you've probably set aside funds in retirement accounts such as IRAs, 401(k)s, and other workplace savings plans, as well as in taxable accounts. Your challenge during retirement is to convert those savings into an ongoing income stream that will provide adequate income throughout your retirement years.

Your retirement lifestyle will depend not only on your assets and investment choices, but also on how quickly you draw down your retirement portfolio. The annual percentage that you take out of your portfolio, whether from returns or the principal itself, is known as your withdrawal rate. Figuring out an appropriate initial withdrawal rate is a key issue in retirement planning and presents many challenges.

Why is your withdrawal rate important?

Take out too much too soon, and you might run out of money in your later years. Take out too little, and you might not enjoy your retirement years as much as you could. Your withdrawal rate is especially important in the early years of your retirement, as it will have a lasting impact on how long your savings will last.

Conventional wisdom

So, what withdrawal rate should you expect from your retirement savings? One widely used rule of thumb states that your portfolio should last for your lifetime if you initially withdraw 4% of your balance (based on an asset mix of 50% stocks and 50% intermediate-term Treasury notes), and then continue drawing the same dollar amount each year, adjusted for inflation. However, this rule of thumb has been under increasing scrutiny.

Some experts contend that a higher withdrawal rate (closer to 5%) may be possible in the early, active retirement years if later withdrawals grow more slowly than inflation. Others contend that portfolios can last longer by adding asset classes and freezing the withdrawal amount during years of poor performance. By doing so, they argue, "safe" initial withdrawal rates above 5% might be possible. (Sources: William P. Bengen, "Determining Withdrawal Rates Using Historical Data," *Journal of Financial Planning,* October 1994; Jonathan Guyton, "Decision Rules and Portfolio Management for Retirees: Is the 'Safe' Initial Withdrawal Rate Too Safe?" *Journal of Financial Planning,* October 2004)

Still other experts suggest that our current environment of lower government bond yields may warrant a lower withdrawal rate, around 3%. (Source: Blanchett, Finke, and Pfau, "Low Bond Yields and Safe Portfolio Withdrawal Rates," *Journal of Wealth Management,* Fall 2013)

Don't forget that these hypotheses were based on historical data about various types of investments, and past results don't guarantee future performance.

Inflation is a major consideration

An initial withdrawal rate of, say, 4% may seem relatively low, particularly if you have a large portfolio. However, if your initial withdrawal rate is too high, it can increase the chance that your portfolio will be exhausted too quickly, because you'll need to withdraw a greater amount of money each year from your portfolio just to keep up with inflation and preserve the same purchasing power over time.

In addition, inflation may have a greater impact on retirees. That's because costs for some services, such as health care and food, have risen more dramatically than the Consumer Price Index (the basic inflation measure) for several years. As these costs may represent a disproportionate share of their budgets, retirees may experience higher inflation costs than younger people, and therefore might need to keep initial withdrawal rates relatively modest.

Your withdrawal rate

There is no standard rule of thumb. Every individual has unique retirement goals and means, and your withdrawal rate needs to be tailored to your particular circumstances. The higher your withdrawal rate, the more you'll have to consider whether it is sustainable over the long term.

All investing involves risk, including the possible loss of principal; there can be no assurance that any investment strategy will be successful.

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Special Needs Trusts

In 1993, Congress officially approved the use of SNTs to maximize the use of all available resources, both private and governmental, to provide more fully for the needs of the disabled.

For tax years beginning after December 31, 2014, states can establish and operate ABLE programs, allowing the establishment of ABLE accounts, which are intended to help pay for the qualified disability expenses of eligible individuals. These accounts won't replace SNTs but may be used as part of an overall strategy.

A special needs trust* (SNT), sometimes referred to as a supplemental needs trust, is a trust that is established to benefit a disabled person or a person who has special needs, while still allowing that person to qualify for and receive government health-care benefits.

*There are costs and expenses associated with the creation of a trust.

Background

Some government programs aimed at assisting the disabled, such as Medicaid and Supplemental Social Security Income (SSI), are needs-based. That means if the disabled individual has access to more than a specified level of resources (generally $2,000), he or she will not be eligible to receive such benefits. In 1993, Congress officially approved the use of SNTs to maximize the use of all available resources, both private and governmental, to provide more fully for the needs of the disabled.

For persons of limited means, government programs may constitute the primary, if not the only, source of funding for their current and future needs. However, government assistance may also be available to families who have resources available to meet their loved one's basic needs. These families may be fortunate enough to be able to use their personal resources to provide for non-basic needs as well. With an SNT, the disabled person is able to first tap into any government benefits to which he or she is entitled, and then can spend personal resources as a secondary source for additional support and comfort.

Types of SNTs

There are three types of SNTs: a self-settled or first-party SNT, a pooled SNT, and a third-party SNT.

Self-settled or first-party SNT

A self-settled or first-party SNT is created for the sole benefit of a disabled person who is under age 65. The trust must be established by the disabled person's parent, grandparent, or guardian, or by the court, but it cannot be created by the disabled person. However, the disabled person can fund the trust. For example, the disabled person could fund the trust with money that has been inherited or received in settlement of a lawsuit, or as a result of a divorce.

As previously stated, in order to qualify for Medicaid or SSI, the person who is enrolling must have a limited amount of income and resources. Generally, Medicaid and SSI will look back 60 months to see if assets have been transferred to someone else in order to qualify for benefits, and if so, a penalty is imposed. The penalty will be that the person who is enrolling won't be able to receive benefits for a certain amount of time. Transferring assets to an SNT, however, does not trigger these look-back provisions.

The other benefit of this SNT, of course, is that assets in the trust will not be countable as resources for eligibility purposes.

One disadvantage, however, is that upon the disabled individual's death, any money or assets remaining in the trust must be used to reimburse the government for Medicaid benefits extended to the individual during his or her lifetime.

Pooled SNT

A pooled SNT is a trust that is managed by a nonprofit organization. Funds are pooled for investment purposes, but separate subaccounts are maintained for each disabled beneficiary. A pooled SNT works in the same way as a self-settled or first-party SNT. However, with a pooled SNT, the disabled individual can create the account for himself or herself.

Furthermore, any funds remaining in the account upon the individual's death can be used to pay back Medicaid, or they can remain in the pooled SNT to help others in the pool, depending on state law.

Third-party SNT

A third-party SNT is a trust created by a disabled person's parent or other third party, but this type of SNT has no payback requirement. The person establishing the trust must not have a duty to support the disabled child, so the child must be age 21 or older, depending on state law. There is no requirement that the disabled person be under the age of 65. However, transfers to a third-party SNT may or may not trigger the Medicaid or SSI penalty period. Again, it depends on state law.

Conclusion

An SNT requires careful drafting and administration to avoid disqualification for government benefits. Be sure to consult a specialist.

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When Your Child Asks for a Loan, Should You Say Yes?

Perhaps you have plenty of money to lend, and you're not earning much on it right now, so when your child asks for a loan, you think, "Why not?" But even if it seems to be the right thing to do, look closely at potential consequences before saying yes.

You raised them, helped get them through school, and now your children are on their own. Or are they? Even adult children sometimes need financial help. But if your child asks you for a loan, don't pull out your checkbook until you've examined the financial and emotional costs. Start the process by considering a few key questions.

Why does your child need the money?

Lenders ask applicants to clearly state the purpose for the loan, and you should, too. Like any lender, you need to decide whether the loan purpose is reasonable. If your child is a chronic borrower, frequently overspends, or wants to use the money you're lending to pay past-due bills, watch out. You might be enabling poor financial decision making. On the other hand, if your child is usually responsible and needs the money for a purpose you support, you may feel better about agreeing to the loan.

Will your financial assistance help your child in the long run?

It's natural to want to help your child, but you also want to avoid jeopardizing your child's independence. If you step in to help, will your child lean on you the next time, too? And no matter how well-intentioned you are, the flip side of protecting your child from financial struggles is that your child may never get to experience the satisfaction that comes with successfully navigating financial challenges.

Can you really afford it?

Perhaps you can afford to lend money right now, but look ahead a bit. What will happen if you find yourself in unexpected financial circumstances before the loan is repaid? If you're loaning a significant sum and you're close to retirement, will you have the opportunity to make up the amount? If you decide to loan your child money, be sure it's an amount that you could afford to lose, and don't take money from your retirement account.

What if something goes wrong?

One potential downside to loaning your child money is the family tension it may cause. When a financial institution loans money to someone, it's all business, and the repayment terms are clear-cut. When you loan money to a relative, it's personal, and if expectations aren't met, both your finances and your relationship with your child may be at risk.

For example, how will you feel if your child treats the debt casually? Even the most responsible child may occasionally forget to make a payment. Will you scrutinize your child's financial decisions and feel obligated to give advice? Will you be okay with forgiving the loan if your child is unable to pay it back? And how will other family members react? For example, what if your spouse disagrees with your decision? Will other children feel as though you're playing favorites?

If you decide to say yes

Think like a lender

Take your responsibility, and the borrower's, seriously. Putting loan terms in writing sounds too businesslike to some parents, but doing so can help set expectations. You can draft a loan contract that spells out the loan amount, the interest rate, and a repayment schedule. To avoid playing the role of parent-turned-debt collector, consider asking your child to set up automatic monthly transfers from his or her financial account to yours.

Pay attention to some rules

Having loan documentation may also be necessary to meet IRS requirements. If you're lending your child a significant amount, prepare a promissory note that details the loan amount, repayment schedule, collateral, and loan terms, and includes an interest rate that is at least equal to the applicable federal rate set by the IRS. Doing so may help ensure that the IRS doesn't deem the loan a gift and potentially subject you to gift and estate tax consequences. You or your child may need to meet certain requirements, too, if the loan proceeds will be used for a home down payment or a mortgage. The rules and consequences can be complex, so ask a legal or tax professional for information on your individual circumstances.

If you decide to say no

Consider offering other types of help

Your support matters to your child, even if it doesn't come in the form of a loan. For example, you might consider making a smaller, no-strings-attached gift to your child that doesn't have to be repaid, or offer to pay a bill or two for a short period of time.

Don't feel guilty

If you have serious reservations about making the loan, don't. Remember, your financial stability is just as important as your child's, and a healthy relationship is something that money can't buy.

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Should I become a franchise owner?

Owning a franchise can be a great way to break into the world of entrepreneurship. However, franchising isn't for everyone. It's best to review the possible pros and cons of franchising before making any commitments.

Potential Advantages

- Mentorship: Most franchisors offer some managerial coaching to new franchisees.
- Trusted brand and/or product or service: Many franchises offer a brand and/or product or service that is typically recognized by your target market.
- Time-tested operating system: With the purchase of a franchise comes an operating system that ideally has been tried and proven through the years.
- Group purchasing power: Most franchisors have contracts with suppliers, providing the cost benefits of buying in bulk.
- Advertising and marketing: After paying a small percentage of gross profits to the franchisor, franchisees can usually take advantage of professionally created campaigns launched by the franchisor.
- Financial help: Some franchisors will provide assistance to new franchisees in securing financing.

Potential Disadvantages

- Fees: In addition to the upfront franchise fee, there may be ongoing royalties and, as mentioned above, advertising fees, which are typically required even if you don't like or want to utilize the campaigns.
- Control: You will generally have to abide by the many restrictions set by the franchisor. These can affect operations, types of goods sold, vendor relationships, marketing strategies, geographic location, and even website content/presence, among other key management decisions.
- Renewal policies: Franchises are generally governed under a contract with an end date, and franchisors may choose not to renew at the time of expiration or may decide to raise fees or impose new restrictions upon renewal.

For more information, visit the Bureau of Consumer Protection website and review "Buying a Franchise: A Consumer Guide."

Will I have to pay a penalty tax if I don't have qualifying health insurance?

It depends. One of the main objectives of the health-care reform law, the Patient Protection and Affordable Care Act (ACA), is to encourage uninsured individuals to obtain health-care coverage. As a result of the ACA, everyone must have qualifying health insurance coverage, qualify for an exemption, or pay a penalty tax. This requirement is generally referred to as the individual insurance or individual shared responsibility mandate.

Health insurance plans that meet the requirements of the ACA generally include employer-sponsored health plans, government health plans, and health insurance purchased through state-based or federal health insurance exchange marketplaces.

Individuals who are exempt from the individual insurance mandate include:

- Those who qualify for religious exemptions
- Certain noncitizens
- Incarcerated individuals
- Members of federally recognized American Indian tribes
- Those who qualify for a hardship exemption

Individuals may also qualify for an exemption if:

- They are uninsured for less than three months
- The lowest-priced insurance coverage available to them would cost more than 8% of their income
- They are not required to file an income tax return because their income is below a specified threshold

For tax year 2014, the penalty tax equals the greater of 1% of the amount of your household income that exceeds a specific amount (generally, the standard deduction plus personal exemption amounts you're entitled to for the year) or $95 per uninsured adult (half that for uninsured family members under age 18), with a maximum household penalty of $285. In 2015, the percentage rate increases to 2%, the dollar amount per uninsured adult increases to $325, and the maximum household penalty increases to $975.

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