Certified Financial Services, LLC
600 Parsippany Road Suite 200
Parsippany, NJ 07054

Richard Aronwald
Financial Specialist
www.richardaronwald.com

Creative
wealth maximization strategies*

March 2020

The Trustee for Your Estate Plan: Choose Wisely

You probably already know a trust is an essential document in estate planning. Properly configured and funded, a trust protects the privacy of your estate, ensures that its assets avoid probate, and provides the grantors with a legally binding framework for distributing assets according to their wishes. But a well-designed trust still requires human management to ensure its execution.

While the grantors (i.e., the creators) of the trust are alive, they usually also serve as its trustees, managing the assets placed in it. When the grantors die, a successor trustee steps in to continue these administrative responsibilities. The successor trustee is the critical human factor in an estate plan.

Responsibilities of a Trustee

A competent successor trustee must:

- Confirm their authority as trustee, and act as the liaison between both financial institutions and beneficiaries. This often requires documentation or registration with appropriate entities.
- Manage and preserve trust assets to fulfill the objectives of the trust.
- Make decisions as to what the beneficiary can have…Which Home, What kind of Car, Which College, etc..?
- Administer distributions according to the terms of the trust.
- Maintain financial records so that tax returns are filed promptly, and beneficiaries have accurate and timely information regarding trust assets and anticipated distributions.
- Communicate regularly with beneficiaries, addressing questions and concerns.

Trustee Options

Typical candidates for successor trustees are family members, financial professionals, or institutions. **It is not uncommon to name different trustees for different roles; one to manage the money, another to make decisions as to what the beneficiary (children) can or cannot have.**

The most common reasons for designating a family member (an adult child, a sibling, or other family relative) are cost and trust. Family member trustees often serve as volunteers, and typically have a strong familial interest in ensuring the wishes of the grantors are honored.

Appointing a relative – even a trusted one – has risks. The trustee might not have the knowledge or expertise to properly manage the trust assets, which could lead to losses, decreasing the amounts intended for beneficiaries. If family members are beneficiaries, prickly personal relationships may become full-fledged conflicts once money is involved.

These potential pitfalls may prompt grantors to name a financial professional as a third-party trustee. These trustees usually charge fees for their services. In some cases, the grantors may choose a business, such as a bank or trust company, to be the successor trustee. These institutional trustees provide management services for many trusts; different members of the trust company may fulfill the trustee's duties; an investment manager for the assets, a tax preparer for returns, etc.

In theory, institutional trustees have the advantage of expertise and impartiality. In estate plans where a family member is the trustee and also a beneficiary, this duality might create conflicts of interest. Institutional trustees are not beneficiaries; they earn their fees by following the dictates of the trust.

On the other hand, beneficiaries may believe the fees charged by the institutional trustee eat away trust assets that should rightly be distributed. One option to resolve this tension: naming co-trustees, such as a family member and a trust company, to be checks and balances for each other.

* The title of this newsletter should in no way be construed that the strategies/information in these articles are guaranteed to be successful. The reader should discuss any financial strategies presented in this newsletter with a licensed financial professional.

Qualifications of Your Trustee

As mentioned earlier, the decision regarding a successor trustee is critical to the trust performing as intended by the grantors. While each estate plan is different, grantors should consider some of the following factors when deciding on a trustee.

Availability of the trustee. It might not be a full-time job, but a trustee's responsibilities are numerous, and may have deadlines. A family member or individual financial professional might be well-suited for the task, but not have the time.

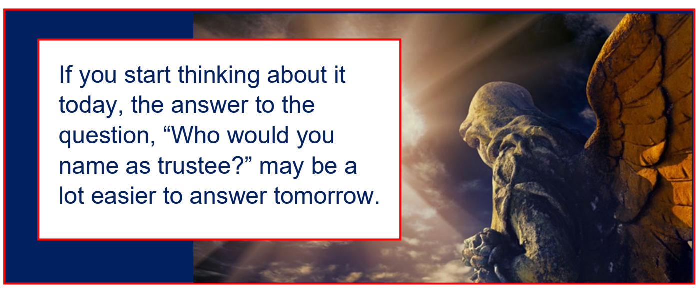
Size of the estate, and the types of assets. If there's a lot to manage, you may need a lot of managers. Real estate, business interests, or investments may require expert guidance. If the trustee isn't competent in these areas, it is imperative that he/she can delegate these management responsibilities to other professionals.

The number and makeup of the beneficiaries. Trust beneficiaries could be a surviving spouse, children, siblings, charitable organizations, private foundations, or other special entities. A trustee should be someone who can interact effectively with the beneficiaries and manage tensions that may arise among competing interests.

An important note: Each state has different rules and each situation is unique, so you should always consult with an attorney or tax advisor when establishing a trust and naming a trustee.

Who would you name as trustee?

Estate planning may not be on your horizon right now. Even if it's a long way off, it can be helpful to consider what you might hope to accomplish with an estate plan, including the people, institutions or causes you'd want as beneficiaries, and who you would appoint to act on your behalf. ❖



For generations of American homeowners, the final payment on a mortgage has been a financial milestone, often commemorated with a big celebration. Financially, no more interest charges and no more monthly payments are big wins. And owning your home free and clear is another piece of retirement security; even if you eventually sell the home, your monthly housing costs can remain affordable, because the proceeds from the sale are often enough to pay cash for another residence.

In the past, paying off a mortgage has often been part of a pre-retirement checklist; homeowners might even commit to extra principal payments or refinance to a shorter term.

The thought of not having a monthly house payment is certainly appealing – at any age. But should paying off your mortgage before retirement be a financial priority? Depends on who you ask.

Some Experts Say No…

In "3 Retirement Myths Debunked," an August 2019 article posted on barrons.com, "paying off your mortgage before you retire" was the first "myth" on the list. Columnist Cheryl Munk presented the opinions of several experts who argued against it:

- The money required to clear the mortgage, either in a lump sum or through increased monthly payments, might be more productive if it were invested instead of used to pay down debt. For example: If the mortgage interest rate is 4 percent, and your investments are earning 6 percent, paying off the mortgage incurs a lost opportunity cost; 6 percent gains are forfeited to clear a 4 percent debt.
- Allocating more money to reduce a mortgage is also a reduction in liquidity. Additional principal payments do increase home equity, but this equity can only be accessed through a loan (such as a line of credit or a cash-out refinance) or at the sale of the property.
- Rather than paying down the mortgage, one expert recommended going in the ***other*** direction, by refinancing for a ***longer*** period, like a new 30-year mortgage. This strategy lowers monthly housing costs ***today***, immediately increasing the amount that can be invested in higher-yielding assets. Larger accumulations and greater liquidity would presumably provide more options at retirement.

Some People Disagree…

One of the benefits of Internet journalism is the immediacy of debate. The "Comments" section that often follows an article puts the arguments and rebuttals side-by-side, giving readers a broader perspective on the topic. In this case, many of the commenters were homeowners who had paid off their mortgage, and they were decidedly opposed to Munk's myth-busting.

Several commenters emphasized the financial freedom and decreased stress that resulted from an early payoff:

– "Paying off your mortgage as quickly and as young as possible is the best decision you can make. It's freedom from debt."
– "I paid off my mortgage when I was 43, and this enabled me to accelerate my savings enormously during the last 18 years I worked."

Another commenter directly rebutted the loss of liquidity, recommending that homeowners "Pay off the house and establish a home equity line of credit…I've never touched it but if, God forbid, one of the children or grandchildren has a horrific and expensive event it is there." He also saw home equity as less volatile than market-based investments: "What happens when I go to tap the money I gave to (investment companies) and the market is down 35%?"

Is There a Third Way?

Both arguments (for and against paying off a mortgage) are based on hindsight. Munk writes from a perspective of what could have been better choices, given the actual returns, interest rates and housing prices of the past several decades. The readers counter with their personal experiences, concluding that their stories validate their approach. But neither side addresses what could have happened, or more importantly, what might happen in the future. And neither mentions another possible strategy.

Instead of a binary choice between paying off the mortgage or investing, there is the option of saving ***outside*** the mortgage to ***pay it off early.*** To illustrate:

Suppose a pay-off-the-mortgage-plan requires $500/mo. in extra principal payments. Instead of sending this extra cash to the lender, deposit the $500 into a separate account. When the balance equals the mortgage payoff amount, make a lump-sum payment to clear the debt.

This approach has the potential to satisfy both sides. There can be opportunities for returns higher than the interest rate, liquidity, and a payoff which still occurs before retirement. Sort of win-win, right?

Some diehards in the pay-off-the-mortgage camp might insist that the only way to ***guarantee*** an early payoff is to commit the $500 to extra principal payments. This is true.

But if you consult with a financial professional and run some projections based on reasonable assumptions about rates of return and taxes, you might be surprised how minor the difference is in payoff dates – even if the returns from the outside account are ***less*** than the mortgage interest rate. Especially for shorter time periods, the extra money – either for extra principal payments or deposits to an outside account – is the difference-maker, not the rate of return. (And if the returns from the outside account should exceed the mortgage interest rate, you could pay off the mortgage even sooner.)

My opinion on when it is an appropriate time to pay off your mortgage is when you have saved up enough money that the likelihood of you ever having to borrow money again is extremely unlikely. ❖

There is no one-size-fits-all answer, but if you're in the pre-retirement phase of life, it might be time to consider various strategies for paying off your mortgage.

There is the option of saving ***outside*** the mortgage to ***pay it off early.***

*Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under 59 ½, any taxable withdrawal may also be subject to a 10% federal tax penalty.

Certified Financial Services, LLC
Richard Aronwald
Financial Specialist
raronwald@cfsllc.com

600 Parsippany Road Suite 200
Parsippany, NJ 07054
973 263-0622