New Parents: Protecting What Matters Most

Next Gen Insights

The arrival of a child is an exciting time for families. This time is often focused on celebratory gatherings, home nursery preparation, and getting as much sleep as possible before the arrival of your newest family member. In the chaos and excitement of welcoming a child, ensuring that your family has an appropriate wealth plan in place is often overlooked. The expansion of your family brings with it new considerations that should prompt you to review and update your wealth plan in order to ensure that it remains appropriate for your growing family's needs.

Financial Planning

Having a child will alter your expenses. Understanding your current and anticipated cash-flow needs will allow you to appropriately budget and determine if your "rainy day fund" is sufficient. One of the most significant expenses for new parents is childcare. For working parents, having conversations about your childcare needs upon returning to the workforce is important. Research different childcare options to determine if they provide the type of care that you are seeking and are affordable options for you. If you are using a grandparent or other family member for childcare, make sure there is an open discussion about everyone's expectations. Many times, a parent will decide not to return to the workforce and instead provide care for their child. If this is something you are considering, you should understand both the potential cost savings and the reduction to income, and how it could impact your retirement savings and Social Security benefits. Whether you or your partner decide to return to the workforce or not, it is important to have open conversations and understand the impact of your choices so that you are able to make informed decisions.

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As humans, we tend to prioritize our short-term goals and needs because they are more imminent. This can cause longer-term goals, such as retirement planning, to be put on the back burner. As a new parent, it is important that you continue to focus on your retirement savings. The earlier you begin saving for retirement and the more you are able to contribute, the better. Take the time to understand your employer's retirement plan options. Does your employer offer a company match? Do their plan offerings include pre-tax and Roth savings vehicles? Lastly, review your plan's investment options and make sure that your asset allocation appropriately reflects your time horizon and risk tolerance.

Education Funding

One of the most significant child-related expenses that parents face is the cost of education. While obtaining an education is important, paying for a child's education should not come at the expense of your retirement savings. Retirement goals should be on track for full funding before assets are diverted for a child's education savings. Ultimately there will be more options to fund college, such as student loans, scholarships, and financial aid, than there will be to fund your own retirement.

If you are able to allocate some of your income to education savings, the following savings vehicles should be evaluated based on your specific circumstances:

- **529 Accounts:** These savings vehicles offer tax-free growth if the funds are utilized to pay for qualified education expenses. If a 529 account is an option that you are considering, funding the account earlier will give the funds a longer time horizon to hopefully benefit from tax-free growth. Under the 2017 Tax Cuts and Jobs Act (TCJA), 529 accounts can now be utilized to fund private elementary and high school tuition up to $10,000 per year, per child. It is also important to not overfund these accounts, as there is a 10% penalty on earnings plus income taxes, if funds withdrawn are not utilized to fund qualified education expenses. For financial aid calculation purposes, a 529 account is considered a parental asset if a parent is the custodian. If a non-parent is the custodian, the amounts distributed to pay qualified education expenses are instead considered income to the child for financial aid purposes. If your child may be eligible to receive financial aid, it is important to understand how utilizing these accounts may impact potential awards.
- **Uniform Transfers to Minors Accounts (UTMA):** These accounts allow a custodian to manage a child's assets until they reach the UTMA termination age, which is age 21 in most states, including Massachusetts. For financial aid purposes, an UTMA is considered an asset of the child, which translates to it being included in the expected family contribution at a higher percentage. Another drawback of an UTMA is that the child will have full control of the assets at the UTMA termination date and can choose to use them for any purpose.

If a grandparent or family member is interested in funding education costs for a child, in addition to the above options, the following should be considered. If a child is likely to apply for financial aid it is important to understand how each of these funding strategies could impact financial aid awards.

- **Pay Tuition Directly to the Institution:** If a grandparent or family member has the means to pay tuition costs directly to the institution, there are wealth transfer benefits in doing so. Paying tuition directly is not considered a gift for gift tax purposes and allows you to transfer wealth without utilizing your lifetime exemption or even the gift tax annual exclusion amount.
- **Set up a Trust:** If you are seeking flexibility in the ultimate use of the gifted assets, creating a trust should be considered. By establishing a trust, the grantor sets the terms as they wish. This could dictate the type of access that the child will have to the funds and can set parameters for the types of expenses the trust can be utilized for, such as education, health expenses, a home purchase, or starting a business. Unlike an UTMA, which becomes the child's asset at the UTMA termination age, a trust can allow for longer-term management and avoid a premature distribution to the child.

Buying A Home

Your growing family may need more space. This is a time where many families begin to evaluate their living arrangements and decide to purchase their first home. Buying a home is both an exciting and emotional time. There may also be new considerations that will affect where you want to live. If you are hoping to utilize public schools, being in a town with a good education system may be a high priority. If you are hoping to utilize family members for childcare, moving closer to family may be necessary. Put some thought into where you want to live and start to research different housing opportunities so that you have a better understanding of what you can afford. In a booming housing market, it is important to not let emotions drive your purchasing and price point decisions. Determine an appropriate budget and stick to it. It may take time, and you may have to adjust your expectations, but do not let the activity of the market cause you to purchase a home that you cannot afford.

For those looking to purchase a home now, low interest rates make this a desirable time to finance your purchase with a fixed, low interest rate mortgage. For those with existing homes, this could also be an attractive time to refinance your current mortgage to a lower interest rate. When refinancing, remember to account for refinancing costs and time horizon. If you hoping to sell your home in the near future, obtaining a lower interest rate may not offset your refinancing costs.

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Life Insurance

The arrival of a child is a great time to review your life insurance coverage to be certain you have an appropriate level of coverage. To protect your family in the event of a tragedy, you will want to understand your family's needs in order to determine the type and amount of coverage that is necessary. With young children, you may find that some of your needs will be temporary while others may be permanent. Temporary needs include ensuring there are sufficient assets for your children's education, replacing what would have been your income prior to your children's emancipation, and paying a mortgage. For these non-permanent needs, a term life insurance product is an attractive option to consider. With a term product, you will have coverage as long as you continue to pay the agreed upon premium, with coverage potentially subject to a maximum duration. With term insurance you are not building any cash value, but are paying a comparatively lower premium for your temporary insurance need, with insurance proceeds only being received if there is a death during the term period. Most individuals will utilize a combination of both term and permanent life insurance policies to satisfy their various insurance needs. Understanding the potential financial impact of the premature death of you or your spouse will guide you in determining an appropriate amount and type of coverage.

Evaluate Employer Benefits

Many employers also offer benefits that are important to evaluate if your family is expanding:

- **Health Insurance:** The arrival of a child is a qualifying event that allows you to update your employer-provided health insurance coverage to include the child and possibly make other changes. In most cases, notification needs to be provided to your plan provider within 30 days of the qualifying event to update coverages outside of the open enrollment period.
- **Health Savings (HSA) & Flexible Spending Accounts (FSA):** After having a child, you may want to further evaluate your employer health plan options to see what best meets you and your family's needs. If you are utilizing a high deductible plan, funding an HSA is an effective way to allocate pre-tax dollars to pay for health related costs. If you are not on a high deductible health plan, health FSAs can be utilized to pay health related costs. If you are enrolled in both an HSA and a health FSA, the FSA funds are limited to dental and vision care costs.
- **Dependent Care FSA:** This program allows employees to allocate pre-tax dollars up to a limit to use on eligible dependent care expenses. You are typically not allowed to rollover any unused funds to the next year, so you do not want to overfund these accounts.
- **Disability Insurance:** Both short-term and long-term disability plans are typically offered by employers. Research the terms of your firm's disability plan so that you can understand what percentage of your salary is replaced in the event of a long-term or short-term disability. You will also want to understand if you or your employer pays the policy premiums, as that impacts the taxability of benefits received under the plan. If you pay the policy premium with after-tax dollars, in the event of a disability, the benefits received under the plan will not be subject to income taxes. If the policy offered by your employer does not provide adequate coverage, you can work with an insurance agent to obtain a private disability policy to make up for the shortfall.

Identity Theft & Freezing Credit

With identity theft on the rise, we recommend that each individual pull a credit report and carefully review for any suspicious activity. If you have not done so already, consider freezing your credit. You can take this action on the Equifax, Experian, and TransUnion websites directly. Children can also be targets of identity theft. As the guardian of a minor child, you can freeze your child's credit on their behalf. Each of the three major credit rating agencies has instructions on how to place a credit freeze on behalf of a minor child. If you do freeze your credit, you will need to contact the agencies to temporarily lift the freeze before applying for additional credit.

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Review Your Estate Plan

If you do not have an estate plan in place, now is the time! There are many estate planning considerations when having a child that you will want to evaluate. One of the most important estate planning decisions when having a child is naming a guardian. This is important, as it allows you to choose the guardian of your child in the event of your and your spouse's premature deaths. If you do not name a guardian, it is resolved in probate court, where the court will appoint a guardian for the child. Having a guardian named in your will can help alleviate stress and potential animosity amongst family members in what would be an already tragic situation. Most importantly, it ensures that your wishes are met in terms of whom you feel is best suited to care for your child.

In planning with minor children, it is common for a parent's estate plan to utilize revocable trusts. Revocable trusts can be changed and amended during your lifetime as your situation and family's needs evolve. In the event of a premature death, the trustee will manage the trust assets and make distributions to the beneficiaries as outlined in the trust terms. This allows for oversight of trust assets and prevents premature access by a child. Trusts offer flexibility, as the grantor is able to establish the terms of the trust, including when the child is allowed access to the funds. When it comes to naming a trustee, you should understand expected trustee duties and responsibilities, to ensure that your selection is able and willing to meet those demands. During your estate plan review, remember to evaluate and update your beneficiary designations, as they may no longer be reflective of your wishes.

Having a child is an exciting time. As parents, protecting our family and children are a top priority. The above considerations can be utilized to help identify your family's goals and needs in order to ensure you have a proper wealth plan in place. If you have questions or would like to further evaluate the topics outlined in this article, please contact your Fiduciary Trust Company Investment Officer. ■

Learn More:

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