DEVELOPING THE FINANCIAL PLAN: The Franklin Financial Plan Presentation

The Franklin Financial Plan Presentation

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A Comprehensive Financial Plan Prepared for
Fred and Farrah Franklin
As of: September 4th, Year 1

CONFIDENTIAL

Prepared by
Cole Ritchey
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September 4th, Year 1

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Dear Fred and Farrah:

We have enjoyed our engagement to help you develop a comprehensive plan that will provide the guidelines that enable you to more easily realize your personal and financial goals.

**Financial Planning Expectations of your Comprehensive Financial Plan**

In our initial discussions, we came to understand that you require guidance in managing your financial affairs on an ongoing basis. Listed below are your financial priorities.

- Your top priority is to have enough funds to provide for your children’s college.
- You want to address your insurance coverages - you are not sure which coverages are appropriate. You want efficient insurance coverage – not too much and not too little.
- You are not worried about Estate planning issues but are open to suggestions.
- You also want to continue to live a modest but comfortable lifestyle in retirement.

You expect us to make objective, professional, and well-considered recommendations and suggestions to help you realize your objectives with due regard for your concerns.

We are impressed with how well you have managed your financial affairs and believe we have provided you with sufficient information and recommendations so that you can make good decisions. We all need to remember that a personal financial plan and resulting implementation is an evolving process. Our discussions of this plan will inevitably result in somewhat modified actions other than those suggested by the plan. It is important for all of us to remember that this evolving process is normal and, for optimal results, will require some monitoring and review as your plan evolves.

**Scope of plan**

The development and presentation of this comprehensive financial plan is completed for a fee of $2,500. As we have discussed in our prior meetings, we believe a comprehensive plan can only realize its true potential if it is viewed as an initial roadmap that must be reviewed and modified over time. If you wish to continue to engage us to provide ongoing services, we will be happy to do so. At that time we will discuss management fees.

**Financial Information**

In order to acquire necessary information to complete this plan, you provided us with a completed financial questionnaire and several copies of financial documents, which we were able to review prior to our second meeting on June 14.

**Family situation**

We have previously verified with you our understanding of your family situation, risk tolerances, and financial goals; thus, we will not repeat them here. As we present recommendations for your consideration regarding specific concerns and objectives, we will repeat your goals and objectives to relate them in a clear context.

**A Note About Financial Assumptions in the Plan:**
In our evaluations, we have made specific assumptions about inflation, interest rates on debt, interest rates for fixed income assets, and projected rates of return for equities. We would prefer that these assumptions prove to be highly accurate, but we all must realize that these projected rates are subject to change in the short- and long-term, and these assumptions are not guaranteed but prudent and not overstated for purposes of making financial decisions. A copy of these assumptions is included in Appendix 1.

**Plan presentation and subsequent process**

We are presenting this plan to you in our scheduled meeting on September 4th. Please ask all the questions that occur to you at that time. Most clients find that it is a good idea to take notes in that meeting. I do not expect you to absorb all of this information or make decisions about a wide range of recommendations after one relatively brief overview. Please review and contemplate the plan’s observations and suggested changes after our meeting. Jot down your new questions and we will schedule to meet again in a week or so. In that meeting, we will sort out your priorities for implementation so you can begin the process of making the changes that will mitigate your concerns and set you on a more direct path to the achievement of your objectives.

Our recommendations are not didactic – we are providing you with information and objective observations that you must evaluate and use to make decisions about your financial future. Our plan is intended to be based on sound information and estimates and designed to make this planning and decision-making process as easy as possible for you.

At the end of this plan, we have accumulated all of our recommendations in a table called **The Implementation Timeline Report**. This is a preliminary report that can be used by you and us to facilitate the implementation process. After our presentation and follow-up meeting, we will very likely need to modify this report as you make decisions about our recommendations. In addition, if you choose to continue our engagement, we will maintain this confidential report for you online, which will greatly facilitate the proper scheduling of planning reviews and implementation of planning decisions as they are made. The report can also include completion of tasks thus developing a history or trail of financial planning implementation.

I have written and approved this summary. Let me know if you have any corrections or supplementary information that might cause alterations to our understanding of you, your financial situation, or our evaluation.

_______________________________
Cole Ritchey

_______________________________
Date
## Goals

Over the past several weeks, we have developed a comprehensive financial plan to realize your financial goals. In this process, we identified and prioritized your goals as we understand them:

<table>
<thead>
<tr>
<th>Priority</th>
<th>Goal</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Saving for children’s college and securing undergraduate tuition for them. Have enough funding for $50,000 a year tuition in today’s dollars.</td>
</tr>
<tr>
<td>2</td>
<td>Saving for a comfortable retirement with the focus of not running out of money.</td>
</tr>
<tr>
<td>3</td>
<td>Making sure that all insurance planning is accurate and up to date. Want to continue to manage all risks.</td>
</tr>
<tr>
<td>4</td>
<td>For Cash flow planning we want to place limits on certain spending. As well as making sure all our investments are accurately allocated</td>
</tr>
<tr>
<td>5</td>
<td>The goal with estate planning is to ensure that you will not become a burden on your kids or family members.</td>
</tr>
</tbody>
</table>
Executive Summary of Recommendations

After an extensive review of your goals, objectives, available financial resources and current financial position, we make the following primary recommendations (along with expected results) for your consideration:

- **Cash Flow/ Cash Reserves**
  - Cash Flow and Cash Reserves should be monitored at least annually and adjustments made when necessary to assure non-depletion of assets.

- **Risk Management**
  We have made several recommendations regarding your medical, auto, and homeowners coverage to boost the efficiency of cost and coverage.

  Based on your objectives, we have made recommendations to increase insurance coverage to cover risks of personal liability, long-term disability, long-term care, and the possibility of an unexpected death of Fred and/or Farrah.

- **Tax Planning**
  Accumulating assets in a 529 Plan versus personal accounts will significantly increase the after-tax return of accumulating assets.

  We have made recommendations regarding the most tax-efficient manner of accumulating retirement income capital.

  Use of a FLEX Plan and possibly a Health Savings Account can convert after-tax medical care expense payments into pretax payments.

  List all potential Miscellaneous Itemized Deductions each year and submit all of these to tax preparer. There may be potential to shift payments to “overweight” a year to create deductions.

  Plan for your itemized deductions to match your estimated taxes for the year to avoid interest-free loans to the U.S. Treasury.

- **Investment Performance/Asset Allocation**
  - A reallocation of your cash reserves, education funds, and retirement account funds in accordance with your risk tolerance should result in substantially improved long-term investment performance and a greater likelihood of realizing your goals.

  - **Education Cost Accumulation**
    A reallocation of assets, placing these assets in a tax-sheltered 529 Plan, and relatively modest increases to your savings for the next eight years dramatically increases the likelihood of realizing your goals.

  - **Retirement/Financial Independence Capital Accumulation**
    A reallocation of assets and increased tax-efficient savings in the coming years dramatically increases the likelihood that you will realize a financially secure retirement in about 20 years. We want to Max out Farrah’s 403b at 18,500 a year and also look at additional non-qualified savings.

- **Estate Planning Issues**
Meet with an estate planning attorney to draft basic planning documents and provide greater protection for the children. Also, address beneficiary designations to coordinate with the final estate plan.
Current Financial Position

In this section, we present two financial statements that provide us with a snapshot of your current financial position, allow us to make observations and recommendations, and provide us with a foundation to later compare these statements to the “REVISED” statements as a result of our cumulative recommendations.

First, we will review the “AS IS” Personal Balance Sheet as of June 30, Year 1. A copy of the statement is available in Appendix 2.

The Balance Sheet lists the current value of all of your tangible assets (in some cases, estimates, such as your personal assets) and current balances of debts. The excess value of your assets over your liabilities is your net worth, currently about $1,127,000. This substantial net worth is a result of your exceptional ability to live within your means and to consistently set aside substantial sums into your savings account, education accounts for Faye and Francis, plus contributions to your 403(b) and 401K Plans.

The “AS IS” Cash Flow Projections completed as of June 30, Year 1 provide an illustration of your estimated receipts and disbursements for last year, this year and next year. A copy of the statement is available in Appendix 3.

This statement immediately indicates that you are spending less than you are taking in from earned income, savings and investment earnings, and annual gifts from Farrah’s parents. We have also included a copy in Appendix 4 of your current estimated living expenses, as well as projected expenses at retirement and in the event either spouse is a survivor.

The footnotes with each statement may amplify your understanding of the statements and stimulate new insights and questions.

We have listed below a few observations and recommendations for your consideration as a result of reviewing these financial statements. As you proceed through this and the subsequent evaluations of this plan, make notes, ask questions, or make comments to us in our next discussion.
Education Funding Recommendations

Goal(s)

Your primary objective is to make sure that you have set aside sufficient capital to provide for undergraduate and graduate school for Faye and Francis. The average annual tuition cost you are considering is $50,000 in today's dollars. You would like us to help you strategize your saving to minimize risk and maximize gains.

Recommendations

1. The easiest part is to convert your taxable returns and withdrawals to non-taxable accumulation and withdrawals by selling the existing education fund assets and transferring the proceeds to Faye and Francis’s 529 Plans and make all future deposits into the 529 accounts. Fortunately, there will be little, if any, taxes on the sale of the mutual funds.

2. Increase your monthly savings contribution into the 529 accounts by $386 per month.

Alternatives Considered

We did three sets of calculations that all used the following assumptions to determine what it will take to reach your funding objectives for Faye and Francis.

We assumed that college and graduate school costs increased by 5% per year. We assumed that your capital will earn 3% while Faye and Francis are attending college. We assumed that you wish to accumulate the necessary funds by the time each child starts college.

Each of these three sets of calculations assumed different rates of return while accumulating capital until Faye and Francis begin college:

- The first calculation is an "AS IS" calculation assuming that the current asset balances and future contributions are invested proportionally as they are now. The net after taxes, in your 25% marginal tax bracket, of Faye's funds are projected to grow at 2.2% per year and Francis's at 2.2% per year. These rates of return are assumed to continue while they are in school and withdrawals occur.

- The second and third calculations assume that the education funds are held in 529 Plans for Faye and Francis that shelter the accumulating funds from being taxed on income and capital gains as they accumulate. In addition, the funds are not taxed if distributed to pay for qualified education expenses. Thus, these funds should never be subject to income taxes once they are positioned in a 529 Plan.

We also assumed that the accumulating funds in the second and third scenarios earn 3% and 5% per year until Faye and Francis begin college. Each 529 account thereafter earns 3% per year on the balance in each account.

The calculations answer several important questions:

1. How much capital will we need to fund Faye and Francis's education when they begin college?

If we assume the funds are invested AS IS, you will need accumulated capital of $340K for Faye and $340K for Francis when they begin college.

2. Will we have sufficient capital to reach these capital requirements if we save and invest as we are now? If not, how short are we?
No. To fully fund college for the twins we need to accumulation about $266,000 of additional assets.

3. **What are our best alternatives to close the gap and reach our goal without taking too much investment risk to reach our goal? Results of recommended alternative strategy**

These changes are reflected in the table below:

<table>
<thead>
<tr>
<th>Accumulation Plan</th>
<th>After Tax Return -Accumulation Period</th>
<th>After Tax Return -Distribution Period</th>
<th>Capital Accumulation Requirement</th>
<th>Projected Capital Accumulation</th>
<th>Projected Shortfall/(Surplus) of Capital</th>
<th>Additional Monthly Savings Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>“AS IS”</td>
<td>1.98%</td>
<td>1.98</td>
<td>681,074</td>
<td>414,400</td>
<td>$266,674</td>
<td>$2,008</td>
</tr>
<tr>
<td>529 @ 6%</td>
<td>6%</td>
<td>3.0</td>
<td>670,780</td>
<td>609,999</td>
<td>$60,781</td>
<td>$369</td>
</tr>
<tr>
<td>529 @ 7%</td>
<td>7%</td>
<td>3.0</td>
<td>670,780</td>
<td>670,051</td>
<td>$729</td>
<td>$4</td>
</tr>
</tbody>
</table>

**Implications of Education Funding Recommendations to Finances and Other Planning Objectives:**

- **Balance Sheet:** Increase for at least seven years, then steady decline as 529 Plan balances are depleted.

- **Cash Flow:** Current assumptions are modest increase in savings now but no annual/future increase is planned. Contributions should stop in no more than eight years. Note that when Faye and Francis graduate from high school in seven and eight years, your annual expenditures for educational expenses will decline significantly due to elimination of secondary school expenses and prefunding of post-secondary school expenses.

- **Income Tax:** The 529 Plans will shelter taxable income generated by plan assets and withdrawals for qualified education expenses will not be taxed. Review of the Alternate Cash Flow Projections will show a reduction in taxes partially due to the repositioning of education assets. This tax-sheltered accumulation environment significantly increases the rate of growth and net distribution amounts when accumulated funds are used to pay for education expenses.

- **Risk Management:** Based on your goals and objectives, you will want to consider the purchase of additional life and disability insurance to assure completion of your education objectives. Enhanced planning of all risk management issues increases the likelihood of realizing your education goals. We reviewed these issues in a previous analysis.

- **Retirement Planning:** There is a tension between allocation of Discretionary Cash Flow to your children’s education and your financial independence. We will address this issue in detail when we complete your retirement planning evaluation.
- **Estate Planning:** Owner of the education assets is currently Farrah and we see no reason why that should change when setting up the 529 Plans. We suggest you name Fred as successor owner. You will want to discuss this arrangement with your estate planning attorney.
Retirement Recommendations

Goal(s)

You both would like employment in about 20 years to be optional. That is, you would like to achieve financial independence in no more than twenty years. The main focus is to not run out of money in retirement.

“When CAN we retire?” Are we saving enough? Can we make our retirement savings work more efficiently?

Your estimated “retirement budget” requires $99,000 per year of expenses in today’s dollars, including income taxes. Your retirement income should be inflation-hedged.

Analysis Process

Our primary objective is to calculate to what degree your current asset allocation, types of retirement vehicles used, current level of savings, and projected Social Security benefits will realize your objective of accumulating sufficient capital to provide sufficient retirement income in no more than twenty years. We will then determine what changes to your “current plan” will increase the efficiency of the accumulation of capital within the boundaries of your risk tolerance. We had several sets of calculations to do. We have grouped them into two phases:

1. Phase One – Analyze the current “AS IS” plan
   - Calculate the amount of retirement income required in today’s dollars, including estimated income taxes.
   - Calculate the retirement income objective to inflated dollars in twenty years.
   - What are the anticipated Social Security retirement benefits to be received at the projected retirement date in twenty years?
   - Calculate income required net projected Social Security benefits; that is, income that is provided by the Franklins’ personal retirement capital (PRC).
   - Calculate the capital amount required to provide the income needed from personal capital.
   - Identify current resources and committed savings that are earmarked for retirement and calculate how much capital will be accumulated in twenty years. In this case, we assume that your 401K and 403(b) contributions, as well as the employer matches, increase by 3% per year over the next twenty years.
   - Determine if the accumulated capital is sufficient or insufficient to meet the capital requirement calculated in Step 5.

Conclusions realized from the Phase One calculations:

We estimate that your required annual gross income in twenty years will be about $191,000, assuming 3% inflation.

We estimate your annual Social Security retirement benefits beginning in 20 years to be about $83,000.

Thus, your personal financial resources will need to provide a minimum inflation-indexed income of $108,000 per year (this assumes reliance on Social Security for just over one-half of your income.)
In order to estimate the amount of income that can be provided by the projected amount of accumulated retirement capital in twenty years, we use two calculations based on two relatively conservative and pragmatic retirement income strategies. We use what we call the "Safe Rate Withdrawal" model and the "Immediate Fixed Annuity" model, which we describe briefly below. The two key reasons we are using these two models are:

- The two options are realistic, prudent, flexible, and can be easily blended with one another to suit any client’s situation and risk tolerance.
- They represent realistic outer boundaries of the dollar amount of capital required to provide a dollar amount of income.

We used withdrawal rates of 4% for the "Safe Rate" model and 6.6% for the "Immediate Annuity" model. The Safe-Rate model assumes that annual withdrawals increase each year by the inflation index. The annuity rate is a 100% Joint & Survivor option with an automatic 3% increase in the benefit amount each year.

The capital required for the "safe rate" model is about $2,713,075. Based on very long-term actual historical market return studies, the probability of retaining at least some capital throughout your lives using this method at an initial 4% withdrawal rate is very high. You would likely have the benefit of being able to bequeath assets to heirs or charities, etc. You also have the flexibility of having access to your capital at any time.

The capital required for the immediate annuity model is $1,808,717. This is the bare minimum amount of projected capital required. This provides a guaranteed income (by one or multiple insurance companies), with automatic increases of 3% per year, to both of you for as long as you live. No portfolio management is required.

If we assume that you both continue contributing 6% of your compensation to the 401(k) and 403(b) Plans and the same investment allocation continues, these assets should accumulate to approximately $1,219,815 in twenty years. The weighted return of your current asset allocation is approximately 3.5%.

Thus, if we assume your accumulated capital is annuitized, we estimate that you will be $588,902 short of capital in twenty years. Or, 238,075 x .066 = $15,713 of annual income.

If we assume the use of the Safe Rate Model for providing retirement income, we estimate that you would be about $1,601,783 short of capital in twenty years. Or, 1,065,761 x .04 = $46,000 short of annual income.

Phase Two – Options and recommendations to improve your ability to reach your objective and to enhance efficiency of your accumulation strategy.

Realistically, you are currently about $250,000 short of your capital accumulation objective IF we assume you are comfortable with all of your retirement capital being annuitized and that over one-half of your income is provided by Social Security (under current law, a very small portion is subject to income tax). In addition, you may wish or need to retire in somewhat less than twenty years. What realistic options are available to allow you to accumulate the amount of capital necessary in twenty years, within the boundaries of your risk tolerance, to reach your objective, or make the process more efficient?

Conclusions realized from the Phase Two calculations:

Below we have culled a list of options available to you to resolve the shortage of retirement capital in twenty years:

- **Lower the objective** – not necessary.
- **Work Longer** – The mathematical effect of time for additional savings, increased compounding, increased Social Security benefits, and a shorter life expectancy all together can make a significant difference in a short period of time. Fred has
suggested that he “may never retire” and Farrah may consider a “second career” that might develop some income. These inclinations may provide additional time for income-producing resources to appreciate and continued savings and/or a shorter period of time that your retirement capital would need to provide the desired amount of income.

- **Save more money** – There should be some room in the next seven years for additional savings, if only on a non-consistent basis.

- **Improve Investment Performance** – The current asset allocation of your retirement assets projects a rate of return of about 3.5%, which is below our most conservative long-term risk profile of 5% per year. We believe you have a long-term risk profile of “moderate-conservative” that has a long-term projected rate-of-return of 6% per year. Thus, we calculated comparisons at the 6% rate of return and determined how much capital would be accumulated relative to your capital objective in twenty years.
How much difference does it make to reallocate the retirement plan and IRA assets to a “Moderately Conservative” asset allocation profile that has a projected rate of return of 6%?

At a growth rate of 6% vs. 3.5%, the retirement assets will grow to $1,631,623, a 23% increase that is just short of the “minimum” capital requirement of $1,808,717 by $177,093 and reduces the “Safe-Rate” capital requirement shortfall to $1,189,975.

Other Realistic Options for the Franklins

We highly recommend that you max out Farrah’s 403(b) immediately by $15,000 to $18,500. As cash flow is available in the future, any additional contributions to non-qualified retirement capital will make your future financial independence more secure, less dependent on Social Security, and give you more flexibility when considering future retirement options.

A Few Other Relevant Factors

It appears that your employment should be stable and your earnings will probably keep pace with inflation.

Implications of retirement planning recommendations to Finances and Other Planning Objectives:

- **Balance Sheet**: Steady increase.
- **Cash Flow**: Current assumptions are a two-year transfer of savings to retirement capital. Hopefully, you will be able to increase savings to retirement accounts in the future. Note that when Faye and Francis graduate from high school in seven and eight years, your annual expenditures for educational expenses will decline significantly.
- **Income Tax**: The 403(b) Plan contributions are made on a pretax basis and are supplemented with non-taxable employer contributions. All earnings and growth occur free of income tax. Withdrawals from your 403(b) Plans are subject to ordinary income tax. Strategically, you will probably withdraw funds from your 403(b) Plans as much as possible to meet your income needs in the early years of retirement since these funds are subject to Required Minimum Distributions. You will actually make logistical retirement income planning decisions when you actually retire, but in the years leading up to retirement, annual reviews can make adjustments with future retirement income planning in mind.
- **Risk Management**: Based on your goals and objectives, you will want to consider the purchase of additional life and disability insurance to assure completion of your education objectives. We reviewed these issues in a previous analysis. You also may want to consider the purchase of Long-Term Care insurance since substantial long-term care expenses in retirement can rapidly drain your financial resources.
- **Education Planning**: Providing a high quality education for Faye and Francis is your highest priority and requires substantial financial resources. At this time, the “competition” between allocating cash flow to retirement capital for a secure retirement and education expenses seems manageable, but you will need to be consistently diligent about adding to your retirement accounts.
- **Estate Planning**: We will discuss beneficiary arrangements of your 403(b) and 401K accounts in the estate planning section.
Recommendations: Cash/Savings Accounts

Your savings account represents almost all of your substantial “Emergency Fund” or “Cash Reserve.” Most rules of thumb consider this cash balance of about $130,000 (checking accounts, cash value of life insurance and savings account) excessive since it greatly exceeds 3–6 months of your monthly living expenses. However, we will be recommending additional uses for some of these funds now and in the future, which should periodically reduce the balance and then resume its climb to a higher balance. In addition, we would like you to compare the estimates of your living expenses to actual expenses over the next year or so to make sure that we have an accurate estimate of your actual expenses and thus a better estimate of how much you can actually add to your cash reserve each month or year.

Henceforth, we would like you to consider also using your cash reserve as a sinking fund to purchase automobiles for cash. You tend to purchase used cars, and the nondeductible interest rates on auto loans for used cars are substantially higher than the funds earn in the cash reserve. We suggest that you pay off the current balance on the Honda loan. This is the equivalent of earning a tax-free, guaranteed rate of return of 5% over the next 18 months. We suggest that you begin adding $350 per month or $4,200 per year to your savings account beginning in Year 3.

Ideally, we would like to see the cash reserve slowly increase over time to where you have a reserve equal to twice your annual expenditures when you retire. If you are able to develop retirement capital from which you draw capital (versus annuitization of all retirement capital to meet your income need), it gives you the option to defer or reduce withdrawals in a downward market cycle of your investment portfolio.

We are recommending withdrawals from savings totaling $3,500 the financial planning fee of $2,500, and the estate planning legal fees estimated to be $1,000 in Year 1. No “extraordinary” withdrawals are anticipated after Year 2. We will discuss the above “extraordinary” expenditures in the forthcoming sections. They are all noted in the “Revised Cash Flow Projections,” which we will review later in this plan after we have discussed all of our recommendations.
Recommendations: Debt Management

Your $296,536 mortgage balance could currently be refinanced for 15 years at a 3.5% interest rate vs. your existing 30-year mortgage interest rate of 5.5%. The new mortgage payment would be about $2,111 per month or $25,332/year versus your current payment of $1,789 per month. The table below summarizes the resulting differences of refinancing the mortgage in calendar Years 1 and 2: (Note the Year 2 numbers are highlighted since these numbers are for a full 12 months and are a better representation of the resulting changes).

<table>
<thead>
<tr>
<th></th>
<th>AS IS SCENARIO</th>
<th>REFINANCE SCENARIO</th>
<th>DIFFERENCES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly Payment</td>
<td>$1,789</td>
<td>$2120</td>
<td>332/month</td>
</tr>
<tr>
<td>Interest Paid Year 1</td>
<td>$16,321</td>
<td>$14838</td>
<td>(124)/month</td>
</tr>
<tr>
<td>Interest Paid Year 2</td>
<td>$16,031</td>
<td>$9957</td>
<td>(506)/month</td>
</tr>
<tr>
<td>Tax Savings Year 1</td>
<td>$4,489</td>
<td>$2787</td>
<td>(141)/month</td>
</tr>
<tr>
<td>Tax Savings Year 2</td>
<td>$2,006</td>
<td>$1,391</td>
<td>(51)/month</td>
</tr>
<tr>
<td>Loan Amortization Year 1</td>
<td>$429/month</td>
<td>$632/month</td>
<td>203/month</td>
</tr>
<tr>
<td>Loan Amortization Year 2</td>
<td>$452/month</td>
<td>$1281/Month</td>
<td>828/month</td>
</tr>
</tbody>
</table>

The Pros and Cons of this recommendation follow:

Implications of Cash and Debt Management Recommendations to Finances and Other Planning Objectives:

- **Balance Sheet:** The refinanced mortgage initially increases the amortization by an additional $204 per month.
- **Cash Flow:** The refinanced mortgage reduces net discretionary cash flow a little.
- **Income Tax:** The refinanced mortgage reduces interest and thus tax reductions by $415 in Year 1 and $1704 in year 2.
- **Education Planning:** Neutral.
- **Risk Management:** A little better since debt reduction is accelerated.
- **Retirement Planning:** Accelerated amortization of the mortgage may permit additional retirement savings in fifteen years.
- **Estate Planning:** Acceleration of debt reduction simplifies estate settlement a bit.

Recommendations: Income Tax

**Income Tax Planning Objectives**

You would be delighted to pay less income tax as long as everything you do is perfectly legal and will not create a hassle for you in the future.
Recommendations:

You should coordinate with us or your tax preparer at the end of each year to make sure that you are having the proper amount of taxes withheld from your paychecks. This planning allows you to keep more cash reserves earning interest throughout the tax/calendar year versus receiving a refund after the end of the tax year. There will also be an income deduction as we increase Farrahs 403B contribution to the max of 18,500.

Implications of Tax Planning Recommendations to Finances and Other Planning Objectives:

- **Balance Sheet:** Tax management and savings accelerate cash flow and increase savings over time.
- **Cash Flow:** Increased.
- **Education Planning:** Use of 529 Plan leverages return.
- **Risk Management:** N/A
- **Retirement Planning:** The Retirement Planning Analysis may uncover accumulation and distribution strategies that will reduce tax depletion of growth and/or distribution amounts.
- **Estate Planning:** N/A
Risk Management Evaluation and Recommendations

Risk Management Goals

You want us to help you determine the efficient amount of auto, homeowner’s, life insurance, or whatever other coverages that we think you should consider. You do not want to “over-insure,” but you do not want to be “blindsided” by unanticipated risks.

Establishing a Good Defense

Managing financial risk must be addressed as a priority in any financial plan because substantial assets and apparent financial security can rapidly diminish or dissipate when unexpected events occur that have unanticipated financial costs. The three primary classifications (Personal, Property, and Liability) of an individual’s or family’s risk exposures are listed in the table titled "Potential Risk Exposures for Individuals and Families” on the following page, along with a description of the potential losses associated with those risks.

This table helps us to not only identify and address these risks, but we must also develop a plan designed to mitigate these risks before we address your "offensive" objectives of providing education for your children, financial independence, etc.

There are two primary types of responses to mitigate risks listed below with examples:

1. Risk Control - such as:
   a. Risk avoidance - Such as purchasing a home not in a flood plain, low crime area, etc.
   b. Risk diversification - For non-businesses, this typically applies to investment portfolio diversification.
   c. Risk reduction/prevention - Such as preventative medical care, healthy lifestyle, timely auto and home maintenance, alarms, using seatbelts, etc.

2. Risk Financing - such as:
   a. Risk retention - Assuming full or partial risk by utilizing cash reserves, deductibles, co-insurance, etc.
   b. Risk transfer - For individuals, this typically involves social and commercial insurance.

We can apply all of these responses to realize a comprehensive and efficient strategy to manage your risk exposures. On the following pages, we will discuss recommendations to all of these potential risks.
## Potential Risk Exposures for Individuals and Families

<table>
<thead>
<tr>
<th>Type of Loss Exposure</th>
<th>Potential Financial Loss Associated with Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Personal</strong></td>
<td></td>
</tr>
<tr>
<td>Poor Health</td>
<td>● Medical care expenses</td>
</tr>
<tr>
<td></td>
<td>● Loss of income by family caregiver(s)</td>
</tr>
<tr>
<td>Disability</td>
<td>● Loss of income</td>
</tr>
<tr>
<td></td>
<td>● Medical care expenses</td>
</tr>
<tr>
<td></td>
<td>● Loss of income by family caregiver(s)</td>
</tr>
<tr>
<td></td>
<td>● Long-term/custodial care expenses</td>
</tr>
<tr>
<td></td>
<td>● Loss of medical insurance coverage and other employee benefits</td>
</tr>
<tr>
<td></td>
<td>● Unfulfilled objectives (e.g., education and retirement capital)</td>
</tr>
<tr>
<td>Death</td>
<td>● Final expenses - e.g., funeral costs, debt, estate settlement and administration costs</td>
</tr>
<tr>
<td></td>
<td>● Loss of income to dependents</td>
</tr>
<tr>
<td></td>
<td>● Loss of medical insurance for dependents</td>
</tr>
<tr>
<td></td>
<td>● Unfulfilled objectives (e.g., education capital)</td>
</tr>
<tr>
<td>Unemployment</td>
<td>● Lost income</td>
</tr>
<tr>
<td></td>
<td>● Lost employee benefits including medical, disability, life insurance and retirement benefits</td>
</tr>
<tr>
<td></td>
<td>● Could coincide with retirement - income may be inadequate.</td>
</tr>
<tr>
<td></td>
<td>● Unfulfilled objectives (e.g., education and retirement capital)</td>
</tr>
<tr>
<td>Superannuation</td>
<td>● Client(s) may outlive ability of financial resources to provide adequate income</td>
</tr>
<tr>
<td><strong>Property</strong></td>
<td></td>
</tr>
<tr>
<td>Real</td>
<td>● Cost of repair</td>
</tr>
<tr>
<td></td>
<td>● Reduction in value</td>
</tr>
<tr>
<td></td>
<td>● Cost of alternative temporary or permanent home</td>
</tr>
<tr>
<td></td>
<td>● Loss of rental income</td>
</tr>
<tr>
<td></td>
<td>● Loss of asset and possible continued debt obligation</td>
</tr>
<tr>
<td>Personal/Tangible &amp; Intangible</td>
<td>● Cost of repair</td>
</tr>
<tr>
<td></td>
<td>● Reduction in value</td>
</tr>
<tr>
<td></td>
<td>● Loss of asset</td>
</tr>
<tr>
<td>Auto</td>
<td>● Cost of repair</td>
</tr>
<tr>
<td></td>
<td>● Reduction in value</td>
</tr>
<tr>
<td></td>
<td>● Loss of asset and possible continued debt obligation</td>
</tr>
<tr>
<td></td>
<td>● Cost of alternative/new auto</td>
</tr>
<tr>
<td><strong>Liability</strong></td>
<td></td>
</tr>
<tr>
<td>Bodily Injury</td>
<td>● Compensatory Damages to compensate or reimburse for a loss</td>
</tr>
<tr>
<td>Property Damage</td>
<td>● Punitive Damages may be awarded to punish the wrongdoer</td>
</tr>
</tbody>
</table>
**The Risk of Unemployment, Unexpected Repair Costs and Asset Value Losses**

As we discussed above, it is imperative that you maintain a cash reserve for unexpected expenses, opportunities, substantial home repair costs, insurance deductibles and coinsurance, and as a sinking fund for auto purchases.

### Asset Loss and Personal Liability Risk Recommendation Summary

**Are You Prepared for these Asset and Liability Risks?**

Your current auto and homeowners policies provide necessary or required protection, but you have some unobvious exposures that can be eliminated or mitigated. In addition, your existing coverages can be improved and designed to be more cost effective. We suggest that you meet with your property and casualty agent (or we can recommend one) to perform a thorough review of your property and liability coverages. We can assist you in this process to the degree you deem appropriate. We have addressed these risks more specifically below:

- **Auto Insurance:** In regard to your auto insurance, we recommend increasing the comprehensive and collision deductibles to the $500-$1,000 range and increasing liability limits to $300,000/$500,000/$100,000. (Your current liability limits are $100,000/$300,000/$100,000. Your current deductibles are $100/$250.) This should result in very little increase in premium and may result in a decrease. The agent will provide you with alternative limits and costs. Your substantial cash reserve allows you to self-insure the higher deductibles.

- **Homeowners Insurance:** The HO policy should be reviewed to make sure dwelling coverage is adequate, particularly since you have made improvements to the home over the last eight years. We recommend increasing the liability limit to $300,000 vs. $100,000 and increasing the deductible from $250 to $1,000. This also should result in very little increase in premium and may result in a decrease. The agent will provide you with alternative limits and costs. Your substantial cash reserve allows you to self-insure the higher deductible.

- **Personal Articles Floater Insurance:** You have indicated that you own some potentially valuable items that may not typically be completely covered by your HO-3 Homeowners policy, such as valuable/antique furnishings, silver flatware, silver serving pieces, crystal, artwork, collections, and valuable jewelry. In order to determine if any items should be appraised for insurance purposes, we recommend that you seek the advice of a qualified appraiser in coordination with your property and casualty agent. It is likely that you will need to purchase supplemental coverage to your homeowners policy to adequately cover certain valuable items. Again, a higher vs. lower deductible would probably be appropriate.

- **Umbrella Liability Insurance:** We recommend that you purchase a $1,000,000 umbrella liability policy. The agent can select an umbrella policy from an insurance company that includes provisions most appropriate to your situation and lifestyle. The policy will not only increase the liability limits of your homeowners and auto policies, but will also provide broader personal liability coverage. The umbrella coverage should cost only a few hundred dollars per year.
We believe these changes will make your coverages broader, more efficient, provide increased protection and result in relatively modest increases in cost.

**Implications of P&C Insurance Recommendations to Finances and Other Planning Objectives:**

- **Balance Sheet:** Neutral.
- **Cash Flow:** Relatively modest increase in long-term premium cost.
- **Income Tax:** Neutral.
- **Risk Management:** Much better coverage for a modest increase in premium. Some risks are currently not covered or coverage is inadequate.
- **Retirement Planning:** Neutral except less risk to assets and income.
- **Estate Planning:** Neutral except less risk of decreasing size of estate.

**The Risk of Substantial Medical Expenses**

**A Substantial Risk**

There are actually two parts to this very substantial risk where medical insurance covers a large portion, but not all, medical expenses. The first part involves covering the risk of very substantial or catastrophic medical expenses. The second part involves paying for the insurance and uncovered expenses as efficiently as possible.

The first part for you is thankfully taken care of – you both have very comprehensive coverage through your employment and you have allocated the costs efficiently based on your respective employers’ plan design. You will always want to monitor changes in the plan choices offered to you to determine if changes in your coverage are beneficial to you.

Your employer-sponsored group medical plans provide good coverage at very attractive costs to both of you. Fred’s coverage is paid for by his employer. Farrah’s plan covers her, Faye and Francis. She has taken advantage of the cafeteria plan and pays her premiums pre-tax. When the annual enrollment period comes up, probably in October or November, we may want to meet and examine the plan options. Since your family health is very good and insurance utilization is low, you may want to consider a Health Savings Plan/High Deductible Insurance plan option to see if this is a viable choice for either and/or both plans. In an ideal situation, this would reduce your premiums and would allow you to build a tax-advantaged Health Savings Account (HSA) or “medical IRA” into your retirement years to pay health care costs from the HSA pretax.

We recommend that you enroll in a FLEX plan during the enrollment period later in Year 1 for the Year 2 plan year. We suggest an amount of $2,500 to be confirmed by you estimating your non-reimbursed health-care expenses. This will save you $625 in federal income taxes.

**Implications of Medical Insurance Recommendations to Finances and Other Planning Objectives:**

- **Balance Sheet:** Neutral, although an HSA may accumulate some cash.
- **Cash Flow:** FLEX Plan will decrease taxes by $625. If viable, an HSA plan would lower premiums and HSA contributions would be tax deductible.
- **Income Tax:** FLEX Plan will decrease taxes by about $625. If an HSA plan is viable, the HSA contributions would be tax deductible.
- **Education Planning:** Increases cash flow a bit.
- **Retirement Planning:** HSA balance theoretically could be available in retirement if utilization in years prior to retirement is low.
● Estate Planning: Neutral except less risk of decreasing size of estate.

The Risk of Long-Term Disability

Another Substantial Risk

What would happen if Fred or Farrah become disabled for a long-period of time? Not only is there the risk of loss of income for the family, but additional expenses can be incurred for the care of the disabled individual.

There are three primary options available to mitigate this risk:

1. If you have substantial assets, they could be converted into sufficient income-producing assets. This essentially means that you have reached a point where you could retire if one of you no longer worked, or was unable to work for several months or years. When we review the retirement analysis, we will see that this is not the case, especially if the disabled spouse required extra health care not covered by his/her medical insurance. Your primary assets are your home (still mortgaged), your cash reserve, your education accounts, and retirement plan assets. You need to maintain your cash reserve and actually should continue to make contributions to it, your education accounts are committed to an objective that still requires more savings and growth, and your retirement accounts require substantially more savings and growth to provide an adequate amount of lifetime income at an older age let alone your current age.

2. Employer-provided Sick-Pay Plan and Group Long-Term Disability: You are fortunate that you both have group LTD coverage that is provided and paid for by your employers. The details are listed in the table below:

<table>
<thead>
<tr>
<th>Type of Policy</th>
<th>Group Disability</th>
<th>Group Disability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insured</td>
<td>Fred</td>
<td>Farrah</td>
</tr>
<tr>
<td>Insurance Company</td>
<td>Unum</td>
<td>Unum</td>
</tr>
<tr>
<td>Waiting Period</td>
<td>180 days</td>
<td>180 days</td>
</tr>
<tr>
<td>Maximum Benefit Period</td>
<td>Age 67</td>
<td>Age 67</td>
</tr>
<tr>
<td>Monthly Benefit</td>
<td>50% of salary, 5K max.</td>
<td>60% of salary, 12K max</td>
</tr>
<tr>
<td>Annual Premium</td>
<td>Employer-paid</td>
<td>Employer-paid</td>
</tr>
<tr>
<td>Definition</td>
<td>Own Occ 5 years, then education, training and experience</td>
<td>Own Occ 5 years, then education, training and experience</td>
</tr>
</tbody>
</table>

Any LTD benefit payments from these plans would be taxable income to you, the employee. You both also have Sick-Pay plans that accrue days of unused sick-leave that can be used in the event of short or long-term disabilities. Fortunately, you both have been employed for several years and accrued substantial sick-leave days:

● Farrah accrues 1 day of sick leave per month of employment. She currently has accrued the maximum of 6 months sick leave.

● Fred accrues 1.5 days of sick leave per month of employment. He currently has the maximum of 6 months of sick leave.

Your accrued sick-leave days will probably increase in the future, but they could decrease if you have extended illnesses that “eat up” your sick leave.
3. Personal Disability Income Insurance can be purchased to replace or supplement the
group coverage within underwriting limitations of the insurance company. Social Security
can also provide long-term disability payments, but these benefits are very difficult to
qualify for and we would not want to make a recommendation based on a resource that
may not be available. In addition, group LTD often integrates with Social Security benefits.

Below, we will employ a quantitative analysis to evaluate the possible need for personal disability
insurance to mitigate the risk of long-term disability of Fred and Farrah.

Disability Risk Evaluation – Fred

Below is a summary of our recommendations. If you wish to review our more detailed
quantitative analysis of calculating Fred’s “need” for Disability Income Insurance, we can easily
provide it to you. We completed this analysis in three steps:

1. Determined the need for post-disability income based on the cash flow projections.
2. Identified the current resources of income in the event of Fred’s disability.
3. Calculate the sources of income less required living expenses and taxes.

Observations

The calculated need for additional monthly income of about $2,369 per month does not reveal
additional less obvious risks. For example, if Fred’s disability income lasted several years, the
group LTD benefit does not increase with inflation while we assume your living expenses would
increase. There is some risk that they could also increase due to increased out-of-pocket health
care. Fred’s medical insurance would no longer be paid by his employer and may increase the
cost of medical insurance coverage with Farrah’s plan. Fred would no longer have the full tax
leverage of pretax contributions to a 401(k) Plan and would not receive employer-matching
contributions.

Based on Fred’s income, and knowing that 80% coverage is the most available for medical
professionals, we know that the maximum amount of monthly benefit he would be approved for
is $11,666. The need based on goals is $2,369 per month, the maximum amount Fred would be
eligible for is $2,916.66.

Since Fred currently provides 78% of their income, we think it would be prudent for him to
purchase the maximum amount of non-cancellable and guaranteed renewable Supplemental
Disability Income coverage. The Elimination Period should be 180 days and the Maximum Benefit
Period Age 70. We suggest two riders: a Cost of Living Adjustment (COLA) rider that would
increase the benefits by a compounded rate of 3% per year, and a “Retirement Protection” rider
that would make additional contributions into a trust for a selected portion Fred’s income (e.g.,
$600 per month). Actual design of the policy will vary with insurance companies and should be
handled by an agent experienced in DI coverage. Estimated cost for provisions outlined above is
about $130 per month. The coverage and premiums would be guaranteed to the policy
anniversary nearest age 67.

Disability Risk Evaluation – Farrah

Below is a summary of our recommendations. If you wish to review our more detailed
quantitative analysis of calculating Farrah’s “need” for Disability Income Insurance, we can easily
provide it to you.

Observations

Farrah will not need additional disability insurance.
Implications of Purchasing Disability Income Insurance on Fred and Farrah to Finances and Other Planning Objectives:

- **Balance Sheet**: Neutral.
- **Cash Flow**: Premiums are an expense. Estimate $165 per month.
- **Income Tax**: Premiums paid after tax, benefits received tax-free.
- **Education Planning**: Mitigates a potentially significant risk to being able to fund the education expenses of Faye and Francis.
- **Retirement Planning**: Substantially reduces risk of not being able to save sufficient capital for retirement income.
- **Estate Planning**: Neutral, except less risk of decreasing size of estate.
The Risk of Long-Term Care Costs

Are you prepared for these potentially very high costs?

You have stated that you do not wish to be a burden to your family or children. The need for long-term care is not ubiquitous, but can often require substantial and consistent care for people of any age, but particularly so for the elderly. The following statistics demonstrate the potential long-term care costs.

The following information about estimated long-term care service usage is copied directly from the website of The National Clearinghouse for Long Term Care Information that was organized by the U.S. Department of Health and Human Services.

**Will You Need LTC?**

About 70 percent of people over age 65 will require some type of long-term care services during their lifetime. More than 40 percent will need care in a nursing home. Things that increase your risk or make it more likely that you’ll need long-term care include:

- **Age:** The older you get, the more likely it is that you’ll need help.
- **Living Alone:** If you live alone, you’re more likely to need paid care than if you’re married or single and living with a partner.
- **Gender:** Women are more likely to need long-term care than men, primarily because women tend to live longer.
- **Lifestyle:** Poor diet and exercise habits increase the chance that you’ll need long-term care.
- **Personal History:** Health and family history can increase the chances you’ll need long-term care.

**How Much Care Will You Need?**

Service and support needs vary from person to person and often change over time.

- On average, someone who is 65 today will eventually need some type of long-term care services and support for three years.
- Women need care longer (on average 3.7 years) than men (on average 2.2 years), mostly because women usually live longer.
- While about one-third of today’s 65-year-olds may never need long-term care services and support, 20 percent will need care for longer than 5 years.

If you need long-term care services and support, you may receive or use one or more of the following:

- Assistance with personal care or other activities from an unpaid caregiver who may be a family member or friend
- Services in your home from a nurse, home health or home care aide, therapist, or homemaker
- Services in the community such as adult day services
- Care in any of a variety of long-term care facilities

The table below shows that, overall, more people use long-term care services at home than in facilities. Also, people use long-term care services longer at home than in facilities.

**Distribution and Duration of Long-Term Care Services**
## DEVELOPING THE FINANCIAL PLAN: The Franklin Financial Plan Presentation

<table>
<thead>
<tr>
<th>Type of care</th>
<th>Average number of years people use this type of care</th>
<th>Percent of people who use this type of care (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any Services</td>
<td>3 years</td>
<td>69</td>
</tr>
<tr>
<td>At Home</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unpaid care only</td>
<td>1 year</td>
<td>59</td>
</tr>
<tr>
<td>Paid care</td>
<td>Less than 1 year</td>
<td>42</td>
</tr>
<tr>
<td>Any care at home</td>
<td>2 years</td>
<td>65</td>
</tr>
<tr>
<td>In Facilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nursing facilities</td>
<td>1 year</td>
<td>35</td>
</tr>
<tr>
<td>Assisted living</td>
<td>Less than 1 year</td>
<td>13</td>
</tr>
<tr>
<td>Any care in facilities</td>
<td>1 year</td>
<td>37</td>
</tr>
</tbody>
</table>

This data, in addition to several other studies, indicate that long-term care (LTC) costs can be financially devastating to people of any age, but particularly seniors who have chronic illnesses. Long-Term Care Insurance (LTCi) has evolved over the past couple of decades to provide comprehensive coverage. Premiums vary based on the Maximum Daily Benefit amount, the Waiting Period, the Maximum Benefit Period, and the amount of inflation coverage provided. Other benefits may influence the cost as well. Premiums for LTCi are not guaranteed and will likely increase in the future. A policy designed with “full benefits,” e.g., $150/day, 90-day Waiting Period, Lifetime Benefit Period, and a 5% annual inflation adjustment, would have a premium of about $3,000 per year. With a 6-Year Benefit Period (or maximum benefit of 72 months x $4,500 per month before inflation increases of $324,000 each) the premium would be about $2,600 per year.

It is an advantage to purchase the coverage at a younger age because the premiums are and will remain lower than if purchased at an older age. In your case, a policy with a shorter maximum benefit period and some self-insurance with a decreased maximum daily benefit would provide substantial protection at a lower cost. We need to consider this coverage carefully and I suggest we meet with a qualified long-term care specialist to review and consider your options.

### Implications of Purchasing LTCi on Fred and Farrah to Finances and Other Planning Objectives:

- **Balance Sheet:** Neutral.
- **Cash Flow:** Premiums are an expense. A policy with a maximum daily benefit of $150, a 90-day waiting period, and a 6-year benefit period would have an annual premium of about $2,600.
- **Income Tax:** Tax credits reduce premium cost. Benefits are received tax-free.
- **Education Planning:** Mitigates a potentially significant risk to being able to fund the education expenses of Faye and Francis. Note that many LTCi claims are filed by insureds well before retirement age.
- **Retirement Planning:** Substantially reduces risk of depleting retirement capital for retirement income and/or threatening financial security in retirement.
- **Estate Planning:** Neutral except less risk of decreasing size of estate.
The Risk of Unexpected Death

From our discussion, you clearly understand that the unexpected death of Fred or Farrah is a relatively unlikely event but a very substantial financial risk. You believe that your current life insurance coverage is probably inadequate. You are concerned about the extra expense and you don’t want to buy too much life insurance based “on some complex and mysterious formula.”

Objectives

Fred made it clear that in the event of his death at any age he wants to be sure that Farrah is financially secure (not wealthy!) for the rest of her life. You agreed for purposes of this calculation that Farrah would retire at age 66. Farrah would also need to keep the medical insurance and retirement benefits from her employment. You both would also want to make sure that your plans to educate the children through graduate school are provided for.

In the event of Farrah’s death, she would also want to be sure that Fred would be financially secure and he would require some help with childcare and homemaking services. She also wants to make sure that their plans to educate the children through graduate school are provided for.

In the event of the death of both Fred and Farrah, you said that you would want all of the cash needs listed below paid off or set aside for payment as required. You would want the children’s guardians to have sufficient funds to support the children above their education expenses through graduate school. Your wills appoint Farrah’s parents as guardians of the children and you still believe that is the best option. This analysis addresses the need for liquid capital to provide for cash and income for the survivor in the event of Fred and/or Farrah’s premature death. In the Estate Planning lesson, we will address the distribution of all of your assets, including beneficiary arrangements of life insurance and retirement plans.

Analysis and Recommendations

We have divided your quantified objectives into “cash needs” and “income needs” of the surviving spouse and children. We did an analysis that assumes a current death of either spouse and that whatever plan we decide upon should be reviewed annually, even if it is a brief discussion. We also discussed that your needs and objectives can change over time. We agreed on the following cash needs as follows (stated cash amounts in today’s dollars):

<table>
<thead>
<tr>
<th>Capital Requirements</th>
<th>Farrah’s Cash Needs</th>
<th>Fred’s Cash Needs – Alt. 1</th>
<th>Fred’s Cash Needs – Alt. 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final expenses</td>
<td>$25,000</td>
<td>$25,000</td>
<td></td>
</tr>
<tr>
<td>Mortgage Balance</td>
<td>296,536</td>
<td>Prefer to retain</td>
<td></td>
</tr>
<tr>
<td>Faye Secondary costs &lt;sup&gt;1&lt;/sup&gt;</td>
<td>30,391</td>
<td>30,391</td>
<td>30,391</td>
</tr>
<tr>
<td>Francis Secondary costs &lt;sup&gt;1&lt;/sup&gt;</td>
<td>30,391</td>
<td>30,391</td>
<td>30,391</td>
</tr>
<tr>
<td>Kids Wedding Cost</td>
<td>20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Extra Child Care</td>
<td>150,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Calculated Income Need &lt;sup&gt;2&lt;/sup&gt;</td>
<td>83,345</td>
<td>74,192</td>
<td></td>
</tr>
<tr>
<td>Total Capital Required</td>
<td>$635,663</td>
<td>$354,974</td>
<td>$60,781</td>
</tr>
<tr>
<td>Less Life Insurance Available &lt;sup&gt;3&lt;/sup&gt;</td>
<td>175,000</td>
<td>50,000</td>
<td>50,000</td>
</tr>
</tbody>
</table>
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| New Capital Required | $460,663 | $304,974 | $10,782 |

Footnotes:

1 Present value of projected future costs are calculated and rounded up. Presume no future contributions from grandparents.

2 The Cash Reserve is maintained – not used to pay cash needs or to provide income.

Projected earned income and Social Security benefits are sufficient to pay Farrah’s expenses up to retirement at age 66. We assume Farrah would continue to fund her 403(b) plan and Roth IRA starting at $3,000 and each contribution increasing by 3% per year. We assume she inherits Fred’s 403(b) plan balance. She will need an additional $96,000 of capital today to be able to retire with desired income at her age 66.

Earned income and Social Security benefits are sufficient to pay Fred’s expenses up to retirement at age 66. We assume Fred inherits the balance in Farrah’s 403(b) plan and Roth IRA. We assume Fred continues to make increasing contributions to his 403(b) plan and invests his considerable discretionary cash flow.

3 Existing group and personal life insurance.

4 The cash flow projections for Fred as a survivor indicate that he would have substantial discretionary cash flow for all of his 20 years from today until retirement. He should be able to handle all cash requirements noted above and still be able to build substantial retirement capital. We believe it is your objective that in the event of death of either or both spouses that you would want to set aside sufficient capital to provide for the post-secondary education of Faye and Francis. Therefore, we have calculated an “Alternative #2”, which only provides sufficient cash to be set aside to fully fund your education objectives.

In order to quantify the income needs of the surviving spouse, we worked jointly with you to estimate living expenses now, in the years after the children are both in college but before retirement at ages 66, and the retirement years beginning at age 66. A copy of these estimated expenses were included earlier with the initial Cash Flow Projections.

There are some calculations involved in determining the cash need. The calculations involving the income needs are much more complex due to estimating variable Social Security payments and varied living expenses. If you would like to review these calculations and assumptions, we will be glad to go over them with you.

We suggest that you purchase $500,000 of twenty-year renewable and convertible term insurance with a Disability Waiver of Premium rider (rounded up from $460,000) on Fred.

We suggest that you purchase $310,000 of twenty-year renewable and convertible term insurance with a Disability Waiver of Premium rider (rounded up from $304,974) on Farrah.

**Implications of Life Insurance Purchase Recommendations to Finances and Other Planning Objectives:**

- **Balance Sheet:** Increases size of death estate considerably.
- **Cash Flow:** Premium payments decrease discretionary cash flow modestly.
- **Income Tax:** Premiums are payable after tax. Death benefit is income tax-free.
- **Education Planning:** Mitigates a potentially significant risk to being able to fund the education expenses of Faye and Francis.
- **Retirement Planning:** The life insurance assures that Farrah would have sufficient income-producing capital for her retirement in the event of Fred’s premature death.
- **Estate Planning:** Guaranteed cash at death. We will address the ownership and optimal distribution of your life insurance in the estate planning section.
Estate Planning Evaluation and Recommendations

Objectives

- You do not want to be a burden to family if one of you should become severely disabled or incompetent.
- You want to make sure funds are available to complete your children’s education and provide for their marriage expenses.
- You would like to be able to gift funds to your grandchildren for education.
- You are not charitably inclined at this time. However, once you have more substantial assets and know that your children are provided for through completion of their education, you may wish to make charitable bequests.
- You want to make sure your surviving spouse and children will be able to maintain a lifestyle that would be comparable to what they have now.
- If Farrah was the survivor, she would prefer to have assets managed, or at least get guidance if assets were not substantial enough for economical professional management.

Analysis and Recommendations

1. Get legal documentation in place to provide some protection in case of incapacity or life threatening injury/illness:

   - **A Durable Power of Attorney** – You should each consider a durable power of attorney to give each other full access to manage the financial assets of the other in case one of you becomes incapacitated.

   - **A Living Will** – This allows you to provide directives regarding the use of life-sustaining measures to be used in the event of a critical illness or accident.

2. Replace your simple “I Love You” wills, where you leave everything to the survivor, with estate plans that utilize trusts at death to provide:

   - **Greater protection for your minor children.** You need to plan for the possibility that you could both die while your children are still minors, e.g., in a common accident. With your present plans, the Faye and Francis would receive their inheritance at age 18, possibly before they are mature enough to handle the funds. The temptations and distractions that can come with such an inheritance could jeopardize your greatest dream for your children – receiving a quality education. Through the use of trusts, you can assure that those funds first get used for education and can stagger the distributions of principal to the children at more mature ages, when they are more likely to use the funds wisely.

   - **Specific funding for your children’s marriages.** Specific language could be provided to empower the trustee to make distributions of funds for this purpose, thereby preserving your specific wish. The trustee AND the children would know that funds were being held in trust specifically for this purpose.

   - **Financial management for Farrah.** Farrah indicated that if she were to survive Fred, she would prefer professional investment management of the funds. While not the only solution, this might possibly be achieved through placing funds in trust for Farrah (and the children) rather than distributing them directly to her.

   - **Preserve the funds for the surviving spouse and children in the event of remarriage.** This may or may not be an issue that concerns you, but it is one that should be discussed in the planning process. A remarriage after the death of one spouse, especially one where other children are involved, could potentially undermine some of the goals you have set for your own children and could potentially diminish or deprive your children of their inheritance. Funding a trust...
when one spouse dies, rather than leaving the funds to the survivor, could potentially provide some protection in this regard.

**Address the beneficiary designations to support the restructured estate plan of number 2 above.** Since there are many ways the estate plan could be structured (using testamentary trusts or revocable living trusts, as just one example), we leave it to the attorney to determine how best to structure the plan to address the preliminary needs identified in (2) above. No doubt, this will be done with further discussion with you to better tailor the plan to your preferences. However, beneficiary designations will need to be structured to support, and not work against, the final estate plan.
Final REVISED Financial Statements

A review of the Revised Balance Sheet and Revised Cash Flow Projections provides the opportunity to see the immediate impact of our cumulative recommended changes and can serve as a focus of discussion to review our recommendations. These two statements are in Appendix 5 and 6.

Note that the Revised Balance Sheet compares the assets, liabilities, and altered values of the assets and liabilities as they are now in the “AS IS” statements versus the adjacent column which shows the effect of the recommended changes that are assumed to be implemented. The Revised Cash Flow Projections compare the receipts and disbursements before and after presumed implementation of our recommendations. If necessary, we can easily estimate and/or run new projections to reflect implementation actions that differ from those recommended.

The footnotes provide clarifying information.

Key Points to Consider:

- **Balance Sheet:** Let’s start from the top and move to the bottom and state the consequences of our recommendations to your assets, liabilities, and net worth:
  1. The CD are liquidated because only cash can be deposited into a 529 Plan. There will be little, if any capital gain realized from the sales. Thus, these three assets are “transferred” to the two new 529 accounts for Faye and Francis. The return will be increased by a tax-free accumulation of earnings and a tax-free withdrawal of cash for qualified education expenses. This tax leverage significantly increases your rate of return in your accumulation assets for education costs. In addition, we are recommending a reallocation of assets to increase your rate of return with a modest increase in risk.
  2. Your net worth is essentially unchanged. However, your assets and future earned income will be substantially better protected by recommended changes to your insurance coverages that have much broader and more substantial limits. In addition, your accumulation accounts will earn higher net returns due to tax leverage and asset allocations more suitable to your risk tolerance.

- **Cash Flow Projections:** Let’s start from the top and move to the bottom and state the consequences of our recommendations to receipts, disbursements, and net discretionary cash flow:
  1. While it appears the income from assets is declining in Year 1 and Year 2, actually about $340,000 of educational savings funds in Year 1 and Year 2 are transferred to tax-sheltered accounts that were previously projected to earn taxable interest, dividends and capital gains in non-trusted and taxable accounts.
  2. The purchase of strategically-designed insurance coverage requires allocation of some income to insurance, but the cost of some coverages may decline slightly and the added coverages significantly reduce your exposure to a broad range of unexpected events.
  3. Refinancing of your mortgage to a lower rate and to a 15 versus 30–year loan significantly reduces the current and long-term interest expenses and deductions, and accelerates the amortization of the loan. The pay-off of the Honda loan provides an attractive 5% after-tax rate of return, guaranteed.
  4. In Years 1 and 2, you are in a “transition period” and your contributions to your savings account will stop. Setting a scheduled savings amount each month beginning in Year 3 gives you a predetermined baseline for managing your cash flow.
5. An increase in your savings for education greatly increases the likelihood of reaching your objective of prefunding the costs before Faye and Francis begin college.

6. Increasing Farrahs 403B to the max gives you a head start on accumulating more funds for retirement.

7. In the Final Revised Cash Flow Projections, we estimate a small amount of Net Discretionary Cash Flow in Years 1 and 2. Several factors and decisions you make will increase or decrease these projected cash flow surpluses. It is important to monitor your actual cash flow in the future to make sure that you maintain positive cash flow.
Plan Implementation and Monitoring

The Implementation Timeline starting on the next page provides a list of all of our recommended changes in the order that we suggest is the most practical to implement over the next several months. The recommendations discussed in this report are intended to be supplemented and/or amended by our discussion and/or after you have had some time to read over and absorb them. This study may cause you to alter some of your goals or raise additional concerns that you had not previously considered. This is perfectly normal, and our purpose is to assist you in making sound proactive financial planning decisions that will serve you well in the future.

We must remember that projections are never exactly accurate, particularly several years into the future. It is imperative that your financial planning be consistently monitored to make sure that you are "on-course" regardless of what unanticipated or unpredictable events occur in your future. We are ready to assist you in that process. Ideally, this Timeline can be installed on our website and is accessible to you as well as myself and our staff. We can monitor and assist in the implementation process as well as scheduling reviews as necessary.
## Plan Implementation Timeline Report

<table>
<thead>
<tr>
<th>IMPLEMENTATION TIMELINE</th>
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<tbody>
<tr>
<td><strong>When</strong></td>
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<td>ASAP</td>
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<tr>
<td>AYEC</td>
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</table>
### Developing the Financial Plan:

<table>
<thead>
<tr>
<th>AYEC</th>
<th><strong>Discuss increase in deductible and maximum liability limit of $300K in HO policy with agent</strong></th>
<th><strong>Fred, Farrah, and your property and casualty agent</strong></th>
<th><strong>Better coverage at little, if any extra cost</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>AYEC</td>
<td><strong>Discuss increase in deductible and maximum liability limit of 300/500/100 in auto policy with agent</strong></td>
<td><strong>Fred, Farrah, and your property and casualty agent</strong></td>
<td><strong>Better coverage at little, if any extra cost</strong></td>
</tr>
<tr>
<td>AYEC</td>
<td><strong>Discuss purchase of personal liability umbrella policy with agent of $1M.</strong></td>
<td><strong>Fred, Farrah, and your property and casualty agent.</strong></td>
<td><strong>Mitigates potentially substantial risk for minimal cost.</strong></td>
</tr>
<tr>
<td>AYEC</td>
<td><strong>Coordinate appraisals and supplemental insurance for selected valuable items of personal property.</strong></td>
<td><strong>Fred, Farrah, an appraiser, and your property and casualty agent.</strong></td>
<td><strong>Mitigates a possibly uninsured risk.</strong></td>
</tr>
<tr>
<td>AYEC</td>
<td><strong>Apply for agreed upon long-term care insurance for Fred and Farrah.</strong></td>
<td><strong>Fred and Farrah. We will communicate with your life and health agent regarding specifications of the coverage</strong></td>
<td><strong>Mitigates substantial financial risk</strong></td>
</tr>
</tbody>
</table>
### DEVELOPING THE FINANCIAL PLAN: The Franklin Financial Plan Presentation

<table>
<thead>
<tr>
<th>AYEC</th>
<th>Meet with Attorney to evaluate estate plan</th>
<th>Fred, Farrah, and attorney. Cole can arrange and participate to the degree needed.</th>
<th>Assures that objectives are realized both seen and unseen.</th>
</tr>
</thead>
<tbody>
<tr>
<td>AYEC</td>
<td>Be sure to address issue of beneficiary arrangements for all life insurance policies, retirement plans, and IRAs.</td>
<td>Fred, Farrah, and attorney.</td>
<td>Assures objectives are realized in a broad range of contingencies.</td>
</tr>
<tr>
<td>AYEC</td>
<td>Meet with Attorney to evaluate estate plan and draft estate planning documents.</td>
<td>Fred, Farrah, and attorney. Cole can arrange and participate to the degree needed.</td>
<td>Assures that objectives are realized, both seen and unseen.</td>
</tr>
<tr>
<td>AYEC</td>
<td>Be sure to address issue of beneficiary arrangements for all life insurance policies, retirement plans, and IRAs.</td>
<td>Fred, Farrah, and attorney.</td>
<td>Assures objectives are realized in a broad range of contingencies.</td>
</tr>
<tr>
<td>Now and Ongoing</td>
<td>Proactively manage insurance advisors.</td>
<td>Fred and Farrah.</td>
<td>Annual reviews will maintain proper coverage.</td>
</tr>
<tr>
<td>By 9/30/Year 1</td>
<td>Refinance residence.</td>
<td>Fred and Farrah. We can assist as needed.</td>
<td>Reduce interest cost and accelerate amortization of loan.</td>
</tr>
<tr>
<td>10/15/Year 1</td>
<td>Enroll in FLEX Plan for Year 2</td>
<td>Fred and Farrah.</td>
<td>Tax savings</td>
</tr>
<tr>
<td>10/15/Year 1</td>
<td>Look at HSA and other medical plan options at next open enrollment date.</td>
<td>Fred, Farrah and Cole</td>
<td>Efficiency and potential premium and tax savings.</td>
</tr>
<tr>
<td>12/1/Year 1</td>
<td>List of all potential Miscellaneous Itemized Deductions each December to see if there is potential to shift payments to “overweight” a year to create deductions.</td>
<td>Fred and Farrah. We or tax preparer can assist as needed.</td>
<td>Potential tax savings.</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Date</th>
<th>Task</th>
<th>Responsible parties</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>By 12/10/Year 1</td>
<td>Determine proper amount of withholding for Year 2.</td>
<td>Fred, Farrah, tax preparer or Cole</td>
<td>Increases time dollars have to earn interest and/or appreciate.</td>
</tr>
<tr>
<td>By 12/31/Year 1</td>
<td>Keep receipts for all potential Miscellaneous Deductions for preparation of Year 2 Income Tax Return.</td>
<td>Fred and Farrah. Cole provide list of potential deductions.</td>
<td>Could increase tax savings.</td>
</tr>
<tr>
<td>1/2/Year 2</td>
<td>Transfer the maturing CD proceeds to each 529 account in January. Also transfer gifts of $10,000 to each 529 Plan as soon as received in June and allocate contributions as agreed upon.</td>
<td>Farrah and Fred. Contact Cole regarding asset allocation of these contributions.</td>
<td>Get dollars working ASAP.</td>
</tr>
<tr>
<td>1/Year 2</td>
<td>Deposit $5,000 into both Roth IRAs as a Year 2 contribution. May be best to pay monthly to take advantage of dollar-cost-averaging.</td>
<td>Fred and Farrah</td>
<td>Enhances retirement capital to more easily reach retirement objectives.</td>
</tr>
<tr>
<td>By 6/30/Year 2</td>
<td>We suggest annual reviews that would include reviewing the 529 Plan performance and rebalancing of assets.</td>
<td>Fred, Farrah, and Cole</td>
<td>Assures efficient movement toward achieving objectives.</td>
</tr>
</tbody>
</table>
APPENDIX 1

List of Assumptions for Franklin Comprehensive Financial Plan

(original found in Lesson 11 – The Franklin Written Comprehensive Plan / Materials for PDF folder)
APPENDIX 2

AS IS Franklin Balance Sheet  (original found in Lesson 4 – Personal Financial Statements / Final Franklin Spreadsheets / Final Franklin Balance Spreadsheet 05312012: "Starting Point" Tab)
APPENDIX 3

AS IS Franklin Cash Flow Projections (original found in Lesson 4 – Personal Financial Statements / Final Franklin Spreadsheets / Final Franklin Cash Flow Spreadsheet 05312012: "Starting Point" Tab)
APPENDIX 4

Franklin Expense Budgets (original found in Lesson 3 Materials for Franklin Case Study PDF / Franklin Expense Budgets (Living, Survivor, Retirement))
APPENDIX 5

Franklin Revised Balance Sheet (original found in Personal Financial Statements / Final Franklin Spreadsheets / Final Franklin Balance Spreadsheet 05312012: "Presentation" Tab)
APPENDIX 6

Franklin Revised Cash Flow Projections (original found in Lesson 4 – Personal Financial Statements / Final Franklin Spreadsheets / Final Franklin Cash Flow Spreadsheet 05312012: "Presentation" Tab)