

# CASE 2

## ALVIN AND FRAN JACKSON CASE

Today is January 2, 2014

### INTRODUCTORY DATA

Alvin and Fran came to you, a financial planner, as a referral from the CFP Board's Make A Plan marketing outreach program. They are in the asset accumulation and risk management phases of life and need help determining how much to save so they can send their three boys to college while also securing their own retirement. They have learned that you need to be flexible when you have three children because things change, sometimes frequently and often unexpectedly. They want their financial plan to be flexible enough to meet their goals. They believe they will benefit from meeting with a CERTIFIED FINANCIAL PLANNER™ practitioner and arrived with the following information for you to assist them in creating a plan to meet their financial goals.

#### THE FAMILY

Alvin Jackson, age 43, works at Mach Speed Company, a family owned firm that supplies the aerospace industry. Alvin has been with the company for 16 years. He plans to retire with 35 years of service at age 62. Alvin grew up in Idaho but moved to Seattle to attend college which is where he met and married Fran 20 years ago. They lived and worked in Seattle until Alvin was offered a higher paying job at Mach Speed which is located south of Seattle in Laplace, Washington.

Fran Jackson, age 43, grew up in Wisconsin and loves the outdoors. She moved to Seattle after high school to be close to the Pacific Ocean and milder weather. Fran learned to surf and spent a great deal of time in, on and around the water. She enjoyed the water so much that she became interested in fluid dynamics and decided to attend college. College is where she met Alvin, who also enjoyed the natural beauty and outdoor activities of the Pacific Northwest. Fran has been in and out of the work force due to having three children, but has been with her current employer, Water Striders, for five years. She expects to work until age 62.

Alvin and Fran have three children: Curly (age 12), Larry (age 8) and Moe (age 6). The boys attend public school. They are intelligent and athletic with college prospects. However, Alvin and Fran do not want to rely on the boys' ability to obtain athletic or merit-based scholarships to attend college. They want to save enough money to provide each boy with 5 years of college at State University, beginning at age 18.

## FINANCIAL GOALS & CONCERNS (IN ORDER OF PRIORITY)

1. Retirement at age 62 with 80% of preretirement income including Social Security. Life expectancy is 96 for both.
2. College education of children for 5 years, each beginning at age 18, at the state university.
3. Appropriate risk management portfolio, investment portfolio, and estate planning portfolio.
4. They plan on buying a vacation home in 19 years in Colorado at a price of \$350,000 in today's dollars.
5. They will not sell the movie collection and may add to it.

## EXTERNAL INFORMATION

### ECONOMIC INFORMATION

- General inflation is expected to average 3.0% annually for the foreseeable future.
- Education inflation is expected to be 6.0% annually.
- They live in the state of Washington which has no state income tax.
- Raises are uncertain but in the long-run are expected to be equal to general inflation (CPI).
- The economy is in a slow growth recovery from a recession with moderate to high unemployment.

### BANK LENDING RATES

- 15-year conforming rate mortgage is 3.75%.
- 30-year conforming rate mortgage is 4.00%.
- Any closing costs associated with any mortgage refinance are an additional 3% of any amount mortgaged and will be paid directly (i.e., not included in the new mortgage).
- They plan to stay in their home through retirement and are more concerned about cash flow and possible monthly savings than the term of debt associated with the home.

### INVESTMENT RETURN EXPECTATIONS

- General market for stocks is expected to return 9.5%.
- The Jackson's required rate of return is 8%.
- Fixed income investments are expected to earn 6%.
- T-Bills are expected to yield 3% per year and are the proxy for the risk-free rate of return.

# INTERNAL INFORMATION

## FINANCIAL STATEMENTS

### Statement of Financial Position (Beginning of Year)

Statement of Financial Position  
Alvin and Fran Jackson  
Balance Sheet as of 1/1/2014

ASSETS <sup>1</sup>		LIABILITIES AND NET WORTH	
<b>Current Assets</b>		<b>Current Liabilities<sup>2</sup></b>	
W Cash & Checking	\$22,000	W Credit Cards <sup>4</sup>	\$11,291
		JT Mortgage	\$9,369
		JT Cars	\$13,333
<b>Total Current Assets</b>	\$22,000	<b>Total Current Liabilities</b>	\$33,993
<b>Investment Assets</b>		<b>Long-Term Liabilities<sup>2</sup></b>	
JT Stock Portfolio	\$200,000	JT Principal Residence <sup>3</sup>	\$270,515
H 401(k) Mach Speed	\$250,000	JT Autos	\$26,667
W IRA Rollover Account	\$28,000	W Credit Cards	\$8,825
<b>Total Investment Assets</b>	\$478,000	<b>Total Long-Term Liabilities</b>	\$306,007
<b>Personal Use Assets</b>		<b>Total Liabilities</b>	\$340,000
JT Principal Residence <sup>3</sup>	\$300,000		
JT Autos	\$40,000		
H Old movie collection of 3 Stooges original Soundtrack	\$100,000	<b>Total Net Worth</b>	\$800,000
JT Furniture and Fixtures	\$100,000		
W Jewelry	\$50,000		
JT Other, Clothing	\$50,000		
<b>Total Personal Use Assets</b>	\$640,000		
<b>Total Assets</b>	<u>\$1,140,000</u>	<b>Total Liabilities &amp; Net Worth</b>	<u>\$1,140,000</u>

- Assets are stated at fair market value.
  - Liabilities are stated at principal only as of January 1, 2014 before January payments.
  - Bought 12 years ago at \$400,000 with 10% down and 30 year mortgage at 5.5%. They have 216 payments remaining. Unfortunately, the value of the residence has fallen to \$300,000. Land value is \$50,000.
  - The balance of the credit cards is \$20,116. They are paying about \$1,000 per month (see income statement) and the cards carry a blended interest rate of approximately 17.6%. They expect to have the cards paid off in 24 months.
- \* Federal income tax refund or liability for 2013 has not been determined and is not included.

**Title Designations:**

H = Husband (Sole Owner)

W = Wife (Sole Owner)

JT = Joint Tenancy with Survivorship Rights

*Statement of Income and Expenses*

Statement of Income and Expenses		
Alvin and Fran Jackson		
Statement of Income and Expenses for 2013 and Projected for 2014		
		Totals
<b>Cash Inflows</b>		
Alvin's Salary	\$75,000	
Fran's Salary	\$50,000	
<b>Total Cash Inflows</b>		\$125,000
<b>Cash Outflows</b>		
<b>Savings</b>		
401(k) Plan - Alvin	\$7,500	
<b>Total Savings</b>		\$7,500
<b>Taxes</b>		
Federal Income Taxes Withheld	\$17,625	
Alvin's Social Security Taxes	\$5,738	
Fran's Social Security Taxes	\$3,825	
Property Tax Principal Residence	\$4,300	
<b>Total Taxes</b>		\$31,488
<b>Debt Payments (Principal &amp; Interest)</b>		
Principal Residence	\$24,529	
Auto	\$13,333	
Credit Cards	\$12,001	
<b>Total Debt Payments</b>		\$49,863
<b>Living Expenses</b>		
Utilities Principal Residence	\$5,000	
Child Care	\$3,600	
Auto Maintenance and Gasoline	\$6,000	
Entertainment and Vacations	\$5,000	
Church Donations	\$600	
Food	\$10,000	
Children's Field Trips, Lunches, Allowances	\$800	
Lawn and Cleaning Services	\$1,400	
Clothing	\$5,000	
Miscellaneous	\$3,000	
<b>Total Living Expenses</b>		\$40,400
<b>Insurance Payments</b>		
HO Insurance Principal Residence	\$3,600	
Life Insurance	\$3,000	
Health Insurance	\$5,000	
Disability Insurance	\$1,200	
Auto Insurance	\$2,400	
<b>Total Insurance Payments</b>		\$15,200
<b>Total Cash Outflows</b>		\$144,451
<b>Net Discretionary Cash Flows</b>		<u>(\$19,451)</u>

*\*All numbers rounded to nearest \$.*

## INSURANCE INFORMATION

### Life Insurance

Policy	A	B	C	D
Insured	Fran	Alvin	Fran	Alvin
Life	\$50,000	\$50,000	\$100,000	\$225,000
Employer Provided	Yes	Yes	Owned Fran	Owned Alvin
Type	Group Term	Group Term	Universal*	Universal*
Beneficiary	Alvin	Fran	Alvin	Fran
Contingent Beneficiary	Children	Children	Children	Children
Premium (Annual)	\$500	\$750	\$1,000	\$2,000

\* The universal policies can be replaced with 25 year term of \$1 million for Fran and \$2 million for Alvin for the exact same premiums of \$1,000 and \$2,000 per year respectively. Neither of the universal policies have any cash value.

### Health Insurance

Group Major Medical
Alvin's Group Major Medical
Unlimited Life Time Benefit
\$3,000 Stop Loss (annual)
\$300 Deductible per Person
80/20 Co-insurance for Major Medical
Premium-Employer provided for Alvin only. Alvin pays for the rest of the family \$5,000 year after tax.

### *Disability Insurance*

Alvin's disability policy has an option to increase the elimination period to 180 days which would reduce the current annual premium from \$1,200 to \$800.

	Alvin	Fran
Coverage (sickness and accident); Hybrid (own and any EET)	5 yr / to age 65	None
Personally Owned	Yes	
Residual Disability Provision	Yes	
Benefit	60% of gross pay	
Benefit Term	to age 65	
Elimination Period (can be changed)	90	
Premium	\$1,200 per year	

*Own = own occupation, EET = experienced, educated, and trained*

### *Long-Term Care Insurance*

Neither Alvin nor Fran have long-term care insurance.

### *Property and Liability Insurance*

Alvin and Fran met with their insurance professional who recommended that they could increase the deductibles on their homeowners insurance (savings of \$1,200 per year) and auto insurance policies (savings of \$300 per year) and add a rider to insure their collectibles (cost of \$300 per year). Net total savings, if implemented, is estimated to be \$1,200 per year.

### **Homeowners Insurance**

Personal Residence	
Type	HO3 with endorsements
Dwelling	\$250,000
Other Structures	\$100,000
Personal Property	\$150,000
Loss of Use (20% of dwelling)	\$50,000
Deductible	\$200
Premium (annually)	\$3,600

Auto Insurance

Auto	
Type	Personal Automobile Policy (PAP) with \$250 deductible for comprehensive and collision
Liability (Bodily Injury)	\$100,000/\$300,000/\$50,000
Medical Payments	\$25,000
Uninsured Motorist	\$100,000/\$50,000
Collision Deductible	\$250
Other than Collision	\$250
Towing and Labor	None
Annual Premium	\$2,400

Liability Insurance (Personal Liability Umbrella)

Neither Alvin nor Fran have liability insurance. Coverage of this type is estimated to cost \$240.00 per year for \$1,000,000.

EDUCATION INFORMATION

- College costs at State University are currently \$18,000 per child, per year in today's dollars or \$72,000 for a four year degree.
- Alvin and Fran have been told that Washington State does not offer a 529 college savings plan, but it does operate a unit-type prepaid tuition program (GET). Each unit purchased through GET is redeemable for one percent of the resident undergraduate tuition at the highest-priced public university in Washington. The units may also be used for eligible educational institutions across the country. Washington State's GET program is backed by the full faith and credit of the State, which is unlike other states' 529 guarantees. However, they are concerned about the payout period since Curly is only six years away from entering college. They also want the flexibility to use any excess funds saved for their retirement should any of the boys get scholarships or decide not to attend college.
- If Alvin and Fran do not purchase the GET pre-paid tuition program in Washington State they might want to invest in another state's 529 savings plan.
- They tell you they have been discussing the idea of purchasing a second home in College City where they expect the boys to attend State University. They explain they might like to use proceeds from the 529 Savings Plan to purchase a home for the boys, or if necessary, purchase the home themselves and charge the boys' 529 Plan accounts rent to reflect room and board. If this is possible, they would sell the College City home when Moe finishes college and use the proceeds from the sale to purchase a Colorado vacation home for the entire family.
- They plan to pay the full costs of college education so the children will have no debt and will not have to work during college so they can concentrate on their studies.

## INVESTMENT INFORMATION

### Risk Tolerance Questionnaire

#### Global Portfolio Allocation Scoring System (PASS) for Individual Investors<sup>1</sup>

Questions	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1. Earning a high long-term total return that will allow my capital to grow faster than the inflation rate is one of my most important investment objectives.	A,F				
2. I would like an investment that provides me with an opportunity to defer taxation of capital gains to future years.	A,F				
3. I do not require a high level of current income from my investments.	A,F				
4. I am willing to tolerate some sharp down swings in the return on my investments in order to seek a potentially higher return than would normally be expected from more stable investments.	F		A		
5. I am willing to risk a short-term loss in return for a potentially higher long-run rate of return.		F		A	
6. I am financially able to accept a low level of liquidity in my investment portfolio.			A,F		

A = Alvin, F = Fran

### Stock Portfolio

The Jackson Stock Portfolio						Recent Returns (Total)				
Stock	Quantity Shares	FMV	Annual Dividend	Beta	Tax Basis	2009	2010	2011	2012	2013
A	100	\$30,000	\$1.00	1.20	\$19,150	8	10	10	11	8
B	300	\$75,000	\$0.30	1.40	\$52,452	9	5	(3)	12	15
C	400	\$60,000	\$0.70	0.90	\$43,187	6	7	7	8	6
D	250	\$35,000	\$0	1.15	\$23,389	7	8	8	9	10
		<b>\$200,000</b>								

The coefficient of correlation between the market and the stock portfolio is 0.7% over the past 5 years. The market has yielded a geometric return of 6.8%.

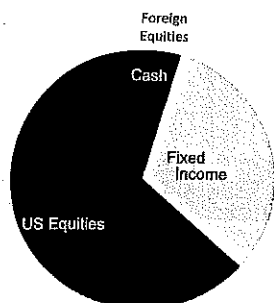
1. Global Portfolio Allocation Scoring System (PASS) for Individual Investors - developed by Dr. William Droms (Georgetown University) and Steven N. Strauss, (DromsStrauss Advisors Inc.) - model used with permission.

Alvin and Fran tell you that they have owned these stocks since January of 2009 and believe they are all good stocks. They provided the tax basis for each stock (above) and want to know which stock or stocks should be sold to fund whatever they decide to do with regard to the 529 Plans or additional IRA contributions they are contemplating.

### Portfolio Information

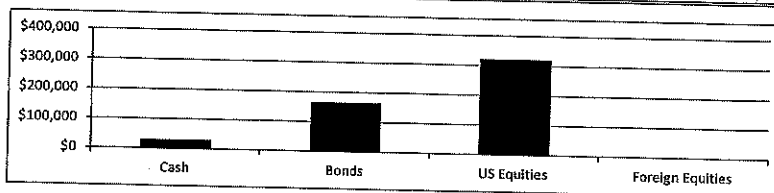
#### Alvin and Fran Jackson Portfolio Information 12/31/13

Total Portfolio		
Cash and Cash Equivalents Plus Investments		
	Dollars	%
Cash	\$22,000	4%
Fixed income	\$160,000	32%
US Equities	\$318,000	64%
Foreign Equities	\$0	0%
<b>Total</b>	<b>\$500,000</b>	<b>100%</b>

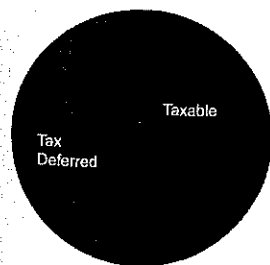


Account	Cash	Bonds	US Equities	Foreign Equities	Total
Cash	\$22,000				\$22,000
Brokerage account			\$200,000		\$200,000
401(k) Plan		\$160,000	\$90,000		\$250,000
IRA Rollover			\$28,000		\$28,000

Total	Cash	Bonds	US Equities	Foreign Equities	Total
	\$22,000	\$160,000	\$318,000	\$0	\$500,000

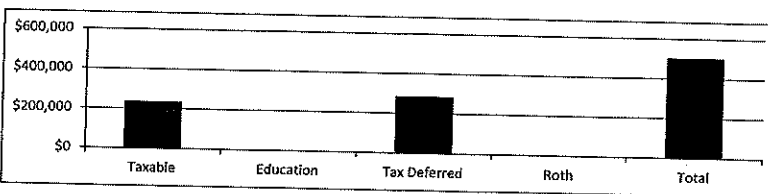


Total Portfolio - Account Types		
	Dollars	%
Taxable	\$222,000	44%
Education	\$0	0%
Tax Deferred	\$278,000	56%
Roth Accounts	\$0	0%
<b>Total</b>	<b>\$500,000</b>	<b>100%</b>



Account	Taxable	Education	Tax Deferred	Roth	Total
Cash	\$22,000				\$22,000
Brokerage account	\$200,000				\$200,000
401(k) Plan			\$250,000		\$250,000
IRA Rollover			\$28,000		\$28,000

Total	Taxable	Education	Tax Deferred	Roth	Total
	\$222,000	\$0	\$278,000	\$0	\$500,000



## RETIREMENT INFORMATION

- Both Alvin and Fran have similar 401(k) profit sharing plans at their respective employers. The plans are safe harbor plans with an employer match of 1% for the first 3% contributed and ½% for any contribution greater than 3% up to 5%. The total possible employer match is 4% of each salary. Both 401(k)'s contain loan provisions.
- Alvin participates in his employer's plan contributing 10% of his annual salary. They would like for Fran to participate in her employer's plan but she has not signed up yet.
- Alvin and Fran are also interested in contributing to traditional IRA accounts for the tax deduction and want to know your thoughts on such a contribution.

## ESTATE PLANNING INFORMATION

Alvin and Fran have no legal or estate planning documents. While they do not expect to take care of their parents they also do not expect to receive any inheritances from their parents or grandparents.

They want to take care of each other and leave any remaining assets in trust for their boys. They tell you that they dislike paying taxes and remind you that they like flexibility. They ask if their estate planning documents can be drafted to reflect these preferences.

## CASE ASSUMPTIONS

1. Alvin and Fran expect to live to age 96.
2. They have a moderate risk tolerance and a required rate of return of 8%.
3. The children's child care expenses are paid to a child care center.
4. They will refinance their home, if possible, and use the additional cash flow to fund savings for retirement, college or both.
5. They will pay any expected expenses from refinancing from their investment account.
6. They want to buy a vacation home in Colorado for \$350,000 in today's dollars in 19 years (2033), but would accelerate the purchase of a second home if they could use proceeds from 529 accounts to purchase a home for the boys to live in while in college. They would sell the College City property after Moe completes his degree and use the proceeds to purchase a vacation home for the entire family in Colorado.
7. Alvin's parents are retired and live on their savings and Social Security. They have told Alvin and his brothers, Theodore and Simon, that they have purchased long-term care insurance so they would not be a burden to anyone.
8. Fran's parents are also retired with a pension and social security. They have not purchased long-term care insurance. Fran tells you there is no history of Alzheimer's on either side of her family and that all of her grandparents are still alive and well, living in retirement communities in Arizona and Florida.
9. Alvin's Social Security retirement benefit at normal retirement age of 67 is \$2,250 per month in today's dollars. Fran's Social Security retirement benefit at normal retirement age of 67 is \$1,800 per month in today's dollars.
10. Alvin and Fran want to retire at age 62.
11. They purchased a luxury SUV at the beginning of last year and financed \$53,333 for 48 months at 0% interest. They pay \$1,111.10 per month (\$13,333 per year).
12. The previous year's 12/31 net worth was \$843,149.
13. The previous year's total assets were \$1,217,149.
14. The previous year's investment assets were \$429,916.

## UNIT PRICES OVER TIME

The GET unit price is established through a complex actuarial formula which accommodates projected tuition increases, projected investment returns, a stabilization reserve and administrative costs. It has increased annually since the program began.

