THOUGHTS ON THINGS FINANCIAL

YOUR GUIDE TO A CHAOTIC MONEY WORLD

ROBERT R. SCHULZ, CFP®

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Chapter 9

KIDS AND MONEY, BUT NOT JUST COLLEGE MONEY

Shelly and I have four kids. Somehow, all four have grown up to become wonderful, smart, and successful young adults. I'm sure we had something to do with it, but it was when we allowed our kids to find their own way that we did some of our best parenting.

I'm not a very emotional person, but there have been what I consider to be monumental moments in each of my kids' lives that have made me bawl like a baby. Gretchen, our oldest, is extremely smart. I was proud when she was accepted into one of the most prestigious architecture programs in the country. But it didn't work out, and she was soon back home from New York City. Broken, depressed, and without any clear direction, she scraped herself up off the ground and slowly worked her way back on track. Later, when she walked across the stage at College Park Center at The University of Arlington to accept her degree, to me it represented not as much what she had achieved but, rather, more what she overcame. I could not have been more proud of her than I was at that moment, and she has gone on to achieve advanced degrees and great success in a career she loves.

Grace, our number two, is a real go-getter. As a youngster, she loved volleyball more than anything and worked hard at it. She would go on to achieve record-setting performance in college, but high school ball was a struggle. Her coach was especially tough on her, too tough. Grace endured overwhelming pressure and negativity. She struggled and fought hard to overcome. At the end of her senior year, it all came together as she dominated the middle of the court and tasted sweet, hard-fought success. Just like with Gretchen, to me her success was so much more than what you saw on the court. It represented her own personal fight against the odds.

Just like any parent, I hate to see my kids struggle, yet looking back, I know that they grew when they failed a little. Our two youngest kids, Daniel and Gwen, have both had to deal with career-ending sports injuries. But those two are amazing. They both bounced back from their setbacks, found new passions, new dreams, and learned to overcome.

Of course, as parents we need to do everything we can to create a safe environment for our children. But we can go way overboard. I'm sure you are familiar with the term "helicopter parent." You know, hovering over and trying to protect our kids from everything. Now, with the big college admissions scandal that hit in 2019, some big names in the entertainment industry got to do some time in the big house for taking it to the next level. They have defined the latest crop of "lawnmower parents" who mow down every obstacle in their child's path, no matter the cost.

But the ultimate cost is potentially never allowing our kids to grow up at all and destroying our own finances in the process. Over the years, I have worked with couples who, nearing their own retirement, are still financially supporting their adult kids. That's ridiculous. Sure, there are circumstances and events that may require us to step in and financially help out a struggling adult child, but ongoing financial support for healthy adult children is not in anybody's best interests, theirs or ours. It's from this perspective, then, that trying to teach our kids how to be adults instead of protecting them from being adults makes the most sense in our quest to help them financially succeed.

Too often, we worry about the wrong things and miss the point. Many of my clients state a strong desire to pass on money to their kids. That's great, but I always ask, "Why?" Sometimes they answer; "Because we want them not to worry or struggle the way we did, and we want them to be happy." Others answer with, "Because that's what our parents did for us, and we want our money to be a lasting family legacy."

Ask yourself, "Why?" Your answer will reveal some important insight into how to move forward with regard to money and your kids. More often than not, it can help us realize these two important factors:

1. Never talking about money with your kids, not being honest about money with them, and treating it as a taboo subject the way that most families do is a really bad idea.
2. Spending all of your time planning and setting up a brilliantly tax-efficient trust strategy that transfers all of your wealth at your death with a multitude of strings and spendthrift provisions probably misses the point.

One of the best gifts we can give to our children from a financial standpoint is to ensure that they don't have to take care of us financially in our old age. This means getting our own financial house in order should be our priority. From there, I think our next step should be to focus on financial education.

Adult Training

One of the hardest parts of being an adult is learning all of the ins and outs of financial responsibility. I know for most of us, we had to figure it all out on our own, but it doesn't have to be that way.

We should educate our kids early about how to value and properly handle money, and the best way to do it is through a good old-fashioned allowance. Executed properly, an allowance teaches kids all of the basics.

An allowance is a critical step toward their eventual financial independence, so it's important to keep this future goal in mind when devising an allowance strategy. The general concept is to ensure our kids already have some money handling skills before they leave for college and beyond. Once they are out of the house, you lose power and insight into what they are doing with their money, and you lose the ability to help. Here are some of my do's and don'ts when it comes to allowances:

Do…

- Have your child create the budget. Before handing over funds, ask your kid to make up a list of what they need money for and how much. I will almost guarantee they will grossly undershoot their actual need because they do not have a clue what things cost. Work with them to come up with realistic numbers and use their budget as a guide for their initial allowance amount. Periodically, get together with your child and make adjustments as necessary.
- Hold the line. If the agreement is for them to buy their own clothes, resist bailing them out if they initially blow all of their money on movies and dinners with friends. Provide your child with the opportunity to feel the consequences of their spending decisions. It's better for them to learn about these consequences now instead of later, when you're not around to provide guidance and support.
- Have your child set up a checking and savings account. Instead of just handing over cash, go ahead and help

your kid learn about banking. I would suggest both a checking and savings account. Teach them to use the checking account for regular monthly expenditures, like gas, and to use their savings account for periodic purchases, like clothes and car repairs.

Don't…

- Use an allowance as a control or discipline device. A well-devised allowance plan is just the opposite of control. The allowance should allow your child the freedom to make some of their own choices and exert some independence. Remember, we're training our kids to be responsible adults not enforcing our will upon them.
- Play "good parent, bad parent." Make sure the guidelines of what your child is responsible for, like clothes and gas, are clearly established and adhered to by both parents. Healthy spending habits will not burgeon if the only thing your child needs to do when they want extra cash is go see Dad.
- Tie an allowance to chores or duties. This is a controversial one, but I'm going with it anyway. Everybody in the household should have duties they are expected to complete. Money has little to do with the roles that family members play to support one another. Think of an allowance as an extension of the financial support we already provide to our children, only we are providing it in a way that teaches them a skill.

It's astounding to me how easily kids pick up great money habits when we approach their training with the right attitude and keep these guidelines in mind. If your kid can establish sound money handling habits early on, it will drastically improve their prospects for a financially sound future. In my opinion, this kind of training is more important and more effective than gifting strategies or inheritance. As the old proverb says, "Give a man a fish, and you feed him for a day. Teach a man to fish, and you feed him for a lifetime."

But each kid responds differently to allowance training. One of my kids is a natural-born saver and investor. Because she has been handling her own money for some time now, she was able to discover this trait and become diligent and successful with her money at a very young age. Another one of my kids loves, loves, loves to spend. Fortunately, she learned this about herself early on and has done an incredible job putting saving and investing on autopilot, so she never has the chance to spend it.

Set Realistic Expectations

I often see parents make mistakes when it comes to their children and the great college search. You need to be honest with them about your financial constraints. We all want what's best for our kids, so ideally, we want them to be able to go where they want for higher education. But tuition has skyrocketed over the years. Thirty years ago, sending a kid off to a college campus to "find herself" in the "college experience" did not cost what it does today. To justify today's inflated tuition bills, there needs to be an endgame career plan that's worth the cost. So, we need to ask our children why they want to go to college and why they want to go to that specific school. They need to verbalize a desire with sound reasoning in order to justify the costs.

More and more, my clients and their kids are discovering ways to achieve a great career path without college being a part of the equation at all. The job market is much more specialized than it used to be. Skills like graphic design, acting, or even robotic technology do not necessarily require college degrees. Good communication about what your child wants to do, along with sound research and planning, can open up new, fun, and creative ways for your child to achieve their dreams.

Case in point, Michael Dell was one year ahead of me at the University of Texas. College was not his thing, so he dropped out to assemble and sell computers. By the time I graduated, Dell Inc. was a publicly listed company on the NASDAQ. He had a great idea. But more importantly, his timing was perfect. The opportunity costs Michael would have paid for finishing his college career just because "that's what you're supposed to do" are staggering. It takes courage to forge your own path and not just go with the flow, but it can really pay off.

Student Loans

Of course, it's best to avoid student loans. I had a young couple come see me recently. They both had great incomes and careers but were struggling financially. Once we dug into their financials, we found their student debt was strangling them. It kept them from being able to afford decent housing, save sufficiently for retirement, or save for *their* kid's college. What a shame. There is around $1.5 trillion dollars of outstanding student debt out there[4] causing financial troubles for another 50 million American adults, just like the young couple who met with me. The financial ripple effect of all of this is beyond my comprehension and could severely impact these families for generations.

Even with the skyrocketing costs, if you are creative and work at it, I think college can still happen for our kids without breaking the bank or putting them hopelessly in debt. For one, there are so many college options. Instead of just blindly defaulting to your alma mater, do some research and see if you can find the schools that are looking for a kid like yours. These days, college shopping is kind of like car shopping. Many times, there is the sticker price, but then there are discounted tuition amounts for kids who meet

4 Ben Miller, Colleen Campbell, Brent J. Cohen, and Charlotte Hancock, "Addressing the $1.5 Trillion in Federal Student Loan Debt," Center for American Progress, June 12, 2019, https://www.americanprogress.org/issues/education-postsecondary/reports/2019/06/12/470893/addressing-1-5-trillion-federal-student-loan-debt/

certain SAT or GPA requirements. Aggressively pursue all scholarship opportunities.

To really save money, you can look into getting the basics out of the way at a local junior college. Our local junior college costs less than $1,800 per year. Better yet, encourage your child to take advanced placement or dual credit courses while in high school. I have a client whose daughter, Bethany, graduated from high school with 30 advanced placement credits. From there, she enrolled locally in the University of Texas at Arlington. Because of her grades and GPA, they waived 90% of her tuition. She hit it hard and graduated in two years, thanks to all of those advanced placement credits. She enrolled in law school well before her 21st birthday. Her parents were able to preserve all of her college savings since her undergraduate degree was almost free (not to mention only two years instead of four), so it could be used for law school. That's being smart about it.

College is not the only big-ticket item on the menu when it comes to raising kids. Don't forget about cars and weddings, or even some assistance with their first home. If you want to help provide any of these items, you'll need to plan ahead.

Planning to Pay for College (or Cars, or Weddings, or…)

For most of us, if there is going to be money available to pay for all of this, we'll have to formulate a plan. Modern financial planning software does a great job of integrating these expenses into an overall long-term financial plan. With software, we are able to take into account a family's income, expenses, and overall savings capabilities in order to provide recommendations.

In running these plans over the years, here are some general ideas and concepts I have found to be helpful. First off, as we already discussed, college is expensive, and tuition rates continue to increase much faster than normal inflation. I usually assume a 6%

increase in tuition costs. That's so high that you can skip the time value of money calculations completely and just assume that college expenses will go up at the same rate as your assumed return.

For this reason, the first time you run a calculation to solve for how much you need to sock away monthly for your kids' college to meet 100% of the cost, prepare to be shocked and depressed. In most cases, it's unattainable. But after you pull yourself off of the floor, open a college savings account and start saving what you can anyway. If you can't fund the whole enchilada right now, that's okay. Any amount you save will be needed and will provide important options.

The amazing thing to me about college planning is that in spite of all of the challenges, it nearly always works out. I don't mean you just finance college with student loans and worry about it later. No, it works out if you're smart about it, communicate effectively, and set realistic expectations. I can't say this about retirement planning. In planning for retirement, if we're not marching along in step with a plan, disaster usually strikes. I think it's because, although college is expensive, it's not nearly as expensive as retirement.

An average couple with a child going off to college this year should expect four years to cost somewhere between $60,000 and $100,000.[5] That's pretty rough, but retirement might be a short 15 years away with a $2.4 million price sticker on it. Don't let college planning take you off track for your retirement planning.

How do most of my clients make college work out effectively? They pay for a lot of it out of current income. There are some expenses in the home (activities, eating out) that diminish when Junior goes away to college, and those expenses get redirected to his tuition. In addition, it seems that right around college time,

5 Katie Lobosco, "No Scholarship? Here's How to Pay for College," *CNN* online, May 5, 2017, https://money.cnn.com/2017/04/25/pf/college/pay-for-college/index.html

mom and dad start hitting full stride in their careers. Age, experience, and less time hauling kids all over tarnation translates into higher wages at this juncture, part of which gets thrown into the college cauldron.

Where to Put It

If you Google "college savings plans," the number 529 comes up. A 529 plan is a tax-advantaged college savings account, kind of similar to an IRA. If you save for college inside of a 529 plan, the earnings are tax free as long as they are used for college-related expenses. These accounts have a lot of flexibility, but if the money is not used for college, you usually have to pay ordinary income taxes on the gains along with a 10% penalty, though there are some exceptions.

I don't get overly excited about 529 plans. First off, the timeframe between saving for college and paying for college is relatively short compared to other long-term investing, like retirement. This means there is not as much time for tax-advantaged savings to make a significant difference in the ending balance. In other words, the juice is not worth the squeeze.

My preference is to save for college in a plain old, simple investment account, in your name so that you can do whatever you want. That way, the money can be used for a multitude of expenses, not just college. The great news here is, if you are able to get your kids through school and preserve some of your "college" savings, it can be used for a wedding, as a down payment for their first home, or my favorite, you can keep if for yourself as part of your retirement plan.

That being said, there are a couple of instances where I like 529 plans. When my client has a lump sum of money and we want to preserve and protect it specifically for college, a 529 plan is the way to go. Contributions into a 529 plan are considered a gift. This means the funds will be protected from creditors or lawsuits against you. Usually, you can only gift a certain amount per year, currently $15,000 per donor per donee, without having to pay gift and estate tax. But with a 529 plan, you can give more. It's called superfunding, and you can contribute up to five years' worth of gifts in a single year. This means a couple can make a single $150,000 contribution into a 529 plan for a child without paying gift tax. A large single lump sum like that early on makes the tax-free return of a 529 plan look pretty enticing all of the sudden. I call this the one-and-done approach to college planning.

But here's an even better way to superfund college: get the grandparents involved. Grandparents often want to help out with college, but they are unsure or wary of doing so. If the grandparents fund a 529, it's kind of like a free trust. It's a gift directly to the grandchild for a specific purpose. It has to be used for college, is protected from creditors or divorce, and can even be transferred to another grandkid if circumstances dictate.

If you are self-employed, you may have the opportunity to fund college on a tax-deductible basis by hiring your kids in your business. If they are under age 18, you don't have to pay payroll taxes on their paychecks, so hire them to do some work for you in your business, then turn around and use that money later for college. Even if they are over 18 and you have to pay payroll taxes, I think it can still be worth it. I hired one of my daughters while she was in college to manage social media postings for me. She used those funds for her living expenses, and they were tax deductible for me.

Inheritance

Eventually if there is anything left, your kids will probably end up with your money. But unfortunately, the odds of your kids being successful with that money are extremely low. Some studies show that, 70% of the time, family money vaporizes by the next generation.[6] I believe it. Early in my career, I had the opportunity

6 Amy A. Castoro, "Wealth Transition and Entitlement: Shedding Light on the Dark Side

to work hand in hand with a well-heeled trust department in one of our local banks. Most of the trust clients were multi-generation wealth heirs, and for the most part, they didn't have a clue about anything. "What a terrible way to exist," I thought at the time. Most of these clients were completely set up financially. They didn't have to do much, so they didn't. I decided right then and there that I wouldn't do something like that to my children.

Due to my experience with these trust department clients, I now work hard to help my clients raise their kids to be financially responsible, capable of handling money in a way that is fulfilling for them and beneficial to society. We aggressively pursue a strategy of financial education with our client's children. We have what we call kid meetings, where their children come in and we discuss the financial aspects of being an adult. This generally happens first right around the time they start driving, and we talk about budgeting, allowances, and college expectations. From there, we try to be an open door for them as they go off to college and take on more financial responsibility for themselves. Then, when they get their first job, we try to be there to help them with their savings and retirement plan decisions. Finally, we try to make it easy for them to engage with us as clients, with no minimum asset requirements and waived planning fees. Why do we do this? Because eventually they will have their parent's money, and if we can help them learn a thing or two about financial responsibility now, hopefully they won't screw it up.

This approach flies in the face of the approach my trust officer compadres take. In contrast, they build out these complicated and expensive trusts and such with all kinds of restrictions, safeguards, trip wires, and provisions. I think that's kind of like when your kid is about to turn 16, and they get their first car. That's scary, so what do many parents do? They do research and buy the safest

of a Charmed Life," The Journal of Wealth Management 18, no. 2 (Fall 2015): http://www.phase3.biz/core/userfiles/TWG/files/JWM_Fall_2015_WG.pdf car on the market, fully equipped with 20 airbags, state of the art crumple zones, lane departure, dashcams, and crash notification systems. But what good is all of that if you never properly trained your child to drive safely in the first place? The key to staying safe on the road is not safety technology, it's good, safe driving skills. The key to making inherited funds last is teaching our kids sound financial skills.

Teaching financial responsibility skills to our kids is critically important to their long-term success, yet few parents really even try. It's sad. You can have a brilliant kid who goes off to MIT and becomes a successful doctor. But if he or she never learned any money skills, there is a decent chance they will never achieve personal financial success. Heck, add a big portfolio of student loans to the mix, and they are practically doomed. I see it all of the time.