The Planning Quarterly

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PEAPACK PRIVATE

Wealth Management

Welcome to the November 2021 issue of the Peapack Private Planning quarterly. Planning issues arise at every stage of life—the articles here address a few of them. This quarter, we're looking at the end of the year, tying up loose ends and preparing for 2022. Please reach out to our authors—or to any of our investment and planning professionals—with your questions. Our guidance can help you achieve your financial goals.

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Navigating Medicare Open Enrollment

Betty S. Thomas, ChFC®, CFP®

If you are approaching age 65, switching from a private, employer-provided health insurance plan to Medicare can be daunting. As you begin your research, your first questions might be when to enroll and what plan to choose.

The answer to the first question, "when to enroll" is during the Initial Enrollment Period. It is seven months surrounding your 65th birthday: three months before age 65, the month you turn 65, and three months after. To get the most from Medicare and avoid the Part B late enrollment penalty, complete the Medicare enrollment application during this period. If you are late enrolling you may be hit with a lifetime penalty that would increase the monthly premium by 10 percent for each 12-month period. The penalty increases the longer you wait to enroll.

Example:

- The current Part B premium for 2021 is $148.50 per month. You delayed enrolling in Medicare Part B for a year once you were eligible. The Part B premium could increase up to $178.20 per month ($14.85 x12). You would have to continue paying this penalty for as long as you are enrolled in Medicare Part B (unless you qualify for the Special Enrollment Period).

The Special Enrollment Period is for individuals who did not enroll for Medicare and sign up for Part B when initially eligible because they were covered under an employer plan (employer plan with 20 or more employees). If you qualify under this situation, you can sign up anytime while you are still covered by a group health plan or during the eight-month period that begins the month after employment terminates or the group coverage ends (whichever comes first). If you have COBRA after your employment ends, the eight-month period is not extended. If you do not enroll during the eight-month window, you have to enroll during the General Enrollment Period.

The General Enrollment Period for Medicare is from January 1st through March 31st. If you enroll in Medicare during this period, coverage begins July 1st.

Now that you are enrolled in Medicare, you may want to make changes to your plan. Why? Medicare Plans change and your medical needs may have changed as well.

If you have made the decision to change or update your Medicare plan, the time to make changes is during the Medicare Annual Enrollment Period (AEP). The AEP runs from October 15th through December 7th each year.

A few reasons you might consider making changes to your coverage:

- Your doctor may no longer be in-network.
- Premiums may have increased
- A new plan may offer extra benefits (vision, dental, fitness/gym membership)
- Changes in Part D formularies (if a medication you take regularly is moved from a lower tier to a higher tier, the cost for your medication has increased)
- Changes in your personal situation.

If you are late enrolling you may be hit with a lifetime penalty that would increase the monthly premium by 10 percent for each 12-month period.

Review your Original Medicare Plan, Medicare Advantage Plan, and Part D prescription drug only plans. The AEP allows for multiple changes and updates including:

- Dropping your Medicare Advantage Plan and returning to Original Medicare. If you are returning to Original Medicare, you can purchase a Medicare Supplement Plan (Medigap Policy). These policies help cover the cost of medical care that Medicare does not cover. The best time to purchase the policy is during the first 6 months of the Medigap Open Enrollment period. If you are turning 65, then the 6 month period starts the month you turn 65 and you have enrolled in Part B. For example, you turn 65 in October and you are enrolled in Medicare Part B, the best time to purchase a Medigap policy would be from October to March. During this time, the prices are generally better, there are more policy choices, and the policy may be approved regardless of health issues. After the enrollment period Medigap insurance companies may require medical underwriting. The underwriting information will be used to determine whether to accept the policy application and how much to charge for the policy. If you apply for coverage outside of the enrollment period, there is no guarantee you will be able to purchase a policy if you don't meet the medical underwriting requirements.

There are 3 ways to switch from a Medicare Advantage Plan and return to Original Medicare during open enrollment.

1. Visit your local Social Security Office and ask to be disenrolled.
2. Call 1-800-633-4227 (Medicare)
3. Contact your Medicare Advantage insurer directly.

- Moving from Original Medicare only to a Medicare Advantage Plan.
- Enrolling in a different Medicare Advantage Plan
- Choosing a new Medicare Part D prescription drug plan
- Adding a Part D prescription drug plan if you don't have one
- Cancelling your current Part D prescription drug plan
  - Note: You must keep some form of prescription drug coverage before re-enrolling in Part D to avoid a late enrollment penalty.
- Update your coverage by switching to a new plan from your current insurer or switching to a new insurer all together.

Below is a chart that might be helpful in determining why you might want to switch your Medicare coverage.[1]

If you have…	You might want to…
Original Medicare with separate Medicare Part D prescription drug plan (PDP) coverage	• Combine your coverage into a single Medicare Advantage (MA) plan with Prescription Drug Plan (PDP) coverage. • Consider a switch to an MA plan that includes prescription drug coverage and telemedicine, fitness, dental, hearing, and/or vision coverage.
Medicare Advantage (MA)	• Switch to an MA plan where your doctor or facility is in-network if your current plan no longer includes them. • Move to an MA plan with better coverage and/or services for the same price (or even lower).
Medicare Supplement (Medigap) Plans	• Drop it if you're paying for extra coverage you don't need, you don't travel a lot, and you prefer local doctors available to you. • Switch or drop coverage if you move to a new state and your coverage cost goes up, but keep in mind you may have to answer questions about your health history if you make a change.
Medicare Part D prescription drug plans (PDPs)	• Switch to a lower-cost plan, even if you might not be taking any prescription drugs now. • Make a change if your regular pharmacy is no longer considered in-network. • Drop and switch to MA with drug coverage if you want to consolidate coverage options and not maintain separate PDP coverage.

[1] Source: Fidelity

All plan and benefit changes become effective on January 1st of the new year.

Before you choose a Medicare plan, think about your options carefully. Talk to your doctor and friends who have Medicare. Compare the cost, benefits, and the quality of the plans you are considering. Ask yourself what is most important to you in a Medicare Plan – cost, coverage, or convenience. Regardless of the specifics of your situation, it is important to check into the options that are available during open enrollment.

A good reference to review and compare Medicare plans is the Medicare Plan Finder. The app can be downloaded from Medicare.gov. It can be used on your smart phone, tablet, or other mobile device. Another resource is the Medicare & You handbook. The handbook can be viewed online, downloaded, or received electronically in your email.

Understanding Medicare is complicated enough having to navigate through different enrollment periods, trying to decide if you should keep what you have or switch to something else, or just reviewing the different types of coverages available. SHIP (State Health Insurance Assistance Program) could help. It's a State provided service that provides objective insurance counseling and assistance to Medicare-eligible individuals. SHIP could help review the different Medicare options available as well as assist with understanding Medicare guidelines. The number is 877-839-2675.

Contact Betty at (908) 464-0102 or bsthomas@pgbank.com with any questions.

Year End Planning Checklist

Lisa McKnight, MBA, CFP™

The end of the year always seems to sneak up on us. After Thanksgiving, the rush of the holidays keeps us busy through the New Year. However, it is important to slow down and assess your financial planning needs. One thing the pandemic has taught is it pays to be prepared. We cannot predict or control macro events, but we can position ourselves to be as prepared as possible. The end of the year is a good time to review year end strategies and plan for the year ahead.

Benefits:

- **Check your Flexible Spending Account balance (FSA).** Make sure you spend the balance in your FSA on qualified expenses, so you don't lose out. At the end of 2020 congressional legislation allows you to roll over any unused funds from 2021 to 2022 for use at any time next year, but only if your company opts in. Make sure you know your employers' policy on this. Schedule any last-minute check-ups and eye exams by December 31 or fill prescriptions for you and your family. A tip for next year's open enrollment period: if you or a family member is going to need medical services, you should consider contributing to your FSA at least the amount of your health insurance deductible.

- **Select next year's employer benefits.** Changes to health insurance coverage typically can be completed only during a specified period each year. Consider taking advantage of all available options, including a flexible spending account, health savings account, life insurance, and other employer provided benefits. Review changes to policy coverages and costs carefully to make sure you are choosing your best option for the upcoming year.

- **Review your executive compensation.** If available, consider deferring income and evaluate your vested stock options or restricted stock units for possible sale.

Income Tax:

- **Review your tax withholdings and payments.** With less than three months remaining in the calendar year, now is a good time to double check your federal withholding to make sure enough taxes are being taken out of your pay. You want to ensure that your withholdings closely match what you owe. The IRS offers a withholdings calculator at www.IRS.gov .

- **Review any tax losses and capital gains.** Be proactive in your tax planning. If you have losing stock positions, consider selling them to offset gains and reduce taxable income. Remember the IRS only allows $3,000 of losses per year against ordinary income. For capital gains, consider selling appreciated assets if there is a chance the capital gains rates effective date is repealed. Wash-sale rule only applies to losses, so investors can sell an asset at a gain and buy it back.

- **Think about bunching your itemized deductions.** Bunch your itemized expenses such as medical and dental expenses, deductible taxes, qualified mortgage interest, including points for buyers, investment interest on net investment income, charitable contributions and casualty, disaster, and theft losses in the same year to meet the threshold percentage of your adjusted gross income to claim such deductions. This may allow you to claim more than the standard deduction, at least in some years.

Retirement Planning:

- **Review 401k and IRA contributions.** Maximize the amount you contribute to take advantage of available tax deductions and employer matching contributions.

- **Fund Roth accounts.** Consider contributions to a Roth 401k if your employer plan allows it and you are in a lower tax bracket now then plan to be in the future. The contributions into a Roth go in after tax and grow tax free forever.

- **Fund Roth IRAs for your children.** If your child has earned income (a small part-time job that issues a W-2) he or she can contribute up to $6,000 to a Roth IRA. The flexibility and tax- free growth of a Roth IRA make this a proven winner for young savers.

- **Consider Roth Conversions.** With higher taxes potentially coming down the road, it could be worth considering a strategic Roth conversion. A carefully planned Roth conversion will move pre-tax dollars to a Roth. It triggers a taxable event, but it is short-term tax burden that must be weighed against the long-term tax gain of having the Roth dollars grow tax-free.

- **Review your beneficiaries.** Double-check that changes or updates are not needed on your accounts. It's all too common to leave an ex-spouse, for example, assigned accidentally. Make any needed updates to the beneficiary portion of your bank accounts, retirement accounts, life insurance policies, and annuities.

Wealth Transfer and Legacy Planning:

- **Fund 529s.** College tuition is not for the faint of heart. Have a tax-advantaged strategy in place to help you prepare for the rising costs. If you already have 529s contribute as much as you can. Ask grandparents and other family members to contribute as well.

- **Make charitable donations.** Donate to an organization that's close to your heart. Consider donating appreciated stock rather than cash. This may help you avoid capital gains tax. Or you can make a qualified charitable distribution (QCD) directly from your IRA. Each year you can donate up to $100,000 directly from your IRA to a charity. This will benefit the charity and may reduce the amount of tax you owe.

- **Set up a Donor Advised Fund.** A DAF can provide an immediate income tax deduction and provide immediate and future benefits to charity over time.

- **Gift to loved ones.** Consider making gifts up to $15,000 per person allowed under federal annual gift tax exclusion. Use assets likely to appreciate significantly for optimum income tax savings. Alternatively, sell losing stock positions and give cash.

Other areas to consider:

- **Review your estate plan.** Ensure your overall estate plan, including your will, trust, durable and health care power of attorney, are current.

- **Review insurance policies.** Review your home, auto and life insurance policies to determine if you have enough coverage or if deductibles need to be adjusted.

- **Check your credit reports.** Review for changes to your personal information, accounts and any errors.

- **Lastly, start planning for future goals and memories.** If it is realistic, your goals should include a savings plan for a family vacation or another memorable event. It's nice to have something to look forward to, even if that something will occur sometime in the future. It'll keep your eye on the prize.

Contact Lisa at (908) 464-0102 or lmcknight@pgbank.com with any questions.

The Document Clash—Should it Stay or Should it Go?

Cynthia Aiken, CFP™

Do you have file cabinets bulging or overflowing with old papers? Do you keep cancelled checks, bank and investment account statements, income tax returns and ATM receipts for decades? Which documents need to be retained? Of those documents being retained, what is the appropriate retention period? Which documents should be retained in their original physical form and which can be scanned and saved electronically?

There are no hard and fast rules about which documents to keep securely, which to shred and how long to keep documents. Generally, tax and financial professionals say that for retention purposes the nature of the document needs to be determined as well as its current and potential future use. Documents tend to fall into several categories - those related to personal identification, legal documents, tax documents, documentation of assets and liabilities, bank/investment account statements, and other important documents.

Documents pertaining to **personal identification** need to be retained in their original physical form forever. Not surprisingly, this list includes: Birth Certificate, Social Security Card, Driver's License, Passport, Marriage License, Prenuptial Agreements, Adoption Papers, Death Certificate and Estate Settlement paperwork if widowed.

Legal documents also should be retained in their physical form in a home safe, strong box, a safe deposit box or an attorney's office safe. Wills, Powers of Attorney, Health Care Directives, Trusts, beneficiary designations, Divorce papers – Separation Agreement and all orders and decrees, and Estate Settlement paperwork if widowed, are among the key legal documents to be kept securely for an indefinite time frame.

Tax documents fall into two groups – those to retain for seven years and those to be permanently retained. Your tax professional will likely recommend that your filed income tax forms and all the supporting documentation be retained for seven years. The supporting documentation includes paperwork for your income, expenses, real estate, and investments such as W-2s, 1099s, expense receipts, real estate tax receipts, evidence of charitable contributions, closing statements for real estate purchases and sales. These documents can be retained in digital format if the digital copy contains all the relevant info. Check the state statutes of limitations to audit tax returns in your state and make retention plans for your state income tax returns accordingly.

Some tax documents need to be retained indefinitely. These include documents related to estate planning – specifically, forms for taxable gifts – forms 709, 8971 and 706. Tax returns for trusts should be kept until after the trust has been dissolved. Form 8606 for nondeductible IRA contributions and subsequent distributions needs to be retained. If a Roth conversion has been executed, then the paperwork and form 8606 should be kept. If you are receiving retirement distributions from pensions, IRAs, or other vehicles, then you should keep the 1099-Rs from your retirement plans. These documents with longer retention periods can be held in digital format but be careful to include all supporting documentation. Many tax professionals encourage the retention of W-2s to confirm correct salary history for computing Social Security benefits, but these W-2s can be destroyed once Social Security benefits have started.

Transactions such as **buying and selling assets and borrowing funds** generate documents that need to be retained. For example, home purchase and sales contracts and the accompanying documents and ownership records should be held securely for a minimum of seven years after the home has been sold. For other tangible assets, retain the property ownership documents – deeds, titles, settlement statements, bills of sale – until seven years after the asset is sold. Mortgage agreements and record of satisfied loans should also be kept for seven years. Auto loans and other debt documentation should be held until the vehicle or asset is sold.

On the home front - Keep documents confirming home improvements, which could affect the cost basis of your home, with your tax files. If you claim a portion of your home as a home office, then retain expense information with your tax returns. Additionally, retain documentation to prove which home is your primary residence if you have homes in two states with your tax returns.

Current **investment and bank account statements** should be kept through the year end, then retain the annual year end statements for seven years. If you have investments purchased before 2012, keep the investment cost basis records. Cost basis information for investments purchased after 2012 is maintained by the custodians. Consider scanning prior investment records and shredding the original paper copies.

Fortunately, some documents can be shredded after **one year,** particularly if they are summarized on a year-end statement. These include – pay stubs, utility bills, cancelled checks, credit card receipts, bank statements. If any of these are needed for income tax filing purposes, then keep them with the appropriate tax return.

There are a host of **other documents** to consider retaining:

- Insurance policies – retain all current policies until no longer relevant.
- Insurance claim documentation – retain until the claim is closed.
- Military – discharge paperwork to establish eligibility for Veterans benefits.
- Non-compete agreement – retain while employed and afterwards for the term of agreement.
- Warranty and associated sales receipts – retain until warranty expires or the product can no longer be returned.
- Pensions and retirement plans – keep documentation until the plan has paid out completely.

Store your highly sensitive physical documents – personal identification and legal documents – in a locked home safe, safe deposit box or the safe of an attorney. Please keep and properly locate the necessary information to access your safe deposit box, if you have one, so that your heirs can access it if necessary. If you decide to retain tax returns, investment/bank account statements and other documents digitally, then secure them on external hard drives, thumb drives or cloud-based solutions. After clearing out your file cabinets and establishing your routine for document retention, maintain a checklist of your key documents, where they are stored and how long to retain them. Now you have organized your documents and eliminated overflowing file cabinets! Bravo!

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Estate Planning Without a Road Map

Claire E. Toth, JD, MLT, CFP™

Right now, the estate tax exemption—the amount a person can give away during life or at death without paying estate tax—stands at $11.7 million. Above that amount, the federal estate tax rate Is 40 percent. A married couple can jointly pass on $23.4 million. Those exemption amounts are scheduled to be halved in 2026, with the estate tax rate increasing to 45 percent. But wait—Congress has proposed moving up those changes to next year, and the Biden White House has proposed reducing them to $3.5 million a person, or $7 million for a married couple.

This shifting landscape poses a dilemma for those who may or may not be looking at significant estate tax liabilities. The government has already stated that if a taxpayer gives away up to $11.7 milling during life and the estate tax exemption is reduced, that taxpayer will not be taxed retroactively on those gifts. However, making those large, irrevocable gifts today may be unnecessary. Waiting too long to act may be counterproductive. Few people want to give away what they don't need to. Rather, they'd like to reduce estate taxes without losing total access to funds. Luckily, techniques exist that, within limits, allow the wealthy to reduce their taxable estates without losing all control of their assets. As of this writing, creating and fully funding these specialized trusts in 2021 can significantly reduce future estate tax exposure.

Spousal Limited Access Trust (SLAT)

Typically, anything one spouse gives to another doesn't even count as a gift. That means it uses up zero estate tax exemption. It also remains subject to estate tax at the second death. For a gift to a spouse to count as a non-gift, the donee spouse must have unfettered access to it.

Enter the SLAT. The donor spouse sets up a trust for the beneficiary spouse. The beneficiary spouse may or may not receive the trust's income and may or may not be able to access trust principal. These limitations mean gifts to the SLAT count against the donor spouse's estate tax exemption. A SLAT can keep the assets within the couple's financial life while consuming estate tax exemption amounts that would otherwise disappear.

Here's a concrete example. Terry and Pat are married and together have $25 million in assets. Terry is the wealthier spouse and establishes a SLAT for Pat, funding it with $11.7 million. The SLAT pays all its income to Pat and can distribute principal if Pat needs it for support or medical costs (Pat's medical costs—the trust can't pay for Terry's). When Pat passes away, the trust assets go to their children.

Thus, so long as Pat is living, both Terry and Pat can effectively benefit from the trust's investment income, with principal available in a worst-case scenario. Future appreciation also escapes estate tax.

There are some negatives to this technique. Because SLAT assets are outside Terry's estate, there is no basis step up to fair market value at either Terry's or Pat's death. Further, spouses sometimes die in the wrong order. If Pat predeceases Terry, Terry has no further access to SLAT assets. The same is true if Pat and Terry divorce. Those considering this technique should not impoverish themselves.

Pat could establish a SLAT for Terry as well, with some caveats. They don't want to risk the IRS to claim the two SLATs are simply swapping funds for each other and invalidate them both. Couples considering establishing dual SLATs should have different provisions in the trusts: for instance, one could also distribute to children, distribute a fixed percentage of value instead of "all income," or some other combination of terms. Terry and Pat should establish the SLATs in different years and with different values. Steps like this help show the SLATs are not mirror images of each other.

Grantor Retained Annuity Trust (GRAT)

GRATs are not for the faint of heart. In a traditional GRAT, a parent funds a trust with assets and receives an annuity—a fixed annual sum—for the GRAT's term. At the end of the term, the assets go to children or grandchildren. The gift to younger generations is created when the trust is funded. Because those younger generations will not receive the gift for several years, its present value is less than 100 percent of the assets put into the GRAT. Monthly, the IRS publishes the assumed rate of return on those assets, called the 7520 rate. The 7520 rate is based on current rates paid Treasury securities—right now, very low.

In a very low interest rate environment, GRATs are worth a hard look.

The young-ish and wealthy could establish a GRAT and transfer significant assets at little or no gift tax cost. For example: Lee, aged 40 and healthy, establishes a GRAT with $5 million of assets in September 2021, when the 7520 rate is one percent. For 35 years, the GRAT will pay Lee an annual annuity of 3.4 percent, or $170,000, after which the remaining assets will go to Lee's children.

When valuing the gift to the children, the government assumes the GRAT will earn one percent annually for 35 years, while paying out more than three times its earnings. With those assumptions, the eventual gift to Lee's children has a present value of $538. That is what shows on Lee's gift tax return. If in fact the GRAT has an average return of just six percent for those 35 years, Lee's children will eventually receive $19,750,000—with no further gift or estate tax due.

Many things must go right to achieve this sort of result, but in a very low interest rate environment, GRATs are worth a hard look. Specifically, Lee must survive the GRAT's term. If Lee dies during the GRAT's existence, some or all of it is included in Lee's taxable estate. Proposed legislation may add further restrictions. The net downside is as if Lee hadn't created the GRAT in the first place—unpleasant, but not penalizing.

A version of the GRAT, called a Qualified Personal Residence Trust (QPRT), is designed specifically to transfer real property to the next generation. A QPRT can be a great vehicle for keeping a beloved vacation home in the family.

Begin with the Basics

It can be easy to be seduced by exotic-sounding trusts and projections of huge future dollars. Before considering any of this, the wealthy should be making consistent annual exclusion gifts.

Before you begin to eat into your lifetime exemption—be that $11.7 million, $3.5 million, or someplace in between—you can give up to $15,000 to as many different people as you like each year. There are rules about the donee having immediate access to the funds, but workarounds exist. A married couple with two children and four grandchildren can make annual exclusion gifts of $180,000 each year. Done consistently, this moves significant assets off the gift and estate tax grid.

Special rules exist for bunching gifts to 529 plans and for making direct payments of tuition or medical expenses on behalf of another. These can expand the dollars available to give to family members. Anyone looking at a potential estate tax issue should begin with annual exclusion gifts.

Smart Use of Debt

Jean H. McAllister, CFP™

The low interest rate environment of the last several years has provided significant opportunity to borrow affordably for a home or other large purchase. Not all borrowing options are a bargain, however, and any decision to finance a purchase should include a review of existing debt, budget constraints and financing costs/options.

Assuming true need, there exists a wide variety of lending vehicles. Matching the right borrowing option for the need requires some thought. You would not, after all, purchase a home using your credit card.

The largest financed purchase for the average consumer is their home, and a mortgage is the optimal option for financing because of the relatively lower cost and long-term financing period. Interest on a mortgage loan is potentially tax deductible, another plus. But what type of mortgage? The proliferation of mortgage options can create confusion. A useful guideline is to match the holding period for the property with the term of the loan.

A fixed rate mortgage of 15, 20, or 30 years locks in a rate and ensures stable payments over the life of the loan. Fixed rate mortgages are typically the most popular for the "forever home" buyer. The longer the term (e.g., 30 years), the higher the interest rate charged, but the lower the monthly payment, all else being equal. Conversely, short-term loans carry lower interest rates, but higher fixed payments. The affordability of the monthly payment should be the primary consideration.

Short-term loans accrue principal/equity in your home more rapidly, which could provide for additional borrowing capacity via a Home Equity loan or line of credit. Consistent additional payments to principal also shorten the term of any loan if debt reduction is desired.

Adjustable-Rate Mortgages, commonly known as ARMs, offer a fixed interest rate for a specific period, typically 7, 5, or 3 years; followed by an interest rate that adjusts on a periodic basis. ARMs are commonly employed when a property will be held short-term and sold before the fixed rate period expires and the adjustable-rate term begins. In fact, the average length of home ownership in the U.S. is 8.09 years; which speaks to the significant size of the short-term home owner market. In a rising rate environment, the risk of future rates being higher should be carefully weighed against the attractiveness of the initial, low fixed rate.

Historically low interest rates and appreciated real estate values have increased the appeal of borrowing against accrued home equity. Equity loans, lines of credit and re-financed mortgages provide an opportunity to pay off higher interest consumer debt, pay for property improvements, fund education costs, or simply reduce the monthly payment of a current mortgage.

A Home Equity Loan (HEL) is a second mortgage, with a fixed interest rate and payment term. As subordinated debt, these loans generally carry a higher interest rate, but involve lower closing costs. Proceeds from a home equity loan are disbursed in a single lump sum and the repayment period commences immediately, as with traditional mortgages.

A Home Equity Line of Credit (HELOC) is similar to revolving credit and has become the preferred method for additional borrowing against home equity. A HELOC carries an interest rate that is tied to an index that fluctuates over time, for example, the U.S Prime Rate (as published in the Wall Street Journal). Funds are borrowed as needed over an initial drawdown period, typically 10 years. Repayment of principal and interest can begin immediately or be delayed until the end of the drawdown period. In a rising rate environment - which we may be seeing - paying down principal and interest, is the best option for avoiding higher future payments.

A mortgage refinance involves the paydown of an existing mortgage using proceeds of a new mortgage. All terms of the initial loan can be revised: borrowed amount, interest rate and loan term. As rates have fallen over the last several years older mortgages have been refinanced to lower monthly payments. A cash-out refinancing takes advantage of lower rates and accrued equity to increase the borrowed amount. Before committing to a refinanced mortgage, carefully consider the ramifications of changing the terms of the existing mortgage including the closing costs and the holding period for the property. Closing costs should be "repaid" within the property holding period.

With a few exceptions (e.g., VA loans), borrowing is capped at 80 – 85% of a property's market value. This cap is referred to as the loan-to-value ratio. For other than initial mortgage borrowing where 20% down payments are standard (and 80% financed), maximizing the loan-to-value ratio with additional debt (e.g., HELOC, HEL) increases risk, especially if pursued when home prices may be artificially elevated, as seen during the height of the COVID pandemic. A regional real estate boom might translate to elevated home equity, but if the market softens following additional borrowing, a mortgage could exceed a home's longer term market value. This is referred to as an "upside down" mortgage – a widespread problem following the housing crisis of 2008.

Auto, consumer, and personal loans comprise a separate class of financing options and pricing terms vary dramatically with the creditworthiness of the borrower. In general, these loans are shorter term, ranging from 3 to 15 years (auto loans rarely exceed 7 years) and carry interest rates well above mortgage rates for all but the most credit-worthy borrowers.

Auto financing offered through a manufacturer can be as low as 0% to the best credit customer, with rates rising as borrower credit scores decline. Consumer loans are among the least attractive borrowing options and should be employed when no other options – like a home equity line of credit - exist.

Credit Cards comprise the most widely available and, consequently, the most misused and costly source of purchase financing. Intended as a temporary financing option, credit cards have become the most popular payment method for even our smallest, every-day purchases. Rates routinely range from 10% to 29% - well above other financing options.

Responsible credit card use involves paying off outstanding balances within one or two billing cycles. Failure to routinely payoff credit card balances results in compounding interest charges applied to outstanding balances month after month. While the minimum payment may seem affordable, the compounding interest charges increase the actual cost of each purchase – in some cases to many times the original purchase price. Because credit card borrowing limits are routinely increased when payment experience is positive, habitual spenders will spend more. If spending is not limited to a feasible budget, credit card spending will cripple future access to credit.

Responsible management of credit card debt should begin with an assessment of the interest rate tied to each financed amount. Paying down the balances subject to the highest interest rate charges is the best approach – even if these amounts are relatively small. If feasible – and with discipline – consolidating outstanding balances on a single, lower-rate credit card could jump-start a workable plan to reduce outstanding consumer debt.

Debt has a place in nearly every individual's financial profile. Home ownership would be impossible for most without mortgages. Large purchases of appliances, travel, and other necessities are handled conveniently and securely by credit card when cash is impractical. Maintaining an affordable level of debt – both short and long term – is essential if credit and financing are to remain useful tools and not devolve to a chronic problem. All responsible spending is handled within the confines of a budget, which should be the starting point for every smart use of debt.

Contact Jean at (973) 276-0839 or jmcallister@pgbank.com with any questions.

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