The Planning Quarterly

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PEAPACK PRIVATE

Wealth Management

Welcome to the August 2022 issue of the Peapack Private Planning Quarterly. Planning issues arise at every stage of life and the articles here address a few of them. This issue addresses questions our clients have been asking. Please reach out to our authors, or to any of our investment and planning professionals with your questions and feedback. Ask your own questions as you may inspire a future article. Our guidance can help you achieve your financial goals.

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Home Buying in Today's Housing Market

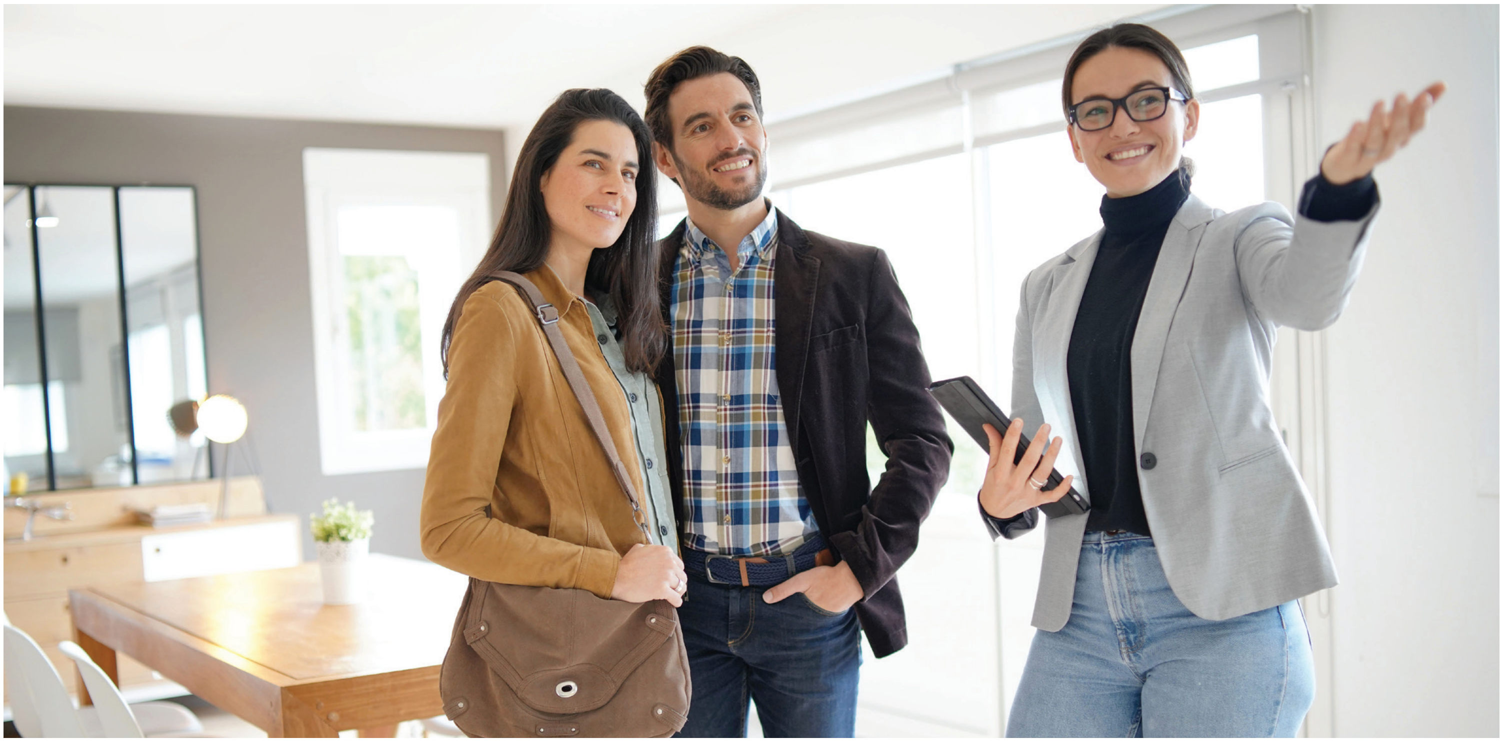
By Cynthia Aiken, MBA, CFP™

Hot home-price summer – high housing demand, low supply and inflation have sent home prices skyward!

The housing price run-up has been driven by rock-bottom mortgage rates and increased consumer demand for more space while supply has been constrained. There has been increased movement as millennials have aged into prime homebuying years and fled the cities and older homeowners are retiring earlier and moving to their targeted retirement locale or purchasing a second home. The exodus from New York City has been a boon for New Jersey as the state gained more than 35,000 new households from migration in 2020 over 2019. Coupled with low interest rates, the New Jersey housing market has become highly competitive with sharply rising home prices. Now as mortgage rates rise, home buyers are faced with increased asking prices and mortgage payments, causing many to halt their search. Because they are typically smaller and more affordable, townhomes have become the next choice for single-family home buyers who are priced out of the market. Not surprisingly, townhome and condo sales are encountering greater competition than a few years ago.

Residential construction slowed for second straight month in June – housing starts declining 2% to seasonally adjusted 1.56 million as reported by the Commerce Department on July 19th. Keep in mind that the supply of new homes is constrained by several factors including zoning laws, available land and increasing material costs. Builders typically follow buyer demand which has reduced as housing prices have hit record levels. In fact, builder confidence dropped in June per the National Association of Home Builders. The organization says that builders are focused on selling completed homes and those under construction and that some builders are stopping construction due to inflation, land prices and rising material costs. Some builders have used a lottery system to sell homes under construction or have created a waiting list of ready buyers.

Interested buyers that are priced out of the market to purchase a home are not finding relief in the single-family rental market. Asking rents have risen sharply – reflecting increasing demand from those who can't afford to buy homes and city residents moving to the suburbs to rent during the pandemic. Furthermore, investors are snapping up homes to rent and large Wall Street firms – Blackstone Group, Invesco and Goldman Sachs have - committed billions to the single-family rental sector. These investors claim that they can't satisfy rental demand and are buying existing homes and new construction. In 2021, 12% of single-family construction was new homes meant to be rented, not sold, per the real estate data company Yardi Matrix. With their significant financial resources, institutional buyers are picking up the same homes that would be starter homes for owner occupiers.



Buying a home in 2022 has been challenging, but there is hope that the situation may be improving. Wage and income growth aren't keeping pace with inflation; thus housing demand is softening. By many measures, the tide is starting to turn: the number of homes sold is down, fewer homes are selling above list price, higher percentage of sales had price drops, pending sales are down, and the bidding war rate dipped below 50% for the first time since the beginning of the pandemic in June. Freddie Mac, the federal mortgage lender, reported that the 30-year fixed rate mortgage fell to 5.54% in the week ending July 21, 2022, from the 13 year high of 5.81% in June. The Mortgage Bankers Association reported on July 21, 2022, that mortgage applications fell to the lowest level since 2000 and were down 6.3% for the week compared to previous week, for a third week of declines. They also reported that refinance and purchase activity were down 80% and 19% respectively, compared to the same week last year.

However, housing inventory remains low – active listings were down 34% in June 2022 from June 2020 and down 53% from June 2019 according to Realtor.com. Due to the still limited supply, the prices of homes continue to increase, but at a decreasing rate. The Case-Shiller index, which measures home prices in major US metropolitan areas, rose 19.7% in the twelve months ending May 2022, down from 20.6% for the same period in April 2022. Furthermore, the share of sellers lowering their asking prices hit a record during the four weeks ended July 3, 2022, according to Redfin.com.

If you are in the market to buy a home, here are some tips:

- Make a home buying budget – determine how much you can afford to pay each month and stick with it. Don't be influenced to borrow more than you will be comfortable repaying. Your mortgage payment should be 25-28% of your pretax monthly income.
- Know your credit score. It will impact your loan approval and your interest rate. If you are a few months away from buying, then you may have enough time to improve your score. Confirm that your credit reports are accurate and resolve any potential issues.
- Research first-time homebuyer programs. There may be a program that would help you. See NextAdvisors guide for programs by state.
- Interview several real estate agents. Work with an agent that is knowledgeable about the local market and understands you and your situation.
- Shop lenders. Make sure you are comparing apples to apples, ask about interest rate lock policies, discuss how long you expect to be in the new home – a few years or "forever" – the final mortgage program should match your short/long term objectives, then get preapproved for a mortgage.
- Have your earnest money and down payment available.
- Be flexible in your home search. Rank features you want most. If priced out of one market, then consider another. Look past the décor. Although they may take more work, fixer uppers may not have as many competing bids as turn-key homes.
- Slow down. Fear of missing out drives buyers to make quick decisions. You can't immediately return a house for a refund.
- Understand your real estate contract – ask for explanations, request modifications, negotiate issues. Know your contingency elections - types of inspections and negotiations that can be done and in what time frame.
- Home inspection. In a hot market, you may be tempted to forgo an inspection – don't! Based on an inspection report, you can request concessions or repairs to offset concerns or potential problems. If handled during the contingency period, you could still walk away if you don't want to negotiate or deal with thorny issues.
- 20% down payment is the traditional target amount, but it is not necessarily required. With a 20% down payment, primary mortgage insurance (PMI) is not required. However, PMI is not overly expensive, and borrowers only pay PMI until the equity in the home reaches 20% of the home's value. A lower down payment may allow you to have funds for repairs and renovations. See elsewhere in this newsletter for more information on PMI.

- Calculate your monthly mortgage costs based on down payment, borrowing amount, interest rate and mortgage term. Once that is determined, add monthly installments for property taxes and homeowners' insurance, so that you are aware of your full financial responsibility.
- Budget for repairs and upgrades, home maintenance, and new home expenses such as decorating and furnishing.
- Be patient. Keep in mind the long-term stability of your personal finances.
  - Are you debt-free?
  - Do you have an emergency fund of roughly three to six months of expenses?
  - Will your house payment be 28% or less of your monthly take-home pay?

Tips to reduce the pain of higher mortgage rates:

- Pay points and fees upfront to cut interest rates and make higher down payments to reduce the amount financed.
- If buying a home under construction, you may be able to lock in at current rates, rather than risk higher ones in the future.
- Consider adjustable-rate mortgages that reset in five, seven or ten years. An adjustable-rate loan has a teaser rate for first five, seven or ten years that is lower than the current market fixed rate, then the rate switches to a variable market rate after the initial period. You could refinance into a lower fixed rate later.

Buying a home in any market is a personal decision. A home is the single largest purchase for most Americans, so you need to have a solid financial position before buying. Determine what you can afford based upon your budget and needs. From a non-financial perspective, how critical is it that you buy now? Remember that trying to time the market and predict future prices or interest rates is difficult at best and most would say it is impossible.

If you are interested in learning about our residential lending solutions, please contact your Wealth Advisor who will introduce you to a Mortgage Banking specialist.

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Charitable Lead Trusts – A Primer

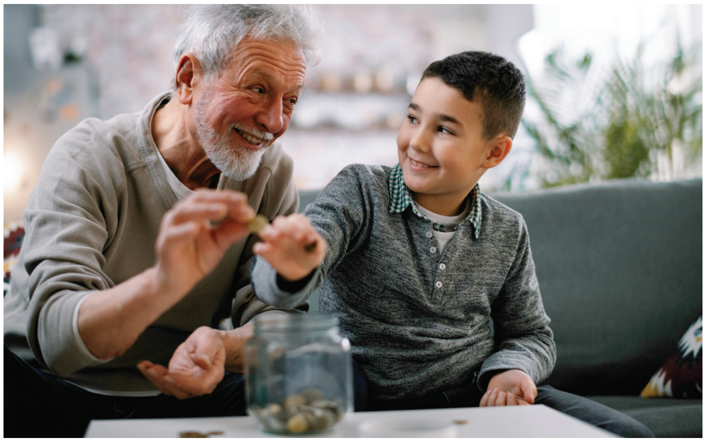
By Gary E. Walker, JD, LLM, CFP™

Charitable Lead Trusts (CLTs) provide an excellent opportunity for high net worth individuals to benefit both charity and their descendants while reducing their tax bills. CLTs work best when interest rates are relatively low and stock prices are depressed—as they are now. The CLT may give its Grantor a large income tax deduction in a high-income year. It also provides significant estate or gift tax savings on assets passing to the Grantor's descendants.

A CLT provides an annual income stream (the Lead Income Interest) to charity for a specific time period, after which the remaining assets pass to beneficiaries named by the Grantor (the Remainder Interest or the Remainder Beneficiaries).

There are two types of CLTs, a Charitable Lead Annuity Trust and a Charitable Lead Unitrust. A Charitable Lead Annuity Trust (CLAT) pays a fixed amount (the annuity amount chosen by the Grantor) to charity in every year of the CLAT's term, and when the term ends the CLAT's assets are paid to the Remainder Beneficiaries. A Charitable Lead Unitrust (CLUT) pays a fixed percentage of the CLUT's fair market value to charity in every year of the CLUT's term, with the amount payable to charity being recalculated each year based on the value of the CLUT's principal at the beginning of each year. At the end of the CLUT's term the CLUT's assets are paid to the Remainder Beneficiaries.

To summarize, a CLAT pays a fixed annuity amount to charity every year; this amount does not fluctuate. A CLUT is different – if the value of the CLUT's assets increase, the annual payment to charity will increase, and if the value of the CLUT's assets decrease, the annual payment to charity will decrease.



Charitable Lead Trusts can last for a set number of years (i.e., 10, 20 or 30 years) or for the lifetime of one or more individuals. Also, there is no minimum or maximum percentage payout for the lead income interest. As we'll see, combining the length of the Lead Income Interest with the right charitable payout can result in significant wealth transfers to younger generations at little or no gift or estate tax cost.

Grantor CLT vs Non-Grantor CLT

Things get a bit complicated when the topic turns to the charitable income tax deduction associated with a Charitable Lead Trust. If the Grantor of a CLT wants to receive a Federal charitable income tax deduction in the year the CLT is established, the CLT must be a grantor trust for federal income tax purposes. This means that while the Grantor gets a substantial charitable income tax deduction in the year the CLT is funded (with a 5-year carryforward of any unused deduction), the Grantor will also be taxed on the CLT's income every year. This is a real-life example of the saying "there's no such thing as a free lunch" - the price of receiving a charitable income tax deduction in the year a CLT is established is that the Grantor will be taxed on the CLT's income in every year of the CLT's term. To be sure, there are ways for the trustee of the CLT to minimize the CLT's taxable income during its term, but this is a critical factor for any Grantor considering establishing a Grantor CLT. A small silver lining with respect to the Grantor being taxed on the income of a Grantor CLT is the trust principal will not be depleted by income tax payments, so the principal will grow "tax free," potentially passing on more wealth to the Remainder Beneficiaries.

The amount of the Federal charitable income tax deduction generated by a Grantor CLT is the present value of the annual payments to be made to charity during the CLT term (this is an actuarial calculation using IRS prescribed interest rates, tied to that of Treasury securities—which is called the 7520 rate). Anyone considering creating a Grantor CLT should ensure they will be able to use the charitable income tax deduction that will be generated in the year the CLT is funded (or over the next 5 years). The charitable deduction for a gift to a CLT is limited to thirty percent of the Grantor's income.

With a non-Grantor CLT, the Grantor will not get a charitable income tax deduction upon funding the CLT, but the Grantor also avoids paying tax on the CLT's income every year during the CLT's term.

Remainder Interest of a CLT

Despite the different income tax treatment of a Grantor CLT and a Non-Grantor CLT, when either trust ends the result is the same. The trust principal (the Remainder Interest) will pass tax free to the Remainder Beneficiaries. While the Remainder Beneficiaries get the trust principal free of any income tax, there is a transfer tax issue that the Grantor must address when he establishes a CLT.

In general, the value of the Remainder Interest passing to the Remainder Beneficiaries is a taxable transfer by the Grantor for gift or estate tax purposes when the CLT is funded. The value of the Remainder Interest is the difference between the amount the CLT is funded with and the present value of the charitable Lead Income Interest (the actuarial value of the annual payments that will be made to charity during the CLT term). Importantly, a Charitable Lead Annuity Trust (CLAT) can be "zeroed out" so there is no taxable transfer upon funding the CLAT. This is accomplished by choosing an annuity percentage, and a trust term, that together with the applicable 7520 rate, results in the charitable income interest's present value being equal to the amount used to fund the CLAT. This means the taxable Remainder Interest is valued at zero. Most CLATs our clients create are zeroed out CLATs.

Additional Facts About CLTs

- CLTs are much more attractive when interest rates are low. The reason for this is simple – the IRS assumes that the CLT's principal will grow at exactly the 7520 rate, which is tied to the rate paid on Treasury securities. If the CLT's principal grows faster than the 7520 rate, the CLT will be a successful wealth transfer vehicle for the Grantor, passing additional assets to the Remainder Beneficiaries free of gift or estate tax, and without using any more of the Grantor's transfer tax exemption. The lower the 7520 rate, the more likely the CLT's principal investments will outperform that rate.
- A low interest rate environment, coupled with depressed financial markets, is the ideal time to establish a CLT. If a CLT is funded with stocks when the financial markets are down, the odds are good that those stocks will appreciate during the term of the CLT, which will ultimately benefit the CLT's Remainder Beneficiaries. This is exactly the environment we find ourselves in at present. The financial markets are depressed, and though interest rates are rising, they are still at historically low levels (the 7520 rate was 3.6% in June and July of 2022, and is 3.8% for August of 2022).

- The best assets to use to fund a CLT are high basis assets like cash (which can then be invested in a diversified portfolio of securities) or stocks with high appreciation potential that generate cash flow (i.e., depressed dividend paying stocks in a down market with big upside potential). Income producing real estate can also work well.
- A CLAT (but not a CLUT) can be structured to make smaller annuity payments in the early years and larger annuity payments in later years. Depending on the trust's investment performance, this approach can result in the charitable income beneficiary and the Remainder Beneficiaries receiving more total benefits from the CLAT as compared to a CLAT making the same annuity payment every year. This is because, with increasing annuity payments, the CLAT has more principal invested (and presumably growing) in its early years, so it grows at an accelerated pace.
- The Grantor of a CLT may not retain the power to change the charitable beneficiary of the CLT. Doing so will cause the CLT's principal to be included in the Grantor's estate at the Grantor's death. However, the Grantor's spouse or another member of the Grantor's family can be given this power, as can an independent trustee. Another very effective way to allow for the charitable beneficiary to be changed, without giving anyone else the power to do so, is to name the Grantor's Donor Advised Fund (DAF) as the CLT's charitable beneficiary. The administrator of the DAF will take "suggestions" from the Grantor as to what charities should receive distributions from the DAF every year. Naming the Grantor's DAF as the charitable beneficiary of a CLT is a very smart way to build flexibility into a CLT.

Conclusion

If you have ever considered establishing a CLT, or if this article has raised your awareness of CLTs to the point you are considering it, the current interest rate and stock market environments make it an excellent time to do so. Any CLT you establish should be structured to meet your particular tax and estate planning objectives with the guidance of your professional advisors.

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Paying for Long Term Care

by Claire E. Toth, JD, MLT, CFP™

Want to terrify yourself? Read statistics about aging and long term care. Today, about 6.3 million Americans need long term care. That number is expected to increase to 15 million by 2050. Moreover, projections are 70 percent of all those turning 65 will need long term care at some point during their lives. Even worse, ten percent of all those currently over age 65 are estimated to have dementia, and that number is projected to increase by 35 percent in the next decade or so. Think of the future as one giant nursing home.

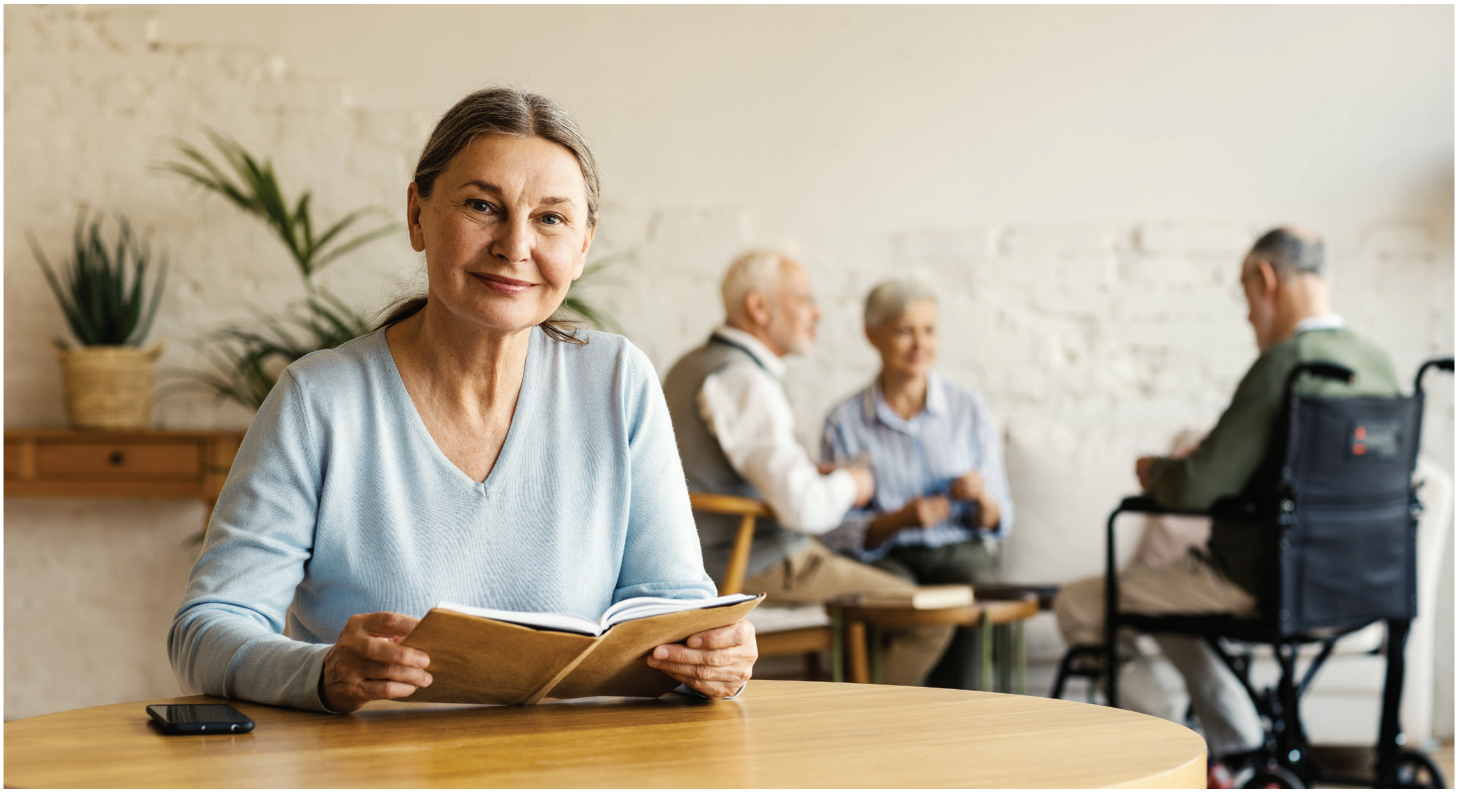
Scarier still is that few individuals have the resources to pay for the necessary care. That's why 83 percent of all care is provided by family members or friends, with the price tag for unpaid care at $470 billion annually. The estimated total lost lifetime wages to providing unpaid care is $3 trillion and rising. Unsurprisingly, 75 percent of unpaid caregivers are women.

Setting the Parameters

It's important to understand what long term care is—and isn't. A person needs long term care when she either (a) receives a diagnosis of dementia, or (b) can no longer perform two of the six activities of daily living without assistance. Those six activities, in turn, are: transferring (for instance, between a bed and a chair), continence, toileting, bathing, dressing, and feeding oneself. The two activities requiring the most fine motor skills—toileting and dressing—are often the first to go. Long term care tends to be what is called custodial care, a step down from medical care. That matters when it comes to payment sources.

The reality is that most long term care occurs outside of nursing homes. That's a good thing, because the average annual cost of a semi-private room in a nursing home is well over $100,000 in the New York metro area. Few people want to enter a traditional nursing home, and receiving outside care at home is considerably less expensive. Still, the value of unpaid services—and the lifetime cost to those family members and friends providing the services—is shocking.

The semi-encouraging news is that while there is no magic bullet in paying for long-term care, with an aging population, players in different parts of the industry are developing different alternatives. Here are a few; more are sure to emerge.



Insurance Combinations

Long term care insurance has not been a success. In 2000, 125 companies offered the product; that number dropped to fewer than 15 by 2014. Fewer policies are sold; those policies are more expensive; they offer fewer benefits. Claiming benefits has become a challenge. It is increasingly difficult to perform a favorable cost-benefit analysis for purchasing long term care insurance.

> *"Projections are 70 percent of all those turning 65 will need long term care at some point during their lives."*

Insurance companies have responded to this by offering a hybrid life insurance-long term care product. Their pitch is that you know you will use the policy—for your care if you need it, for your family if you don't. Premiums on these policies may be less than those for standalone long term care, but so are the benefits. Few retired people need any life insurance, and very few people, even those still working, need anything other than term insurance, which doesn't combine with long term care.

The hybrid can make sense if you already own a paid-up whole life policy. Chances are you don't need the death benefit. Swapping out some of that unneeded death benefit for long term care insurance can make sense under these limited circumstances.

CCRCs—Inside and Outside the Walls

Continuing Care Retirement Communities have long appealed to a specific segment of seniors—they skew towards healthy 80 year olds with significant assets. In the gold-plated version, a resident pays a significant fee to move in and then a monthly maintenance fee. Should the resident need to move from independent living to assisted living to skilled nursing care, the monthly fee remains constant. Permutations abound. CCRCs offer much more than long term care, but knowing that care is available and at what cost can be a powerful motivator for choosing a CCRC.

CCRCs have begun to expand beyond the residential model, offering many services to seniors who can't afford or otherwise are not prepared to move to a CCRC. Again, there is an entrance fee plus a set monthly fee for services, which can include access to a geriatric care manager and in-home health aides. These programs may or may not be feeders to the residential CCRC. In both cases, a selling point is that the senior is known to the CCRC before needing long term care, allowing for a continuum of services. Further, that set monthly fee means care costs are fixed.

Before signing that contract, take a close look at the CCRC's financials. Many have insufficient assets to meet the actuarial value of their financial obligations to residents. Combine that with heavy debt loads, and residents are at a distinct disadvantage should the CCRC file for bankruptcy. CCRC bankruptcies are on the rise.

Government Insurance

Medicaid is the payer of last resort, and approximately 20 percent of its entire budget goes towards long term care. That doesn't mean anyone wants to be on Medicaid. It covers nursing home care (medical care), not in home services (custodial care). Medicaid is administered at the state level, meaning there are fifty different sets of eligibility requirements. In general, a person must be impoverished to be on Medicaid, and it works most successfully by allowing the healthy spouse to remain in the home.

Veterans and their spouses may be eligible for another funding source, the VA's Aid and Attendance program. This provides funding for at-home assistance with those six activities of daily living and can also pay for adult day care. As with Medicaid, there are low income and asset limits for eligibility. Further, the veteran must have served during wartime to be eligible for this program. However, the veteran need not have a service-related disability.

Traditional Medicare does not pay for long term care, though it can pay for a few months of in-patient rehabilitation. Essentially, Medicare is intending to pay for medical costs, not for custodial care. Still, Medicare Part A (hospitalization coverage) can pay for a few months of rehabilitation. The rules differ depending on whether care is provided at an inpatient rehabilitation facility or at a skilled nursing facility; it's important to work with your medical team to ensure you are admitted to the appropriate facility in the correct way to qualify for coverage.

Most Medicare recipients also purchase supplemental insurance, sometimes called Medigap. Medigap does not cover long term care either.

One alternative to Medigap is Medicare Advantage. Medicare Advantage bundles some traditional Medicare coverage with Medigap, for a lower monthly premium. The tradeoff is that Medicare Advantage plans include a limited network of heath care providers, much like an employer-provided HMO or PPO plan. Traditional Medicare and Medigap are not restricted this way. Some Medicare Advantage plans have begun to offer some long-term care and related benefits. These may include assistance with some of the activities of daily living, adult day care services, transportation, and nutrition. With more than 3,100 Medicare Advantage plans across the country, there is yet no consistency in what's provided.

Washington State has been working to implement a state-mandated long-term care benefit, funded by payroll taxes. If it goes into effect, it will eventually provide coverage for the equivalent of a half-time caregiver for a year. Other states are investigating similar programs.

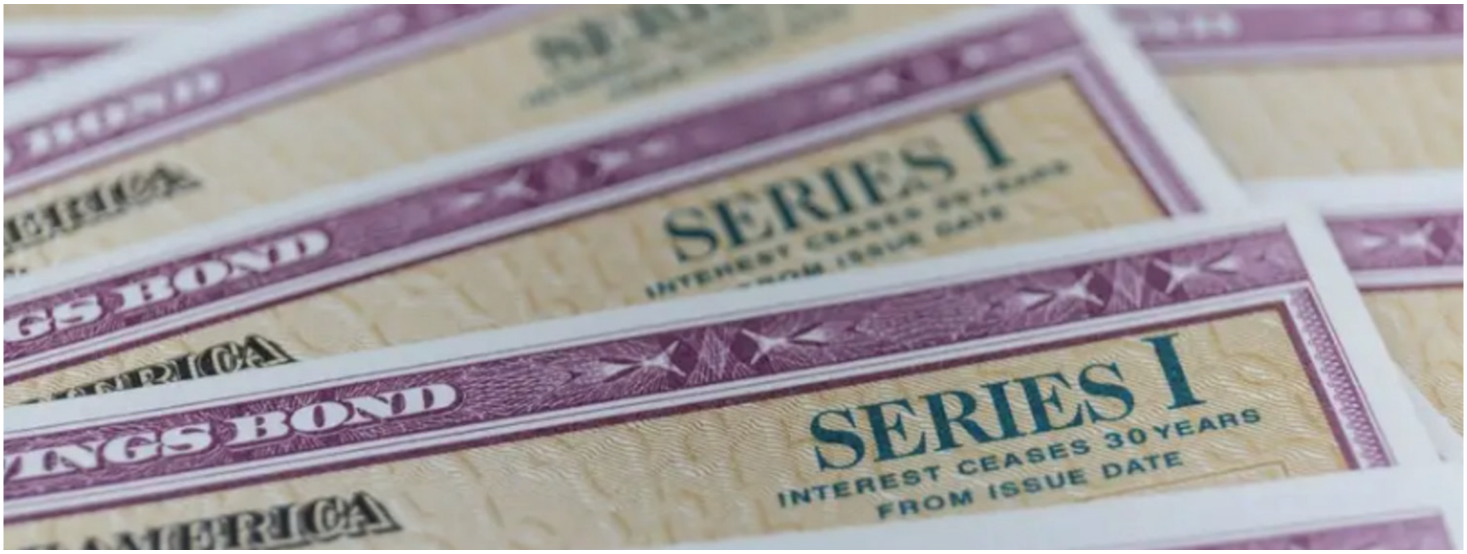
Surely more alternatives will emerge as we grapple with a more aging, frail population. No one-size-fits-all solution is emerging, but some combination of options may fit your family's situation.

Contact Claire at ctoth@pgbank.com or (908) 598-1717 with any questions.

Our Clients are Asking

Our Readers Ask: What are I Bonds?

by Sarah Vehap, MBA



If you've been watching financial news lately, you've likely heard of I bonds. However, not many people know what they are. Here are some key facts.

- Also known as I Series savings bonds, I Bonds are risk-free investments issued by the U.S. Treasury, designed to protect cash from inflation.
- They earn interest from a combination of a fixed rate (set when the bond is issued) and an inflation-adjusted rate (set every six months) referred to as a composite rate.
- As of this writing, the fixed rate on I Bonds is zero. The inflation-adjusted rate is 4.81% for the current six-month period, making the annualized composite rate an historically high 9.62%. As recently as 2015, I bonds paid zero interest.
- I Bonds can be purchased at any time during the six-month period (e.g., May-October and November-April). The composite rate will apply for the 6 months after their purchase is made. For example, if a bond is purchased on August 1, 2022, the composite rate would be applied through January 31, 2023 (6 months after purchase). The interest compounds semi-annually.
- The bonds mature at 30 years and are required to be held for at least one year. If sold between year two and year five, the purchaser will forfeit the previous three-month's interest; there is no penalty if sold after five years. Interest is not taxed until maturity or until the bond is sold.
- I Bonds are subject to federal income taxes but not state and municipal income taxes. Taxes are paid on the interest earned at maturity or when it is sold.

There are two key limitations for I Bonds.

- They can only be purchased by individuals through Treasurydirect.gov (denominations starting at $25).
- There is an annual maximum purchase of $10,000 per person. (An additional $5,000 of paper I Bonds can be purchased each year in lieu of federal income tax refunds for an annual maximum of $15,000.)

In conclusion, I Bonds are a safe investment and can be a hedge against inflation; they are a good place to deploy cash that might be needed within one-five years. However, the maximum annual purchase of $10,000 limits their utility for some investors.

Contact Sarah Vehap at svehap@pgbank.com or (908) 227-3773 with any questions.

Our Clients are Asking

Our Readers Ask: What is Private Mortage Insurance, and Do I Need It?

by Robert Gavin

Private mortgage insurance (PMI) can allow a borrower to purchase a home using a down payment smaller than the traditional twenty percent. That twenty percent down payment protects the lender should the house decline in value or the borrower go into default. With a smaller down payment, the lender typically insists on insurance to protect itself from those risks.

"Deciding between opportunity costs could be the largest factor when deciding to obtain a loan that would require PMI."

PMI can be paid a few different ways, and this can vary lender to lender. As with any major financial transaction, ask lenders what choices they offer before agreeing to a mortgage. The most common way to pay for PMI is a monthly premium added to your mortgage payment. The borrower will get an estimate of PMI costs when applying for a mortgage. Alternatively, the borrower can pay for PMI with a one-time up-front premium at closing. If the borrower makes an up-front payment and then later moves or refinances, the premium likely will not be refunded. Finally, a borrower could have the option to pay a combination of up-front cost and reduced monthly premiums. If the lender offers more than one option, ask the loan officer to help calculate the total costs over a few different time frames. All these options can be included on the Loan Estimate and Closing Disclosure. Depending on the price of the house, the amount of the down payment, and the borrower's credit score, the total PMI premium can range from 0.58% to 1.86% of the original loan amount.

One factor to consider is the ability to cancel the monthly PMI premium once the level of equity in the home reaches at least 20% of the original purchase price or the current market value. The borrower may need to be proactive to ensure the PMI is cancelled. PMI is often cancelled automatically once the borrower has reached 22% equity.

When shopping for a mortgage, a borrower may be able to find a lender offering conventional loans with smaller down payments that do not require PMI. In these cases, the borrower will pay a higher interest rate. Paying a higher interest rate can be more or less expensive than PMI. When going this route, the borrower should think about how long they plan to stay in the home.

Borrowers who plan on making a lower down payment should consider other types of loans, such as FHA loans or VA loans (if the borrower qualifies). Other types of loans may be more or less expensive than a conventional loan with PMI, depending on their credit score, the down payment amount, the lender, and general market conditions.

Deciding between opportunity costs could be the largest factor when deciding to obtain a loan that would require PMI. The option of having more available funds from making a smaller down payment would allow the borrower to use those funds to complete home renovations or invest and save. PMI is one tool that may help first-time homebuyers qualify for a mortgage.

Contact Robert at rgavin@pgbank.com or (908) 306-8071 with any questions.