

2021 Personal Finance Case Study

*Your team focuses on providing clients with comprehensive financial planning and meeting the fiduciary standard. Mr. and Ms. García heard about your services from a neighbor, who stated that you are great at helping families evaluate various options so they can develop a plan that will help them reach their goals and make intelligent financial choices along the way.*

*When you first met with the Garcías, you learned the facts described below and were provided with both the attached balance sheet and budget. Use this information to help the Garcia family improve their financial condition and reach their financial goals.*

PERSONAL INFORMATION:

Javier and Sofia García live in Roanoke, VA in a home Javier inherited from his parents. They have two daughters: Ariana (age 8) and Isabela (age 10); both attend the neighborhood elementary school. Javier (age 35) earned an Associate’s degree in building trades from Virginia Western and currently works as a welding supervisor for a commercial construction company. Sofia (age 32) received a B.S. in Commerce from University of Virginia and now runs a small online retail business out of their home which has proven to be very successful.

Sofia’s mother, Isadora, is living in Floyd County, but she may be unable to live on her own much longer. Sofia needs your help in assessing whether her mother should move in to their Roanoke home or seek residence at an assisted living facility. Isadora has requested that Javier and Sofia try to help her find a local facility where she could live with people her own age, maintain her independence but have the support she may need. She is not opposed to moving in with the Garcías in their Roanoke home but doesn’t want to bring a burden to the family. She can help fund the cost of care through the sale of her home and current Social Security income, but needs help finding some quotes for different levels of care.

OBJECTIVES/GOALS (in priority):

1. Restructure and reduce debt to the greatest extent possible.
2. College funding for both Ariana and Isabela (tuition and living expenses).
3. Reallocate investments to meet both their goals and attitudes.
4. Recommend any end of life documents they need to have.
5. Retire when Javier turns 67 (Sofia age 64) with 80% pre-retirement income.

Money Attitudes

Additionally, Javier and Sofia provided us with their answers to the money personality questionnaire. From the questionnaire it was determined that Javier was the spender of the family and enjoyed buying new and sometimes expensive things while Sofia was much more frugal about purchases. In the section about risk tolerance, Javier stated that he previously had a small brokerage account and that he enjoyed playing the market. Sofia was much more nervous about the financial markets and shared her worries about the risk of investing in the stock market and abroad. Jointly they agreed with a moderate level of risk tolerance.

DEBT INFORMATION:

While Javier inherited their home, they did take-out a $95,000 mortgage when Ariana was born to pay-off Sofia’s remaining school loans and to make some home improvements. They remember the interest rate (3.8%) and monthly payment ($565.72), but don’t know the current balance.

The family is also carrying combined credit card balances of $12,000. They are making a monthly payment of $500, but recognize that the 16.9% annual interest rate is adversely affecting them. They are considering accelerating paying off their debt.

Javier and Sofia own two automobiles: a 2016 Ram 1500 Quad Cab and a 2011 Dodge Grand Caravan. The latter they bought just after Ariana was born and has been paid off for a couple years, but with over 120,000 miles it needs to be replaced. The truck they purchased in January 2016 and financed part of the purchase by borrowing $33,000 on a 6-year loan. They don’t mind pulling some money from savings, but don’t want to incur more than a $450 monthly payment on a new van.

Other debt and asset information can be found in the balance sheet.

EDUCATION INFORMATION:

The Garcías primary financial objective is to pay for a good portion of their children’s college expenses, but they don’t know where to begin. They have saved $16,000 in a Roth IRA in Sofia’s name that they would not mind using to partially fund the goal. They know that they have made contributions of $10,000 as she has put in $1,000 per year since Isabela’s birth.

INSURANCE INFORMATION:

**Health**

* Insured Persons are Javier and Sofia García and all dependent children
* Major Medical Limit is unlimited
* Co-Insurance is 80/20
* Deductible is $750 per person per year with a maximum of $1,500 per year
* Stop-Loss is 20% of the first $8,000 per person per year with a maximum of $3,000 per year

**Life**

* Sofia has a $300,000 whole life insurance policy; Sofia’s mother is the beneficiary.
* Javier has a group life insurance policy equal to two times his gross salary; Sofia is listed as the beneficiary on his life insurance policy.

**Homeowner’s**

* Standard HO-3 Policy
* $280,000 coverage on dwelling
* $140,000 replacement cost coverage on contents
* $150,000 liability coverage
* Annual Premium is $800

**Auto**

* No-Fault (Two Vehicles)
* Split Limits: 50/100/25
* Collision Deductible is $500
* Comprehensive (other-than-collision) Deductible is $500
* Annual Premium is $2,000

**Disability**

* Sofia has no disability insurance coverage
* Javier has “any occupation” long-term disability insurance through his employer. This policy has a short, 90-day elimination period, and provides 70% salary replacement.

ASSET INFORMATION:

The couple has a joint brokerage account that really hasn’t been set aside for a specific purpose. It has a current balance of $41,250 and isn’t preforming very well as it is invested almost entirely in cash equivalent investments and a Treasury bill mutual fund. On the other hand their retirement accounts have done very well as they are totally invested in U.S. stocks – at Javier’s urging.

INVESTMENT ASSUMPTIONS:

Listed below are assumptions of future expected returns and standard deviations (a standard measure of risk or how far a return will deviate from its expected average). This table is given to help you provide high-level guidance over how the Garcías might consider reallocating or diversifying their retirement assets based on their risk tolerances. Additionally, they want to plan on a 2% inflation rate.

|  |  |  |  |
| --- | --- | --- | --- |
| **Region** | **Asset Class** | **Average Annual Return** | **Standard Deviation** |
| Domestic (U.S.) | Stocks |  |  |
|  | Large-Cap Stocks | 8.9% | 19.5% |
|  | Mid-Cap Stocks | 11.4% | 21.2% |
|  | Small-Cap Stocks | 11.6% | 25.0% |
|  | Bonds |  |  |
|  | Corporate Inv Grade Bonds | 3.4% | 7.0% |
|  | Corporate Hi-Yield Bonds | 7.4% | 11.3% |
|  | Treasuries | 3.0% | 2.2% |
|  | Commodities | 4.5% | 17.8% |
|  | Real Estate | 8.9% | 17.8% |
|  | Cash (Money Market Funds) | 1.0% | 1.6% |
|  |  |  |  |
| International | Developed Markets Stocks | 10.0% | 20.6% |
|  | Emerging Markets Stocks | 14.3% | 29.6% |
|  | Corporate Bonds | 3.0% | 11.2% |
| Source data: Morningstar | | | |

RETIREMENT INFORMATION:

Javier and Sofia would like to retire at age 67. They would like to ensure they have enough money in their retirement accounts to allow them the equivalent of 65% of their preretirement income on top of what they expect from Social Security – they want to assume that Social Security will only cover about 15% of pre-retirement salary. They are assuming they will be retired for a total of 30 years.

Javier’s employer is currently matching one half of all employee contributions up to 6% of his salary in his 401(k). They are unsure if they are meeting the employer match provided by Javier’s 401(k). They also want to know how much they could/should save in Sofia’s SIMPLE IRA.

ESTATE PLANNING INFORMATION:

The Garcías would like you to instruct them on any estate documents they will need to prepare for any life-ending related decisions and to ensure their assets go to protect their children after their passing.

**To Begin The Process**

Once a planner gets to know their client and has agreed to work together, the next step in the planning process is to analyze the clients’ current situation. To that end, fill-in the missing information in their income statement and balance sheet to determine their available discretionary cash flow (unallocated income) and their net worth (how much their assets are worth after deducting any liabilities).

The García family has **provided you with a current balance sheet and an estimated budget of their living expenses for the year 2020.** These statements will show you the García family’s current financial situation and how the Garcías manage their personal finances. Using the information on the balance sheet as well as in the case, you will need to calculate some of the inputs that they didn’t know or have available.

**The Outcome**

At a minimum your written plan should address the following goals:

* The main strengths and weaknesses of the García family’s current financial condition.
* Your recommendations for improving upon their current financial situation.
* Discuss the resolution of any conflicts between the clients’ goals and needs, and the ability to satisfy them due to financial or other constraints.
* Identify the extent to which you would advise them to use other professionals to implement any recommendations.
* Answer to the assigned questions.

QUESTIONS TO GUIDE YOUR RECOMMENDATIONS

**Investment and Risk focused questions:**

1. According to the following article what general (stock/bond) asset allocation might you recommend to the Garcías if they told you that they had a moderate tolerance for risk? <https://www.aaii.com/asset-allocation>
2. To achieve better regional diversification, the Garcías would like to own some international assets. Using the same article as above, what percentage of their assets would you suggest for international investments?
3. Using the information above how would you allocate their portfolio and what would be the expected rate of return?
4. The Garcías would like to know how they are doing on their retirement goal. Using the rate of return from above and the other information from the case and financial statements complete the retirement calculator found here: <https://www.dinkytown.net/java/retirement-nestegg-calculator.html>. Additionally, you should plan to decrease their expected rate of return in retirement by 2% to account for reduced investment risk.
5. Can either Javier or Sofia contribute to a traditional IRA? Would the contribution be deductible? What about a Roth IRA? If so, what is the maximum amount for each of them? At what level of adjusted gross income (AGI) would they no longer be eligible to contribute to a Roth?

**Debt focused questions:**

1. They want to purchase a new van in the near future. They would like to keep the car payment to $450 per month. What is the maximum purchase price for the car if they finance the purchase for 4 years, assuming they use the $4,000 value of their van for the downpayment? Visit <https://www.dinkytown.net/java/car-loan-calculator.html> and use a 5.0% interest rate. How much can they borrow if they extend the loan to 5 years, or even six?
2. Given all of the goals competing for their extra income, what minimum payment on their credit card would you recommend? Use the calculator found at <https://www.dinkytown.net/java/PayoffCC.html> and assume that they are charging an additional $350 per month in otherwise undocumented expenses.

**Elder-care focused question:**

1. According to <https://www.payingforseniorcare.com/virginia> what is the current average monthly cost for assisted living care in the Roanoke Virginia area? How much could that change if the Garcías can move her mother into their home and pay for 60 hours per month for home-based care?

**College focused questions:**

1. The Garcías mentioned having a Roth IRA, what are some of the pros and cons of using a Roth IRA to fund a child’s college expenses? Begin your research here: <https://momanddadmoney.com/saving-for-college-roth-ira/>.
2. The Garcías want to know how much it currently costs to attend a 4-yr college in Virginia. Assuming they do not receive any grants or scholarships, complete the following summary table using the data found on page 9 of <https://schev.edu/docs/default-source/Reports-and-Studies/Tuition-and-Fees/201920tuitionandfeereportacc.pdf>. Further assume that Room and Board expenses would be $11,000 per year. Use the Future Value Calculator in your Excel file to complete the last column.

ANSWER:

|  |  |  |  |
| --- | --- | --- | --- |
| School | Tuition and Fees | Total per year | Current four-year total (assumed 4% per year increase in both tuition and R&B) |
| James Madison |  |  |  |
| William and Mary |  |  |  |
| Radford University |  |  |  |
| University of Virginia |  |  |  |
| Virginia Commonwealth |  |  |  |
| Virginia State |  |  |  |
| Virginia Tech |  |  |  |

1. Javier and Sofia want to provide financial support (tuition and fees, books, room and board) for each of their children to a four-year university. They have heard of a special account designed to save for education, but don’t know the name or really what it is. Use the <https://www.virginia529.com/new-savers/basics/> website to briefly explain the Virginia 529 plan. Especially consider any limitations for using the money in the account for vocational school?
2. They have not started saving for their daughters’ college and would like your help in determining which education investment product they should use and how much they will need to invest per month to cover $75,000 of their daughters’ combined college cost. Use the Dinkytown calculator found here: <https://www.dinkytown.net/java/savings-goal-calculator.html>. To begin, assume 11 years to achieve goal, no current savings, monthly savings of $250, an expected rate of return of 6% and inflation of 0 (this is because they are targeting $75k in the future). What happens to the amount of savings needed as you change the interest rate up and down?

**Insurance focused questions:**

1. Javier recently spoke to a co-worker who was in the hospital after a car accident and is now wondering if they have enough coverage in case they hurt another person or property. What is the minimum auto coverage required by the State of Virginia? What seems to be the generally recommended coverage to provide adequate liability protection?
2. What is a potential issue with Isadora named as the beneficiary of Sofia’s life insurance? Would there also be an issue with naming the children? Visit <https://www.protective.com/learning-center/life-insurance/life-insurance-basics/five-beneficiary-mistakes-people-can-make-on-their-life-insuranc-policy-and-retirement-plans/> to begin your search.
3. In passing, Sofia mentioned that they had not had their homeowners policy reviewed in a while. Do you believe that they are adequately covered in case something happens to their home and/or contents? What does this article say about minimum coverage amount <https://www.morningstar.com/articles/855063/homeowners-dont-make-this-common-insurance-mistake> What other recommendations might you make based on your review of this article <https://www.iii.org/article/how-much-homeowners-insurance-do-you-need>

**Retirement focused question:**

1. The Garcías stated that they believe that Social Security retirement benefits will only cover approximately 15% of pre-retirement salary. According to the Social Security Administration Quick Calculator found here: <https://www.ssa.gov/OACT/quickcalc/> what percentage of their current salary is likely to be covered assuming no changes to benefits? Use his birthday of 11/1/1984 and hers of 1/25/1988, his estimated retirement date of 11/1/2051 and hers of 1/1/2055 and their salaries from the income and expense statement to answer the question. (Select “today’s dollars” to see their estimated benefits in comparison to today’s salaries.)

**Estate focused question:**

1. Conduct an internet search for suggested estate documents that are generally recommended for married people with children. Write a brief response to the Garcías inquiry.
2. Given Isadora’s advancing age and current concerns about her living arrangements, what documents from the previous question might be considered the most important for the Garcías?