Pro$perity

A quarterly update on financial and family issues for women

RATES, REVIEW, REMODEL, RETIRE

Understanding Interest Rates and Your Financial Situation

When discussing bank accounts, investments, loans, and mortgages, it is important to understand the concept of interest rates. Interest is the price you pay for the temporary use of someone else's funds; an interest rate is the percentage of a borrowed amount that is attributable to interest. Whether you are a lender, a borrower, or both, carefully consider how interest rates may affect your financial decisions.

The Purpose of Interest

Although borrowing money can help you accomplish a variety of financial goals, the cost of borrowing is interest. When you take out a loan, you receive a lump sum of money up front and are obligated to pay it back over time, generally with interest. Due to the interest charges, you end up owing more than you actually borrowed. The trade-off, however, is that you receive the funds you need to achieve your goal, such as buying a house, obtaining a college education, or starting a business. Given the extra cost of interest, which can add up significantly over time, be sure that any debt you assume is affordable and worth the expense over the long term.

To a lender, interest represents compensation for the service and risk of lending money. In addition to giving up the opportunity to spend the money right away, a lender assumes certain risks. One obvious risk is that the borrower will not pay back the loan in a timely manner, if ever. Inflation creates another risk. Typically, prices tend to rise over time; therefore, goods and services will likely cost more by the time a lender is paid back. In effect, the future spending power of the money borrowed is reduced by inflation because more dollars are needed to purchase the same amount of goods and services. Interest paid on a loan helps to cushion the effects of inflation for the lender.

Supply and Demand

Interest rates often fluctuate, according to the supply and demand of credit, which is the money available to be loaned and borrowed. In general, one person's financial habits, such as carrying a loan or saving money in fixed-interest accounts, will not affect the amount of credit available to borrowers enough to change interest rates. However, an overall trend in consumer banking, investing, and debt can have an effect on interest rates. Businesses, governments, and foreign entities also impact the supply and demand of credit according to their lending and borrowing patterns. An increase in the supply of credit, often associated with a decrease in demand for credit, tends to lower interest rates. Conversely, a decrease in supply of credit, often coupled with an increase in demand for it, tends to raise interest rates.

The Role of the Fed

As a part of the U.S. government's monetary policy, the Federal Reserve Board (the Fed) manipulates interest rates in an effort to control money and credit conditions in the economy. Consequently, lenders and borrowers can look to the Fed for an indication of how interest rates may change in the future.

In order to influence the economy, the Fed buys or sells previously issued government securities, which affects the Federal funds rate. This is the interest rate that institutions charge each other for very short-term loans, as well as the interest rate banks use for commercial lending. For example, when the Fed sells securities, money from banks is used for these transactions; this lowers the amount available for lending, which raises interest rates. By contrast, when the Fed buys government securities, banks are left with more money than is needed for lending; this increase in the supply of credit, in turn, lowers interest rates.

Lower interest rates tend to make it easier for individuals to borrow. Since less money is spent on interest, more funds may be available to spend on other goods and services. Higher interest rates are often an incentive for individuals to save and invest, in order to take advantage of the greater amount of interest to be earned. As a lender or borrower, it is important to understand how changing interest rates may affect your saving or borrowing habits. This knowledge can help with your decision-making as you pursue your financial objectives.

What's the Value of Your Estate?

Federal estate taxes can take a chunk out of the assets you hope to leave your heirs—up to 40% in 2018. Federal estate taxes are generally due if the sum of your net taxable estate at your death exceeds your individual estate tax exemption ($11.18 million in 2018).

Regulations relating to the taxation of property owned at death contain a catch-all definition stating that the "gross estate of a decedent who was a citizen or resident of the United States at the time of his death includes the value of all property—whether real or personal, tangible or intangible, and wherever situated—beneficially owned by the decedent at the time of his death." What does this mean? The first step in understanding the potential implications of the Federal estate tax is to understand some of the major items that may or may not comprise your estate:

Personal assets. Many people are aware that their personal property, savings, real estate, and retirement plans, as well as the proceeds of any life insurance policies they own, are included in their estates.

Rights to future income. What may be less well known is that rights to future income, such as rights to payments under a deferred compensation agreement or partnership income continuation plan, may be includable in your estate. These rights are commonly referred to as "income in respect of a decedent (IRD)" and may be includable at their present computed value.

Business interests. Likewise, interests in any business you own at death, whether as a proprietor, a partner, or a corporate shareholder, may be includable in your gross estate.

Social Security benefits. The value of Social Security survivor benefits received as either a lump sum or a monthly annuity is not includable in your gross estate.

Estate planning can help *minimize* estate taxes and *maximize* the amount you transfer to your heirs. It is important to accurately itemize an inventory of your estate to project your potential liabilities, as well as to perform periodic reviews to make sure your plan is up to date. By developing strategies early on, you may be able to make the most of your tax-saving opportunities and make sure that your assets are distributed according to your wishes.

Which Home Improvements May Benefit You?

When it comes to home improvements, it is important to consider which would be the most profitable in terms of resale value. While some improvements, such as a remodeled kitchen or added bathroom, may add value to your home, others can actually make your home more difficult to sell. For example, not all prospective homebuyers will appreciate a full spa with a whirlpool, hot tub, pool, steam bath, and built-in stereo system.

So, how do you know which home improvements might increase your home's resale value? Start by researching the recent selling prices for comparable homes in your neighborhood. If most homes range from $175,000 to $250,000, your top resale price will most likely be equal to or less than $250,000, no matter how many rooms, baths, hot tubs, or skylights you add. As you consider remodeling, keep in mind that it is usually difficult to recover any costs that raise the value of your property over comparable homes in your neighborhood. You may also choose to spend less on home improvements if you are thinking about moving again in a few years.

The following interior home improvements may increase resale value:

An interior facelift: Repainting ceilings, walls, and interior trim can create a clean, bright, and inviting appearance.

A remodeled kitchen: The kitchen is viewed by many as the center of the home, and it often serves as a combination family room/workplace.

Addition of a second bathroom: Many prospective homebuyers want more than one bathroom.

Fireplace installation: Even though fireplaces may lose more heat than they provide, they do add considerable charm to a home.

Installation of central air conditioning: Central air conditioning could help sell your house if it is located in a warmer climate. In colder regions, buyers may be reluctant to pay extra for it because of the operating expense.

Improvements in energy efficiency: Additional insulation, thermopane windows, and energy-efficient appliances could begin to pay for themselves immediately, even before selling your home.

Refinished or newly installed hardwood floors: Hardwood floors can add character, durability, and elegance to your home and may add to the sale price.

When it comes to recovering your investment, home improvements can be a mixed bag. Before you begin a remodeling project, consider what improvements may be most advantageous in terms of resale value.

Automatic Features in Retirement Plans

Millennials are the first generation of workers to fully benefit from improvements made to retirement plans over the last decade, including the introduction of automatic features, and these improvements are reflected in their retirement savings habits and attitudes, the results of a survey conducted by retirement benefits consultancy Empower Institute indicate.

The survey of 4,038 working adults aged 18 to 65 was conducted between December 18, 2017, and January 21, 2018. Researchers observed that the landmark Pension Protection Act of 2006 (PPA), which was enacted at a time when the millennials were first entering the workforce, recognized the importance of employer contributions to employee accounts, and reformed workplace retirement plans in a number of ways.

Most significantly, researchers noted, the PPA allowed retirement plan sponsors to implement automatic enrollment of plan participants and automatic escalation of participants' contributions. The survey found that 41% of millennial respondents are automatically enrolled in a defined contribution plan, compared to 38% of Gen Xer and 33% of baby boomer respondents; and that 38% of millennial respondents are enrolled in a plan with auto-escalation features.

The survey results included a retirement progress score (RPS), or a numeric estimation of the percentage of working income that U.S. households are on track to replace in retirement. The findings showed that the median projected income replacement among all the survey participants is 64%. Broken down by generation, the findings indicated that respondents of the millennial generation (born after 1981) are on track to replace 75% of their income in retirement, compared to 61% for Generation X and 58% for baby boomer respondents. Researchers also observed that there is an 11-point difference in median income replacement percentages among participants across all generations who were enrolled automatically in a defined contribution plan and those who opted into a plan.

In addition, the survey results suggested that attitudes about retirement planning differ across the generations, with millennial workers expressing less certainty than their older counterparts that Social Security will provide them with retirement income in the future. When asked to identify the sources they expect will provide them with income during retirement, 59% of millennial respondents cited Social Security, compared to 88% of boomer and 73% of Gen X respondents.

The findings further indicated that while millennial respondents currently have smaller amounts of investable assets than Gen Xers and baby boomers, these younger workers are more likely to have a financial advisor and a formal retirement plan.

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