



## Johnston Investment Counsel

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Student Loan Debt: It Isn't Just for Millennials

Infographic: 4 Things to Do in the 4 Years Before College

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LIFE THE WAY YOU PLANNED IT.

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## *LIFE THE WAY YOU PLANNED IT.*

### Four Numbers You Need to Know Now



When it comes to your finances, you might easily overlook some of the numbers that really count. Here are four to pay attention to now that might really matter in the future.

#### 1. Retirement plan contribution rate

What percentage of your salary are you contributing to a retirement plan? Making automatic contributions through an employer-sponsored plan such as a 401(k) or 403(b) plan is an easy way to save for retirement, but this out-of-sight, out-of-mind approach may result in a disparity between what you need to save and what you actually are saving for retirement. Checking your contribution rate and increasing it periodically can help you stay on track toward your retirement savings goal.

Some employer retirement plans let you sign up for automatic contribution rate increases each year, which is a simple way to bump up the percentage you're saving over time. In addition, try to boost your contributions when you receive a pay raise. Consider contributing at least enough to receive the full company match (if any) that your employer offers.

#### 2. Credit score

When you apply for credit, such as a mortgage, a car loan, or a credit card, your credit score is one of the tools used by lenders to evaluate your creditworthiness. Your score will likely factor into the approval decision and affect the terms and the interest rate you'll pay.

The most common credit score that creditors consider is a FICO® Score, a three-digit number that ranges from 300 to 850. This score is based on a mathematical formula that uses information contained in your credit report. In general, the higher your score, the lower the credit risk you pose.

Each of the three major credit reporting agencies (Equifax, Experian, and TransUnion) calculates FICO® scores using different formulas, so you may want to check your scores from all three (fees apply). It's also a good idea to get a copy of your credit report at

least annually to check the accuracy of the information upon which your credit score is based. You're entitled to one free copy of your credit report every 12 months from each of the three credit reporting agencies. You can get your copy by visiting [annualcreditreport.com](http://annualcreditreport.com).

#### 3. Debt-to-income ratio

Your debt-to-income ratio (DTI) is another number that lenders may use when deciding whether to offer you credit. A DTI that is too high might mean that you are overextended. Your DTI is calculated by adding up your major monthly expenses and dividing that figure by your gross monthly income. The result is expressed as a percentage. For example, if your monthly expenses total \$2,200 and your gross monthly income is \$6,800, your DTI is 32%.

Lenders decide what DTIs are acceptable, based on the type of credit. For example, mortgage lenders generally require a ratio of 36% or less for conventional mortgages and 43% or less for FHA mortgages when considering overall expenses.

Once you know your DTI, you can take steps to reduce it if necessary. For example, you may be able to pay off a low-balance loan to remove it from the calculation. You may also want to avoid taking on new debt that might negatively affect your DTI. Check with your lender if you have any questions about acceptable DTIs or what expenses are included in the calculation.

#### 4. Net worth

One of the key big-picture numbers you should know is your net worth, a snapshot of where you stand financially. To calculate your net worth, add up your assets (what you own) and subtract your liabilities (what you owe). Once you know your net worth, you can use it as a baseline to measure financial progress.

Ideally, your net worth will grow over time as you save more and pay down debt, at least until retirement. If your net worth is stagnant or even declining, then it might be time to make some adjustments to target your financial goals, such as trimming expenses or rethinking your investment strategy.



### **The intersection of student loan debt and Social Security benefits**

Since 2001, the federal government has collected about \$1.1 billion from Social Security recipients to cover unpaid federal student loans, including \$171 million in 2015 alone. During that time, the number of Americans age 50 and older who have had their Social Security benefits reduced to pay defaulted federal student loans has risen 440%.

Source: *The Wall Street Journal*, *Social Security Checks Are Being Reduced for Unpaid Student Debt*, December 20, 2016

## **Student Loan Debt: It Isn't Just for Millennials**

It's no secret that today's college graduates face record amounts of debt. Approximately 68% of the graduating class of 2015 had student loan debt, with an average debt of \$30,100 per borrower — a 4% increase from 2014 graduates.<sup>1</sup>

A student loan debt clock at [finaid.org](http://finaid.org) estimates current outstanding student loan debt — including both federal and private student loans — at over \$1.4 trillion. But it's not just millennials who are racking up this debt.

According to the Consumer Financial Protection Bureau (CFPB), although most student loan borrowers are young adults between the ages of 18 and 39, consumers age 60 and older are the fastest-growing segment of the student loan market.<sup>2</sup>

### **Rise of student debt among older Americans**

Between 2005 and 2015, the number of individuals age 60 and older with student loan debt quadrupled from about 700,000 to 2.8 million. The average amount of student loan debt owed by these older borrowers also increased from \$12,100 to \$23,500 over this period.<sup>3</sup>

The reason for this trend is twofold: Borrowers are carrying their own student loan debt later in life (27% of cases), and they are taking out loans to finance their children's and grandchildren's college education (73% of cases), either directly or by co-signing a loan with the student as the primary borrower.<sup>4</sup> Under the federal government's Direct Stafford Loan program, the maximum amount that undergraduate students can borrow over four years is \$27,000 — an amount that is often inadequate to meet the full cost of college. This limit causes many parents to turn to private student loans, which generally require a co-signer or co-borrower, who is then held responsible for repaying the loan along with the student, who is the primary borrower. The CFPB estimates that 57% of all individuals who are co-signers are age 55 and older.<sup>5</sup>

### **What's at stake**

The increasing student loan debt burden of older Americans has serious implications for their financial security. In 2015, 37% of federal student loan borrowers age 65 and older were in default on their loans.<sup>6</sup> Unfortunately for these individuals, federal student loans generally cannot be discharged in bankruptcy, and Uncle Sam can and will get its money — the government is authorized to withhold a portion of a borrower's tax refund or Social Security benefits to collect on the debt. (By contrast,

private student loan lenders cannot intercept tax refunds or Social Security benefits to collect any amounts owed to them.)

The CFPB also found that older Americans with student loans (federal or private) have saved less for retirement and often forgo necessary medical care at a higher rate than individuals without student loans.<sup>7</sup> It all adds up to a tough situation for older Americans, whose income stream is typically ramping down, not up, unlike their younger counterparts.

### **Think before you borrow**

Since the majority of older Americans are incurring student loan debt to finance a child's or grandchild's college education, how much is too much to borrow? It's different for every family, but one general guideline is that a student's overall debt shouldn't be more than his or her projected annual starting salary, which in turn often depends on the student's major and job prospects. But this is just a guideline. Many variables can impact a borrower's ability to pay back loans, and many families have been burned by borrowing amounts that may have seemed reasonable at first glance but now, in reality, are not.

A recent survey found that 57% of millennials regret how much they borrowed for college.<sup>8</sup> This doesn't mean they regretted going to college or borrowing at all, but it suggests that it would be wise to carefully consider the amount of any loans you or your child take out for college. Establish a conservative borrowing amount, and then try to borrow even less.

If the numbers don't add up, students can reduce the cost of college by choosing a less expensive school, living at home or becoming a resident assistant (RA) to save on room costs, or graduating in three years instead of four.

<sup>1</sup> The Institute for College Access & Success, *Student Debt and the Class of 2015*, October 2016

<sup>2-7</sup> Consumer Financial Protection Bureau, *Snapshot of Older Consumers and Student Loan Debt*, January 2017

<sup>8</sup> *Journal of Financial Planning*, September 2016



## Infographic: 4 Things to Do in the 4 Years Before College

College is a huge financial undertaking. With costs increasing every year and the prospect of too much student debt at the forefront of many families' minds, it's more important than ever to be an educated college consumer. Go into the planning process wisely with these four steps.

1

### Take stock of your savings

A few years before you need to start paying tuition bills is a good time to look at your college savings. How much have you saved? Are you currently making monthly contributions? Can you increase them? How much will you have saved by the time your child graduates from high school?

### Get familiar with financial aid...

Get an estimate of your expected family contribution (EFC) by filling out the federal government's FAFSA4caster tool at [www.fafsa.ed.gov](http://www.fafsa.ed.gov). Your EFC will depend on your family's income, assets, and household information, like the number of children you'll have in college at the same time.

2

### ... and net price calculators

Colleges differ in the amount of merit and need-based financial aid they offer. To get an idea of how generous a college is, run the net price calculator available on every college website to get an estimate of what your out-of-pocket costs will be at that college. This 10-minute endeavor can help you compare the cost of different colleges in an apples-to-apples way.

3

### Have a frank conversation with your child about college costs

Share how much you expect to have saved and how much you will be able to contribute each year during college. When talking about loans, make sure your child knows exactly what the monthly payment will be after graduation for different loan amounts. Help your child avoid excessive borrowing.

4



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## I'm thinking about buying a new home. Should I consider the risk of climate changes?

If you're thinking about buying a home, you probably have a checklist of qualities you're looking for as you shop

around. But have you considered how environmental factors could affect your choice? In the event your dream home is in an area that could be affected by flooding or a storm surge, you'll have some additional factors to think about before you make your purchase.

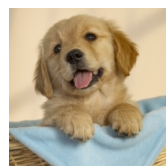
**Do your research.** Seek information on the locations vulnerable to climate changes. Some of these regions are located in coastal areas. Climate changes have been linked to more severe weather events and rising sea levels, which increases the risk of frequent and major flooding. Even though there's uncertainty as to how much sea levels could rise in the future, it's still important that you know the risks. You can find more information on this subject on NASA's global climate change website at [climate.nasa.gov](http://climate.nasa.gov) or by reviewing FEMA's "Information for Policyholders" page at [fema.gov](http://fema.gov).

**Know your insurance options.** Generally, homeowners insurance does not cover floods.

This means you'll want to look into coverage options (and the cost) if you're relocating to an area susceptible to flooding. Many insurance companies participate in the National Flood Insurance Program (NFIP), which makes flood insurance available through a partnership with FEMA. Contact your homeowners insurance provider to learn more.

**Tour the home with weather-related and environmental risks in mind.** When you check out your potential home's features, think about safety. Will the home be able to withstand severe weather? Specifically, is the home equipped with hurricane shutters? Do the windows have special impact-resistant glass? What about a storm cellar? Is the roof in good condition? Are there many trees on the property?

Take time now to estimate the potential financial impact of owning a home in an area affected by the risk of climate changes, and it may help you avoid unexpected expenses and stress later.



## What is a pet trust?

A pet trust is an arrangement to provide for the care and financial support of your pet(s) upon your disability or death.

You fund the trust with property or cash that can be used to provide for your pet based on your instructions in the trust document.

Your pet trust should name a trustee who will carry out your instructions for the care of your pet, including handling and disbursement of trust funds and turning your pet over to the person or entity you designate to serve as your pet's caregiver. The trustee and caregiver could be the same person or entity.

As with most trusts, you can create your pet trust while you're alive (an inter vivos or living trust) or at your death through your will (a testamentary trust). In either case, you can generally change the terms of your pet trust at any time during your lifetime to accommodate changing circumstances. If you create an inter vivos trust, you can fund it with cash or property either during your life (needed if the trust is to care for your pet if you become incapacitated) or at your death through your will. A testamentary trust is only funded after you die.

Some of the instructions to consider for your pet trust include: provisions for food and diet, daily routines, toys, medical care and grooming, how the trustee or caregiver is to document expenditures for reimbursement, whether the trust will insure the caregiver for any injuries or claims caused by your pet, and the disposition of your pet's remains.

You may also want to name a person or organization to take your pet should your trust run out of funds. Also consider naming a remainder beneficiary to receive any funds or property remaining in the trust after your pet dies.

A potential problem arises if your pet is expected to live for more than 21 years after your death. That's because, in many states, the "rule against perpetuities" forbids a trust from lasting beyond a certain period of time, usually 21 years after the death of an identified person. However, almost every state has laws relating to pet trusts that address this issue in particular and allow for the continued maintenance of the trust, even if its terms would otherwise violate the rule.

Note that there are costs and expenses associated with the creation of a trust.



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