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On Watch

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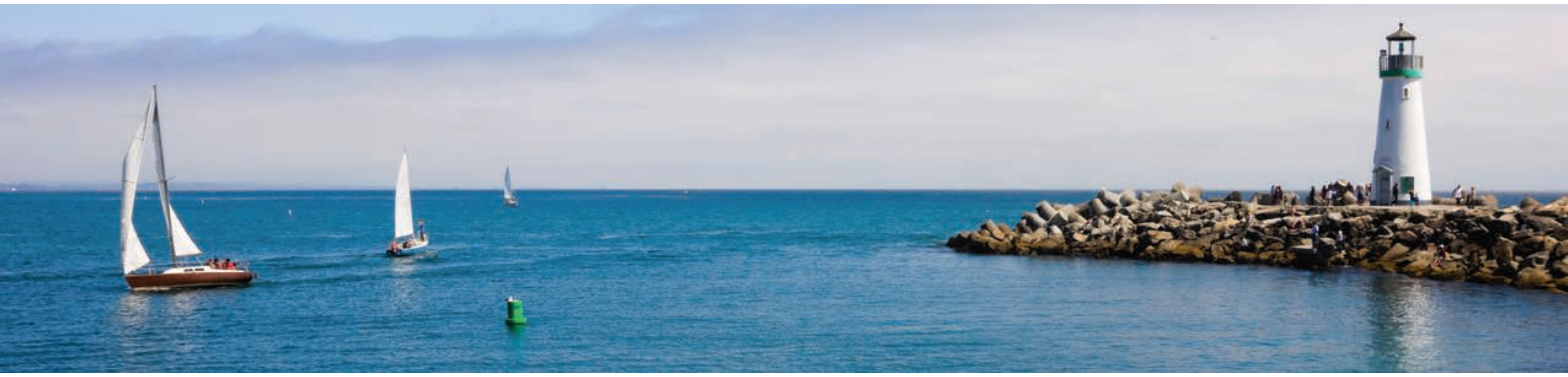

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Should You Lend to Friends and Relatives?

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WE ALL KNOW THAT THE ANSWER IS "NO!" Yet, friends and family inevitably will ask you for a loan one day and, because they are friends and family, you will be tempted to agree even though you wouldn't even entertain the idea if a stranger with equivalent credit worthiness walked in off the street and solicited a loan.

The ideal answer is, "I'm sorry, I simply do not lend money to friends and family because doing so risks our relationship, which is important to me." If you are still tempted, please reread the preceding sentence. If you are going to loan money anyway, following are some thoughts for you to consider.

Think about Worst Case

There's a good chance that you'll never be repaid. After all, if the person could get the loan elsewhere, he probably wouldn't ask you. Inability to get the loan elsewhere tells you something about the chances of your loan being paid. So, think about what you will do when a payment doesn't arrive in your mailbox on time. What will you say the next time you see the borrower? How will you deal with your emotions and his embarrassment? What, if any, legal actions will you take?

Story continued inside.

And, since it is virtually guaranteed to happen, what will you do and say when the person seeks an extension of time to pay and an additional loan to bridge the gap until he can generate the money to repay the first loan?

Perhaps you should talk candidly about these issues with the person before you make the loan and reach an understanding about how you will handle them. Then, document the answers.

Formal Terms

In all cases, the loan should be documented with a written promissory note containing specific repayment terms and interest rate. Ideally, you should require collateral (if the prospective borrower has anything worthwhile for that purpose).

While formal terms are important, we all know that the practical reality is that you may have trouble enforcing them. After all, we're talking about a friend or family member. And, if he doesn't pay, he probably can't and it's hard to image foreclosing on his home or forcing him into bankruptcy.

Taking the Emotion Out

The primary problem with loaning money to friends and family is the emotions that arise when the borrower doesn't pay. So, how about excluding you from collection activities? Delegate that function to someone else, perhaps your family office head or attorney, who will handle the matter in a business-like manner based upon the facts at the time. Have the borrower sign a statement that he understands this arrangement and that he should not bother to appeal to you. This statement also may include a representation that the borrower agrees not to seek additional loans from you and that you simply will not entertain the possibility of an additional loan.

Guarantees

Some advisors recommend that, instead of loaning your own money, guarantee a bank loan to the friend or family member. Arguably, the borrower may be more likely to give priority to timely paying a third party creditor, so I don't dismiss the idea. However, the real issue is what happens when the borrower starts to miss payments. The likelihood is that the lender won't waste much of its time on collection activities and will turn to you. The result is that you are back in the soup as if you had made the loan in the first place, so you should try to have all of the above legal and emotional safeguards in place in advance even in the guarantee scenario.

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Uncle Sam Takes a Piece of the Action

You probably know that the tax law generally requires you to charge at least the appropriate applicable federal interest rate. In fact, with interest rates so low, some advisors recommend lending money to younger generation family members as an estate planning strategy. They can invest the funds and generate higher returns, rather than you doing so and augmenting your estate. (At least that's the hoped for result.)

What you may not know is that the IRS also has an interest in the outcome of a loan to a friend or family member. If you never intended to collect the loan, you made a taxable gift upon making the "loan." If you did intend to collect, but don't, here are some of the possible tax consequences:

- If you don't make reasonable efforts to collect (which might include taking assets), you may be deemed to make a taxable gift.
- If the borrower is an employee, he may have compensation income (because gifts to employees generally are considered compensatory) subject to income and employment taxes.
- If you forgive the loan, you may have a taxable gift and/or the borrower may have debt forgiveness income.

It's probably not fair to say that nothing good can come from loans to friends and family. If you decide to go forward notwithstanding the risks to your capital and relationships, please think through the potential outcomes and agree with the borrower in advance how potential issues will be handled. Doing so can avoid potential surprises and misunderstandings and might even limit the damage.

Making a Senior's Home Safe

My client comes to his office daily, actively contributes to the running of the business and enjoys a weekly lunch with his men's group and bi-weekly Pilates classes. At age 93, he lives independently at home with his wife of 54 years.

Yet he and his family decided to take steps to ensure his safety and well-being as he moves about his home and office. In order to maximize self-sufficiency, he (and several of Sentinel's other clients) recently conducted Senior Home Safety Assessments (SHSA) for themselves or an aging relative. Their goal was to ensure as safe a living environment as possible in order for themselves or their loved ones to "age in place" for as long as practicable.

During an SHSA, an occupational therapist, geriatric care manager or other qualified consultant performs an assessment of a senior's living conditions with a focus on improving self-sufficiency, self-reliance, mobility, safety, security, comfort, and convenience. This consultant has specialized training in home and client assessment. The process benefits the senior by identifying in-home hazards or unsafe practices, helping to determine the proper amount of assistance needed in the home, providing recommendations for equipment and referrals for supportive services, and providing caregivers and clients with training on safe transfers.

When to Do It

It is best to undertake home assessment and modification well before a crisis occurs so that the work can be carefully planned and new skills learned when seniors are still of sound mind and body. Ideally, people in their 60s or early 70s should prepare their homes for later modifications while they are carrying out routine home improvements and repairs. Extra-wide doorways and hallways that can accommodate a wheelchair can be an attractive feature in any home. Strong supports can be installed behind tile walls when updating bathrooms to later accommodate grab bars. That said, if a loved one is in the middle of a decline, and wishes to stay in his or her home, there is no time like the present to make the living environment safer.

An SHSA begins with interviews of family and any caregivers to gain a full understanding of the living conditions and any immediate concerns. Fall prevention typically is a major safety concern, especially for those living alone. Slip and fall accidents are one of the leading causes for senior hospitalization, but there are a number of useful living aides that can help prevent these accidents.

The Process

The consultant then spends time, usually a long morning, with the senior in the home discussing, among other topics, medication regimens, meal habits, personal hygiene, transportation, socialization, home management and administration (bill pay, etc.). The seniors give a tour of their home, while the consultant looks for safety hazards and watches mobility as they move about the premises. The consultant also tours the outside of the home, looking for poorly-lit pathways or overgrown shrubs which might limit accessibility or security. They often take photos of safety and health issues, such as loose area rugs or bare cupboards. The photos help to counter any future pushback from their senior clients.

After meeting with both the family and the elderly individual or couple, the consultant prepares a list of recommended improvements, ranging from the installation of grab bars which contrast with the tile wall, making them more visible, to hiring a driver or cook. Recommendations might include contrasting colors (red and yellow are best) to indicate a change in height from one room to another as at a rear doorway, garage entry or sunken living room. Inexpensive measures can be taken, such as using colored tape, to indicate the top and bottom steps on a stairway. Furniture might need to be rearranged for ease of passage and to create appropriate walkways, but there should not be so extensive a redecoration as to make the room feel unfamiliar. All stairways should have handrails on both sides that extend beyond the last step. This enables a person who is physically weaker on one side to always have a railing available on the stronger side. Handrails should be strong enough to support the full body weight of a falling person.

For those with deteriorating vision, walls should be painted a light but glare-free color while ceilings should be white to better reflect the room's lighting. Floors should be dull rather than waxed both for safety and to eliminate glare. Since older people need more light to perform the same tasks that they did in their younger years, more lighting fixtures may be needed, especially direct-task lighting and higher wattage bulbs. Light bulbs should not be visible so that glare is reduced. Stairways should be well lighted with switches at both the top and bottom.

Recommendations Presented

The recommendations are listed in order of importance and presented to the family or caregivers in advance of the final meeting with the seniors in order to anticipate any possible negative reactions and create the most effective presentation strategy. Finally, the recommendations are presented to the seniors and a plan for changes to the home or lifestyle is made. The consultant oversees changes made to the home, for example, to ensure that grab bars are installed at the right height and meal plans are created to meet the specific nutritional needs of the seniors. The consultant might identify appropriate contractors or staffing agencies with whom they have worked in the past.

The SHSA is just a piece of the puzzle. For the plan to be effective, seniors must also be willing to recognize and accept the need for change, something that is often a tough pill to swallow. It would, however, be contrary to the goal of enhancing independence to force unwelcome changes on a reluctant individual. The professionals conducting the SHSA are aware of this potential issue and know how to gain a senior's cooperation by involving the person as much as possible in the planning process.

Of course, it is impossible to make any home completely accident-proof. The emphasis, instead, should be placed on preserving and strengthening the existing capabilities of the senior, enabling him or her to remain independent, yet feel supported, for as long as possible. An SHSA, especially one done well ahead of time, can provide exactly the kind of reassurance sought by seniors and their loved-ones to accomplish the goal of preserving independence in the golden years.

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How Fear Can Increase Investment Risk

WE HAVE ALL HEARD THE MAXIM THAT fear and greed drive investor behavior, typically to the investor's detriment. Examples usually focus on greed driving investors to take on too much risk at inopportune moments (such as the tech bubble of the late 1990s) and fear driving them to not take risk when it would have been highly beneficial (such as after the market crash of 2008-2009).

While investors' fear is most often associated with being overly risk adverse, wealthy families' portfolios often are victims of fears that tend to increase rather than decrease risk; occasionally with very bad consequences.

The risk that creeps (and sometimes gallops) into wealthy families' portfolios is usually in the form of being overly concentrated in one type of asset class, or even a single holding. Modern portfolio theory teaches us that a sure way to lower portfolio risk is to diversify holdings among a number of asset classes and to avoid concentrations. So what are the common fears that keep investors from being rational?

Fear of Loss of Connection with the Past

When a family sells its business and receives stock in the buyer, the family often is hesitant to sell any of the buyer's stock. Members worry about being disloyal to the family's heritage as well as to their former employees and customers. This concern is aggravated if a family member has a position in the acquiring company.

Family members often view the new company as being similar to what they had. While there are certainly similarities (industry, products, customers and employees), the difference in riskiness can be great. The buyer's willingness to issue its own stock in exchange actually may indicate that the buyer views its shares to be overvalued. The new owner may have its own risks, take on new ones, and operate in a different manner from the way things were historically. And, the family typically has less control over and knowledge of the business as its involvement fades.

Fear of Sellers Remorse

Selling a stock that continues to appreciate can make someone feel foolish, irrespective of whether selling was a good portfolio decision. This fear can paralyze an investor who is constantly worried about lost opportunity for continued appreciation even though the risk of continued ownership can rise as the price increases.

People tend to exhibit fear of sellers remorse more often with large positions in their portfolios that they have held for a long time. Because of the large size relative to their total holdings, maintaining these concentrations can significantly raise overall portfolio risk.

Fear of Paying Taxes

Being careful about how much tax is paid on investment income can be a virtue that leads to greater wealth over the long term; however, being fearful of paying any tax can lead to avoiding trimming positions that are significant concentrations or that have become more risky considering current valuations.

Fear of the Unknown

Investors often are comforted by an in-depth understanding of the companies and industries in which they have holdings. The desire for this comfort combined with a fear of the unknown often leads to concentrations of holdings in a particular asset class, industry, and even company.

Understanding these fears can help an investor more rationally analyze portfolio actions (or inactions), potentially allowing steps that increase returns and reduce risk.

Sentinel Trust Company provides custom integrated planning, investment, fiduciary and administrative solutions to affluent families and their closely held businesses and entities.

Founded in 1997 as the successor to two 40-year old, investment-focused family offices, today Sentinel offers the stability of an institutional firm, the entrepreneurial spirit of a young firm, the personal feel of a family office and the in-house technical skills of independent planning and investment management firms.

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