Part B

The minimization of income taxes and reduction of probate estate goals are very achievable given the couple’s financial situation and behavior. The couple could reduce the income taxes and increase their ability to meet their retirement asset goals by maximizing their contributions to June’s 401(k) plan and setting up a SEP IRA for Karl. The couple’s oldest child will be in university in 8 years while their youngest child will be in university in 12 years. They both intend to retire in 25 years and will be in service over the course of their children’s university education. This has positive implications for their ability to meet their children’s university education costs. Additionally, the couple need not account for university education as part of their retirement needs.

Assuming that their net cash flow surplus of roughly $10,000 grows at 1.25% (simple average of Karl and June’s income growth rates less the inflation rate) over the next 8 years and earns the 11% investment rate, the future value of the reinvested surpluses will be $147,666.13. currently, the average cost of tuition, room, and board for in-state students at Texas universities is $18,700. Assuming that the cost increases at the inflation rate, university education will cost roughly $23,700 in 8 years when the couple’s first born enters university. If the couple uses the $147,666 to fund their Sebastian’s university education, the remaining amount will be $59,368.77 at the end of his 4-year education. Sandy will join university a year after Sebastian has completed university while April’s university studies will overlap with Sandy’s for one year. Ignoring the time of value money, the balance will cover slightly more than half of Sandy’s university education and the couple’s surplus over the four-year period will not be sufficient to cover the remainder of her tuition. Consequently, the couple will need to liquidate investment and personal property to meet their children’s university cost. Given the difficulty in meeting their goal of paying for the children’s education, the couple are unlikely to meet their retirement goals.

The Monroes should earmark their mutual fund for their children’s university education and increase the proportion of funds held in growth and balanced funds while reducing their holdings of corporate bonds to reflect their lower risk aversion at this stage of their investment life cycle. The couple should also invest a portion of their cash flow surplus in the mutual fund every month to benefit from compounding effects. They should determine the amount needed for their children’s education and make appropriate adjustments to their spending to increase the monthly savings in the mutual fund to achieve the long-term goal of educating their children.

I would also recommend that the Monroes refinance their mortgage using the 30-year mortgage and deposit the $188 in monthly savings from lower mortgage payments in a savings account with a 4% rate compounded monthly. The annuity will be worth $96,401. The amount can be used as part of the mortgage repayment as part of the zero mortgage at retirement goal. Karl should also increase his retirement savings as their income increases and switch to a SEP IRA for a higher contribution limit. I would advise against using June’s 401(k) to meet the bar expansion costs. Instead, the couple could accumulate earnings from the strip mall they intend to buy to finance the bar expansion costs. They could also “borrow” from their children’s education fund by selling their mutual fund assets provided they formulate a comprehensive plan for repaying the amount from bar income to attain the future value that would have been attained sans the borrowing.

Part 2