

AKD Consultants
Adam Dworkin
CPA
188 Whiting Street
Suite 10
Hingham, MA 02043
781-556-5554
Adam@AKDConsultants.com

Financial Planning Issues for New Parents





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What is it?

As you prepare for life with your new child, it's time to prepare a new financial plan for your family or make any necessary changes to your existing plan. You'll want to consider how your baby will affect your budget, make sure you have adequate insurance, protect your child's future with a well-thought-out estate plan, and determine how having a child will affect your income taxes.

Budgeting for baby

Develop a new spending plan

The birth of a child is an opportunity for you to set up a new budget or review an existing one. You'll have to consider the impact that your child will have on your living expenses as well as account for any shift in income that might occur if you decide to quit your job. You'll also need to save more money to ensure that your family has money to meet its future needs.

Expenses that typically increase when you have a baby

- Your grocery bill: Diapers and formula (you may use some even if you're breast-feeding) are very expensive, adding \$100 or more to your monthly grocery bill. Later, when your baby turns to solid food, you'll have to figure in the cost of baby food.
- Your housing costs: If you don't already live in a house or large apartment, you may find yourself moving once your baby gets old enough to take up a lot of space with toys and equipment.
- Your transportation costs: If you have a small car or a two-seat convertible, you may find it difficult to fit in a car seat, and you may need to buy a new car. Or, if you have an old car, you may want to buy something more reliable now that you have to worry about your baby's safety.
- Your clothing and household expenses: You'll find yourself spending less on yourself and more on your child now that your budget has to stretch. You'll spend a lot initially to buy essentials for your child and then spend a bit more each month than you're used to for items your child needs.
- Medical expenses: You'll probably pay a co-payment for each of these trips unless your health insurance plan covers 100 percent of well-baby care. Your health insurance premium will likely dramatically increase as well, unless you already had family coverage for you and your spouse.
- Cost of child care: Whether you look for full-time day care or hire an occasional baby-sitter, you need to plan for the impact this will have on your budget.

Initial expenses

The initial outlay for your baby can be quite high. You'll have to equip your home with baby furniture, a stroller, a high chair, an infant seat, a car seat, bedding, and clothing, among other items. You could spend well over \$1,000 equipping your home with just the basics, and many new parents spend a lot more.

However, when you're shopping for the baby you're expecting, try to separate emotion from need. Of course, you want your baby to have the best, but you don't really need the best in most cases. Your baby won't look any cuter in that \$1,000 crib than he or she will look in the \$200 one, and many parents can tell stories about the top-of-the-line stroller he or she bought then found was too heavy to push easily. The best way to proceed is to ask other parents for recommendations, then shop around. Usually, you don't have to sacrifice quality to save money. If you start shopping far enough ahead, you can find good deals in discount stores, department stores, and superstores. You can also look for items in thrift stores, consignment shops, and yard sales, although finding clean secondhand items in good condition can be a challenge. Ask friends and relatives, too, if you can borrow baby items that they're not



currently using. If your friends are throwing you a shower, ask for items you need.

Tip: Don't buy more than you initially need for your baby, because you may find that what you thought you needed, you really don't. In addition, your friends and relatives may shower you with gifts once the baby is born, and you won't need to buy as much as you thought you would. In particular, don't go overboard buying clothes until you can gauge how rapidly your baby will grow. One thing you definitely should buy is a car seat. Many hospitals won't let you leave without having one, although they may loan you one temporarily.

Costs of day care

The cost of day care will depend on where you live, how many children you have in day care, how old your children are, and what type of child care you choose.

Saving for education

It's wise to begin saving for your child's education as early as possible. There are several ways to do this. You can begin by depositing a certain amount every month into a savings or money market account, contribute to a college savings account, purchase Series EE bonds (may be called Patriot bonds), or take advantage of a wide variety of other investment vehicles.

Saving for emergencies

If you don't have an emergency fund, now is the time to set one up. If your child gets sick, your car breaks down, you need to move unexpectedly, or you lose your job, you can dip into your emergency account. An emergency account should normally contain an amount that equals three to six months' worth of living expenses.

Estate planning issues

Estate planning is a subject many parents would like to avoid. After all, you're celebrating new life, and it's sad to think that you may not be around to raise your child. However, it's crucial to the welfare of your child that you leave behind instructions that clarify your wishes in the unlikely event that you die before your child grows up. If you don't currently have a will, now is the time for you (and your partner, if any) to draw one up. If you do have a will, you'll need to review it. You'll want to nominate a guardian for your child and decide how you want your assets distributed. You may also consider setting up a trust to protect your child's interests after your death. You should also review your beneficiary designations.

Wills

Each parent should have a will to ensure smooth distribution of his or her estate. After your child is born, you should review your will (or draw up a will if you don't already have one) to make sure that your assets are distributed as you would like, to nominate a guardian for your child, and to choose an executor for your estate.

Tip: You may want to write a letter to your child that will be your testament (i.e., a message from you that your child can read at a future date). It can be about anything--your philosophy on life, the family history, or some advice that you'd like to give your child. You can attach a copy to your will or put it in with your important records for safekeeping.

Example(s): When her daughter Sara was born, Emily wrote a letter to her that described the night Sara was born and Emily's hopes and dreams for Sara's future. When Emily was killed in a car accident the year Sara turned 16, Sara read the letter and found out that her mother was proud of her and really wanted her to attend college. So Sara worked hard the next two years of school so that she could get into the local university.

Nominating a guardian

Choosing a guardian for your child is very important. If you die without naming a guardian for your child, it will be up to the court to do it for you, and the person whom the judge names may not be the person you would have chosen to look out for your child. When choosing a guardian, look for someone who will look out for the best interests of your child, preferably someone who has the time and energy to meet the demands of raising a child. Make sure that



you ask a potential guardian whether he or she would like to serve as your child's guardian. Often someone you think is the perfect choice really doesn't want the responsibility. For this reason, you should also nominate a contingent guardian.

Periodically rethink your choice of guardian. As your children grow older, you can ask them whom they would like to live with in the event you die. Although this can be a scary subject for children, it's important to raise the issue with them. In addition, once your children are old enough, tell them whom their guardian will be in the event you die.

Setting up a trust

Setting up a trust can be a good way of passing your assets along to your child. A trust document lists how you want any money left to your children spent, and it can ensure that your child's money is protected. A trust can help the guardian manage assets and make sure that estate funds are used to benefit your children according to your wishes.

Insurance issues

Before your child is born, review your insurance coverage to make sure that you and your family are adequately protected. If you or your spouse is going to quit your job(s), you may cut off your life, disability, or health insurance benefits from that job, and you'll need to buy more coverage.

Life insurance

Having a child will increase your need for life insurance coverage. Many experts recommend that you have life insurance equal to five times your annual salary.

Health insurance

The best time to check your maternity coverage is before you become pregnant. If you don't have health insurance or if your health insurance doesn't cover maternity care, you'll need to buy maternity coverage or figure out how to pay the cost of having your baby. Make sure that you understand your deductibles, your co-payments (if any), and whether your policy covers testing, emergency care, and all the costs of delivery (including anesthesia, if necessary). Find out about claims-handling procedures, how long you will be able to stay in the hospital once you've been admitted for delivery, and whether your choice of doctors is limited. Usually, your baby will be covered from the time of birth, but check your insurance policy anyway to make sure. Determine, too, whether your policy covers routine visits to a family practitioner or a pediatrician once your child is born. If both you and your partner are covered by or eligible for coverage under an employer-sponsored policy, you may need to decide which policy offers the best (or most cost-effective) family coverage.

Disability insurance

Before you had a child, you may not have worried about becoming disabled. Now that you're planning to have a child, you may be thinking about what would happen if you suffered an injury or illness and couldn't work for days, months, or even years. If you're married, you may be able to rely on your spouse for income, but could your spouse really support all of you?

Example(s): Bob worked as an accountant, a relatively nonhazardous occupation. However, on Christmas Eve, he broke both wrists when he slipped and fell on a patch of ice. Since his injury was not work-related, he wasn't eligible to receive workers' compensation insurance. In addition, he wasn't covered by an individual or group disability policy. His wife was working full-time as a seamstress but wasn't able to support Bob and their children on her salary alone. Within a few weeks, they were financially destitute.

To protect your family in case your income is cut off due to disability, consider purchasing disability insurance if you don't already have it. You may have a group disability policy through your employer or you may want to purchase an individual disability insurance policy. A disability policy won't replace your total income, but it will likely replace 50 to 70 percent of your earnings.



Income tax considerations

At tax time, you'll find out that some financial benefits can help defray the cost of raising a child. You'll suddenly be eligible for an extra exemption, and you may be eligible for one or more tax credits.

Exemptions

When you file your income tax return, you may be able to claim an exemption for you, your spouse, and your dependents if your adjusted gross income is below a certain phaseout amount. This means that when you file your income tax return in the year of your child's birth (and ensuing years), you'll be able to claim an extra exemption that will reduce your tax liability.

Tax credits

Having a child might enable you to qualify for one or more tax credits. Credits related to children are the child and dependent care tax credit (if you have qualifying child-care expenses), the child tax credit, and the earned income credit (if you have income under a certain level, having a child raises the amount of income you can have and still claim the credit).

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