

Total Term

ASSESSMENT GUIDE

Total Term (Tt) estimates the number of years a client could live on their current assets at their current lifestyle if neither changed.





Total Term

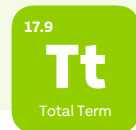
Assessment Guide

What is it?

Total Term (Tt) estimates the number of years a client could live on their current assets at their current lifestyle if neither changed.

CALCULATION

$$\frac{\text{Net Worth}}{\text{Annual Living Expenses}} = \text{Total Term}$$



Example: If a client's net worth is \$1,000,000 and they spend \$100,000 annually, then their Total Term (Tt) is 10. They could live for about 10 years on their assets assuming no asset growth and no change in spending.

Why is it important?

Typically, at the core of most clients' goals are some personalized versions of "freedom" or "security". And to that end, clients often ask



questions like “how am I doing?” or “do I have enough money?”

While these are certainly broad questions that require deeper discussions, Total Term is a great anchoring point to quickly address that question, framing the answer in a way that is easily digestible by the client (years versus dollars). You can also look at the change in Total Term over time to better understand the pace of a client’s progression towards financial independence.

Lastly, breaking apart Total Term by its underlying components - Liquid Term, Qualified Term, Real Estate Term, and Business Term - can help frame the health of the score. Ultimately, finding the “right” mix of assets can help you better understand if a client is prepared for retirement.

A traditional long-term retirement projection is useful in certain cases, but it’s “expensive” (i.e. time consuming) as the basis for an ongoing monitor of “where am I?” (and the implied precision can actually provide a false sense of certainty in some cases). Alternatively, Total Term is an efficient tool at broadly understanding and conveying current health and progress towards financial independence.

How do I use it?

Use this process to assess whether a client’s Total Term is appropriate or if they need to make improvements:

- 1. Accuracy:** Ensure the accuracy of the Total Term inputs.
- 2. Assessment:** Assess whether the given Total Term is appropriate.
- 3. Improvement:** Identify areas of improvement.



STEP 1

Score Accuracy

1. Updating Net Worth: To calculate any of the Term Elements scores all you need is an up-to-date net worth statement and an accurate spending number (see the burn rate guide for details on how to obtain an accurate spending number).

Populating a client’s net worth by adding accounts is only the first step. Maintaining the accuracy of those accounts over time is essential to tracking progress. The following table displays how frequently you should try to obtain updated values for different types of assets and liabilities to ensure a reliable set of Term scores.

Quarterly	<ul style="list-style-type: none">● Cash accounts● After- and pre-tax investments● Debt balances
Annually	<ul style="list-style-type: none">● Real Estate● Businesses

Elements’ client prompts and the quarterly net worth progress reporting process will help clients keep these values up to date, in addition to any client education you can provide them on the purpose of helping you maintain an accurate net worth statement.

2. Accounting for Student Loans & Consumer Debt: Generally, Total Term is the sum of the other four term elements (Liquid Term, Qualified Term, Real Estate Term, and Business Term) which are net equity values (i.e. net of related debts). However, in cases that involve student loans or high consumer debt, the Total Term score will be less than the sum since these debts typically aren’t netted against other assets (just against net worth as a whole).



Example: A client has a net worth of \$1,000,000 and spends \$100,000 annually. Included in net worth is a student loan balance of \$200,000. While the following term scores add up to 16.3, Total Term is 10.0 since the student loan is only netted out of total net worth, not individual assets within each of the other Term scores:

- $Lt = 1.7$
- $Qt = 0.4$
- $Rt = 2.6$
- $Bt = 11.6$

STEP 2

Score Assessment

To assess this score:

1. Determine whether the score is too high, too low, or just right.
2. Review the asset mix and underlying term scores.

Score Ranges

Average Total Term scores and associated growth rates depend primarily on age as a barometer of net worth size. The following graph presents average Total Term scores based on age ranges.

Age Range	Tt Score Range	Tt Annual Growth
25-35	< 5	0.5-1
35-45	5-15	1
45-55	15-25	1-2
55+	25+	2-4

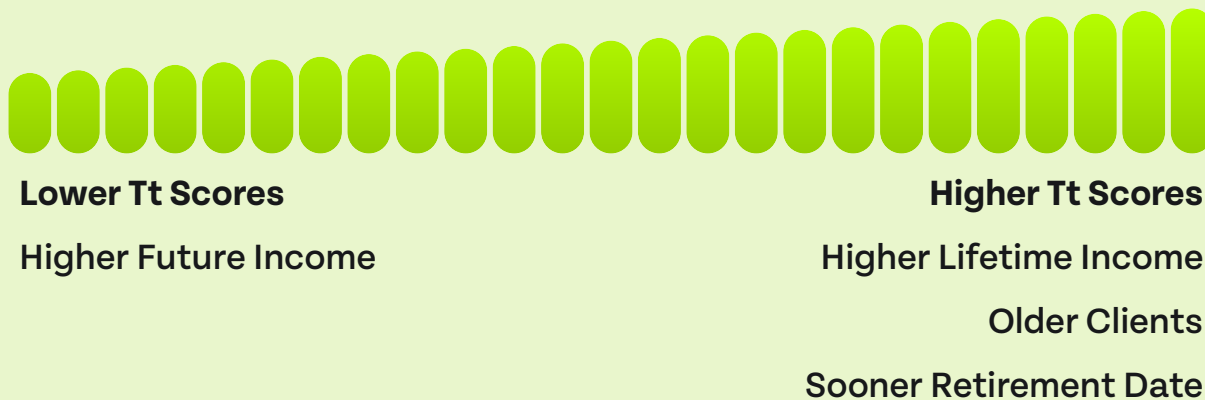


Generally, a client's Total Term will increase at a nonlinear rate:

- When a client is young and net worth is likely lower, it grows at a smaller rate; a larger portion of their cash flow is allocated toward non-discretionary living expenses (versus saving) and the effects of compound growth have yet to really kick-in.
- When a client is older and net worth is likely higher, it grows at a higher rate; they have more disposable income to save and the effects of compound growth are greater.

CORRELATING FACTORS

Understanding the correlation between these factors and your Total Term will help you determine if the given score is appropriate or not.

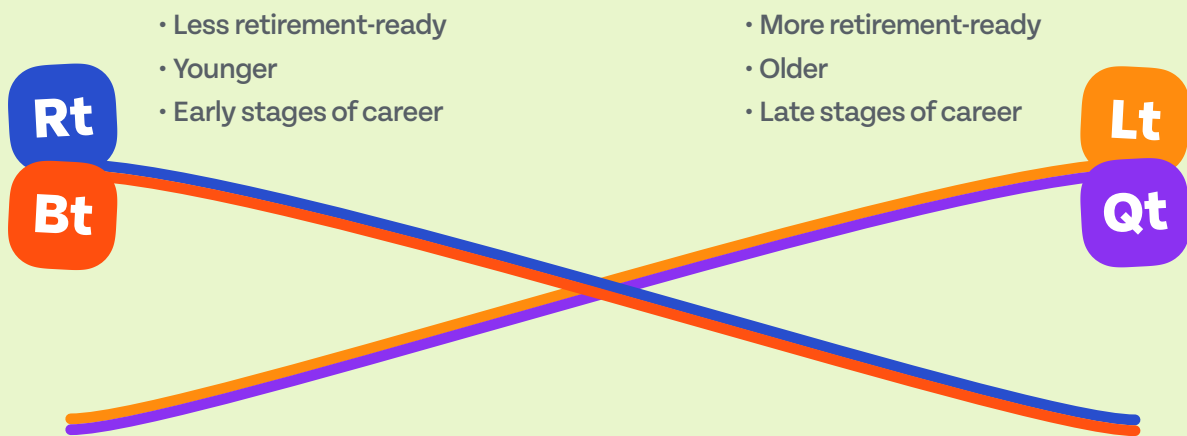




Asset Mix

It's also essential that you examine the underlying assets to determine if a client has an appropriate asset mix. The “right” mix of assets depends on a variety of factors that differ from client to client. However, the following graphic displays the general principle at play when assessing if a client's asset mix is appropriate.

HOW IS YOUR CLIENT'S ASSET MIX?



Generally, a client with a heavier allocation toward Liquid Term and Qualified Term will have more flexibility in their retirement strategies. Whereas a client with a heavier allocation towards less liquid assets like Real Estate Term and Business Term will have less flexibility in their strategies.

Further, when considering a client's “retirement readiness,” look at both the composition and overall size of their Real Estate Term. Personal-use real estate should generally not be considered as part of the retirement strategy. So for clients whose Real Estate Term is highly or completely composed of their primary residence, you might want to consider reducing their Total Term by that value.



Example: A client has a Total Term (Tt) of 28.0 and a Real Estate Term (Rt) of 12.0. Approximately half of their Rt score is composed of equity in their primary residence, while the remaining is composed of income-producing investment properties. Therefore, this client's Tt score is more reasonably closer to 22.

Alternatively, liquidating personal real estate in favor of renting could meaningfully change the composition of a client's Term scores (i.e. more liquid assets, higher spending).

STEP 3

Score Improvement

To start, you should consider the following overarching questions as you seek to make overall improvements to your clients' Total Term and financial health.

- What is the underlying asset mix of other Elements (Lt vs Qt vs Rt vs Bt)?
- Is the client's Tt over-reliant on certain asset types?
- In which Term Elements can the client feasibly make some improvements to scores?

As it relates to the underlying individual Elements, consider the following levers a client can pull to improve the absolute value of their Total Term score or the pace of its growth:



LEVERS FOR GROWING TOTAL TERM

Savings

- ▶ Is the client able to save more?
- ▶ Where should the client be saving at this stage in their life?
- ▶ Will future retirement income lessen the reliance on assets alone for income?

Spending

- ▶ Should the client reduce spending?
- ▶ Can the client afford to increase spending?

Debt Reduction

- ▶ Should the client accelerate their debt payoff?
- ▶ Should the client refinance to improve cash flow?

Asset/Income Growth

- ▶ Should the client reallocate their investments to pursue a different growth rate?
- ▶ Does the client need to find opportunities to increase their income?
- ▶ Should the client invest more in their business or other private ventures?

Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given a Total Term of 12.9 and considering the following information, you begin your assessment of whether a client's Total Term is appropriate:

Lt = 1.7

Qt = 4.1

Rt = 1.1

Bt = 6.0

Tt = 12.9



Lifetime Income	\$2.7 million
Age	52
Future Retirement Income	40% income replacement
Target Retirement	About 10 years away

Step 1 - Determine Score Appropriateness: By first considering this client's age, you determine their score of 12.9 is far below average.

Then, considering the additional information you find that given a shorter time horizon until retirement and a large income replacement, this client's Total Term score is too low for their needs.

Step 2 - Identify Improvements: Through data gathering, you find that the client can save additional money each month, and that they could stand higher risk in their investments. You target a healthy Total Term growth year over year, and use that as your guide.

Liquid Term

ASSESSMENT GUIDE

Liquid Term (Lt) indicates the number of years a client could live on their current liquid assets at their current lifestyle if neither changed.



Elements[®]
Financial Planning System



Liquid Term

Assessment Guide

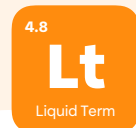
What is it?

Liquid Term (Lt) indicates the number of years a client could live on their current liquid assets at their current lifestyle if neither changed.

CALCULATION

$$\frac{\text{Total Liquid Assets}}{\text{Annual Living Expenses}}$$

Liquid Term



Liquid assets include all cash accounts (checking, savings, CD, business cash, etc.) and after-tax investments (brokerage, insurance cash value, after-tax annuity, etc.)

Example: if a client has \$50,000 in cash and \$300,000 in brokerage accounts, and they spend \$100,000 annually, then their Liquid Term score is 3.5.



Why is it important?

Keeping adequate liquidity means having enough money in the bank and/or after-tax accounts to weather the unexpected or pursue the next stage of growth in your clients' lives.

Without adequate liquidity, clients can feel more stressed about day-to-day decisions and become less able to see the big opportunities in front of them. Maintaining the right amount of liquidity can help them feel less anxious about their finances in turbulent times and give them the confidence they need to live in the moment.

However, as in all things, finding balance is critical. There are certainly times where clients might need to be willing to sacrifice some liquidity for the right investments and opportunities.

How do I use it?

The following process can be used to assess whether a client's Liquid Term is appropriate or if they need to make improvements:

- 1. Accuracy:** ensure the accuracy of the Liquid Term inputs.
- 2. Assessment:** assess whether the given Liquid Term is appropriate.
- 3. Improvement:** Identify areas of improvement

STEP 1

Score Accuracy

To calculate Liquid Term all you need is an up-to-date net worth statement and an accurate spending number. For details on ensuring the accuracy of these inputs, reference the Burn Rate (for spending) and Total Term (for net worth) assessment guides.



STEP 2

Score Assessment

***Note:** While important to understand a client's Liquid Term by itself, all Term scores are typically best assessed together to be able to compare total asset mix, holistically. See the Total Term assessment guide for more details.*

While Liquid Term combines both cash and after-tax investments, it's a good proxy to measure emergency expense preparedness. For example, a Liquid Term of 0.5 indicates 6 months of expenses covered, and if the underlying mix of that score is mostly cash, then this client might have a good buffer for unexpected expenses.

CORRELATING FACTORS

Understanding the correlation between the below factors and your client's Liquid Term will help you determine if the given score is appropriate or not.



Lower Lt Scores

Early Career Stage

Higher Lt Scores

Upcoming Purchases

High Income Variability

High Growth Business Stage

Larger Family



STEP 3

Score Improvement

Underlying assets composing a client's Liquid Term include cash and after-tax investments. Finding a healthy balance among these should be your top priority when improving your client's overall liquidity position.

In addition to finding balance in these assets, consider the following questions:

- Should the client increase their liquidity?
- Does the client have an emergency fund? And how long will it cover? (i.e. 3 - 6 months)
- Does the client have any upcoming purchases or investments they need liquidity for?
- If the client wants to aggressively pay down debt, what Lt score should they have before pursuing that?
- For business owner clients:
 - Should they make use of idle business cash?
 - Do they have enough cash to cover overhead for a couple months?



Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given the following Elements scores and additional information, you begin your assessment of whether a client's Liquid Term is appropriate.



Upcoming Purchases?	Down payment on rental property
Career Stage	Mid-career
Family Size	Married, 1 child
Income Variability	Highly variable
Business Growth Stage	Early, high growth

Step 1 - Score Assessment: As part of the client's total asset mix and considering their small family size, their low Liquid Term seems healthy.

However, recognizing that they have an upcoming purchase, have highly variable income, and their business is experiencing high growth, their liquidity needs are not met with the current score of 1.7. From this assessment, you determine that the client should increase their Liquid Term.

Step 2 - Identify Improvements: You'll first focus on improvements to the client's Savings Rate in order to increase their total liquidity.

After this, you resolve to build the client's cash position over after-tax



investments. Because the client is in high growth for the business and they have a large down payment due within the next 6 months, they'll need access to cash quicker.

Qualified Term

ASSESSMENT GUIDE

Qualified Term (Qt) indicates the number of years a client could live on their current qualified retirement assets at their current lifestyle if neither changed.





Qualified Term

Assessment Guide

What is it?

Description: Qualified Term (Qt) indicates the number of years a client could live on their current qualified retirement assets at their current lifestyle if neither changed.

CALCULATION

$$\frac{\text{Retirement Assets}}{\text{Annual Living Expenses}} = \text{Qualified Term}$$



Retirement assets include accounts that have the potential for a tax penalty upon early or nonqualified withdrawal. These accounts include:

- Roth and Traditional IRAs
- Roth and Traditional 401(k)s
- SIMPLE IRA
- SEP
- 529



- Profit Sharing Plans
- Defined Benefit Plans
- Health Savings Accounts (HSA)
- 403(b)s
- Annuities
- Minor Roth and Traditional IRAs

Example: Assuming a client has a traditional IRA worth \$50,000, a 401(k) worth \$100,000 and a Roth IRA worth \$36,000 and they spend \$100,000 annually. Their Qualified Term is about 1.9.

Why is it important?

Generally, a client who maximizes retirement plan contributions each year in the right plan will end up with a lower tax liability and will have more cash to save over their career.

Psychologically, clients also tend to frame qualified retirement accounts as being earmarked for long-term objectives. This results in better, more consistent long-term investment behaviors.

While a client who is maximizing qualified retirement contributions may have higher savings rates and better investment behaviors, finding balance between retirement accounts and liquid accounts is critical. There are certainly times where clients might need to focus on building liquid assets over qualified retirement assets to provide greater flexibility.



How do I use it?

The following process can be used to assess whether a client's Qualified Term is appropriate or if they need to make improvements:

- 1. Accuracy:** ensure the accuracy of the Qualified Term inputs.
- 2. Assessment:** assess whether the given Qualified Term is appropriate.
- 3. Improvement:** Identify areas of improvement

STEP 1

Score Accuracy

To calculate Qualified Term all you need is an up-to-date net worth statement and an accurate spending number. For details on ensuring the accuracy of these inputs, reference the Burn Rate (for spending) and Total Term (for net worth) assessment guides.

STEP 2

Score Assessment

Note: While it's important to understand a client's Qualified Term by itself, all Term scores are typically best assessed together to be able to compare total asset mix, holistically. See the Total Term assessment guide for more details.

Generally, age is the only clear factor that correlates directly with a client's Qualified Term because as clients age, their retirement accounts will grow from investments and additional savings contributions.



STEP 3

Score Improvement

Consider the following questions for employees and business owners as you identify steps to make improvements:

For employees:

- What retirement plan options are available?
- Is the client maximizing the employer benefits?
- Do they have old plans that are “closed” that can be rolled over?

For business owners:

- Considering cash flow, staffing, and savings rate, does the client have the proper retirement plan in place?
- Is the client’s current TPA meeting their needs?

What are the client’s liquidity needs?

- Should they focus their savings on growing liquidity or qualified retirement assets?

Should the client contribute more to retirement accounts to reduce their overall tax liability?



Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given the following Elements scores and additional information, you begin your assessment of whether a client's Qualified Term is appropriate.



Tax Rate	High
Liquidity Needs	High
Age	Mid-40s
Future Retirement Income	Social Security

Step 1 - Score Assessment: Considering just the high tax rate, you may determine that this client's Qualified Term is low because a higher tax rate generally necessitates higher pre-tax contributions. However, also considering their need to increase liquidity, you decide to allocate some cash flow toward increasing Liquid Term as well

Step 2 - Identify Improvements: You'll first focus on improvements to the client's Savings Rate in order to increase both Elements score.

After this, you resolve to build the client's after-tax and pre-tax investments equally. This will allow you to reduce their current tax liability and build their liquidity as well.

Real Estate Term

ASSESSMENT GUIDE

Real Estate Term (Rt) indicates the number of years a client could live on their current real estate equity (assuming no asset growth/decline).





Real Estate Term

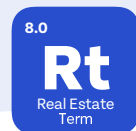
Assessment Guide

What is it?

Real Estate Term (Rt) indicates the number of years a client could live on their current real estate equity (assuming no asset growth/decline).

CALCULATION

$$\frac{\text{Real Estate Equity}}{\text{Annual Living Expenses}} = \text{Real Estate Term}$$



Real estate equity includes any homes or investment properties less related debts.

Example: assuming a client has a \$500,000 home with a \$300,000 mortgage, and they spend \$100,000 annually, then their Real Estate Term is 2.0.



Why is it important?

For generations real estate has been touted as one of the best solutions to achieve financial independence. The reality is that few people truly understand the real implications that owning and maintaining physical real estate will have on their spending and overall financial health.

As a significant part of many clients' net worth, real estate stands as a major consideration when determining if a client is prepared for financial independence. Further, understanding the allocation of real estate assets (i.e. personal-use property vs. investment property) will have major implications on the success of a client's retirement plan.

How do I use it?

The following process can be used to assess whether a client's Real Estate Term is appropriate or if they need to make improvements:

- 1. Accuracy:** ensure the accuracy of the Real Estate Term inputs.
- 1. Assessment:** assess whether the given Real Estate Term is appropriate.
- 1. Improvement:** Identify areas of improvement

STEP 1

Score Accuracy

To calculate Real Estate Term, all you need is an up-to-date net worth statement and an accurate spending number. For details on ensuring the accuracy of these inputs, you can reference the Burn Rate (for spending) and Total Term (for net worth) assessment guides.



STEP 2

Score Assessment

Note: While it's important to understand a client's Real Estate Term by itself, all Term scores are typically best assessed together to be able to compare total asset mix, holistically. See the Total Term assessment guide for more details.

Generally, a client with a heavier allocation toward Real Estate assets as part of their total net worth will have less flexibility in their retirement strategies.

Additionally, age is the only clear factor that correlates directly with a client's Real Estate Term because as clients age, their equity will grow as they pay down their real estate debts.

Be sure you know the composition of their real estate holdings. Sometimes clients have real estate they call their vacation home, but it is really more of an investment property (i.e. they are happy to part ways with it). Other times, they would not sell it for any reason. These details will help you better detail the amount of true liquidity behind their Total Term score.

STEP 3

Score Improvement

Understanding the objective of each real estate property is essential to making improvements. Consider the following questions for each type of property

For personal-use real estate:

- How much of the client's Real Estate Term is composed of their primary residence?
- When considering a client's retirement readiness, and if



Rt is primarily composed of the primary residence, you should exclude the client's Rt score from Total Term. This gives you a more accurate representation of where they stand.

For Investment real estate:

- Should the client invest in real estate?
 - What are their real estate goals?
 - What type of property should the client invest in?
 - Does the client understand the implications of investing in real estate?
- Considering the client's total asset mix, do they need to focus on increasing liquidity before investing in additional real estate?

Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given a client in their mid-50s, and the following information, you begin your assessment of whether a client's Qualified Term is appropriate.



Real Estate Term Composition:

- 6.0 Primary Residence
- 7.0 Vacation Property
- 8.0 Investment Rental Property



Step 1 - Determine Score Appropriateness: By first reviewing the client's asset mix, you determine their allocation toward real estate is too high for their current needs. Additionally, the majority of their real estate composition is in personal-use properties.

Step 2 - Identify Improvements: After discussing the objectives of each property, you learn the client does not enjoy their vacation property, and would be happy to rent it out or sell it to increase their total liquidity. You'll discuss with your clients the implications of selling the property versus keeping it for rental income.

If they sell the property their Liquid Term score will improve and their spending will decrease due to no more maintenance expenses. If they keep the property and rent it out, you're essentially shifting their Rt allocation from personal-use to investment property, justifying the high real estate exposure with their Liquid Term and spending remaining the same.

Business Term

ASSESSMENT GUIDE

Business Term (Bt) indicates the number of years a client could live on their current business equity (assuming no asset growth/decline).





Business Term

Assessment Guide

What is it?

Business Term (Bt) indicates the number of years a client could live on their current business equity (assuming no asset growth/decline).

CALCULATION

$$\frac{\text{Business Equity}}{\text{Annual Living Expenses}}$$

Business Term



Business equity includes any assets owned by a business entity less any related debts.

Example: assuming a client has a business valued at \$1,000,000 with a loan of \$300,000, and they spend \$100,000 annually, then their Business Term is 7.0.



Why is it important?

For business owners, it's not uncommon to have the majority of their net worth tied up in their business. While generally illiquid, a business can serve as the primary driver for financial success for many clients. To them, their business is directly under their influence, making it a clear choice of focus to improve their chances of success in the future, and make a better life today.

How do I use it?

The following process can be used to assess whether a client's Business Term is appropriate or if they need to make improvements:

- 1. Accuracy:** ensure the accuracy of the Business Term inputs.
- 2. Assessment:** assess whether the given Business Term is appropriate.
- 3. Improvement:** Identify areas of improvement

STEP 1

Score Accuracy

To calculate Business Term all you need is an up-to-date net worth statement and an accurate spending number. For details on ensuring the accuracy of these inputs, you can reference the Burn Rate (for spending) and Total Term (for net worth) assessment guides.

STEP 2

Score Assessment

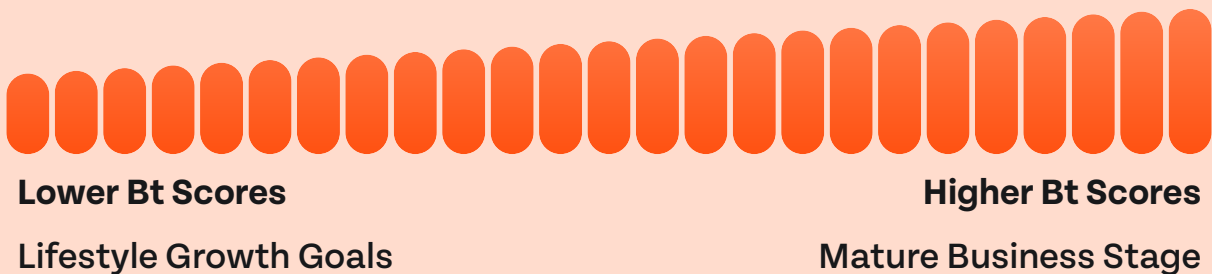
Note: While it's important to understand a client's Business Term by itself, all Term scores are typically best assessed together to be able



to compare total asset mix, holistically. See the Total Term assessment guide for more details.

CORRELATING FACTORS

Factors correlating with Business Term stem primarily from business characteristics as opposed to personal characteristics. These factors will help you determine if the given score is appropriate or not.



STEP 3

Score Improvement

Consider the following questions for business owners as you identify steps to make improvements:

- Is the client's business structure appropriate for their needs?
- What entities are involved in the business? What is the purpose for each entity?
- Is the profitability of the business healthy?
- Should the client consider hiring a business coach or consultant?

Savings Rate

ASSESSMENT GUIDE

Savings Rate (Sr) is the percentage of a client's annual gross income being saved for future use. This guide will help you understand more about it and how to use it for client assessment.





Savings Rate

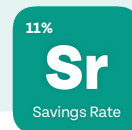
Assessment Guide

What is it?

Savings Rate (Sr) is the percentage of a client's annual gross income being saved for future use.

Calculation

$$\frac{\text{Total Annual Savings}}{\text{Total Personal Income}} = \text{Savings Rate}$$



Example: Assume a client's annual gross income is \$200,000. If they save \$19,500/yr into a 401(k), \$10,000/yr into a brokerage, and \$5,000/yr into a 529, their Savings Rate (Sr) is 17.25%.

Why is it important?

Savings Rate tells an important story about your client's current financial wellness and preparation toward long-term financial security. It allows you to measure the overall flexibility in their plan (a higher Sr provides more cushion or unexpected liquidity needs). And it can help clients feel more prepared for financial setbacks.



Setting a reasonable savings goal and sticking with it is highly correlated to financial independence. Set a goal, save the right amount of money each year, and don't give yourself a pass. It might be the most important indicator of long-term success for many clients. In reality, most clients struggle to save money for the future because humans, by nature, tend to have a behavioral tendency “to give stronger weight to payoffs that are closer to the present time” (it's called “Present Bias”). That bias often results in clients spending before saving.

As a result, lifestyle and consumption choices are by far the biggest variable in savings rates.

There are dozens of examples where increased lifestyle costs might result in fewer dollars to save (think housing, food, family size, education, etc.). Also in competition with our ability to save is a modern economy that continues to have more stuff to buy, more easily (think subscription services, doorstep delivery of anything, etc.).

All of these lifestyle considerations have tradeoffs. If you're going to have any money left to save, there are so many things to say “no” to. You just can't get the “best” of everything if you're going to maintain a healthy savings rate.

How do I use it?

Use this process to assess whether a client's Savings Rate is appropriate or if they need to make improvements:

- 1. Score Accuracy**—ensure the accuracy of the Savings Rate inputs.
- 2. Score Assessment**—assess whether the given Savings Rate is appropriate.
- 3. Score Improvement**—identify areas of improvement.



STEP 1

Score Accuracy

1. Confirm Recurring Contributions

Keep in mind that Elements scores, and Savings Rate in particular, are reflections of a client's behavior. A one-time bonus is typically not a predictably recurring contribution (though certainly positively impactful to net worth and will show up in the form of increased net worth in Elements). Focus on including and tracking consistently recurring savings contributions.

2. Add Employer Contributions

You should include all employer contributions in savings, but make sure to add the same amount back to current annual income. The income estimate your clients provide typically is not grossed up for employee savings contributions. Adding these back to income in Elements ensures the client's Savings Rate (Sr) will not be inappropriately inflated.

Example: A client has a 401(k) plan where they contribute 6% of their \$100,000 annual salary (\$6,000/yr). Their employer match formula is 100% of contributions up to 3% of salary (or \$3,000/yr). You will enter \$9,000 total contributions into the 401k for the year, and you will also enter the annual income as \$103,000.

3. Add Extra Debt Payments

If a cash outflow has a positive effect on net worth, Elements includes it as a savings contribution. This applies to extra debt payments.

A client may choose to make extra debt payments beyond the required minimum payment for a debt. This amount will generally go toward paying down principal, thus increasing the client's net worth.



BEST PRACTICES

Any additional debt payments beyond the required minimum payment should be included in the Savings Rate Element by entering them as an “extra debt payment”.

Example: A client has a mortgage with an outstanding balance of \$75,000 and a required monthly payment of \$1,200. The client also contributes \$300 per month as extra debt payments to reduce principal. \$1,200 will be included in the Debt Rate (Dr) element, and the \$300 will be included as an extra debt payment under Savings Rate (Sr).

STEP 2

Score Assessment

To assess this score:

1. Determine whether the score is too high, too low, or just right.
2. Identify roadblocks to improvement.

Score Ranges

Average savings rates generally fall between **10% and 30%**.

5% 10% 15% 20% 25% 30% 35%

Generally, a client’s Savings Rate should **increase or remain the same** as their income rises. As a client’s Burn Rate has the potential to become a smaller percentage of their income during their high-earning years, a client will have greater cash flow to allocate toward savings contributions.



CORRELATING FACTORS

Understanding the correlation between these factors and your clients' savings habits will help you determine if the given Savings Rate is appropriate or not.



Roadblocks to Improvement

Before you determine steps a client can take to improve their Savings Rate, you'll need to identify the functional and emotional hurdles holding them back.

Functional hurdles include quantitative reasons a client may not move forward. For savings some functional hurdles may include:

- **Cash Flow Restraints:** The largest hurdle with most clients is just not having enough free cash flow to allocate toward saving. This is often a result of over spending or allocating too much toward paying down debt.



Emotional hurdles are qualitative reasons a client may not move forward. For savings some emotional hurdles may include:

- **Overspending:** Overspending can happen for a variety of reasons, so we suggest you reference the Burn Rate assessment guide for more guidance here. Often overspending is born from past experiences or lack of accountability.
- **Debt Aversion:** Clients who have an aversion to holding debt often disproportionately allocate cash flow toward paying down debt.
- **Fear:** Saving and investing can be a fearful thing. Whether it was an experience in the past, or fear of the unknown, many clients lack the courage and confidence to save more.
- **Naivete:** Whether it's the overwhelming amount of information out there, or just a lack of desire, many clients just don't understand where or how much they should save.

STEP 3

Score Improvement

After you identify functional and emotional hurdles that may be hindering the client from moving forward, you can start creating a plan to make improvements. As you create your plan, consider the following:

- **What accounts should the client save to?**
 - Is the client utilizing the full employer match?
 - Is the client maxing out pre-tax contributions?
 - What should be the allocation of pre- vs. after-tax contributions?
 - Should the client set up a retirement plan?



- If the client wants to make extra debt payments, are they allocating enough toward long-term savings first?
- What should their savings frequency be?
 - You're trying to influence savings behavior. Consistency is key. The more frequent and transparent the savings contribution, the more salient the behavior of saving will seem to the client, and the quicker they will become comfortable with and adherent to saving.
- Do they have sufficient liquidity (i.e. emergency funds, upcoming purchases)?
 - Referring to Liquid Term (Lt) will provide good context.

As you review these questions, you'll be able to guide the client toward good financial behaviors that ultimately improve their financial health.



Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given a Savings Rate of 11.3% and considering the following information, you begin your assessment of whether a client's Savings Rate is appropriate:

Annual Income	\$232,000
Age	36
Target Retirement	About 30 years away
Upcoming Purchases?	No
Future Retirement Income?	Only Social Security

Step 1 – Determine Score Appropriateness

By first considering this client's income, you determine their score of 11.3% is low, but not below average ranges.

Then, considering the additional information you find that 3 of the 5 factors justify a low Savings Rate:

- Young age
- Later retirement target
- No upcoming purchases

However, the other two factors—limited future retirement income and a higher-than-average current income—indicate that the Savings Rate should be higher.



From these you determine that the client's Savings Rate of 11.3% is just a little too low given their situation.

Step 2 – Identify Improvements and Roadblocks

Through conversations with the client you discover they have a deep aversion to debt, more specifically towards their student loans (where they already have a lower-than-average balance).

Knowing this, you decide to focus your time on understanding why debt is viewed so negatively with the client to help you ultimately determine what you can do to allocate more cash flow toward savings.

Debt Rate

ASSESSMENT GUIDE

Debt Rate (Dr) is the percentage of a client's annual gross income being allocated toward required debt payments.



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Debt Rate

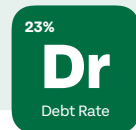
Assessment Guide

What is it?

Debt Rate (Dr) is the percentage of a client's annual gross income being allocated toward required debt payments.

CALCULATION

$$\frac{\text{Total Annual Debt Payments}}{\text{Total Personal Income}} = \text{Debt Rate}$$



Debts include payments toward:

- Personal real estate (primary mortgage, HELOC, etc.)
- Business debt (acquisition, equipment, etc.)
- Commercial real estate (condo, rentals, etc.)
- Student loans
- Other (auto loan, personal loan, other depreciating asset loans, etc.)

Example: If you're spending \$3,000/month on mortgage



payments and \$500/mo on student loan payments, and your household is earning \$200,000 in annual income, your Debt Rate is 21%

Why is it important?

Overall debt levels have risen substantially over the past 30 years. Most notably, younger generations are in a fairly unprecedented economic period. Student loan and total debt-to-income ratios are very high, especially for those with more than a bachelor's degree or those who attend private schools. It's not uncommon to see a graduate with student loans over four times their expected annual income.

While managing debt levels has always been a component of overall financial health, it is likely to be a more frequent part of 'the conversation' today.

Tracking Debt Rate allows you to continuously monitor how much of your clients' income is going toward debt payments. It helps you assess how their debt rate changes over time to identify patterns, to make smarter decisions about financing, and to help clients avoid getting into hot water where they lose optionality and risk emotional stability.

How do I use it?

Use the process to assess whether a client's Debt Rate is appropriate or if they need to make improvements:

- 1. Accuracy:** ensure the accuracy of the Debt Rate inputs.
- 2. Assessment:** assess whether the given Debt Rate is appropriate.
- 3. Improvement:** Identify areas of improvement



STEP 1

Score Accuracy

1. Extra Debt Payments: In Elements, extra debt payments (anything entered as “extra debt payments” above normal recurring payments) are included as part of Savings Rate, not Debt Rate. This is primarily to not “punish” a client for making extra debt payments with a higher debt rate with money that would likely otherwise go towards savings.

BEST PRACTICE

Any extra debt payments beyond the required minimum payment should be entered as an “extra debt payment” therefore excluding them Debt Rate (including them in Savings Rate), so long as they are recurring (i.e. client makes an extra debt payment each month or each year), not “one-time” (e.g. client gets a bonus and pays down some debt).

Example: A client has a mortgage with an outstanding balance of \$75,000 and a required monthly payment of \$1,200. The client also contributes \$300 per month as extra debt payments to reduce principal. \$1,200 will be included in the Dr element, and the \$300 will be included as an extra debt payment under Savings.

2. Mortgage Escrow: Clients often include mortgage escrow payments with the estimated payment value they provide you.

If the escrow is a relatively small amount of the payment, you can simply include it in Debt Rate knowing that the score will be minimally impacted.

If the escrow is a substantial portion of the monthly payment, we recommend excluding it from the debt payment and including it in general spending instead.



3. Credit Card Debt: In Elements, credit cards only have “extra payments” instead of monthly payments and extra payments (like with other debts).

BEST PRACTICE

If a client pays off their balance each month or doesn't carry a balance for longer than a year, do not enter any payments.

If they do carry a balance on credit and will pay it off over multiple years, include it .

Example: A client has a line of credit with a balance of \$20,000. They plan on paying down that balance over the course of 2 years. This should be included in “recurring extra payments”.

STEP 2

Score Assessment

To assess this score:

1. Determine whether the score is too high, too low, or just right.
2. Identify roadblocks to improvement

Score Ranges

Average Debt Rate scores depend on a variety of factors, the most prominent being the client's chosen career path and their aversion to debt. The following graph presents the range of average Debt Rates.

Low	Average	High
10-15%	20-30%	+40%



Correlating Factors

Understanding the correlation between these factors and your clients' savings habits will help you determine if the given Debt Rate is appropriate or not.

Savings Rate: High Savings Rate = Low Debt Rate

Debt Tolerance: Low debt tolerance = High Debt Rate

Age: Older = Low Debt Rate

Career: Different careers necessitate different debt levels. For example, someone with an advanced degree is more likely have much higher levels of debt than someone without one.

STEP 3

Score Improvement

In the majority of cases, you will work to decrease a client's debt rate. This is most likely to be the case where the client needs to start saving, but there's not yet enough free cash flow to do so.

However, some clients' financial situations might allow you to focus on increasing their debt rate. This could occur to fund an investment opportunity or business expansion (not to fund a lifestyle beyond what the client can afford).

As you identify which direction the client should move to improve their debt rate, you may want to consider the following questions:

- What is the purpose of the debt? What are the interest rates / terms on their existing debt?
- What is the client's debt tolerance?
- Does the client have ample liquidity?
- If the Debt Rate is too high, in what order should the



client pay down debts?

- If the Debt Rate is low, could the client utilize more debt to accelerate growth?
- Should the client consolidate or refinance some debt?

As you review these questions, you'll be able to guide the client toward good financial behaviors that ultimately improve their financial health.

Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given a Debt Rate of 35% and considering the following information, you begin your assessment of whether a client's Debt Rate is appropriate:

Debt Rate	35%
Savings Rate	15%
Debt Tolerance	Low
Age	36
Career	State Employee
Lifestyle	Average

Step 1 – Determine Score Appropriateness: The single most important factor here to consider is the client's savings rate at 15%. From the



previous assessment of their savings rate, you've determined a need to increase their Sr score beyond 15% and therefore a need to create more free cash flow to do so.

While their age is low and they have a low tolerance for debt, all other factors indicate this debt rate is too high. Therefore, you decide to focus on decreasing their debt rate.

Step 2 - Identify Improvements and Roadblocks: Through fact-finding with the client you discover they have a high mortgage balance with a 15 year term. With low current interest rates and the opportunity to decrease monthly payments by extending the term, you recommend the client refinance to a 30 year mortgage. This will decrease their debt rate significantly and allow them to allocate a higher percentage of income toward savings.

Burn Rate

ASSESSMENT GUIDE

Burn Rate (Br) is the percentage of a client's annual gross income being spent on personal living expenses. This guide will help you understand more about it and how to use it for client assessment.





Burn Rate

Assessment Guide

What is it?

Burn Rate (Br) is the percentage of a client's annual gross income being spent for personal living expenses.

Calculation

$$\frac{\text{Annual Living Expenses}}{\text{Total Personal Income}}$$

Burn Rate



Living Expenses excludes debt payments, savings, and taxes (in other words, expenses already included in Debt Rate, Savings Rate, and Tax Rate).

Example: If a client spends \$10,000/month and their household annual gross income is \$200,000, their Burn Rate is 60%. If part of the \$10,000 is a \$1,200 mortgage payment, their spending value would be \$8,800/month and their Burn Rate (Br) would be 52.8%.



Why is it important?

Spending habits affect clients' ability to save and pay down debt. It affects their ability to make work optional. It affects the amount of insurance they should apply for. It affects the risk they should take in their investments. And in Elements, it's one of the main inputs into several other Elements scores (the "Term" scores).

So, tracking spending is an essential part of a client's financial health, and accurately knowing a client's spending habits could be the single most important piece of financial data. At the same time, we know it can be difficult for clients to provide an accurate spending number.

How can we resolve this?

What's important here is simply **awareness** of spending habits, be it the absolute dollar amount or where the money is going.

Clients often conflate budgeting and tracking. "Budgeting" is a specific spending plan, whereas "tracking" is awareness.

Budgeting is optional. Tracking is necessary.

The reality is that healthy spending doesn't always require detailed budgeting. But at a minimum, advisors should track their clients' spending habits over time. This helps you truly understand where you are, how you got there and what needs to change.



How do I use it?

Use this process to assess whether a client's Burn Rate is appropriate or if they need to make improvements:

- 1. Score Accuracy**—ensure the accuracy of the Burn Rate inputs.
- 2. Score Assessment**—assess whether the given Burn Rate is appropriate.
- 3. Score Improvement**—identify areas of improvement.

STEP 1

Score Accuracy

1. Gather a Monthly Spending Estimate

Gather an estimate of the client's monthly spending. While an initial spending estimate is often inaccurate, it reveals important information about the client's understanding of their spending habits.

Example: A client gives you a monthly spending value of \$9,000. Then, after conversation and maybe transaction analysis, you discover that they are actually spending around \$12,000 per month. This gives you the opportunity to dig in and find out why there was a discrepancy.

Many clients include debt payments in their estimates which need to be excluded from Burn Rate, so clarify what their estimate includes.

2. Track Actual Spending to Verify Estimate

After getting a spending estimate from your client, you may want to have them track spending over a few months and get a more accurate spending number. This can be accomplished by having the client start



free services like Mint, Personal Capital, or even their own bank's dashboard.

Alternatively, checking a bank and/or credit card statement a few months later is another method.

STEP 2

Score Assessment

To assess this score:

1. Determine whether the score is too high, too low, or just right.
2. Identify roadblocks to improvement.

Score Ranges

Average Burn Rate scores depend primarily on the ranges of annual gross income a client earns. The following graph presents average Burn Rates based on income ranges.

Income Range	Br Scores
\$0-\$100,000	50%-70%
\$100,000-\$250,000	45%-65%
\$250,000-\$500,000	40%-60%
\$500,000 and up	30%-50%

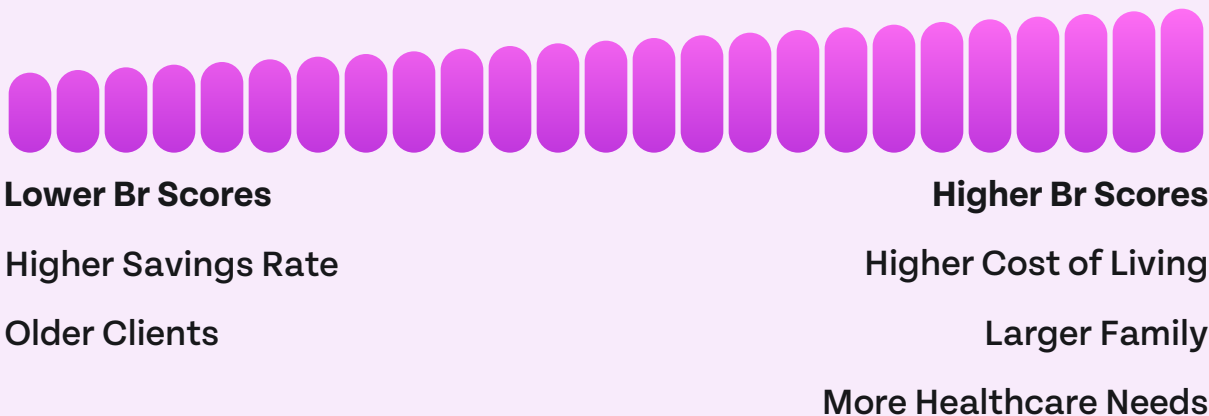
Generally, a client's Burn Rate should **decrease or remain the same** as their income rises. Since most of their personal living expenses early in their career are non-discretionary, a client's Burn Rate has the potential



to become a smaller percentage of their income during their high-earning years if they can control their discretionary spending.

CORRELATING FACTORS

Understanding the correlation between these factors and your clients' spending habits will help you determine if the given Burn Rate is appropriate or not.



Roadblocks to Improvement

Before you determine steps a client can take to improve their financial health, you'll need to identify the functional and emotional hurdles holding them back.

Functional hurdles include quantitative reasons a client may not move forward. For example:

- **High Fixed Expenses:** The client spends very little on discretionary spending and a lot on fixed expenses. This may be a result of their costs of living in certain areas
- **Spending not Tracked:** The client may not track spending which results in little awareness around their spending habits. This may be the result of just not know how or where to track, or even past emotional experiences



Emotional hurdles are qualitative reasons a client may not move forward. For example:

- **Social Circle:** Clients often adopt the spending behaviors of those closest to them
- **Family History:** There may be an experience in their family that influences how they feel about spending today.
- **Past Experiences:** These include any experiences that may affect spending habits today.

STEP 3

Score Improvement

After you identify functional and emotional hurdles that may be hindering the client from moving forward, you can begin creating a plan to make improvements. As you create your plan, consider the following:

- Are they maintaining a healthy savings rate?
- Do they track spending? Or can you gain access to this data?
- Should the client create and follow a detailed budget?
- Does their Burn Rate follow a consistent pattern? Or is there a spike or dip due to other circumstances?
- Are they intentionally spending their money to match what is most important to them?

As you review these questions, you'll be able to guide the client toward good financial behaviors that ultimately improve their financial health.



Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given a Burn Rate of 60% and considering the following information, you begin your assessment of whether a client's Burn Rate is appropriate:

Annual Income	\$175,000
Age	45
Savings Rate	12%
Cost of Living	Resident of New York City
Family Size	Single
Healthcare Needs	Low

Step 1 – Determine Score Appropriateness

By first considering this client's income, you determine their score of 60% is high, but not above average ranges.

Then, considering the additional information you find the only factor that justifies a high burn rate is their high cost of living. All other factors oppose a high burn rate including:

- Higher Age
- Small family size
- Low Savings Rate
- Low healthcare needs



Given this assessment, you determine the client's Burn Rate of 60% is too high given their situation.

Step 2 - Identify Improvements and Roadblocks

Through conversations with the client you discover they've had a lot of negative family experiences around detailed budgeting, and they now have a strong aversion to careful tracking and budgeting.

Knowing this, you decide to focus your time on just tracking spending with the client, so you can begin to identify spending patterns. You help them to see if they are intentionally spending on things that matter to him which will help him begin to start to change behavior.

Tax Rate

ASSESSMENT GUIDE

Tax Rate (Tr) is the percentage of a client's current year annual gross income (not necessarily the tax year's income) being allocated toward tax payments.



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Tax Rate

Assessment Guide

What is it?

Tax Rate (Tr) is the percentage of a client's current year annual gross income (not necessarily the tax year's income) being allocated toward tax payments.

CALCULATION

$$\frac{\text{Total Annual Taxes Paid}}{\text{Total Personal Income}}$$

Tax Rate



Tax payments include federal income tax, state & local income tax, and payroll tax (for 1099s or business owners).

Example: In 2020, a client paid \$16,000 toward federal income tax, \$6,000 toward state taxes, \$3,500 toward state taxes, and \$5,400 toward payroll tax as a 1099 employee. The client's current income in 2021 is \$165,000, so the estimated Tax Rate is 18.7%.



Why is it important?

For clients, tax payments represent a significant percentage of their cash outflows, making taxes an essential part of their financial plan. While this guide will not go into details around the importance of tax planning, we'll simply note that as advisors, it's important to periodically review a client's tax situation to make sure the client is capturing all the opportunities available to them, reducing the percent of income going towards tax.

How do I use it?

By following the process detailed below, you will be equipped to assess whether a client's Tax Rate is appropriate or if they need to make improvements:

- 1. Accuracy:** ensure the accuracy of the Tax Rate inputs.
- 2. Assessment:** assess whether the given Tax Rate is appropriate.
- 3. Improvement:** Identify areas of improvement

STEP 1

Score Accuracy

In a perfect world, the four cash flow Elements (Savings Rate, Burn Rate, Debt Rate, and Tax Rate) will add up to 100% of annual gross income. But Tax Rate relies on historical tax data divided by current year income, so it can be difficult to obtain a perfect allocation of income. In many instances, your most recently available tax return is 1-2 years old.

Example: Its 2021. A client estimates they'll earn gross income of \$100,000 this year. They have not yet filed their 2020 return, so you rely on 2019 tax data. In 2019, the



client's income was lower so tax payments only totaled \$12,000. As a result, in Elements, their current Tax Rate is 12%, lower than it's likely to be after filing 2020 taxes.

The client is allocating income in 2021 as follows:

- Savings = \$20,000 = 20%
- Spending = \$40,000 = 40%
- Debt = \$15,000 = 15%
- Estimated Taxes (2019) = \$12,000

You'll notice that these items total \$87,000, falling short of the annual gross income value. This is likely because the tax return data is 2 years older than the other cash flow items.

STEP 2

Score Assessment

Average Tax Rate scores depend primarily on earned income as defined by the IRS. Because there are so many factors that influence tax rate, it is difficult to standardize benchmarks and provide average score ranges.

STEP 3

Score Improvement

Volumes have been written about tax planning and strategies to decrease tax payments now and in the future. This brief list will help you get started as you consider ways you can help clients have a more health tax situation.

1. What strategies can a client utilize to increase above- and below-the-line deductions?
2. Are there any tax credits a client can utilize to reduce tax payments?



- 3.** Can you find tax savings in the clients:
 - a.** Investment accounts
 - b.** Charitable contributions
 - c.** Businesses
 - d.** Roth Conversions