GREENLEAF® TRUST

Perspectives

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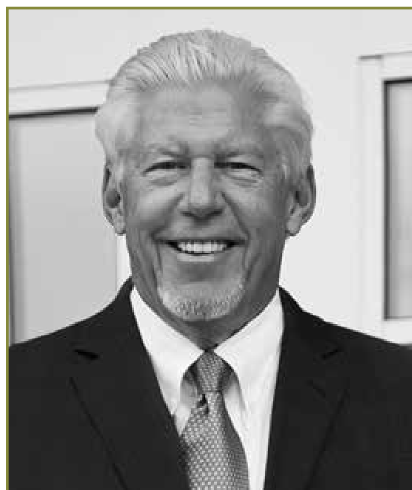

William D. Johnston
Chairman, Greenleaf Trust

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Economic Commentary

The popular culture media would have us believe that we are losing the COVID-19 battle, have lost all momentum in vaccinations, and are falling on economic hard times. It seems that we should test these themes with an examination of facts and raw data. As the sage mechanic might say, "Let's lift the hood and see what's going on."

We have maintained from the outset that a full and complete economic recovery would depend on beating the COVID-19 virus. That was and continues to be our premise, because the full exchange of commerce cannot occur with interruptions of labor, production and consumption, either prolonged or intermittent. All of the available science from immunologists who study and track global pandemics have suggested strongly that countries that achieve 80% levels of vaccinated populations will experience victory over the virus. As with all previous pandemics, each specific virus is new or novel, and thus requires thorough and accurate analysis of how the virus acts in actual populations, and how the virus reacts to different protocols and vaccination products. While the world longs for one set of common facts, the science of immunology requires continuous fact gathering over longer continuums of time to allow for public policy recommendations that will improve the condition we are in.

Currently, 59% of all Americans are fully vaccinated. If you judge that total by the 80% standard established as necessary to defeat the virus you might come away disappointed. If you peel away the layers of the onion a bit, as we like to say, you discover that for people forty years of age or older 79% are fully vaccinated, and when we consider the most vulnerable ages 65 and above, 87.6% are fully vaccinated. So what is keeping us from the 80% target rate? You probably have already guessed it, those 18 years of age or younger. If we maintain the current rate of growth of vaccinations per month (5%) we will achieve the 80% threshold by the end of February of 2022. Should the roll out and adoption of vaccines have been quicker? Sure, but given the intense politicization of the COVID-19 virus, and the resulting public policy debates that gave fuel to vaccination resistance, we have made significant progress. If we were to only focus on the public debates occurring on the nightly news, you might significantly underestimate the total number of Americans fully

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Commentary, continued

vaccinated as well as the daily increase in vaccinations (320,000). Were we capable of doing better? Certainly. As Winston Churchill was given credit for saying during World War II, "Americans will eventually do the right thing, but only after they have tried everything else." December 14 of 2021 marks the one year anniversary of the first vaccination approval, and the actual roll-out in substantive quantities wasn't until late January of 2021. We can wish for a quicker return to normal and a reduction of variants or spikes, but what will actually get us to normal will be the accumulation of the 320,000 first time vaccine doses being administered every day.

It is well above my pay grade to influence those reluctant to become vaccinated, let alone those who actively raise doubt about the science and value of the vaccine; thus, I prefer to focus on the rate of growth and aggregate progress that we as a country are making in the pandemic fight. As we have experienced many times in our economy, steady incremental growth results in progress that eventually becomes significant. We will continue to monitor the data and report on the vaccination progress, because our economic return to normal depends upon it.

"We will continue to monitor the data and report on the vaccination progress, because our economic return to normal depends upon it."

Labor, production and consumption are foremost on our minds and in our weekly analysis. Assisting us in this focus has been the New York Federal Reserve's Weekly Economic Index. This index is a real time analysis of all of the data that surrounds the larger components of labor (employment and wages), production (raw materials, factory utilization, utility consumption), and consumption (consumer sentiment, consumer savings and consumer spending). The current index as of October 29 registered 7.06%, reflecting a growing economy year over year, though decelerating from this year's March economic low. The thirteen-week moving average is 7.94%, and the annual real GDP data suggests a current annualized growth rate of 4.87%.

October's unemployment rate of 4.8% fell below 5% for the first time since the pandemic began in February of 2020. As we have stated previously, the unemployment rate at this point in our economic recovery will be incremental from month to month and also reflective of our labor participation rate, which is down .02% from the previous month (120,000). Personal income as well as wages grew incrementally. Consumer confidence dipped slightly while retail sales remained essentially flat. The Purchasing Managers Index (PMI) was flat at 60.8%, and significantly above the 50% threshold that implies positive GDP growth. Government consumption held steady while private consumption advanced by $280 billion. New home prices declined while existing home prices grew slightly for the period. Days on inventory for existing home sales declined, and residential housing starts remained flat while new residential permits weakened into the winter season.

The recovery from the April 2020 economic lows continues, albeit at a slower and more sustainable rate. We would expect the GDP growth rate to exceed

5% for the full 2021 year, and continue to moderate below 5% for 2022. As we have suggested previously, reductions in unemployment below the current level of 4.8% will be stubbornly difficult. We are in the first full academic year of in-classroom learning. Those that depend upon childcare to return to work are significantly challenged, as many daycare centers are dependent upon low-wage earners who themselves are dependent upon child care to re-enter the workforce. Irrespective of any provisions in pending legislation for universal pre-K education, the current condition for low wage earners requiring childcare to return to the workforce will not change soon.

Historically, voters are significantly influenced by their personal economic condition, which includes employment income and spending power; thus, most presidents want low unemployment and low inflation. Conversely, the opposition party wants to question the strength of the economy and fuel the flames of inflation fears. During the beginnings of the global COVID-19 pandemic, all production of goods and services ceased globally. No country was spared the infection, which is why it was termed a pandemic. As a mature economy, we import more than we export. Our demand for imported goods, both raw (commodities) and finished (fully manufactured), exceeds our exportation of those goods. The vast economic resources of our country, and our ability to deficit spend, allowed our federal government to provide economic relief directly to the consumer during the deepest parts of the pandemic-induced recession. This economic relief allowed the consumer to continue to spend and save, which assisted in creating demand for goods and services. In many product areas the demand for goods, supported by the direct-to-consumer support, outstripped goods and services available for sale. Whether the demand was for housing, automobiles, gas, consumer durables, electronic goods, or clothing, the recovery cycle of demand was swift and felt globally. When too few goods are chased by too many dollars, pricing equilibrium is impacted and consumers began to experience increases at the gas pump and retail checkout stands.

Fed Chair Powell has acknowledged increased price inflation and has requested some patience with what he believes is temporary, not structural, price equilibrium issues that are forecasted to moderate in 2022 as supply chain interruptions are mitigated. As Americans, we don't have to be hungry to eat or thirsty to drink, that is the nature of our robust and mature economy. The holiday season is upon us, and some shelves might well be bare, which I am certain will add fuel to the fire of the inflation flames. We are on the side of Fed Chair Powell, and see pressure moderating in 2022 but don't expect doomsayers eager to take advantage of current inflation trends to stop their messaging.

"Those that depend upon childcare to return to work are significantly challenged, as many daycare centers are dependent upon low-wage earners who themselves are dependent upon child care..."

Michael F. Odar, CFA®
President

Scary Times

Halloween is just behind us and it's scarier than ever out there. Consider these fear factors:

- The damage caused by cybercrime reached $4.2 billion in 2020. (IC3,2020)
- The average cost of a data breach on remote work is about $137,000 per attack. (IBM,2020)
- In 2020, malware increased by 358% overall and ransomware increased by 435% as compared to 2019. (Forbes, 2021)
- 96% of cyber-attacks through social actions use emails as their mode of delivery. (Verizon, 2020)

If you are not scared, you should be. It's not a question of *if* you will be the victim of a cyber-attack, it's a question of *when*.

We take our responsibility to protect our clients' data very seriously. We receive billions of "knocks on the door" to get to our entrusted data each month, and hundreds of phishing emails every day. Phishing emails are those that fraudulently purport to be from a trusted source to induce individuals to reveal personal information or click on a link that then provides a hacker access to their system. Our initial budget in 1999 didn't even have a line item for information security. Today, we invest hundreds of thousands of dollars on information security and countless hours of security awareness training.

"… we want our clients to know that we are always here to help them increase their security posture."

We put in place state-of-the-art firewall protection technology with intrusion prevention tools that are monitored 24/7 by trusted security vendors. In addition, we vet the security posture of every vendor that we do business with through our vendor management program. We also partner with our state of Michigan examiners and outside auditors to not only review our capabilities but also stress test them. Our Business Information Services (BIS) team helps to hold all of us accountable as well. Adaptive security awareness training requires that everyone participates and they are held accountable. Internal and external phishing tests help to make sure the training becomes a learned behavior.

Information security is a journey, not a checked box. The work is never done, and it's important to realize that it is all of our responsibility. So, if we are in this together, we want our clients to know that we are always here to help them increase their security posture. We consider it part of our holistic continuum of care for our clients. We stand ready to assist. In that spirit, below are a couple of simple tips that can keep your information a little safer:

- Embrace multifactor authentication
- Avoid autofill in browsers
- Use a password management tool

There is a saying at Greenleaf Trust: "If you see a link, stop and think." By not simply clicking on links in emails, you can save yourself from the very unpleasant consequences of phishing attempts.

The Long & Short of the Labor Shortage

Christopher D. Burns, CFA®, CPA, CFP®
Vice President
Investment Strategist
Senior Fixed Income Analyst

There has been no shortage of explanations offered for the United States' current labor shortage. In this article, we will play judge and jury on several of the common narratives about the labor market. Are people staying home due to more generous government support programs? Are previously-working moms staying home due to childcare disruptions? Are retirements upending the labor market? The public discourse on these issues is tinged with partisanship. We will do our best to give these questions a neutral hearing and render verdicts consistent with the available evidence.

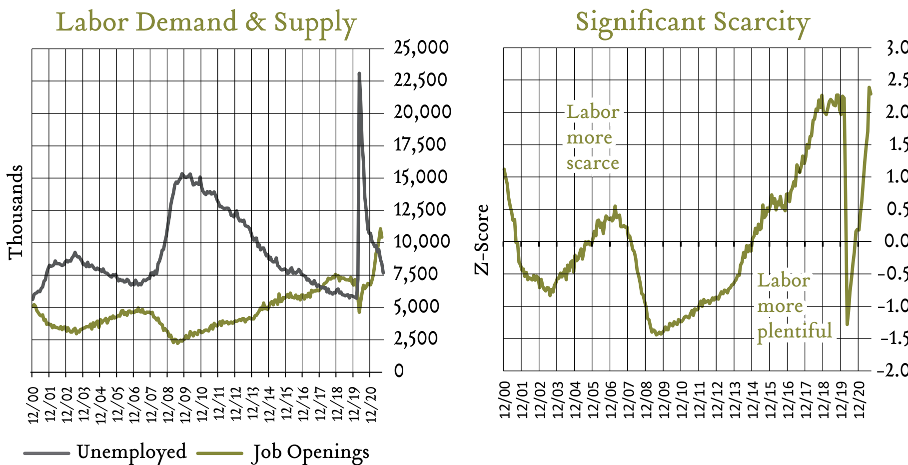
CLAIM #1: THE UNITED STATES HAS A LABOR SHORTAGE

Before we begin, we should start with the premise. Is there actually a labor shortage? Shortages occur when demand outstrips supply. We gain a sense of labor demand through the Job Opening and Labor Turnover Survey (JOLTS). We can examine labor supply by reviewing the labor force data in the Household Survey. Both surveys are done by the Bureau of Labor Statistics.

The evidence:

We've constructed the ratio of Job Openings (demand) to Unemployed Persons (supply). It shows that as of August (the latest available data), there were 10.4 million job openings and 8.4 million unemployed, a ratio of 1.25 jobs per unemployed person. This ranks in the 99th percentile over the past 20 years and is 2.3 standard deviations away from the mean of 0.6 job openings per unemployed person.

> "... we should start with the premise. Is there actually a labor shortage?"



The verdict:

Guilty. There certainly appears to be evidence of labor shortages.

The Long & Short of the Labor Shortage, continued

CLAIM #2: WORKERS AREN'T RETURNING TO THE LABOR MARKET BECAUSE OF NEW GOVERNMENT SUPPORT

Federal & state governments expanded the duration & quantity of unemployment benefits and relaxed the qualification requirements during the pandemic. Initially, the additional Federal benefit was $600 per week from April to July 2020, then was reinstituted in September 2020 at $300 per week. The $300 supplement expired after Labor Day, September 6, 2021. Economists estimated that around 70% of workers receiving the $600 supplement received more than the level of compensation they made while working, so the benefits may have served as a disincentive to rejoining the labor force and sacrificing income.

"Economists estimated that around 70% of workers receiving the $600 supplement received more than... they made while working, so the benefits may have served as a disincentive to rejoining the labor force..."

The evidence:

We got a natural experiment in June and July, 2021 when 26 states opted to end their participation in expanded unemployment benefits early. For the other 25 states and D.C., expanded benefits expired September 6.

	Exp. Date																									
Group 1	By July 1	TX	FL	OH	GA	IN	MO	SC	AL	OK	UT	IA	AR	MS	NE	ID	WV	NH	MT	SD	ND	AK	WY			
Group 2	By August 1	AZ	TN	MD	LA																					
Group 3	Sept. 6	CA	NY	PA	IL	NC	MI	NJ	VA	WA	MA	CO	WI	MN	OR	KY	CT	NV	KS	NM	ME	HI	RI	DE	DC	VT

		Values				Change since Jun 2021			
		Jun 2021	Jul 2021	Aug 2021	Sep 2021	Jun 2021	Jul 2021	Aug 2021	Sep 2021
Group 1	Unemployment Rate	4.9%	4.8%	4.6%	4.5%	0.0%	-0.1%	-0.2%	-0.4%
	Unemployed	2,909,802	2,855,332	2,781,909	2,679,756	0.00%	-1.87%	-4.40%	-7.91%
	Employed	56,664,274	56,887,516	57,083,344	57,285,745	0.00%	0.39%	0.74%	1.10%
	Labor Force	59,574,076	59,742,848	59,865,253	59,965,501	0.00%	0.28%	0.49%	0.66%
Group 2	Unemployment Rate	6.1%	5.9%	5.7%	5.4%	0.0%	-0.2%	-0.4%	-0.7%
	Unemployed	746,456	720,394	695,784	661,752	0.00%	-3.49%	-6.79%	-11.35%
	Employed	11,407,622	11,450,492	11,483,366	11,509,840	0.00%	0.38%	0.66%	0.90%
	Labor Force	12,154,078	12,170,886	12,179,150	12,171,592	0.00%	0.14%	0.21%	0.14%
Group 3	Unemployment Rate	6.3%	6.2%	6.1%	6.0%	0.0%	-0.1%	-0.2%	-0.4%
	Unemployed	5,616,907	5,513,158	5,445,167	5,319,621	0.00%	-1.85%	-3.06%	-5.29%
	Employed	83,518,288	83,677,922	83,851,569	84,064,720	0.00%	0.19%	0.40%	0.65%
	Labor Force	89,135,195	89,191,080	89,296,736	89,384,341	0.00%	0.06%	0.18%	0.28%

The verdict:

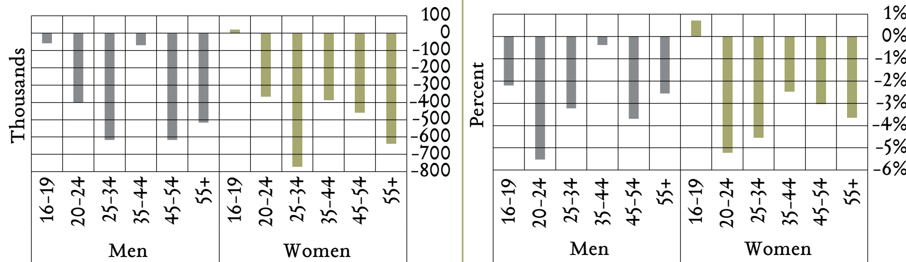
Hung jury. We find evidence on both sides of this argument but consider it too early to render a verdict. The states that ended benefits early have done marginally better at reducing the number of unemployed people and increasing employment and the labor force since June, but there is not a dramatic difference in these measures from before-and-after expanded benefits ceased. There are also important differences in employment across these groups of states which may offer more robust explanations for the differences. One other complicating factor may be accumulated savings from pandemic benefit programs that allow workers to stay out of the labor force longer, thus creating a lag in labor market impacts.

CLAIM #3: WOMEN ARE DISPROPORTIONATELY NOT WORKING BECAUSE OF CHILDCARE DISRUPTIONS

The 2020-2021 school year was an exceptionally difficult period for working families. Many schools converted to hybrid learning models and reduced their in-person courses. In addition, childcare facilities were impacted by COVID regulations. As a result, it has been argued that a portion of the labor shortage is attributable to mothers leaving the workforce to handle childcare duties resulting from the pandemic.

The evidence:

Schools are back in session this year, but we still observe that the largest decline in employment from February 2020 – September 2021 has been among women aged 25-34, precisely the group you would expect to have the most significant childcare responsibilities. On a percentage basis, employment among men aged 20-24 has fallen the most, followed by women aged 20-24 and women aged 25-34.



The verdict:

Guilty. A preponderance of the evidence, both in the employment numbers and in qualitative data like the Federal Reserve Beige Book, show that childcare responsibilities do seem to be holding back employment among women.

> "… it has been argued that a portion of the labor shortage is attributable to mothers leaving the workforce to handle childcare duties resulting from the pandemic."

CLAIM #4: RETIREMENTS ARE THE CAUSE OF THE SHORTAGES

Part of the labor market issue may not be reflected in the unemployment rate, which has fallen from 14.8% in April 2020 to 4.8% as of September 2021, but in the labor force participation rate. The unemployment rate only reflects people actively seeking work. The labor force participation rate captures the number of people working or seeking work as a percentage of the working-age population. The labor force participation rate fell from 63.3% in February 2020 to a low of 60.2% in April 2020 and has been slow to recover, registering just 61.1% as of September 2021. It has been argued that part of this decline, and the resulting labor shortages, has been caused by people leaving the labor force to retire.

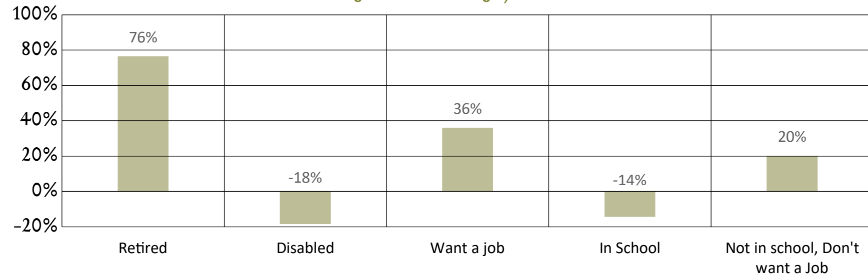
The evidence:

The Philadelphia Fed produces quarterly reports on the reasons for nonparticipation in the labor market. The data shows that 76% of the

The Long & Short of the Labor Shortage, continued

increase in nonparticipation is the result of retirements. The remainder is made up of people who want a job but aren't actively looking. People out of the labor market due to disability or due to being in school have fallen since before the pandemic.

Contribution to Increase in Nonparticipation Rate
Q4 2019 – Q2, 2021



The verdict:

Guilty. This is a worrisome piece of evidence. Unlike people who have left the labor force to go to school, or who just haven't looked for a job recently, retirees have a much lower propensity to rejoin the labor market. This means that at least a portion of our labor market shortages are unlikely to abate anytime soon. Taken together with unemployment, retirements appear to account for roughly 48% of the overall reduction in employment levels since February 2020.

"It appears to us that there are elements of truth to several of the common narratives, but that no single explanation sufficiently explains the current labor shortages."

CONCLUSION

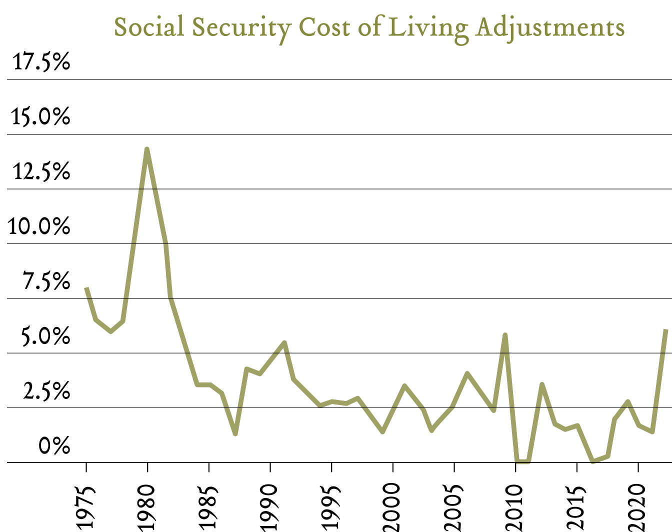
It appears to us that there are elements of truth to several of the common narratives, but that no single explanation sufficiently explains the current labor shortages. The good news is that labor demand remains strong. Supplemental unemployment programs have expired and schools and childcare facilities are largely reopened, so we may see an additional rebound in labor supply. However, with the high level of retirements, we expect for labor market tightness to continue and for a full employment recovery to be many years away, if ever. This will have important implications for earnings, economic growth and inflation and we will adjust our investment strategies as needed. Please feel free to contact a dedicated member of your client centric team if you would like to discuss these ideas in greater detail.

Sources:
Bureau of Labor Statistics
Ganong, Noel, and Vavra (2020)
Fujita, Philadelphia Fed

Social Security Benefits Getting a Big Boost in 2022

Lisa A. Hojnacki
Participant Services Coordinator, Team Lead

Americans receiving Social Security benefits in 2022 will see the biggest increase in four decades, according to the latest news from the Social Security Administration. The 5.9% cost-of-living adjustment (COLA) will impact approximately 70 million Americans receiving Social Security and Supplemental Security Income (SSI). This is the largest increase since 1982 and is expected to bring retirees' average monthly benefit next year up to $1,657, which is an additional $92 per month compared 2021.



The increase in payments reflects near-term inflation during the pandemic. The purpose of COLA is to ensure the purchasing power of Social Security and SSI benefits is not eroded by inflation. It is based on the Labor Department's measure of inflation in the Consumer Price Index, which rose 5.4% in September compared to a year earlier.

The Social Security Administration has also raised the maximum amount of earnings subject to the Social Security tax from $142,800 this year to $147,000 in 2022, a 2.9% increase. The increase is based on the agency's calculation of the changes in annual wages.

The earnings limit for workers who are younger than "full" retirement age receiving benefits will increase to $19,560 along with an increase to the earnings limit for people reaching their "full" retirement age in 2022 to $51,960. Beginning the month an individual reaches "full" retirement age there is no longer an earnings limit on benefits. To learn more about your "full" retirement age and benefit calculation, visit www.ssa.gov.

"Americans receiving Social Security benefits in 2022 will see the biggest increase in four decades..."

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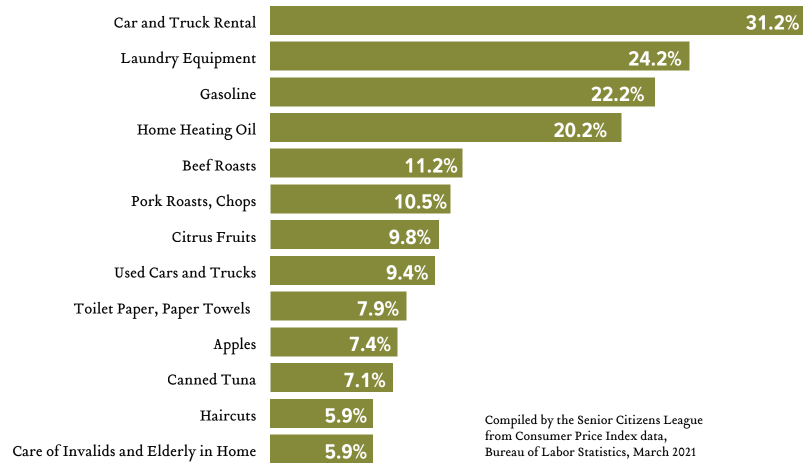
Social Security Benefits Getting a Big Boost in 2022, continued

HOW DOES INFLATION FACTOR IN?

The overall financial impact to retirees and other recipients will remain to be seen and is largely dependent on whether inflation eases next year. Consumer prices have risen due to disruptions in supply chains and have had a large impact on those living on fixed incomes in retirement and otherwise. According to the DOL, prices have increased significantly from a year ago for consumer goods such as gas, used cars, furniture, appliances and meat, fish, poultry and eggs. As a result, unless inflation eases, much of the COLA increases will be absorbed by the rising cost of goods and the increase in Medicare Part B premiums, which rise from $148.50 in 2021 to $158.50 in 2022. Most retirees' Medicare Part B premiums are automatically deducted from their monthly Social Security benefit payment.

Fastest-growing Retiree Costs from March 2020 to March 2021



> "Federal Reserve Chairman Jerome Powell and other Fed officials have said they expect elevated inflation to be temporary and to ease as disruptions associated with the economy's reopening fade."

DON'T PANIC

Federal Reserve Chairman Jerome Powell and other Fed officials have said they expect elevated inflation to be temporary and to ease as disruptions associated with the economy's reopening fade. If higher prices turn out to be transitory and reflective of temporary supply shocks, then it would be quite positive for those that receive increased benefit payments. Additionally, proposed legislation from U.S. Representative John Larson (D-Conn.), dubbed the "Social Security 2100: A Sacred Trust," calls for a benefit increase for current and new Social Security beneficiaries, protection against inflation for retirees, increased protections for low-income workers, improved benefits for widows and widowers in two income households, a repeal of the Windfall Elimination Provision (WEP) and Government Pension Offset (GPO) that currently penalizes many public servants, an end to the five-month waiting period to receive disability benefits, providing caregiver credits, extending benefits for students through age 22 and increasing access to benefits for children living with grandparents or other relatives. If enacted, the bill would also impose payroll tax on earnings above $400,000 to support the cost of the enhancements to Social Security.

Tax Planning in a Year of Uncertainty

R. Cory Spaulding, CTFA
Trust Relationship Officer

Much has been written this year about potential changes to tax law in 2021 and many across the country are trying to divine just what exactly Congress will accomplish before December 31, 2021. I will not use this space to add another voice attempting to make that prediction because the real answer is: none of us can say with any certainty what will happen.

The focus is less about what Congress will put in or out of any possible legislation and much more about how you can plan for your best interests in spite of a lack of predictability from the Capitol building.

For illustrative purposes, let's briefly review what appears to be the current shape of things within the House Ways and Means Committee. As of changes in late September, the bill being considered includes, in part:

- Corporate tax rates increase to 26.5% from 21% (White House wanted 28%)
- 3% surtax on earnings above $5 million
- 3% surtax on estate and trust income in excess of $100,000
- Long-term capital gains tax increase on top rate to 25% from 20% (White House wanted 39.6%)
- Top Marginal tax rate for individuals (to 39.6% from 37%)
- Minimum tax on foreign income of U.S. companies up to 16.6% from 10.5% (White House wanted 21%)
- Lifetime exemption for estate tax from $11.7 million to $6.02 million (indexed for inflation – as of January 1, 2022)
- Changes to the taxation of grantor trusts (potentially including popular strategies such as SLATs, GRATSs, QPRTs, and ILITs) to include these assets in the grantor's taxable estate
- Elimination of valuation discounts on transfers of ownership interest to family members for entities that own passive or income generating assets as opposed to an operating business

Again, this is not an exhaustive list nor is it likely to be what the bill looks like in its final form. And then it has to pass through a divided Congress and the President has to sign it into law. Back to our earlier unanswerable questions: What will the final bill say? Will it become law? What should you do now in order to plan for these potential changes? The best answer that I can provide is that you should be speaking with your client centric team at Greenleaf Trust, and potentially your attorney and CPA, to review your specific needs and concerns and determine the best route forward for you.

"The focus is... much more about how you can plan for your best interests in spite of a lack of predictability from the Capitol building."

That said, I will share with you that as I have been having conversations with clients throughout 2021 regarding proposed changes to tax and estate law, there are a few themes that have been consistent. First, are you considering

Tax Planning in a Year of Uncertainty, continued

> "If, on the other hand, you are only considering making changes because Congress might act by year end, I would caution you to be very thoughtful and deliberate with your next steps."

speeding up plans you already have in place for the next several years to instead complete the changes before year-end 2021? And, a closely related question, if Congress does not act in 2021, would you regret any action you might currently be considering? If you are simply hastening an already well-established plan for the transfer of your assets, that may be an effective strategy for responding to the uncertainty in Congress to ensure the goals you have are carried out in a tax-efficient manner.

If, on the other hand, you are only considering making changes because Congress might act by year end, I would caution you to be very thoughtful and deliberate with your next steps. Many of the changes you will likely be considering are irrevocable in nature and would result in you having a different relationship to your assets going forward. It is sometimes the case that the strategy that makes the most sense on paper does not feel right for clients. In a time where it feels that your decisions have to be made quickly and with incomplete knowledge, there is a wide margin for error and regret.

If Congress does act and you make no changes in 2021, it may mean a higher tax bill for you or your heirs, but you might prefer that compared to giving up control over your hard-earned assets during your lifetime. These decisions are deeply personal and your client centric team is here to help, but it is you who will live with the results of the choice and so you must be comfortable with the final decision.

George F. Bearup, J.D.
Senior Legal Trust Advisor

Using a GRIP in Anticipation of the Transfer Tax Sunset

While the 2017 Tax Act effectively doubled the federal transfer tax exemption per person, it also provided that the lower transfer tax exemption would automatically drop beginning in 2026. That scheduled sunset of the higher federal transfer tax exemption has produced among many wealthy individuals a "use-it-or-lose-it" mindset when it comes to estate planning these days.

One planning technique that has not received much attention is a Grantor Retained Interest Partnership (GRIP). A GRIP locks-in the currently large federal gift and estate tax exemption, "freezing" the value of the transferor's estate, while preserving transferor's access to the income generated by the "transferred" assets. A GRIP sounds almost too good to be true.

This planning strategy intentionally exploits one provision of the Tax Code, much like the planning strategy of a sale of an appreciated asset to an intentionally defective grantor trust. In a GRIP strategy's most basic form, a wealthy individual establishes a partnership with two types of interests: a

preferred interest and a common interest, and then gifts the common partnership interest to family members.

A bit of background on the Tax Code helps to understand how this estate freeze strategy works. About 30 years ago, the Tax Code was amended to add Section 2701 in order to regulate, or more accurately deter, certain types of asset freeze transactions that reduced an individual's exposure to the federal estate tax. In effect, Section 2701 treats the transferor or donor as having made a significant taxable gift when what was actually transferred was a common interest in the partnership entity which has no, or minimal, value. The donor retains the preferred interest in the partnership entity and gives away the common interest as a taxable gift.

An example explains how the GRIP estate planning strategy works. Don has a $11.7 million transfer tax exemption. Don wants to fully use that exemption before it drops to $6.0 million starting in 2026. Don transfers an investment portfolio worth $10 million to a preferred partnership that he creates. Don initially takes back all of the preferred and common partnership interests. The partnership agreement provides that on the partnership's liquidation the preferred partnership interest possesses the right to receive the return of at least $9.9 million capital. The preferred partnership interest also holds the right to receive an annual non-cumulative 7% return. Don gifts the common partnership interests, worth $100,000, to his children. Section 2701 operates to value Don's retained preferred partnership interest at $0.00 and it attributes all of that interest's value to the common partnership interests Don just gifted to his children. Accordingly, Don's children's common partnership interests, which will grow but only in excess of the 7% preferred's annual return, will be valued at $10 million.

Don will use $10 million of his available federal gift tax exemption to shelter his gift of the common partnership interests to his children, valued at $10 million, when, in fact, the actual value of Don's retained preferred partnership interest is worth $9.9 million and the common partnership interest is worth $100,000. When Don dies, his preferred partnership interest will be included in his taxable estate. However, because Don already was treated in the year of the gift as having gifted $10 million of value when he gifted the common partnership interests to his children, section 2701 applies a mitigation rule that provides a reduction in Don's taxable estate of $9.9 million.

To summarize a GRIP, the preferred partnership interest enables the donor to use today's currently large federal gift tax exemption to offset the value of the preferred interest included in the donor's estate on his later death, whatever the available federal transfer tax exemption is at the time of the donor's death. In addition, the preferred partnership interest retained by the donor provides the donor access to and use of that interest during the donor's lifetime, e.g. the 7% distribution. The donor will retain control to decide who will receive his retained preferred partnership interest at the time of his death. And if the current rules still apply

"… a GRIP… enables the donor to use today's currently large federal gift tax exemption to offset the value of the preferred interest included in the donor's estate on his later death, whatever the available federal transfer tax exemption is at the time…"

Using a GRIP in Anticipation of the Transfer Tax Sunset, continued

when the donor dies, his preferred partnership interest, because it was included in the donor's taxable estate, will qualify for an income tax basis adjustment on the date of the donor's death equal to the interest's fair market value.

Like the intentionally defective grantor trust, the GRIP works because the donor intentionally violates one of the rules of IRC 2701. Specifically, the preferred partnership interest must not be a qualified payment. Key to this is to make sure that the preferred partnership interest only holds a non-cumulative return, meaning that if the partnership does not have sufficient earnings in a particular year to pay the specified return (in Don's example, 7%) the return lapses and does not cumulate into the next year's preferred payment. By intentionally violating the rules to not have a qualified payment the donor's retained interest in the partnership is valued at zero.

A fair number of technical rules were skipped over in this summary. What is important to remember is that a subsequent decrease in the donor's available federal transfer tax exemption will not impact the benefits of the GRIP. Key to the success of the GRIP strategy is the donor's estate reduction, which offsets the inclusion of the preferred interest in the donor's taxable state. So while individuals wonder what Congress will do to the current federal transfer tax exemption, or they understand that even if Congress does nothing, come 2026 the transfer tax exemption amount will dramatically drop, there is something that they can do today to "use their exemption before they lose it" while still having access to the wealth represented by their retained preferred partnership interest.

Secure Your New Home with an Asset Based Line of Credit

Steve Wilbur
Wealth Management Associate

BACKGROUND

Cash has always been king when purchasing a home, especially in today's hot housing market. Being able to purchase a home with cash can give you a significant advantage over the other potential buyers. The ability to purchase a home in cash is not feasible for many people without having to draw from their taxable investment portfolio. Having to pay capital gains tax in order to purchase a home reduces the size of your portfolio, and depending on the portfolio may cause a significant tax bill.

BECOMING A CASH BUYER WITHOUT HAVING CASH

Asset based lines of credit (ABLOC) offer an attractive way to acquire liquidity from your portfolio without the tax drag of selling individual

investments. ABLOC's allow individuals to take a line of credit out against their portfolio, and if they so choose, use that cash to purchase a new home. A headwind to this strategy is that interest rates on ABLOC's can be much greater than that of a traditional mortgage.

YOU GET THE BEST OF BOTH WORLDS

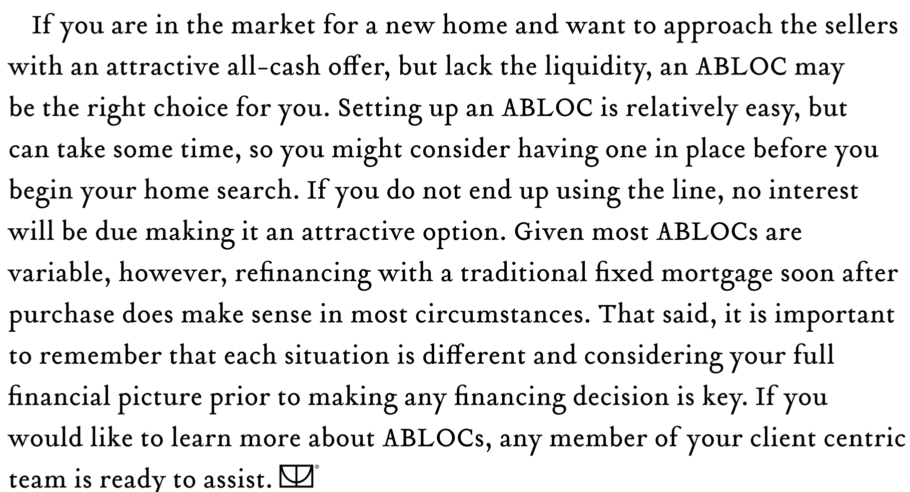
What if I told you there was a way to combine the liquidity and tax advantage of an ABLOC with the low interest rate and stability of a traditional mortgage? When structured correctly with your bank, you can use a secured line of credit based off of your portfolio and then soon after you purchase the home, use a traditional mortgage to pay off that line. This gives you the ability to appear as an all cash buyer while also eliminating the higher and floating interest rates that can come with an ABLOC. This strategy requires clear communication with your bank, is an effective way to save tax dollars, and can continue to grow your portfolio.

RISKS

Since the secured line is collateralized with your portfolio, there is volatility risk with this strategy. If the market takes a significant downturn, this can result in you having to deposit additional dollars into your investment account to meet the bank's loan-to-value requirements. This risk can be somewhat mitigated by refinancing with a traditional fixed rate mortgage soon after purchase, but the risk due to market uncertainty remains. Additionally, due to the nature of portfolios, you will not be able to receive 100% of the value of your portfolio as a line of credit. This occurs because the amount of your line will depend on the underlying investments in your portfolio and the bank's assessment of them and their risk.

> "If you are in the market for a new home and want to approach the sellers with an attractive all-cash offer… an ABLOC may be the right choice for you."

CONCLUSION



If you are in the market for a new home and want to approach the sellers with an attractive all-cash offer, but lack the liquidity, an ABLOC may be the right choice for you. Setting up an ABLOC is relatively easy, but can take some time, so you might consider having one in place before you begin your home search. If you do not end up using the line, no interest will be due making it an attractive option. Given most ABLOCs are variable, however, refinancing with a traditional fixed mortgage soon after purchase does make sense in most circumstances. That said, it is important to remember that each situation is different and considering your full financial picture prior to making any financing decision is key. If you would like to learn more about ABLOCs, any member of your client centric team is ready to assist.

Stock Market Pulse

Index	10/31/21	Total Return Since 12/31/2020
S&P 1500	1,051.26	23.95%
Dow Jones Industrials	35,819.56	18.77%
NASDAQ	15,498.39	20.89%
S&P 500	4,605.38	24.03%
S&P 400	2,794.11	22.32%
S&P 600	1,376.46	24.14%
NYSE Composite	17,016.41	19.26%
Dow Jones Utilities	915.91	8.75%
Barclays Aggregate Bond	2,354.21	-1.58%

P/E Multiples	10/31/21
S&P 1500	25.4x
Dow Jones Industrials	20.2x
NASDAQ	98.8x
S&P 500	25.9x
S&P 400	21.3x
S&P 600	20.2x

Key Rates

Rate	
Fed Funds Rate	0.00% to 0.25%
Tbill 90 Days	0.43%
T Bond 30 Yr	1.93%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	1,051.26	25.4x	1.30%
S&P 500	4,605.38	25.9x	1.30%
Dow Jones Industrials	35,819.56	20.2x	1.72%
Dow Jones Utilities	915.91	17.9x	3.40%

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.63%

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