A gift that keeps on giving

Instilling fiscal responsibility in your children or grandchildren

One of the best legacies you can leave to your children or grandchildren is financial savvy. It's important to teach younger family members fiscal responsibility as early as possible, especially if you plan to gift or bequeath them a significant inheritance that you want to be sure will be well managed. Let's examine several financial issues and how you can make sure your children or grandchildren understand them.

Start young

People are creatures of habit. If at an early age a youngster is aware of the difference between saving and spending, as he or she gets older the child likely will continue to understand that there are choices to be made with respect to money. And, it's a good way for you to instill your values with respect to wants vs. needs, and to encourage charitable giving.

With a young child, a good place to start is his or her allowance. For example, Jack gives his five-year-old daughter, Jenny, $1 a week allowance. When Jenny sees a stuffed animal she wants, Jack encourages her to save her allowance to buy it. He explains it in terms that are age appropriate, saying "That will take 10 weeks of allowance." Obviously, each child is different, and you must gear the lesson accordingly.

The power of compounding

As Jenny grows up and gets her first part-time job, Jack further encourages the idea of saving. Plus, this is an ideal time to teach her about income tax — explaining to her that $8 per hour at 10 hours a week doesn't equal an $80 paycheck.

On the saving side, Jack might show Jenny how putting money into an IRA can help her for the future. Of course, getting a 16-year-old to think about retirement might not be easy, but the lesson is simple — the sooner you start investing, the more opportunity you'll have to accumulate wealth because of compounding growth.

This might also open the door to talk about basic investing strategies. Jack refers to the chart below, which shows how much one is able to accumulate by investing just $1,000 per year, using certain assumptions.

Managing credit

Soon after Jenny celebrates her 18th birthday, Jack decides to start her down the path of establishing and maintaining good credit. He decides that a credit card — albeit one with a very low credit limit — or even a bank loan might be appropriate.

He helps her get a credit card, and explains that it can help to build a good credit history. He stresses that, if the balance is paid in full each month, no finance charges will be assessed.

Jack also shows Jenny an example of how quickly the interest can add up if she carries a balance, and warns that charging more than she can pay is a good way to get into financial distress. By starting her slowly, he is confident that she'll have the discipline to not get in over her head and that she'll develop good credit habits.

The employer "match"

After graduating from college, Jenny gets her first "real" job. She asks Jack about "this 401(k) thing" and mentions that there is a "match or something." Jack enlightens her, explaining that the match is basically free money.

For every dollar she contributes up to 6% of her salary, her employer will match 50%. This means that, for every $11,111 of salary, $1,000 will go to retirement if Jenny puts away 6% of her salary. That is, 9% of $11,111 is $1,000.

The chart below shows that, if Jenny is 25, she will accumulate a sizable amount by age 70. Plus, it presumes that just $1,000 is being contributed each year. As Jenny contributes more money, she can accumulate more.

The ins and outs of a mortgage

A few years later, Jenny is newly married. She and her husband are considering the purchase of a home and ask Jack for advice. He tells them that the amount they borrow, the interest rate and the term will dictate their monthly payment.

A $200,000 mortgage at, for instance, 6%, and repayable monthly over a 30-year period, will be retired in 360 payments of $1,199.10. But, he warns, they might have to pay more than that amount each month. Why? First, the mortgage company might require an escrow for real estate taxes and insurance. Second, the mortgage might include private mortgage insurance (PMI), the extra fee that is charged on mortgages in excess of 80% of the home purchase price. Jack tells them that, unless they proactively try to get PMI waived, it will continue even after the mortgage balance drops below 80% of the property value.

He also tells them about "points," and that they're really nothing more than a fee paid upfront to have a lower mortgage rate. Whether it's worthwhile to pay the points requires an analysis of the fee, the interest rate reduction and, importantly, a guesstimate of how long they intend to stay in the property. He also cautions that, if there is a likelihood of refinancing anytime soon, they should factor that into their decision as well.

A good education goes a long way

Jack beams with pride that Jenny will soon have her very own home and he reflects on how the lessons he's imparted have helped her to reach this milestone. He also feels confident that he can start an annual gifting program to Jenny and her husband with the confidence that his money will be well managed. Then Jenny tells him that there is another big event on the horizon — he is going to be a grandfather. Jack is thrilled, and looks forward to sharing his wisdom — and his wealth — with his grandchild.

Amount accumulated by age 70 if $1,000 is saved per year

Starting at age:	6% return	8% return	10% return
15	$395,567	$854,028	$1,897,779
25	$212,744	$386,506	$718,905
35	$111,435	$172,317	$271,024
45	$54,865	$73,106	$98,347
55	$23,276	$27,152	$31,772
65	$5,637	$5,867	$6,105

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