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San Francisco • Silicon Valley

Financing Fatherhood

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My wife and I are expecting our first child in January. As any current or expectant parent will tell you, it is both a very exciting and nerve-wracking time. You wonder and worry about how prepared you are. Will you be good parents? Did you buy the right stroller or diapers? Or, in my case, how do you even change a diaper?

I have been told that this is supposed to be a wonderful time of life – a time for my wife and me to reflect on our past and discuss our hopes and dreams for our soon-to-be born daughter. What people seem to forget is that I am a financial advisor. It is my job to worry about money and to plan for people’s financial futures, making it hard for me to just relax and enjoy the ride. I am sure it will be wonderful to have children, but they also present significant financial challenges. According to the USDA, the average cost of raising a child born in 2013 will be almost $250,000. This figure may double for high income families living in big cities and the costs are only a piece of the family financial puzzle. Children affect your taxes, insurance needs, estate plans and many other aspects of your financial lives. All of this can be quite complicated and overwhelming, but it helps to have a plan.

Below I have outlined some of the key financial decisions new parents need to make, in the order in which they will likely arise.

Health Insurance
One of the first decisions expectant parents will make is regarding their health plans. Most employers have an annual “open enrollment” period during which each employee must select a health plan for the year.

Choosing the right health care coverage can be quite difficult, as there are a number of things to consider. Two of the most common health plan options are HMOs and PPOs. The primary difference between these plans is the way in which they interact with health providers. PPOs provide more flexibility to visit doctors without the need for a referral, but also generally cost more. Typically, HMO plans will be the most cost effective plans for pregnancy. They usually cover all, or at least a large portion, of pre- and postnatal care. However, the devil is often in the details here and it can pay to take a closer look at your options. When I ran the numbers for my wife and me, it was most cost effective for each of us to stay on the PPO plans offered by our separate employers, even though we had an HMO option. We also set up a Flexible Spending Account (FSA), which allowed us to cover our out-of-pocket costs tax free (up to a maximum). It is worth checking to see if you are eligible to participate in an FSA, Health Savings Accounts (HSA) or Health Reimbursement Account (HRA). Each of these offers tax benefits for medical expenses, but there are different rules governing the plans.

Another health insurance tip is to check the plan’s coverage of maternity related costs. Plans may cover things you wouldn’t expect, such as birthing classes and breast pumps. Lastly, do not forget to add the newborn to your health plan. Generally, parents have 30 days after the birth to get this done, or typically must wait until the next open enrollment period.

Childcare
The next big decision parents will probably face is about childcare. For families with two working parents, this will likely be the biggest child related expense. Whether hiring a nanny or using day care, the cost can easily exceed $2,000-$3,000 per month. With one child, it is generally more cost effective to use a day care center. However, as families grow, the cost advantages of hiring a nanny increase. Care.com provides some good information on average childcare costs for different
neighborhoods. In San Francisco, the average weekly day care cost for a family with an infant and a preschooler is $440. A nanny costs $580 per week on average. If your employer offers a Flexible Spending Account (FSA), you can set aside a maximum of $5,000 for childcare tax free. Unfortunately for those of us who will need full time childcare help, the FSA provides very little relief.

**Estate plan**
One of the most crucial conversations new parents need to have concerns who will take care of the kids if they are not around. This will also almost certainly lead to a disagreement, so be prepared. It is an opportune time for each spouse to make their case for why their in-laws should not raise their kids in any circumstance. Any disparaging comment politely held back in the past is now fair game. Even if the parents agree, the grandparents will almost certainly have a different perspective. This is why it is incredibly important to write or update a will with your chosen guardians. For California residents who own a home or have more than $150,000 in assets, creating a living trust is also a good idea. A living trust gives parents full control over their assets while alive, but lets the estate avoid the probate process if one or both parents die prematurely. The probate process can be lengthy and expensive, which is why it may be best avoided. Lastly, make sure to update the beneficiaries of your retirement plans and insurance policies. Those beneficiary designations supersede the instructions of your will.

**Disability Insurance and Life Insurance**
While most families purchase some form of life insurance, it is also important to have adequate disability insurance. It is more likely that someone will become disabled before 65 than die before 65. Many employers offer basic disability and life insurance coverage, but the benefits available through these policies generally do not sufficiently replace lost income. After reviewing employer offered plans, families may need additional disability and/or life insurance coverage. The size of the policy will be a function of earned income and outstanding debt. If you are a high earner or have a large mortgage, you will probably need a higher benefit payout. It is also important to consider the cost consequences of an untimely death and not just the loss of income. As an example, a stay-at-home spouse does not earn income, but if he or she were not able to care for the kids, the surviving spouse may need to pay someone to provide childcare. In this case, the couple may want to have a policy that covers not just the working spouse, but the other spouse as well. As with many of these decisions, it is best to consult with a financial advisor before you sign on the dotted line.

**Education funding**
It may sound crazy, but it is never too early to start saving for your child’s college education. 529 plans are state sponsored accounts that let you invest without ever paying taxes on the earnings (as long as the money is used to pay qualified education expenses). Some states also offer tax deductions on 529 plan contributions (unfortunately, California is not one of them). With the cost of education increasing well above the rate of inflation, it is important to start college savings early. Depending on where they live, many parents may also need to fund primary or secondary education. If you are thinking about moving, you will definitely want to factor this into your decision. If the public schools in a neighborhood are not good and you are considering private schools, the costs for schooling should factor into your home budget.

Pregnancy should be a period of time when parents enjoy the anticipation of parenthood. It can be a wonderful time to talk about your plans, expectations,
values and traditions. However, it is easy to be overwhelmed by the cost associated with children. Having a strong financial plan can provide the peace of mind necessary to focus on the bigger questions, like who you want to be as parents and what you want for your children.

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