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Are You Coddling Your Grandkids?

By Kelly Greene
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People Are Showering Money on Their Children's Children— Even at the Expense of Their Own Retirement. Here's How To Give Smartly

It is only natural for grandparents to want to help their grandchildren financially. But the weak economy and job market are spurring a growing number of older people to give until it hurts.

Scott Pollack

Tips

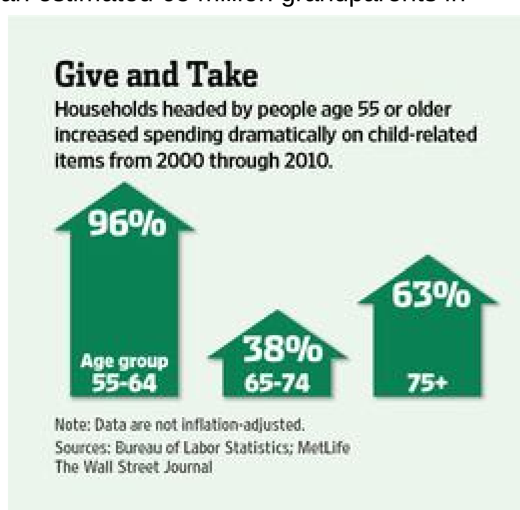
- Reduce or delay gifts if your portfolio tanks.
- Lend money instead of making gifts.
- Use gifts to teach kids about investing.
- Equalize gifts through estate planning.

Financial planners say that is a mistake. Grandparents living off their savings should consider how the gifts they make now, by drawing down their investment principal, will affect their future earnings. In the worst-case scenario, such gifts could wipe out their savings before they die.

"It's a delicate balance," says Sandra Timmermann, a gerontologist who directs the MetLife Mature Market Institute, "between wanting to help your family and making sure that down the road you're not a burden."

The good news is that there are ways to keep giving now while avoiding trouble later in life. Among other strategies, experts suggest paring gifts when portfolios sputter, making loans with strict repayment terms instead of gifts, using gifts to teach grandkids broader lessons about financial planning and leaving tax-free gifts after you die to make sure you don't run out of money.

All told, there were an estimated 65 million grandparents in the U.S. in 2011, according to independent demographer Peter Francese. Within eight years that number is expected to reach 80 million, or nearly one of every three adults.



There are no federal data tracking grandparents' gifts to grandkids. But in 2010, households headed by people ages 55 or older spent $9.7 billion on infant food, equipment and clothing, along with toys, games and tricycles for older kids—a 143% increase from 10 years earlier. And they spent $2.4 billion on elementary and secondary school tuition, triple their contribution in 2000, according to the Bureau of Labor Statistics. A third of the grandparents surveyed by MetLife in April who said they give to their grandkids said they did so despite worries about the impact on their own finances.

The main culprit for the rise in giving is the weak economy, which is hampering efforts by the grandparents' children to care of their own kids, Ms. Timmermann says. Financial planners say they see more grandparents giving when their children are coping with divorce or are saddled by debt.

Dorothy Nelson, a 73-year-old retired widow in Lindenhurst, N.Y., spent much of her savings over the past decade helping her children pay for housing, oil bills and other expenses for her eight grandchildren. The money covered a $40,000 bedroom addition, $60,000 in mortgage payments and other big-ticket items.

But she found herself running so low on savings that she had to take out a reverse mortgage to pay property taxes, and started volunteering through a foster-grandparent program that provides a small stipend.

"You live for your children and your grandchildren. You want to make the world a little better place for them. In the meantime, you forget about yourself," Ms. Nelson says. "If I had to do it over again, it would be completely different."

So, how do you help your grandchildren without wrecking your own financial future or creating a sense of entitlement? Here is the collective wisdom of grandparents and financial planners across the country.

Pare your gifts to offset the pain. Giving to grandchildren isn't an all-or-nothing proposition. You might be able to stay on track just by scaling back a bit.

Donald Rhoads, a 74-year-old retired geologist and entrepreneur in Falmouth, Mass., was hoping to contribute $10,000 a year to each of his four grandchildren's college costs, for a grand total of $160,000. Mr. Rhoads and his wife have two sons in their 40s, "a time of their life when it's very stressful financially. They're trying to save for retirement at the same time tuition's coming up," he says.

The way the grandfather sees it, his sons can use the money more now than as an inheritance later.

The couple has about $1 million in investible assets, including a fixed-income pool that provides Mr. Rhoads and his wife with lifetime income, a conservatively invested pool from which they plan to pull the college contributions and a higher-risk pool they hope to leave to their two sons and four grandchildren.

When the couple's investment adviser, Kenneth McGuire, ran the numbers, he concluded that Mr. Rhoads and his wife were putting their retirement plan in jeopardy.

Mr. McGuire suggested the grandparents contribute $5,000 a year for each grandchild, $80,000 in all. "If they're fortunate, they might be able to contribute more from year to year, and if they have excess dollars when the last child finishes, they could pay off any loans, or at least contribute toward that," he says.

"The $80,000 is very workable, so that's what we're doing," Mr. Rhoads says. "This is a conservative fallback."

Make loans instead. Some grandparents opt to become lenders. Loans to their grandchildren can serve as a less formal alternative to co-signing bank notes. But it is wise to provide specific repayment instructions.

When Charles and Rachel Howell's granddaughter approached them to co-sign an $8,000 loan to help her pay nursing-school expenses not covered by grants, the Fort Worth, Texas, couple told her they would consider it. But when they learned that the smallest loan she could get was for $25,000, with 5% interest and payments starting six months after graduation, they decided to make the loan themselves.

The grandparents worked with their financial planner, Burk Rosenthal, to structure the loan. Their terms: The granddaughter has to request money from them for specific needs. If they approve, they then write her a check from an account they have set up at their bank, and she provides receipts showing how she spent it. She will owe no interest, and the first payment isn't due until a year after she graduates.

"We're keeping her responsible, but without having that problem of paying large interest," Mr. Howell says.

Grace Avallone, a retired plastic-surgery technician in Valley Stream, N.Y., says she lent her live-in granddaughter $1,000 for a car repair. Her granddaughter, 23, has been paying back $50 a week for several months, along with $200 for car insurance and other expenses.

"I told her, 'This is how it works. You can borrow, but you pay back. The day you don't pay back, don't ever ask for more, because you won't get another penny,'" Ms. Avallone says.

Create a teaching moment. You can use stocks to impart investing and financial-planning lessons to grandkids, especially if you would like to pass along the assets anyway.

Sam Franz, an 82-year-old retired orthopedic surgeon in Madison, Conn., is giving appreciated stock to each of his 12 grandchildren as they graduate from high school.

His financial planner, Denis Horrigan, suggested using the investments because they are going "to kids who are in a lower tax bracket and may pay no, or low, capital-gains tax," Mr. Horrigan says. And it gets the stock out of the estate, he adds, meaning it might be subject to less tax when he dies.

This summer, Dr. Franz brought a grandson entering Yale University to Mr. Horrigan's office, and the staff at his firm, Connecticut Wealth Management in Farmington, gave the student a "Personal Finance 101" class.

"Usually they have no idea what to do with the money," Dr. Franz says. "I suggest that they reinvest it and let it grow. The parents have all grabbed onto this. I get a lot of support."

Delay grandkids' gratification. One of the best ways to make gifts to grandchildren is posthumously—leaving them a Roth individual retirement account, from which inherited withdrawals are free of income tax.

Although heirs have to take distributions every year, they are allowed to spread them across their life expectancy, so younger inheritors could choose to leave much of the account intact, with any future earnings income-tax-free as well.

When Harold Weil, a retired retail-operations manager in Edison, N.J., received an inheritance last year, his planner suggested he use it to pay the taxes involved to convert the 401(k) account held by his first wife, who died in 1998, to a Roth.

"Her wish was for this money to be for the grandchildren," Mr. Weil says. "I'm following through."

Walter Pardo, Mr. Weil's investment adviser, suggested rolling over the 401(k) account to a traditional IRA first, before converting it to a Roth. That way, if the investments have lost substantial value by the Oct. 15 deadline, or if the tax bill had been too high for Mr. Weil to handle after all, he could "recharacterize" the IRA, meaning he could return it to a traditional account and pay no tax.

Mr. Weil says he might use some of the account's assets to help pay college bills, rather than saving it all for an inheritance. "My one granddaughter in another two years is going to be looking at college, and this will help," he says.

Practice equality. Whichever approach you use, think about conflicts that could arise if one grandchild gets more than the others. In the worst-case scenario, family members could wind up in court over such disparities.

One strategy for avoiding future battles: Instead of "straight giving," make a loan. You can specify in your estate-planning documents that any amount not repaid would be subtracted from that child's or grandchild's share, says Jon Beyrer, a certified financial planner in Solana Beach, Calif.

One caveat: The lender has to charge interest and claim it as income, even if he never collects it. Still, for loans of up to $10,000, you don't have to claim interest, and for up to $100,000, it is an issue only if the borrower has other interest income, Mr. Beyrer says.

Another way to make it clear that all the grandchildren are getting the same inheritance is to set up a trust that equalizes everything, he says.

"It's also a good chance to sit with your family and say, 'This is the trust we've set up in estate planning, and we think it's the fair way to go. If anyone has a problem with it, let's talk about it now,'" Mr. Beyrer says.

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