Planning for Change

Navigating Low Yields and High Asset Valuations

Equal or Equitable: What is Fair?

Planning & Investing as a Couple

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But change is also a constant. While the end of the year may concentrate minds, we know, as the guardians of our clients’ wealth, that the best time to plan and invest is always. Life, as our Chief Wealth & Fiduciary Advisor Chris Zander says in the cover article of this issue of Independent Thinking, keeps coming at us. Weddings and funerals, children and grandchildren, setbacks and triumphs; much of the planning that investors typically leave to year-end should really be an ongoing concern. (We also include an end-of-year planning guide on page 4, in recognition that this is the time that most clients tend to review their affairs with their accountants and attorneys, as well as with their wealth advisors.)

Also in this issue is our current investment outlook from our Chief Investment Officer John Apruzzese. Continued low yields and high valuations are, understandably, fraying some investors’ nerves. However, we see no evidence of recession and are hopeful that the Federal Reserve will soon be able to progress to a more normal interest rate regime.

We also expand on the perspectives section in this issue. All of our offices across the United States are committed to advancing our educational programs, in the belief that informed clients – like informed voters – make the best choices. A recent article in The New York Times, “Making Financial Management Both Spouses’ Job,” featured Evercore Wealth Management clients and Partner and Portfolio Manager Martha Pomerantz on the importance of fully engaging a couple in wealth planning. To view the article in full, please visit: http://nyti.ms/2d2T8l2. Senior Advisor Fred Taylor addresses the same subject here on page 16.

So much of wealth management is about helping clients define and express, through the devolution of their assets, their sense of right and wrong, and their hopes for their families and legacies. In my regular column from the perspective of an aging Baby Boomer, I consider the difference between fair and equitable, in an attempt to help couples think about one of the most challenging issues of all – how to treat children fairly. Communicating this decision-making process is also something that we spend a great deal of time on with our clients and is the focus of several regular seminars, as you’ll see on pages 14 and 20.

This is shaping up to be another busy season at Evercore Wealth Management. We are mindful that we remain in a low-growth environment, and we are encouraging our clients to plan – and spend – accordingly. But we continue to invest with confidence and look forward to the conclusion of this election.

It’s been almost eight years since we opened our doors, at the nadir of the Great Recession. We have much to be thankful for this season, most of all for the confidence of our clients as we continue to grow. As always, please feel free to contact any one of us with any questions or comments you may have; we

Jeff Maurer
Chief Executive Officer
Planning for Change

By Chris Zander

There’s more to financial planning than death and taxes. Sure, legacies – for spouses, children, and charities – are a big deal. And tax efficiency should underpin every aspect of the discipline, especially now as we prepare for a new administration. But if there is a third thing that can be said to be certain in this life, it’s change.

Marriage, children, career moves, business start-ups and sales, grandchildren, philanthropic interests, and retirement are just some of the headline life events for many private investors. Behind these are myriad decision points that can make or break fortunes. Financial markets and the regulatory environment are in almost constant flux. (As we discuss in these pages, the challenge now is to navigate low yields and high asset valuations, as well as tax proposals that could substantially affect high earners.)

Perhaps the best analogy is to a business plan. Just as a company seeks to expand, merge or sell according to a plan, so too can a family plan its financial life. Indeed, the biggest regret of many investors is that they didn’t start planning for their own wealth sooner. A looming retirement or a liquidity event is the usual wake-up call – the point at which a family seeks professional help to address increasingly complex issues. Ideally, planning should start much sooner, to better align spending, investing, and fiduciary structures to meet family goals, and harness the power of time and compounding to magnify the positive impact of those strategies.

Planning doesn’t stop there. Plans can and should change as families, businesses, and legacy interests evolve. The days of three-ring binders embossed with a private bank’s seal are long gone. These static plans were probably out-of-date by the time they were printed, as the families and their businesses, as well as the markets, continued to evolve.

Most families experience both struggle and success

Families can struggle, with divorce, with physical or mental illness, and with addiction. Or they can prosper, with weddings, tuitions, first homes, and even start-up businesses to fund (or successful businesses to sell or pass down to the next generation). Most families experience both struggle and success. It’s important to note that spouses should engage in this planning as a team and that decisions affecting each other, and their children, should be as transparent and effectively communicated as possible. (See Fred Taylor’s article on couples and wealth management on page 16 and Jeff Maurer’s article on treating children fairly on page 14.)

Business life is similarly complex. For a corporate executive, each year closer to retirement brings decisions to make on balancing bonus deferrals with...
cash flow, on diversifying accumulated company stock and stock options, and on the bigger question of whether they can afford to retire. Business owners share many of these concerns but also have to evaluate the eventual transfer of their business in the context of their personal financial goals and the market environment (while staying focused on their usually all-consuming day job). Family-owned businesses also share the added complexity of balancing governance, management succession, ownership and control among family members while keeping the business on track for future success.

If the business owner foresees future appreciation in the value of his or her shares, the owner may consider transferring non-voting shares of the company to intentionally defective grantor trusts for the benefit of their children and or grandchildren. While the current value of the shares would be a taxable gift, the owner can utilize part or all of his unused estate and gift tax exemption of $5.45 million ($10.9 million for married couples). The value of the shares and the future appreciation (which could be significant, especially in a sale or IPO) would all inure to the benefit of the trust, and the grantor, under current gift tax law, would be responsible for all of the income taxes, allowing the trust to enjoy the full appreciation on those assets.

**Constant change should always be a consideration in trust and fiduciary planning**

For those who have fully utilized their gift tax exclusions (or are only interested in transferring the future appreciation on their assets and not the principal), historically low interest rates make this an opportune time to implement certain estate freeze planning strategies such as Grantor Retained Annuity Trusts, or GRATs, and sales to intentionally defective grantor trusts in return for an installment note.

Let’s say the company is sold to a public company in return for stock of the acquirer in a tax-free transaction. Now the trusts own a concentrated position in a public company. If it is sold, the grantor (if still alive) is liable for the income taxes. However, the grantor can swap in higher basis assets (e.g., cash or bonds) of an equivalent value and take back the appreciated stock in return. Why? The grantor may then give some of the stock to charity or the family’s private foundation to fulfill his or her charitable legacy and avoid a capital gains tax while achieving a significant charitable income tax deduction.
Alternatively, if the business were not sold, the grantor could execute a swap of the private company shares to realign ownership of the business while diversifying the trusts for the family members who may not work in the business.

Constant change should always be a consideration in trust and fiduciary planning too. In this planning and investing environment, there is real concern about transferring ownership in the business (or other financial assets) to trusts before securing a bulletproof retirement. However, utilizing carefully drafted spousal limited access trust provisions in a trust can allow a spouse to have access to income and principal in times of financial duress at the discretion of a truly independent trustee.

In short, life keeps coming at us all. None of us can predict the future, in the markets or in our own businesses and families. Establishing a strategic, fully integrated wealth plan early on and, crucially, viewing it as a dynamic and flexible tool in annual or more frequent discussions with close advisors, can help families prepare for – and perhaps even embrace – the change that is certainly coming.

Chris Zander is the Chief Wealth & Fiduciary Advisor at Evercore Wealth Management and the President and CEO of Evercore Trust Company of Delaware. He can be contacted at zander@evercore.com.

**Strategic Wealth Planning**

**Tax Planning**

Capital gains and losses during the tax year are netted against one another for income tax purposes. While it may be beneficial to harvest losses within an individual portfolio by year-end, it is important to review capital gains and losses across all investment portfolios, including business assets, LLC or partnership interests, and gains on the sale of any real estate. By realizing capital losses and reinvesting the proceeds into the same general asset class, investors can use the capital losses this year but still remain invested in the market. These capital losses can be used to offset gains taken earlier in 2016 or carried forward to future years.

**Charitable Giving**

Given current income tax rates, individuals should consider charitable contributions using qualified appreciated stock. If you have held the shares for more than one year, you can deduct the current fair market value of the securities contributed (subject to certain AGI limitations) while avoiding the capital gains tax due on the appreciation if you otherwise sold the asset.

If you have longer-term philanthropic objectives and also would benefit from a larger charitable deduction in 2016, you may want to consider establishing a private foundation, donor advised fund, or a charitable remainder trust.

**Gifts and Wealth Transfer**

The lifetime federal gift, estate and generation-skipping tax exemption increased to $5,450,000 in 2016 from $5,430,000 per individual. This allows individuals who have utilized all of their exemption in 2015 to make a gift of an additional $20,000, exempt from federal estate, gift, and generation-skipping tax.

Annual exclusion gifts allow individuals to give up to $14,000 per year to anyone without gift tax (married couples may give up to $28,000). The annual gift tax exclusion amount for gifts to a non-U.S citizen spouse is $148,000 in 2016. Gifts must be made prior to the end of 2016. Checks to individuals must be cashed prior to December 31.

Historically low interest rates make this an opportune time to implement certain estate freeze planning strategies such as Intra-family loans, Grantor Retained Annuity Trusts, and Charitable Lead Annuity Trusts. Additionally, proposed regulations released by the Internal Revenue Service and the Treasury Department on August 2, 2016, if finalized in their current form, would likely eliminate valuation discounts on transfers of interests in family-controlled entities. Time may be running out for transfers of interest in family-controlled entities.

**Required Minimum Distributions, or RMD**

IRA owners who turn age 70½ during 2016 have until April 1, 2017 to take their first required minimum distribution and must take the second by December 31, 2017. IRA account owners already in distribution mode must take their annual RMD by December 31, 2016. IRA account owners over age 70½ can make tax-free direct transfers (up to $100,000 in the calendar year) from IRA accounts to charity to satisfy the RMD.

Editor’s note: This is extracted from a comprehensive review of the current wealth planning landscape mailed to Evercore Wealth Management clients in early October. Please contact Jen Tse at tse@evercore.com or your Wealth & Fiduciary Advisor for further information.

– C.Z.
Luxury Industry: Health is the New Wealth

By Oman Saad

We expect soft global luxury demand to persist as Chinese consumption of high-end luxury goods continues to wane, but also due to the rising importance of healthy living and active lifestyle, which appears to be replacing traditional luxury goods as the most important social badge of status, affluence, and style.

Today, health, fitness, and leading an active lifestyle are powerful ways to express education, affluence, style, work ethic, and motivation, a phenomenon that is magnified in a digitally connected world where everyone has a high-definition camera in their pocket and a social media profile to maintain.

Interestingly, while this dynamic has become well established in North America and Europe over the last five years, it is now rapidly spreading into Asia and emerging markets in other regions. For example, the Chinese government is making a concerted effort to encourage health and fitness across its population. Last year, the Chinese State Council publicly set a goal for total sport spending to rise from 0.6% of GDP to 2.5%-3.0% (in line with Western countries) over the next decade, which would equate to hundreds of billions of dollars of growth.

This effort is already quite visible on the ground in China, where gyms, fitness centers, running clubs and yoga studios are popping up everywhere. Although we have seen boom and bust cycles in China before (including in the athletic market after the 2008 Beijing Olympics), it seems the measures being implemented today have a better chance of taking root, as they are focused on institutionalizing activity through sports programs and school curriculum and on encouraging parents to allow kids to shift some focus from exams toward active and team-oriented endeavors. It is clear that China’s new policy is aimed at a much broader participation in sports.

The luxury goods market is understandably worried that society’s current obsession with health, fitness and sports is more of a temporary fashion/lifestyle trend than a structurally sustainable phenomenon. However, we believe that consumers are just beginning to integrate sports into their fashion choices. In fact, consumer desire to display wealth through an active lifestyle is even causing them to build highly specialized dual sports wardrobes; one for actual sport performance usage and one for sport fashion purposes.

Given these factors, we believe the best way to invest now in the high-end consumer is via athletic and related stocks instead of traditional luxury sectors, such as Swiss watches, European handbags and fine jewelry.
We have been living with near-zero interest rates for so long that they are beginning to feel almost normal – but they are not. Distinguishing between artificially inflated assets and those of real value will challenge investors through 2017 and beyond.
The world's major central banks have deliberately boosted the price of financial assets, in an unprecedented effort to increase investment and economic growth. While they succeeded in increasing the value of financial assets across the board, the real economy is not feeling the love. U.S. real GDP is growing at an annual rate of 2%, and real income has been stagnant by some measures. However, it should be noted that because the recovery and expansion have been relatively long—and are expected to continue—the cumulative growth of the economy since the financial crisis is respectable.

Low interest rates have also given governments license to pile up debt, while harming banks’ earning power and punishing conservative savers. For instance, the amount of U.S. government debt held by the public has more than tripled since 2000, and yet interest costs of about $250 billion per year have held steady, due to the dramatic drop in interest rates. A significant increase in interest rates would put pressure on future federal budgets. The federal budget deficit would increase by about 3% of GDP if interest rates suddenly moved back to levels that prevailed before the crisis.

At best, the reach for income flows from high-quality assets will support asset values as the central banks slowly ease up on the gas. At worst, the central banks will discover that they have run out of ammunition to combat future recessions. If we were to enter a recession at or near current interest rate levels, the Federal Reserve will only have two options left—negative interest rates, which so far have not demonstrated efficacy in Europe or Japan, or so-called helicopter money, which is the final frontier. (Helicopter money refers to the Fed directly funding federal government deficit spending and/or extinguishing some of the government debt held on the central bank’s balance sheet.) Although we do not expect a recession in the near term, it is impossible to judge when the markets might start to lose confidence in the central banks and price down assets accordingly.

In the interim, slow but steady economic growth coupled with zero interest rates continues to drive up the value of perceived high-quality, stable income flows. The higher investor confidence that the income flows will continue undiminished, the higher the valuation. So the sovereign debt of the most stable economies has become the most highly prized asset, followed by high-quality corporate and municipal debt. Next on the list are top-quality, income-producing real estate (Class A buildings in gateway cities) and large, stable, dividend-paying stocks (utilities, food packaging and REITs). Investors are now willing to take on equity risk or illiquidity to capture future income, even if there are little or no prospects for growth.

While relatively expensive, these asset classes should not be completely avoided. They will continue to be the preferred investments should zero interest rates persist and should the U.S. economy slow further and begin to resemble those of Europe and Japan. However, it is equally important that investors diversify away from the currently favored assets and find pockets of reasonably valued investment opportunities that should not be harmed when and if we return to more normal interest rates. These include direct investments in unsecured consumer and small business loans (see Stephanie Hackett’s article on page 10), and illiquid middle market leveraged loans.

Sovereign debt has become the most highly prized asset

The illiquid private equity and private real estate sector are very inefficient relative to the public markets, meaning that the spread between the returns of top-performing managers and average returns are large and persistent. This suggests that first-quartile performing managers should produce attractive returns, even in an environment of generally falling asset values due to rising interest rates. We are recommending that qualified investors allocate approximately 10% of their portfolio to illiquid assets; a higher allocation may be appropriate depending on each client’s individual circumstances and goals.

We remain focused on building all-weather portfolios that can achieve our clients’ investment objectives, striving to preserve and grow their assets to produce the best possible risk-adjusted, fee-adjusted returns. No one can predict the future, but we can chart a course to withstand a wide range of possible outcomes.

John Apruzzese is the Chief Investment Officer of Evercore Wealth Management. He can be contacted at apruzzese@evercore.com.
Overload at the California Ballot Box

By Howard Cure

In another bumper season for statewide ballot initiatives, including some that seem too complicated for a general electorate, investors in California have to be wondering how much of a good thing is too much for the state’s fiscal health.

The number of signatures required to get a measure on the California ballot is reset every four years, based on the votes cast for governor in the previous general election. Since only 42% of the state’s registered voters – a record low – turned out in November 2014, it’s even easier now to put a proposed law before the voters. At the same time, state law now requires all citizen initiatives go before voters in November during a general election.

Important decisions are therefore left to a relatively small – and quite possibly overwhelmed – electorate. Of the 17 statewide ballot initiatives confronting voters this season, the product of record campaign spending, a number could have an outsized impact on the state’s operating and capital budgets. The estimates from the California Legislative Analyst’s Office on the total operating budget impact is between $6 billion and $11.4 billion, or 5% to 9.5% percent of California’s entire general fund revenue budget for fiscal 2017.

For investors in California bonds, the outcome of these initiatives and their relationship to the state’s budget is critical for California’s future. On the operating side of the budget, the importance is based on the state’s volatile revenues, which are linked to difficult-to-forecast financial market performance caused by a highly progressive income tax structure. On the capital side of the budget, there is a huge backlog of deferred maintenance and infrastructure needs across the state. Forcing people to vote on these complicated policies during a tumultuous election cycle makes the outcome difficult to predict.

This unwieldy ballot forces both proponents and opponents of each measure to rethink their strategies to compete in an unusually crowded field. Unlike voting for candidates, in which there are signals around
Since only 42% of the state’s registered voters turned out in November 2014, it’s easier now to put a proposed law before voters. Partisanship or ideology based on political party affiliations, individuals voting in a referendum who don’t know the specifics around a measure, or are confused about the wording, may be likely to skip it or just vote no out of frustration.

The many recent propositions involving the tobacco, oil, plastics, and pharmaceutical industries also drive up the costs, as deep-pocketed interest groups are willing to spend considerable amounts of money to protect their interests. It also encourages a dual-track system for managing state finances, with some decisions made at the Capitol and others at the ballot box, as politicians lack the political will to make unpopular decisions. Conspicuously absent from the 17 statewide ballot proposals this November, for example, is any explicit mention of funding transportation programs after the governor’s failed attempt during a special session calling for a transportation package of $3.6 billion a year.

Democracy in California
Change in state statute requires signatures of 5% of voters in most recent gubernatorial election; 8% for constitutional change.

We favor California bonds secured by essential purpose enterprise systems

While we remain reasonably confident that California will retain its recent fiscal discipline and that the state and most local entities will manage their long-term liabilities while identifying new revenue sources to address capital needs, the sheer volume of initiatives add a level of uncertainty. At present, we favor purchasing California bonds secured by essential purpose enterprise systems in affluent regions. We continue to research and purchase a diversified variety of state and local credits that help provide appropriate risk/return rewards for our clients.

Howard Cure is the Director of Municipal Bond Research at Evercore Wealth Management. He can be contacted at cure@evercore.com.
In short, alternative lenders have a more streamlined and faster underwriting process at a lower cost – and are able to pass these savings along in the form of lower rates to borrowers and higher yields to investors. Investors in alternative loans generally expect to make about 8% through a full market cycle, net of fees and losses due to charged-off loans. That compares with the current yield of less than 0.25% on bank deposits. 

For investors, alternative lending is essentially a new asset class, providing direct access to consumer, student and small business loans, and expanding the investable credit universe beyond government and large corporate bonds. It has a low correlation to other asset classes, including global equities and traditional fixed income, as returns are impacted more by factors such as local unemployment rather than Federal Reserve fund rate changes or fiscal policies.

Investing in alternative loans is not a low-risk strategy and is more appropriate

Alternative lenders provide credit directly to borrowers. Their ranks include direct lenders that raise capital from institutional investors to make loans to middle-market companies, and peer-to-peer lenders, also known as marketplace lenders, that make loans to consumers or small businesses. Marketplace lending has grown substantially, but still only accounts for 1% of the $3 trillion U.S. consumer credit market. Industry analysts estimate that it could grow fivefold to $150 billion by 2020.

At their core, alternative lending platforms and traditional banks have the same functions and are subject to many of the same regulations governing credit cards and banks. But alternative lenders are more nimble and efficient than banks, as they don’t need to maintain significant reserve requirements, an expensive branch infrastructure, or embedded practices such as manual data input. Instead they are able to tap into a different source of funding and use technology to gain operating efficiencies. (See the box on page 11 for a comparison of alternative lending companies and banks.)

The human capital-intensive process of banks doesn’t just slow down the lending process, it makes it uneconomic for banks to lend at all, even to borrowers with sound financials. Currently only 5% of small business loan applications are approved by traditional banks, leaving an increasing number of business owners with limited options for capital other than credit cards, despite fees that average 22%. With rates averaging 14%-15%, alternative lenders can be a much more attractive option for borrowers.

Banks have long been the primary source of credit, using their low-cost deposits to fund loans to consumers, small businesses, and students. Recently, however, advances in technology and the disintermediation of banks have opened up a new channel: alternative lending. This rapidly growing industry can be of significant interest to qualified private investors.
for portfolios with a medium- to long-term investment horizon. The industry came under significant scrutiny in May 2016, when the CEO of Lending Club, an industry leader, resigned following an internal investigation. Some institutional investors backed off from buying loans from alternative lending platforms, but as demand from borrowers remained steady and default rates did not materially change, many have since returned.

We believe the loan underwriting and servicing processes remain robust at many alternative lenders. While increased regulation could increase costs or slow down the underwriting processes, it seems likely that it will have a greater impact on those lending platforms that target subprime or lower credit quality borrowers. Across fixed income investments, the borrower’s ability and willingness to pay drives the performance of the asset class. A turn in the credit cycle will affect all lenders, but should have less of an impact on the platforms that focus on higher quality borrowers.

In its current form, alternative lending has not experienced a significant downturn. Losses have historically increased during times of economic stress, although charge-off rates have never risen to a level where lenders faced principal losses, even during the global financial crisis. In 2009-2010, charge-off rates for consumer and small business loans ranged between 6%-8%, well below the current yields of 12%-14% for these loans. Alternative lenders mitigate these risks through careful underwriting practices, targeting the borrowers that they believe will have the highest ability and willingness to repay the loans. Monthly payments on alternative loans are auto-debited from borrower bank accounts, significantly reducing the risk of non-payment. The high-touch servicing component of these platforms is critical too.

Investors can access the alternative lending market through a variety of sources, including funding individual loans directly through one of the alternative lending platforms. While this provides direct access to alternative loans, there is limited ability to diversify broadly.

Investors can also invest in a pool of funds, either managed directly by the alternative lending platforms or managed externally by hedge fund or mutual fund managers. We recommend the latter, as institutional managers who oversee large pools of capital have the flexibility to invest across multiple alternative lending platforms to ensure diversification across geographies and loan types. They also receive significant transparency into the underwriting process and can ascertain which platforms have the more rigorous underwriting and servicing processes. All else being equal, we also prefer fee-efficient funds with reasonable liquidity.

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**Faster and More Efficient: Alternative Lenders vs. Banks**

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<td>• Consumer/Personal, typically unsecured loans used for debt consolidation, home improvement, and major purchases</td>
<td>• Consumer/Personal, typically unsecured loans used for debt consolidation, home improvement, and major purchases</td>
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<tr>
<td>• Small Business, typically below $500,000</td>
<td>• Small Business, typically below $500,000</td>
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<td>• Capital from investors, either individuals or institutions</td>
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<th>Rates Paid for Capital</th>
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<td>• 8% average historic return on portfolio of alternative loans(^4)</td>
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2. Lending Club Corp survey, 9/30/2015. Survey borrowers reported interest rate on outstanding debt or credit cards averaged 21.8%. Lending Club borrower rate is average rate paid by borrowers (FICO 699).
3. FDIC data as of September 26, 2016 for national average rates for savings, interest checking and money market accounts and for CDs 12 months and shorter.
4. Federal Reserve data.
5. Lending Club Corp survey, 9/30/2016. Median Adjusted Net Annualized return for investors with 100+ notes, note concentration of >2.5% of portfolio value, all loan grades, and a portfolio age of 12-18 months. EWM may recommend or has recommended Lending Club Corp. within its investment strategies.

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Preserving Real Estate Assets for Future Generations

By Kirsten Weisser

Commercial real estate has been a major source of wealth in parts of the United States for generations, and families are understandably eager to preserve these assets for their heirs. Investments in office developments, retail and industrial space, and multifamily residential properties can potentially generate strong real returns, both in cash yields and long-term appreciation, while providing diversification from other asset classes and potential tax benefits.

Transferring commercial real estate can be complicated, however. Planning, as Chris Zander notes on page 2 of this issue of Independent Thinking, is an ongoing process. In the case of illiquid real estate holdings, this means addressing some tough questions well in advance of placing the assets within multigenerational trusts or establishing other forms of estate or gift transfer.

The starting point is the intent of the grantor. Does he or she envision this property remaining intact over several generations? If so, is it part of a larger, diversified portfolio of assets or does a single property represent the bulk of the estate? For estate settlement, will there be sufficient liquidity to pay any estate taxes and administrative expenses (or does the real estate business qualify for estate tax deferral under Internal Revenue Code Section 6166.) Balancing the original intent of the grantors and the needs of the beneficiaries, which may change over time, can be complicated but manageable, with careful planning.

Is the grantor able to foresee the needs of the next generation? Do the heirs have other sources of income, or will they depend on these particular assets singly and entirely, for the source of their income or wealth? Will the anticipated cash flow of these properties be able to meet any unexpected or emergency needs?

Grantors will not want to underestimate liquidity needs

For ongoing trusts, there needs to be adequate liquidity within the trust’s portfolio, in addition to the property, to meet the ongoing maintenance and capital improvements, and to preserve its desirability as an asset. Commercial real estate markets are cyclical in nature, and grantors will not want to underestimate the trust’s liquidity needs, as well as those of the beneficiaries, over several market cycles.

Real estate investors may want to revisit their ownership structures when planning for the eventual transfer of their assets. There are advantages and drawbacks to various entity structures in terms of risk management, asset protection, and the accounting of cash flows as well as asset management.
Tax planning is also critical. Many commercial properties have been depreciated over time to a zero, or even negative, cost basis. Depending on the long-term appreciation in the property holdings, estate planners may recommend a transfer at death, instead of a lifetime gift, to obtain a step-up of income tax basis. Property taxes should also be evaluated, within the context of local laws and regulations, to understand when reassessments may occur.

The management of the assets is the next order of business in planning. How involved have other family members been in managing the portfolio? Are the assets professionally managed by independent parties? Or is it the intent of the grantor that family members be employed to manage the property? How will other family members benefit from the assets?

Balancing the original intent of the grantors and the needs of the beneficiaries can be complicated

Another consideration is the grantor’s use of debt. For many investors, significant real estate portfolios have been built with the astute use of leverage. Once these properties move to a different entity, such as a trust, it may be difficult to access leverage without the personal guarantee of the original investor. How will these facts impact the proposed transfer of the assets?

When our clients are considering appointing us trustee or co-trustee, through Evercore Trust Company, N.A., we bring our experience in managing unique assets, such as real estate, to the planning process. We work closely with our clients, and their legal and tax advisors, to develop a plan that can provide the trustees with both a clear view of our clients’ intent, as well as flexibility to meet the needs of the beneficiaries over time.

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Equal or Equitable: What is Fair?

By Jeff Maurer

I know life isn’t fair, but why is it never unfair in my favor?

Calvin, the irrepressible six-year-old created by cartoonist Bill Watterson, raises an important point. Distinguishing between fair and equal is one of the biggest challenges in estate planning. How do we treat our children and their families? Equally, regardless of their circumstances? Differently? Either way, how can we preserve family harmony?

For most parents, equal and equitable seem synonymous in dividing an estate. On reflection, however, the decision can be more complex. Differences in their children’s means and needs, and in their relationships, can challenge many families to consider what, exactly, fair means to them.

To start with an obvious case in point, what if the elder child is established and the younger has years left in his or her education? Certainly, a provision needs to be made for the younger child, to equalize their support. That’s straightforward enough, albeit occasionally complicated by questions around the duration of undergraduate or graduate study.

Later on, there may be substantial differences in wealth among children. How do we fairly treat both a CEO and a schoolteacher? In some cases, parents choose to favor the less wealthy child with financial gifts during their lifetimes and/or after their death. That approach can work if they are entirely transparent about their intentions. Secret gifts, which, if significant, will be reported in gift and estate tax returns, and unexpected discrepancies in wills can cost lasting family disharmony, and even litigation. Discussions allow parents to differentiate between money and love – they give their love equally but favor the less well-off child with their money.

Other situations are more delicate still. Parents may view their children’s ability to manage their finances differently, perhaps seeing one as a spendthrift, and choose to leave their inheritance in trust. A trust may also be used if parents are concerned about a child’s spouse or creditors. If, however, parents leave one child’s inheritance in trust and another child’s inheritance outright, hard feelings almost always ensue, particularly if expectations have not been set.
This situation can be exacerbated if one child is made the trustee of the trust and becomes the financial watchdog for the other child; an arrangement like this rarely works well. Again, in these and many other circumstances (seen Karen Francois’ article on blended families on page 20), a discussion about possible future transfer tax savings, professional management, protection against creditors, and the ability to distribute to grandchildren may win over the reluctant heir. Of course, treating them equally with trusts for all children can also make good sense.

A variation on the above is the situation in which one child has a physical or mental disability and will be challenged to provide for themselves. Some parents leave a limited amount in a so-called special purpose trust for that child, which permits them to qualify for government benefits and yet assures that they will have adequate resources available for their special needs. Others will leave a full share in trust, still with provisions to qualify for government benefits. In both instances, the trust residue will go to the remaining children and, if stipulated, subsequent generations.

Grandchildren, life’s dividend in so many ways, can further complicate estate planning. Many grandparents create trusts for their grandchildren. These are normally designed to pay out when the grandchild reaches a certain age, generally around 30, but they can also be used for tuition, a residence, or to start a business. The trusts are funded annually with the gift tax-free annual exclusion, currently $14,000 per person or $28,000 for a couple. But if, as is usually the case, the oldest grandchild is many years older than the younger, there could be a discrepancy of several hundred thousand dollars in inheritance. The grandparents may choose to equalize their giving with distributions through their lifetime or at death, utilizing estate and generation-skipping tax exemptions. If they have exhausted their exemptions, they may still choose to equalize their giving to their grandchildren and pay the associated gift, estate, and generating-skipping taxes.

What if one child has, say, five children, and the other only one? What about grandchildren who may be born later? Consider the grandmother who hopes to leave her assets in trust for each of her two children, with the grandchildren receiving the trusts when their parents die. That seems simple enough until we consider that one of the children has five children, and the other only one. Should the only child receive 50% of the ultimate estate and the other five children just 10% each? Perhaps – that seems to be the approach that most families favor. On some occasions, however, the terms of the trust will require that the trust remainders be divided by six and distributed equally to the six grandchildren.

In a similar vein, families in which some branches have children and others do not can either dole out inheritances equally among the first generation of children or place the childless child’s share in trust, with the remainder divided equally between the other grandchildren or divided based on an equalization between each family branch. Careful consideration needs to be given to placing only one child’s share in trust.

Equal and equitable distributions to children are, for most families, one and the same. For many, however, there may be good reasons to make other arrangements. In my 40 years of managing wealth for multigenerational families, I have come to believe that, irrespective of the situation, honest discussions and transparent planning work best.

**Grandparents may choose to equalize their giving with distributions**

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Planning and Investing as a Couple

By Fred Taylor

Fifty years ago, wealth management typically started with a man-to-man conversation about the investor’s income, savings, and goals. Today, professional women are confident equal partners in planning their family’s financial futures. But what of the couples whose marriages have spanned these social changes? Are they treated fairly by institutions that are mired in the past or focused exclusively on Millennials?
It’s an important question. Quite simply, engaging both partners in a relationship makes for more effective planning and investing. While the focus here is on so-called traditional couples, this certainly applies to all couples, regardless of age, sex, or financial expertise. Even if one has built a career in finance while the other has stayed at home, they’ll do better managing their wealth as a team.

Two perspectives – on risk, on lifestyle, on family, and philanthropy – best inform the financial discussions that, in turn, drive asset allocation, investment management, and trust and fiduciary solutions. Indeed, amid all the media frenzy about leaning in and leaning out, one thing seems clear: Couples, as well as companies and countries, do better when both men and women are fully represented in the decision-making.

Consider a couple, both in their early 60s, with very different views on risk. The husband, who had held a variety of senior executive roles in finance before retiring, was eager to grow their portfolio. The wife, who had left the workforce when they had children, was extremely anxious about cash flow. By allocating enough to defensive assets to cover their expenses for five years, they were able to invest the remainder – 65% – in growth assets, combined with a longer life expectancy for women generally, can mean that she will outlive him for years. Both may have thought of managing their assets as his role, but she will be the one left with the lasting responsibility. The better educated and involved she is, able to share her values and her views, the better for her, for their children, and for their shared legacy.

Too often, however, one partner, usually the woman, is silent. (This is especially true for the Silent Generation, born between the mid 1920s and the early 1940s.) In many cases, the advisor is at fault, projecting his or her biases in addressing only one partner. In that case, the solution is simple enough – find a new advisor. Wealth managers should never assume or indeed accept a lack of interest: Just about everyone wants to engage in at least some aspects of the management of their wealth.

Other situations are more complex. Interestingly, wealth managers often see a disconnect between spouses. The breadwinner may feel frustrated that the non-working spouse seems to show little interest in their finances, the fruit of their labor. But they may simply be intimidated, a concern that can be addressed through private wealth education, whether in an individual or family setting, or in groups of like-minded women. (See the article by consultant Sharna Goldseker on page 18 and the list of upcoming Evercore Wealth Management Wise Women and other educational events on page 20.)

In some cases, one spouse may be genuinely disinterested in investing. In these circumstances, it may be that that she – and again, it could very well be he – should be actively encouraged to regard involvement as a shared responsibility. If a reminder that the likelihood is that she will one day have to manage their assets doesn’t do the trick, asking her to engage on behalf of her family and her charitable interests, and to set an example for her children and grandchildren almost certainly will.

Either way, it’s important that the education extend beyond the theoretical to hands-on, practical training. Start with regular discussions – both spouses should try to attend all meetings with their advisors – and then consider allocating responsibility for a meaningful proportion of the assets to the less experienced partner. There’s no better way to acquire knowledge.

We all have things to learn, from our advisors and from each other. Educating ourselves to share that responsibility is the most effective way to plan and invest. It can also be a pleasure.

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Engaging the Next Generation

By Sharna Goldseker

Charitable planning often takes into account the role that next-generation family members will play in serving as trustees and successor trustees of foundations, donor advised funds and other vehicles. With four generations above the age of 21 in American society today, “the kids” are often adults by the time they become involved in philanthropic activities. Here are ten tips for engaging adult children in charitable endeavors.

1. Foster a transition from a parent-child dynamic to one of peers. While we might imagine our children as they were at age 5, 12 or 16, often they are more like 25, 35 or sometimes 45 when they become trustees of charitable vehicles. Adult children bring academic degrees and work experiences as well as their own values to bear on the responsibility of making philanthropic decisions. Consider how you might transition the relationship between parents and children to one of peers making philanthropic decisions where every voice is heard.

2. The “next generation” is two different generations – Generations X and Y – with distinct personalities: Use different approaches for each generation. Members of Generation X were born between 1964-1980 and often bring a strong sense of independence, resourcefulness as well as skepticism to institutions. Learn how you can embrace the creativity as well as the curiosity of Gen X family members, even if it means creating new funding vehicles for them to explore their own philanthropic identities. Gen Y’s have birthdates between 1981-2000 and were reared on the Internet and its many applications. They are used to using technology to access information and to engage in civic activities. Consider offering them ways to tap into information about their family’s giving and grantees. Also consider internships and other means of hands-on involvement.

3. Generational personalities are enduring. Traditionalists (born 1925-1945) and Baby Boomers (born 1946-1964) also tend to carry certain generational hallmarks. Traditionalists who lived through the Depression tend to “save for a rainy day” and believe in building lifelong institutions, while Boomers invest in...
causes like the social movements in which they grew up. The “generational personalities” of Gen X and Y will continue to influence their values and decision-making, just as the events and conditions of Traditionalists and Baby Boomers continue to influence theirs.

4. Uncover the values that lie beneath the next generation’s choices. Take time to discover what motivates someone else’s choices – members of different generations may find they have a lot in common with each other. A Gen Y’s wish to support microloans in rural Kenya and her grandpa’s funding of scholarships in Chicago might both be choices rooted in creating opportunities for low-income people.

5. You don’t have to step away to let the next generations step up. Think about ways to share and trade power rather than transfer it. Facilitate conversations among family members about the roles they want to play in philanthropy. Help create multiple paths of engagement for next-generation family members, such as separate grant and investment committees, site visit teams and internships. Senior family members may find new yet equally meaningful roles.

6. Learning is a two-way street. As families prepare the next generation for their philanthropic responsibilities, there is a tendency to assume learning has to be unilateral, with one generation educating another. While the next generation might not have the longevity of experience possessed by the older generations, they have fresh skills and perspectives to bring to the table. Once asked to share what they know, next-generation family members tend to be more receptive learners.

7. Despite the next generation’s facility with technology, it is a means to an end rather than an end in itself. Teach the younger generations to concentrate on first building relationships. Email and social media can then provide a means of communication.

8. Transparency matters. Access to information is a given these days. While parents often worry about “the kids” learning about family money or philanthropic resources at too young an age, current technology allows next-generation family members to google more than we realize. Rather than worrying about what next-generation family members may know, learn how to discuss what is already in the open and provide the next generation with tools and skills for handling their philanthropic legacy.

9. Show rather than tell. Experiential learning is preferable to didactic learning with the next generation. Encourage tactile experiences like site visits, grantee presentations, philanthropy conferences and educational journeys to learn about funding areas.

10. Drawing people in is easy. Sustaining their engagement requires change. Next-generation family members can only stay at “the kids’ table” – or the junior board or the associate position level – for so long. Material involvement is eventually what all adults seek. Discuss the trajectory of what their participation will look like so that along with what is expected of them, they know what they can expect in return.

For further information on educational events at Evercore Wealth Management, please contact Jewelle Bickford at jewelle.bickford@evercore.com.
Providing for the Children of Blended Families

By Karen Francois

Parents and grandparents with blended families – the result of more than one marriage – can face real challenges in dividing assets fairly.

The “yours, mine and ours” approach, in which separate but equal provisions are made for each group of offspring, can be relatively simple. The younger children may need support through their educations, to equalize their benefits in a manner that avoids antagonizing their step siblings.

More complicated are families in which the spouses have come into the marriage with different levels of wealth. Parents or grandparents planning for children usually decide to provide separately for their own biological descendants, often through trusts. In our experience, this approach generally meets with the full support of the combined families. The trust enables the wealthier spouse to provide for the other for his or her lifetime and ensures that the balance of the property passes to his or her own children.

In all instances, open discussions about estate planning goals will put the children’s fears to rest and provide for a more supportive and cohesive family. Please contact your wealth advisor for information about our educational programs for blended families and to discuss your own circumstances.

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