

# Interest Rates are at Historic Lows – Is it Time to Refinance?



In May of 2018, Gustuf and Clara entered into a private financing arrangement with their grantor trust, lending \$5,000,000 at the then-current long-term Applicable Federal Rate (AFR) of 2.94%, in order to fund a survivorship policy on their lives for estate liquidity. The plan was for the funds to be invested at 5%, generating enough income to fund the \$147,000 annual interest cost, leaving \$98,095 for premiums. This design structure allows the trust to maintain the loan principal for repayment of the note at the death of the last-to-die.

In the two years since they entered into the private finance loan, the long-term AFR had fallen to 1.01% (as of June 2020). If Gustuf and Clara refinance the original note, they would drop the interest rate 1.93% and would reduce the trust’s annual interest cost by \$96,500. After refinancing the note, the trust’s annual interest due would be just \$50,500. Based on their current ages and assuming that their health has had no change over the past two years, this would give them to an extra \$91,905 to purchase more survivorship life insurance — without any additional out-of-pocket cost.

Year	Age	Trust Value	Loans to Trust	Gifts to Trust	Premium Payment	Trust Growth	Annual Interest	Note Payments	Cumulative Loan	Trust Value	Death Benefit	Net from Trust (Less Note)
1	72/71	0	5,000,000	0	98,095	245,095	147,000	147,000	5,000,000	5,000,000	5,000,000	5,000,000
2	73/72	5,000,000	0	0	98,095	245,095	147,000	147,000	5,000,000	5,000,000	5,000,000	5,000,000
3	74/73	5,000,000	0	0	190,000	240,500	50,500	50,500	5,000,000	5,000,000	9,500,000	9,500,000
4	75/74	5,000,000	0	0	190,000	240,500	50,500	50,500	5,000,000	5,000,000	9,500,000	9,500,000
5	76/75	5,000,000	0	0	190,000	240,500	50,500	50,500	5,000,000	5,000,000	9,500,000	9,500,000

## THE BOTTOM LINE

Just two years ago, clients were entering into loan arrangements or installment sale transactions with their trusts in order to lock in those seemingly low interest rates of less than 3%. As we’ve watched the AFRs continue to drop, savvy clients have been inquiring into the possibility of refinancing their existing transactions. With the ability to lock-in a nearly 1% interest rate for the duration of the transaction, there’s never been a better time to refinance.

Given that the rate reductions are so dramatic, there is a significant amount of freed up cash flow inside the trust. This extra liquidity can be used to: 1) purchase additional insurance, 2) pay down the note at a faster rate or 3) purchase additional illiquid assets from the estate.