FAMILY FINANCIAL EDUCATION FOUNDATION

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Retirement Finances

Finances can change virtually every goal you make when planning your retirement. Financial problems are always a challenge to overcome, but they can be even more challenging during retirement.

Your Income

For the most part, the rules you follow to maintain financial stability now, are the same ones you need to follow during retirement. However, there will be some differences as well, in this month's newsletter, we will explore them. Remember, the lessons you've learned lessons you've learned during the previous Workbooks will help your ongoing journey toward financial fitness and freedom.

Throughout his career, Bruce had all his checks automatically deposited into the bank. His wife Diane gladly budgeted the money accordingly, because she knew just how much would be in the bank. Both Bruce and Diane were happy with this arrangement. However, now that Bruce has retired, they'll need a new approach in planning the use of their various sources of income.

Please Note: Tax laws are always changing. You need to consult a qualified investment or tax consultant regarding terms of investment, how much you can invest, and conditions affecting your withdrawal. Your employer may also have rules affecting your pension. The following descriptions are offered only for informational purposes and are not to be considered investing or tax advice. You can find more information at the U.S. Department of Labor website.

Income Sources. Keep in mind that tax-deferred contributions and earnings make up the best one-two punch in investing. Both the contributions and investment earnings grow tax-deferred until withdrawal. One or more of these plans may very well be the most likely sources of your retirement income:

Pension and Profit-Sharing Plans

It's important to become familiar with your pension plan. You may even have more than one. Because it may be a major part of your retirement income, you need to know how it works. You don't want to take it for granted, or gamble with your financial security.

Self-Employed Pensions

Anyone with income from work can set up an Individual Retirement Account (IRA). If you're self-employed, you can set up a do-it-yourself pension. There are several types of self-employment or personal retirement plans, and seemingly more each year. Your employer can even sponsor some. Review the following summaries to check your general knowledge. The more familiar you are with various retirement plan options, the better.

1. KEOGH PLAN: is a tax-deferred retirement plan designed to help the self-employed establish a retirement savings plan. There is more than one type of Keogh Plan. You save money by reducing your taxable income by the amount you invest (depending on your gross income.) One of their advantages are they offer high levels of maximum tax-deferred contributions. Five basic types of IRAs (pending tax laws may even increase the number of plans):

2. TRADITIONAL IRA: You can contribute up to a minimum amount per year (as little as $2,000 but increases by law) into an IRA. The amount of the contribution deductible on your income tax return depends on your Adjusted Gross Income (AGI) and whether you're

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covered under an employer-sponsored qualified retirement plan. Thus, depending on your filing status (Single, Joint, etc.), and your AGI, your contributions may range from fully deductible to completely non-deductible. So you need to get advice on whether or not this will be an advantage to you.

3. EDUCATION IRA: You can put away a varying amount up to a maximum per year into an education IRA, the money grows tax-free and has preferential tax treatment upon distribution to the beneficiary who uses it for authorized education expenses. These plans aren't as common because they're very restrictive on who can contribute to them, the amount of total contributions each year, and the limitations on what exact education expenses qualify. Your financial planner should be able to assist you in evaluating what savings plan you should use to prepare for higher education costs, and help you review the tax-sheltered savings plans now sponsored by various states, even for benefits of non-state residents.

Being self-employed gives you many deduction options. Consult irs.gov and your tax professional to find the deductions that are right for your small business.

4. SEP IRA: Simplified Employee Pension: An employer established and funded IRA, where the employer can put up to a percentage of your compensation into a special IRA account. Sole proprietors may establish these plans for their own benefit. They're sometimes used instead of Keogh retirement plans because they have fewer administrative and tax filing requirements.

5. SIMPLE IRA: This is another employer sponsored and administered retirement plan. The attractive features of the plan include not only the ability for employers to establish and fund a retirement plan for themselves and their employees, but it also permits employees to contribute up to 100%, but no more than a maximum per year, into an IRA. Separate rules relative to required employer contributions and premature distributions apply.

6. ROTH IRA: Contributions are NOT deductible when the funds are contributed, but the Roth IRA earnings accumulate tax-free and remain tax-free upon distribution. When you're retired and on a fixed income, you don't have to worry about paying taxes on your withdrawals. To be eligible to contribute, your Adjusted Gross Income must be under $110,000 for singles and $173,000 for married couples, as of 2012. You can't withdraw your funds within the first five years after the establishment of the Roth without a penalty. Given that, this 5-year testing period can successfully be addressed by proper tax planning. The funding of a Roth IRA account should be considered by every taxpayer who qualifies for it.

7. 401(k): is a tax-deferred investment and savings plan that acts as a personal pension fund for employees. Usually made through payroll deductions and sometimes includes matching funds by your employer. Contributions are pre-tax, reducing your taxable salary. 401(k) plans are also portable. When you change jobs, you can roll over your account into another employer's 401(k) plan or an IRA. Most employers (over 80%) offer a company match—both as an incentive for employees to join the plan and as part of the overall benefits package. The employer contributions are a real attraction of the 401(k) account. If your employer matches your contribution at 50 cents on the dollar, you've made an instantaneous 50% return.

Advantages to Consider

These retirement plans can help you in four ways: (1) Part of the income you put into these plans may not be subject to tax; (2) Money you withdraw may not be subject to tax—Roth IRA; (3) Interest or dividends earned by money put into these plans may accumulate tax-free during your working years; and (4) You may be in a lower tax bracket when you start drawing income from these plans.

Social Security

In 1950, social security represented 50% of retirement income for people in the U.S. In the twenty-first century, it represents less than 30% of retirement income and will be a declining share. The hard fact is retirees in the future will be able to depend less and less on social security as a source of money.

Social security benefits are available to you at age 62. If you retire before your full retirement age, you'll receive a smaller monthly benefit. If you continue to work after you begin to receive social security benefits, you'll lose some or all your benefits under certain conditions. If your income from various sources exceeds a certain amount during retirement, you may have to pay taxes on your benefits.

Your local social security office can explain how social security can work for you. Also, you may ask for a Statement of Earnings to see the social security earnings credited to your account to date. You should verify this record at least every three years.

Investments and Savings

Investment and saving are good methods of putting your money to work, to "earn" money for the future. The Federal Reserve Bank of New York offers the following advice on saving and investing. There are two basic methods: the first involves lending (making investments), and the second buying (creating asset equity):

1. Debt or Money Market—When you lend money you can typically expect to receive interest on it sometime in the future. The following are examples of putting your money to work in the "debt" or money market:

- **U.S. Treasury and Agency Securities:** These are investment securities or opportunities backed by various agencies of the U.S. government, including the U.S. Treasury. They include issues from such agencies like the Federal National Mortgage Association (FNM), Federal Home Loan Bank Board, Federal Land Banks, and U.S.
- **Savings Bonds.** They're considered to be highly safe investments.
- **Corporate Bonds:** These investment securities are offered by many companies and vary considerably in their quality and rates of earning returns. Such securities are graded according to their financial backing by bond-rating services—the highest rating being AAA and generally offering lower interest yields. The market price of corporate bonds fluctuates.
- **Municipal Securities:** These are tax-exempt bonds offered by municipalities and states. Usually, they carry lower yields than taxable bonds. They're rated by quality, much like corporate bonds, and their value may fluctuate too. Such bonds provide little or no tax benefits to lower-tax-bracket investors, but may assist you if you're in a high tax bracket.
- **Savings Plans:** Such plans include savings accounts, certificates of deposit (CDs), money market accounts, and interest-paying checking accounts.
- **Money Market Mutual Funds:** These funds are investor "pools" that invest in a variety of investments, such as those listed above. Most of these funds are not insured, and their yields can fluctuate daily. Many have "check-writing" privileges.
- **Annuities:** An Annuity is a contract sold by a financial institution or insurance company guaranteeing the buyer a fixed income from the contract for a certain period, often for life. Such investments provide a steady income and freedom from managing your investment capital.

2. Equity—The second way to put money to work is creating asset equity by buying something with value or equity. You hope to sell what you buy for more money than you paid for it. Also, what you buy may generate income—such as dividends from stocks or rental income from property. Here are examples of equity buying:

- **Stocks:** When you buy stock in a company, you're buying a piece or "share" of ownership in the company. Your equity value increases or decreases as the price of shares rise or fall—depending on the profitability of the company. Other factors may affect the price also.
- **Mutual Funds:** These funds allow you to diversify your stock investment. You're able to buy shares in a professionally managed fund, which invests in various kinds of securities. The funds are high, medium or low-risk.
- **Own Your Own Real Estate:** You can invest on your own in real estate, or as a member of a syndicate or investment group. Any real estate venture involves risk; so it's wise to consult with experts at each stage of the investment process.
- **Commodities, Metals, Gems, and Collectibles.** These investments are very speculative and have the potential for great loss as well as gain. It's like placing a "bet" on the future value of your investment: things like pork bellies, corn, precious metals, and foreign currency. Your money earns no interest, dividends, or rent from such investments. And the return depends entirely on the value of the investment at the time of sale.

Evaluate each investment in terms of: (1) yield, (2) safety, (3) liquidity, (4) guarantees and insurance, (5) term of investment, and (6) inflation hedge—in other words, how the value of your investment will keep up with inflation. With all there is to know about investments and savings, it's a good idea to get professional help.

Your Spending Habits

Retirement planning depends on a careful analysis of how much money you'll have to spend. Here's a good example:

Your current spending is a good projection of how you may spend after retirement. Don't forget to take inflation into account and make adjustments for it.

Needs: The essential items you need to live your life: food, clothing and shelter—the basics. These expenses also include necessary large expenses like medical care, transportation, funeral expenses, etc.

Wants: Optional items like a tour of Australia or that new Land Rover—do you really need it, or to you want it. You know the difference and either way it's all right as long as your retirement spending plan can handle it. Overextending yourself is one stress you don't want to deal with during retirement.

Major Retirement Expenses

Keep in mind several retirement expenses large and small you need to plan for.

Housing—What's Your Lifestyle?

As you learned earlier, many things can affect your retirement housing costs. It's important to have a clear picture of what you want your retirement housing lifestyle to be. You'll want to be comfortable where ever you call home.

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Medical and Dental Expenses—How about Insurance?

There's no denying it: Age sometimes brings with it higher and more catastrophic heath care costs. Some options are continuing with your employer or utilizing various health care plans available through the government, the American Association of Retired Persons (AARP), insurance companies, and facilities like Health Maintenance Organizations (HMO).

The U.S. government has been examining various health care reform options. If any programs are developed by legislation, options for your retirement could be drastically altered. You need to keep track of legislation and laws affecting your retirement.

Medicare covers about 40% of health care expenses for retired persons. Supplemental health coverage may be available to you during retirement through your employer's group health insurance or senior groups like AARP.

Other Types of Insurance

Even in retirement, you're going to need insurance protection for your automobile, home, and personal property, as well as good health insurance.

Transportation—How Are You Going to Get Around?

Should you use private or public transportation when you retire? There are benefits to both. Compare the cost and commitment involved with owning a private automobile to the cost and convenience of public transportation. You may not always be able to drive yourself.

Food, Clothing, and Personal Items

It's likely you'll be living on a fixed income during retirement. You'll need to be careful in your expenses for food, clothing, and personal items. You can use frugal practices like discount coupons, generic brand products, shopping sales, and buying in bulk.

Travel, Entertainment, Hobbies

Special discounts are often available for "senior citizens." As you plan for your retirement, become aware of things like "two-for-one," "off-season," and "early-bird" pricing to make the most of your money.

Gifts and Contributions

Think now about your plans for gift giving. Birthdays and holidays may cause hardships for retirees with large extended families and friends. You can still give everyone thoughtful gifts, but maybe you'll just need to get a bit more creative. Giving of your time and yourself makes the most meaningful gifts i.e. stories you record on tape for a grandchild who lives far away, or scrapbooks.

Other kinds of contributions, such as to charity or your church, may be part of your retirement plans. You may be able to devise ways to contribute time and personal service instead of giving money. Volunteer work is a very fulfilling way to contribute to a charity or cause, instead of money.

Family Assistance

You'll always be Mom, Dad, Brother, Sister, Grandma, or Grandpa. You can include plans to aid a child, grandchild, or other family member in time of need or in an emergency.

But, be realistic with yourself. Maybe you can't buy all the presents you once did, or throw that big feast at Thanksgiving every year. That's okay, retirement is your time to slow down and enjoy living. The gift of time can be very valued and won't be such a hardship on your retirement funds.

Parental Care

Even after your own retirement, you may find you need to care for one or both of your parents, or your spouse's parents. Be prepared for these situations, because they can create huge financial problems.

Consult with your parents' doctors and other healthcare providers and make your decisions very carefully. Consider the other people who might help share the work and finances, like brothers and sisters and community support. ■

This article is a portion of the Access Education Systems Financial Fitness Training Series Workbook 3. To read the full article and print out the workbook with questions visit www.accesseducation.org/workbooks.htm

If you know of someone who would benefit from this information, please pass this newsletter along.

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