



SOCIETY FOR FINANCIAL EDUCATION AND PROFESSIONAL DEVELOPMENT

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U C C E S S

WINTER 2015

Make Your Money Last a Lifetime

Imagine yourself on the first day of the retirement you've been looking forward to for years. You're in good health and between your pension, Social Security, and IRA, you have more than enough to fund your lifestyle.

Now, imagine it's 10 years later: you're still in good health; but to maintain your lifestyle, you've had to dip deeper and deeper into your IRA each year. You've realized that at the rate you're going, your IRA will be depleted in a couple of years. You're 75 years old and your alternatives are grim: you either make drastic cuts in your expenses or go back to work, where you'll struggle to replace what you're going to lose.

Sound like a nightmare? It's been a reality for many retirees who after years of living comfortably, suddenly face the prospect of severely tightening their belts to continue to make ends meet. If you don't want that to happen to you, you need to know what to do to make

your retirement money last your entire lifetime. The sooner you learn how, the easier it's going to be.

The secret is to withdraw less from your nest egg than it earns, so that each year it will grow. While that sounds simple, it's not quite so easy. It involves keeping your expenses, inflation, withdrawal rate, and investment returns in dynamic balance. Let's take a closer look at each component of the equation.

Your Expenses Always Grow

Even if you watch your pennies, the fact is that every year it becomes

more expensive to buy exactly what you bought the previous year. That's because of inflation, which over the last 80 years has averaged about 3% a year.

Of course, the inflation rate has fluctuated from year to year, sometimes going negative (called deflation, which has happened 18 times since 1900) and sometimes going into positive double digits (as in 1975 and 1981, at 11% both years). But at an average rate of 3% a year, a basket of goods and services

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Borrow Wisely

- ✓ Use debt only for items that have the potential to increase in value, such as a home, college education, or home remodeling. Avoid incurring debt on items like clothing, vacations, or other luxuries.
- ✓ Consider a shorter term when applying for loans. Even though your monthly payment will be higher, you will incur much less interest over the life of the loan.
- ✓ Make as large a down payment as you can afford. If you can make prepayments without incurring a penalty, this can also significantly reduce the interest paid.
- ✓ Consolidate high-interest-rate debts with lower-rate options. It is typically fairly easy to transfer balances from higher-rate to lower-rate credit cards. Another option is to obtain a home-equity loan.
- ✓ Compare loan terms with several lenders, since interest rates can vary significantly. Negotiate with the lender.
- ✓ Review your credit report before applying for a loan. You then have an opportunity to correct any errors on the report. ○○○

Make Your Money

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becomes 25% more expensive in just eight to nine years, and 50% more costly in 15 years.

While Social Security has a built-in cost-of-living adjustment, the amounts in pension and annuity checks generally never change from day one. That means that just to keep your lifestyle from degrading, you must take out more from your retirement savings to cover the income/expense gap.

Keep Returns Equal to Withdrawals Plus Inflation

The problem with increasing withdrawals is that as your account balances decline, the same rate of return puts fewer dollars back into that balance. To solve that problem, your investments have to earn enough to do *two* things: earn back the purchasing power you've lost to inflation and earn enough to replace what you've withdrawn.

For example, let's say that you have a \$100,000 portfolio and you withdraw \$4,000 at the beginning of the year to cover your expenses — a 4% rate of withdrawal. That brings your portfolio balance down to \$96,000. If your portfolio earns only 4%, you're going to get progressively poorer, because to maintain your lifestyle your withdrawals must increase.

The rate of return that keeps your original \$100,000 worth the same amount in future dollars in this scenario is 7%, which is your withdrawal rate plus the rate of inflation. That preserves the value of your nest egg for as long as you live.



Don't Forget about Inflation

Inflation has been tame for so long, it's easy to forget how much it can affect your purchasing power over a long retirement. Over the past 10 years, inflation, as measured by the consumer price index, has averaged 2.4% (Source: Bureau of Labor Statistics, 2013). At 2.4% inflation, \$1 is worth 79¢ after 10 years, 62¢ after 20 years, and 49¢ after 30 years. Thus, you need to look for strategies to lessen inflation's impact during retirement:

✓ **Use a conservative inflation rate when planning for retirement.** You don't want to run out of money during retirement. So when calculating how much to accumulate by retirement age and how much to withdraw during retirement, use a conservative inflation rate. While inflation has averaged 2.4% over the past 10 years, it has averaged 2.9% over the past 30 years (Source: Bureau of Labor Statistics, 2013).

✓ **Determine how much of your retirement income is indexed for inflation.** Social Security benefits are currently indexed for inflation, although that could change in the future. Most defined-benefit pension plans do not make adjustments for inflation. Thus, other income sources will have to fill an increasing income

gap over time.

✓ **Invest in tax-advantaged retirement vehicles.** Look into 401(k) plans, individual retirement accounts, and other retirement vehicles. While each has different rules for taxing contributions and earnings, all provide some tax-free or tax-deferred benefits. Since you aren't paying income taxes on earnings during the years, that typically means you'll have a larger balance at retirement. Thus, you'll start out with a larger retirement base to help combat inflation's effects.

✓ **Choose investments carefully.** To avoid losing purchasing power, your after-tax rate of return should be higher than the inflation rate. Review your investments annually to make sure you aren't losing purchasing power.

✓ **Be prepared for change.** After retirement, keep a close eye on your investments. If inflation increases and you are concerned that increasing withdrawals may deplete your investments, you may want to look for ways to reduce your living expenses or go back to work at least part-time.

Please call your financial advisor if you'd like to discuss what impact inflation may have on your retirement plans. ○○○

Fine-Tuning the Approach

In reality, people don't withdraw everything they're going to need to pay their bills at the start of the year. Neither does inflation hold steady at 3% a year, nor do investment portfolios generate the same rate of return year after year. So the key to keeping your finances in balance is to make adjustments. When prices go up faster than 3% or your returns are less than projected, you either spend less or shift to investments with a higher rate of return, or some combination of the two.

Making all these calculations and adjustments requires staying keenly alert and financially agile. It's well worth your while to have another look at your retirement plan. Please call if you'd like to discuss this in more detail. ○○○

Returns mentioned are intended as hypothetical examples for illustrative purposes only and are not intended to reflect the actual performance of any security. Past performance does not guarantee future results. Investing always involves risk, and you may incur a profit or a loss. No investment strategy can guarantee success.

How Much House Can You Afford?

Even after the Great Real Estate Crisis of 2008 — which wiped out home values across the country and left hundreds of thousands of homeowners with mortgages they could no longer afford — buying a house is still a key part of the American dream. Many people see purchasing real estate as a way to create a stable, secure life for themselves and their families, have a home to call their own, and build wealth.

Whether you're dipping your toes into the real estate market waters for the first time or are a current homeowner looking to buy a new place, there's one big question you need to ask yourself: How much house can I afford?

Sky-high home prices and unaffordable mortgages both contributed to the most recent real estate bubble and the subsequent crash. Now home prices are on the rise again in many parts of the country. That means homebuyers need to carefully think about what they can reasonably afford.

There are many online calculators you can use that will help you assess how different down payment amounts and mortgage terms will affect your monthly housing expenses. Here are seven tips that everyone who is considering buying a house should keep in mind.

Rent does not equal a mortgage: Just because you pay \$2,000 every month in rent doesn't mean

you can afford a monthly mortgage payment of \$2,000. One of the beauties of renting is that your landlord covers certain expenses, like repairs. As a homeowner, you'll be responsible for those, and they'll take a bite out of your monthly budget. When considering how much house you can afford, be sure to budget for ongoing maintenance, unexpected repairs, property taxes, insurance, and homeowners association fees. Don't forget to include one-time costs, like closing costs, moving expenses, and new furniture.

The down payment makes a difference: The more you pay upfront, the lower your monthly payment. If you put 10% down on a \$250,000 home with a 30-year fixed mortgage at 4.125%, your monthly payment would be \$1,090. If you put 20% down, your payment would be \$969 — a difference of \$121 per month. Also keep in mind that if you put down less than 20%, your lender will likely require you get private mortgage insurance (PMI), which typically costs between 0.15% and 2.5% of your total loan amount.

Your interest rate will affect your payment: Consider the second example above (a mortgage loan of \$250,000 with a 30-year fixed rate mortgage at 4.125%). If you lower that interest rate by just 0.5% to 3.625%, your monthly payments drop to \$912. If you raise it by a half a percentage point, your payments jump to \$1,028 per month. Over the life of the loan, that extra half a percent costs you roughly \$21,000 in interest.

Your mortgage type affects how much you pay: 30-year fixed rate mortgages are common, but if you can afford the higher monthly payment, consider a 15-year loan. You'll pay more each month, but your overall interest costs will be lower and you'll be debt free soon-

er. If your lender offers something other than a 15- or 30-year loan, proceed with caution. Other mortgage products abound, like adjustable rate mortgages and interest-only loans, but you need to make sure you understand all the risks (like the possibility that your mortgage payment may rise significantly in the future) before signing up for one of these loans.

Aim for 25%: Ideally, you shouldn't be spending more than one-quarter of your monthly take-home pay on your housing expenses. While you may be approved for a mortgage resulting in payments that total 30% or 40% of your income, that doesn't mean you should spend that much.

Your debts and credit score matter: If you have a lot of debt or a low credit score, it will affect your ability to buy a home, no matter what you think you can afford. Lenders will look at your liabilities and credit, and they may offer you a loan at a higher interest rate or deny you altogether if they don't like what they see.

Don't forget the future: Let's say you and your spouse were just married and are ready to buy your first home. You both have good, stable careers and together make a healthy six-figure income. You're doing well for yourselves, and you want a home that reflects that. But what happens if one of you loses a job or decides to step off the corporate fast-track and shift to a lower-paying career? What if you have kids and one spouse wants to stay home, either temporarily or permanently? You can't know what the future will bring; but when buying a home, it's important to consider what could happen. While you may be able to afford that \$600,000 mortgage on today's income, will it still be a good fit in five or 10 years? ○○○



The Tax Treatment of IRA Losses

If you sell stocks with losses in your taxable account, you can offset losses against gains and deduct an additional \$3,000 of excess losses against ordinary income. But what about losses in your individual retirement accounts (IRAs)?

You must withdraw the funds from your IRA before there are any tax consequences. The tax treatment of any losses on those distributions depends on whether you received a tax deduction for your original contribution. If you made deductible contributions to a traditional IRA, your distribution, including contributions and any earnings, are taxable as ordinary income when withdrawn. Thus, if your IRA has losses, you will withdraw a lesser amount, paying less income taxes. You get no specific benefit for the investment loss.

When nondeductible contributions were made to a traditional IRA, you pay taxes only on the earnings when making withdrawals. Your contributions are withdrawn with no tax consequences. If your account balance is less than your total contributions, you can take a deduction for the difference, but only by completely liquidating all your traditional IRAs. The same is true with Roth IRAs. You can deduct a loss when

your account balance is smaller than your contributions, provided you completely liquidate.

However, those losses are a miscellaneous itemized deduction, subject to adjusted gross income limitations. There are advantages and disadvantages to this tax treatment. On the plus side, this is a deduction against ordinary income. Also, the deduction is not subject to the limit of \$3,000 of excess losses offset against ordinary income. On the negative side, you can only recognize this loss by itemizing deductions. Because it is subject to a limitation, you lose part of the deduction unless you have other miscellaneous deductions. If you are subject to the alternative minimum tax (AMT), you can't deduct miscellaneous deductions and could lose the entire deduction.

If the Roth IRA was converted from a traditional IRA, you could incur a 10% federal income tax penalty by liquidating before age 59½ and before the fifth year after conversion. However, if you only made annual contributions to your Roth IRA, the 10% penalty would not apply, since it is only assessed on Roth IRA earnings. Since the value of the IRA is less than your contributions, you would not have any earnings. ○○○



Credit Issues as You Age

While obtaining credit can be just as important for older individuals as it is for younger ones, older individuals often have unique credit issues. To help ensure that you don't have credit problems as you age, consider these tips:

- ✓ **Apply for major loans while you are still working.** If you are getting close to retirement and know you'll need a loan, apply for credit a few years before retirement.
- ✓ **Make sure that credit cards are obtained as joint accounts.** If you have an individual account with your spouse listed as an authorized user, the lender can close the account if you die. However, if the account is a joint one, the creditor cannot automatically close the account.
- ✓ **Ensure that both you and your spouse have a good credit history.** That way, either of you will be able to obtain credit if the other dies.
- ✓ **If you are denied credit, find out why.** It could have been an error, or you may convince the lender to consider other information. ○○○

Financial Thoughts

For 70-year-olds today, out-of-pocket medical costs are 8% of their income. When 45- to 54-year-olds reach 70, out-of-pocket medical costs are projected to increase to 15% of their income (Source: *Time*, June 30, 2014).

In a recent survey, 72% of grandparents want to help their grandchildren with college expenses, but only 37% said that they are currently saving for those expenses. Those who are saving

or plan to save said that they will give a median of \$25,000 to all their grandchildren, while 35% plan to give \$50,000 or more (Source: *InsuranceNewsNet Magazine*, July 2014).

Approximately 95% of respondents to a recent survey said that financial responsibility was an important attribute when considering a spouse. That compares to 86% for physical attractiveness and 77% for career ambi-

tion. The top spot for desirable attributes was personality compatibility at 98% (Source: Experian Consumer Services, 2014).

Almost 38% of those 40 and older regret decisions made with their retirement savings, namely not starting to save early enough. About 46% feel it is not possible for a typical middle-income family to save for a secure retirement (Source: *InsuranceNewsNet Magazine*, July 2014). ○○○