PLANNING AHEAD FOR RETIREMENT




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INTRODUCTION

Retirement is not a single event but rather a process involving a series of decisions over time. It is important to begin planning for retirement early in life but it is never too late to begin. While most people focus on finances when planning for retirement, it is equally important to consider emotional and social aspects of your life. This publication guides you in developing a retirement plan that takes into account all these important considerations.

Chapter 1, *More than Money Decisions,* has activities that help couples and individuals identify their approach to life and priority values. It provides tools for setting and reviewing goals and explains how you can productively discuss priorities among goals and areas of disagreement. These activities will help you focus your energies in the right direction and provide a starting point for other retirement planning decisions covered in the book.

Chapter 2, *Will You Be Able to Afford the Life You Want?,* helps you assess your current expenses so you can estimate the income you will need in retirement. The chapter helps you project your current expenses into retirement considering the effects of inflation. With this income target for retirement in mind, you will know how much you will need to save. The chapter also helps you determine your net worth. How early or late you want to retire will also be a factor in determining what you currently need to do.

Increasingly, people need to make decisions about financial products within their pension plans and in individual retirement saving plans. **Chapter 3, *Developing Income Sources,*** gives you the basic information needed to plan for retirement income. It is never too late to save for retirement, but the earlier you begin, the better. Money takes time to grow.

Chapter 4, *Saving and Investment Options,* provides basic information about accumulating money beyond the retirement income sources discussed in Chapter 3. It presents eight building blocks to establishing a solid financial foundation that includes saving and investing. The chapter outlines criteria to consider in making decisions about investment choices. It provides advantages and disadvantages of many saving and investment products.

Wondered if you need a financial planner to assist with pre-retirement planning? **Chapter 5, *Should You Hire a Financial Planner?*** helps you answer that question. It outlines the content of a good financial plan as well as listing what you need to do before consulting with a financial planner. It includes qualifications for financial planners and questions to ask before you hire one.

Unexpected events can threaten the plans you make and the assets you are trying to protect for retirement. There are a number of ways to protect yourself against the risks you and your family face. **Chapter 6, *Protecting Against Risks with Health and Life Insurance,*** includes information on health insurance concerns at retirement such as Medicare and Medicare supplements. It also briefly discusses health-related risk protection documents such as powers-of-attorney, living wills, health-care powers of attorney, and long-term care insurance. The life insurance section has information on types of life insurance, choosing the appropriate life insurance policy, and figuring out how much life insurance you need. A glossary of terms is also included.

Retirement plans often need to be reviewed and revised as time goes on and if major events such as death, marriage, divorce, or illness occur. Whether you have started planning for retirement or not, this book will be an invaluable resource.

Chapter 1

More Than Money Decisions

Planning Ahead For Retirement

When people plan for retirement, they often focus on financial security. There's no question that future income sources are important, especially as our projected life span has increased. Yet money is not the only important part of your retirement planning.

It is easy to overlook your future expectations and those of your partner. Often our individual picture of the future changes over time, perhaps without any conscious realization on our part. If you have a partner, it can be easy to assume you want the same things, when in actuality no two people have an identical picture of their later years. That is why regular examination and communication about retirement expectations are so important.

This chapter has activities that assist you in assessing your approach toward life and your priorities among your values. It provides tools for setting and reviewing goals and explains how couples can productively discuss goals and areas of disagreement. The exercises are just as critical to do as planning for retirement finances. In fact, they may be more important because they will help you target your energies in the direction you need to go.

Identifying A Vision for Retirement

Retirement is a major transition for almost all of us. Adjusting to retirement varies from person to person. Some people work their entire lives anticipating the time when they can quit. Others consider work their ultimate priority, and can't imagine the time when they no longer will start their day by going to the workplace.

Whether your attitude toward retirement is positive or negative, retirement is change and change can be a very stressful. The more you plan for retirement, the less stress you will likely experience. Even for those who must retire suddenly because of an unexpected circumstance, having planned ahead will make the transition easier.

To begin identifying your own vision of your retirement years, start with Worksheet 1. (If you have a partner, make a copy of all five worksheets before writing on them.) The questions are not listed in order of importance, since your own values determine their importance. Ideally, you will be filling this worksheet out by the time you are in your 40s, or younger, but the information is valuable at any point. It is a tool to help you define your own picture of retirement. The more clearly you know what you want, the easier it is to move toward it.

WORKSHEET 1. RETIREMENT QUESTIONS

If you have a partner, photocopy this and all the worksheets ***before*** writing so you and your partner can each fill a worksheet out. Then compare the worksheets and discuss differences. This way, you can start working toward a shared vision. Save worksheets to refer to periodically so you and/or your partner can make adjustments as needed over time. This worksheet poses questions to help you think about factors involved in your life after retirement. Use the worksheet to write notes, answer questions you think you know, mark questions for follow-up, or eliminate factors that do not apply. Take your time with it.

1 **TIME** What do I want to accomplish after I retire? ______________________________

____

2 Have I developed enough post-retirement income sources so that I can do what I want when I retire?

____

3 Will I want or need to work? If so, what would I like to do? Are there things I can be doing now to prepare for this new career? How much time could I spend working without affecting my benefits?

____

____

4 How much time do I need alone versus with other people? ______________________________

____

5 What activities do I want to be involved in? ______________________________

____

6 Will I want to volunteer in the community, and if so, what would I like to be doing? ______________

____

7 How much time do I want to spend with my partner? If one of us becomes bored, is the other obligated to provide entertainment? ______________________________

____

8 **HEALTH** Should I develop a long-term illness, how will I deal with it in retirement? Will I have the financial, medical, and emotional support I need? ______________________________

____

____

9 Have I completed a Health Care Power of Attorney (HCPOA) to legally appoint someone to make my health care decisions if I cannot? If so, does it reflect what I currently want or do I need to revise it?

____

____

10 Have I completed a living will? If so, do my next of kin and hospital have it on file? Does it reflect my current wishes? ______________________________

____

____

____

WORKSHEET 1. RETIREMENT QUESTIONS

11 What do I see as my financial, medical, and emotional responsibility if my close relatives fall ill?

12 **RELATIONSHIPS** How involved do I want to be in the lives of my family (children, parents, grandchildren, and other relatives)?

13 If I have more time, will others try to claim it? If so, can I handle possible conflicts without hurting people's feelings? In what ways can I better prepare myself or others for the ways I want to spend my time in retirement?

14 Do I have the number and quality of friendships to sustain me, now and in the future?

15 Where in my future vision do I see untapped sources of friends or relatives, should my current relationships change?

16 **SPACE** Do I want to live my retirement years in my current home? Would my current home fit my needs in terms of space, location, maintenance needs, and access should I become disabled?

17 Do I want to remain in my present community?

18 If I want to relocate, what preparations can I make now to prepare for relocation later?

19 **FINANCES** Have I set up my finances to support the kind of life I want after retirement?

20 Do I need to do more to set up income sources for my later years?

21 Will I have enough money to live independently? If not, how should I prepare for my later years?

22 To what extent will others expect or want financial support from me after retirement? To what extent will I want or be able to provide it? Are there things I can do to prepare myself or others for my financial decisions in retirement?

Adapted with permission from Life Path: Enhancing Individual Potential From the Middle Years Through Retirement, Control Data Business Advisors, 1985.

Assessing Your Approach to Life

There is no better predictor of your approach to life in retirement than your approach to life now. Investigating your current attitudes and ideas can help lead the way towards greater happiness now and in the future.

If your work is difficult, it can be easy to think that retirement will solve your problems. But in fact, negative perspectives are not necessarily altered by a change in lifestyle. Consider your approach to life now.

Worksheet 2 addresses attitudes about life. The worksheet provides an opportunity to think about your overall mood, zest for life, tendency toward conformity, and ability to affect your surroundings. Use this information to think about whether you want to improve your outlook in certain areas. A positive or negative perspective affects all your current experiences, and it will affect your retirement years, too.

After completing Worksheet 2, take some time to reread the questions and your answers. After thinking about them, ask yourself these questions:

- How surprised am I with the satisfaction/dissatisfaction I expressed with my life?
- How in tune am I with my thoughts and feelings?
- If I am disappointed with the direction my life is taking, am I willing to change it? If so, what might be my first steps?

What Do You Value in Life?

As you reflect upon your attitude toward life, an obvious but important question is, what makes you happy? Achieving happiness is partly a matter of creating opportunities to do the things you find rewarding. For example, if being outdoors is very fulfilling to you but your current life allows for little contact with nature, happiness may be more difficult to experience.

One way to discover what makes you happy is to determine whether your life reflects your values. For our purposes, values are defined as the elements of life that are important to you. Our values are influenced both by our culture and the family in which we were raised. Values directly influence the lifestyle, partner, and career we choose. Values are not right or wrong. They are individually determined. By comparing the elements in your life with your values, you can mold your present and future to include more things that are fulfilling.

Retirement, in particular, can be an excellent time to pursue set-aside values because it gives you the luxury of time. For example, if you value education but don't have the time to take classes, you may realize that this is an important priority for your retirement years, which may, in turn, affect where you plan to live or how much you plan to save. Worksheet 3 can help you sort these things out.

There may be no need to wait until retirement to incorporate into your life more of the values that make you happy. Perhaps it is wise to start on a smaller scale now with the intention of devoting more time to valuable pursuits at retirement.

Identifying Priorities

Every item in Worksheet 3 may be important to you, but realistically you will need to decide which items deserve the most of your time and attention.

This is where Worksheet 4 comes in. Working from the information in Worksheet 3, list the elements in life that are most important to you. Then list those elements that you are most dissatisfied with. By identifying your priorities and areas of dissatisfaction you can learn more about your values and get some idea of the adjustments you need to make to feel happier. An investigation of values will help clarify what is truly important to you. Where do you want to devote the most time and energy?

Here are some brief examples of what may happen as a result of completing Worksheets 3 and 4.

Example 1: Pete and Stan
Two men, Pete and Stan, were both retired. Their situations were very similar except that Pete was widowed and Stan was married. Their activities were fairly similar. One month they also took a fishing vacation with friends, completed a few good golf games, and visited with their children and grandchildren.

At the end of the month, both Pete and Stan were asked to evaluate how they felt about the way they used their time. Pete was ecstatic and claimed retirement was everything he had hoped for and more. He felt contented, relaxed, and satisfied. Stan, on the other hand, admitted that he had a good time and felt relaxed, but he also felt dissatisfaction – that something was missing. Why were their evaluations different?

Both men then filled out Worksheet 4. Here were their five top priorities.

Pete	*Stan*
1. Grandchildren	1. Partner
2. Health	2. Work
3. Hobbies	3. Grandchildren
4. Friends	4. Education
5. Physical activities	5. Community involvement

When examining these two men's priorities, it is fairly obvious that their month's activities much better matched Pete's priorities than Stan's.

Thinking about his priority list from Worksheet 4, Stan might realize that he enjoys vacationing with his partner more than he enjoys vacationing with friends. Since work maintains a high place on Stan's priority list, he may realize that he has underlying frustration or lack of fulfillment in that area, and decide to get a part-time job.

Example 2: Barbara
Barbara has worked full time her entire life, and is also raising five children; two are now grown, and the others are in high school. While her responsibilities are huge, she can't imagine what her life would be like without them. She is very active outside work, but her activities revolve around transporting her children and being a spectator at their sporting events, plays, etc. As she began to plan her retirement 6 years ago, she realized that her priorities were going to change a great deal without work and her children's daily demands. Barbara was used to having too little time. She never cultivated hobbies or outside interests because she didn't have the energy to pursue them. Now she feared her future would be boring, restless, and lonely.

She used Worksheet 4 to set her current priorities and look at the biggest gaps in satisfaction. Her list looked like this:

Current priorities	*Areas of largest gaps*
1. Children	1. Friends
2. Work	2. Health
3. Financial matters	3. Community involvement
4. House	4. Gardening
5. Health	5. Religion/spirituality

Using this information, Barbara began to ask about activities in her neighborhood. She discovered there was a walking club that met early in the morning three times a week. She did not have time to join the club, but she began to join their walks whenever she had a day off and her children were still sleeping. As a result she got more exercise, and made friends with neighbors she never knew. This brought more of what she valued into her current life. It also gave her a more positive image of the future and better prepared her for retirement.

Remember, goals are most helpful when they are:

Specific.
"I want to stay in Florida every winter" will help you plan your financial future much better than, "I want to travel after retirement."

Realistic.
Rather than worry over a large amount of money you think you'll need in 15 years, figure out how much you really have and what manageable amount you may need to save in addition to what you have.

Flexible.
"I want to retire at age 57" may change if you realize you want to work longer to have a better level of post-retirement living.

WORKSHEET 2. ASSESSING YOUR APPROACH TOWARDS LIFE

If you have a partner, photocopy this and all worksheets ***before*** writing so that your partner also has a copy. Go through the worksheet individually, perhaps marking questions you think are most important to discuss. Then get together to compare worksheets.

Circle whether you ***mainly*** agree or disagree with each statement. Answer every question.

1	As I grow older, things seem better than I thought they would be.	Agree	Disagree
2	I have gotten more of the breaks in life than most people I know.	Agree	Disagree
3	This is the dreariest time in my life.	Agree	Disagree
4	I am just as happy or happier than when I was younger.	Agree	Disagree
5	My life could be happier than it is now.	Agree	Disagree
6	These are the best years of my life.	Agree	Disagree
7	Most of the things I do are boring or monotonous.	Agree	Disagree
8	I expect some interesting and pleasant things to happen to me in the future.	Agree	Disagree
9	The things I do are as interesting to me as they ever were.	Agree	Disagree
10	I feel old and somewhat tired.	Agree	Disagree
11	As I look back on my life, I am fairly well satisfied.	Agree	Disagree
12	I would not change my past, even if I could.	Agree	Disagree
13	Compared to other people my age, I make a good appearance.	Agree	Disagree
14	I have made plans of things I'll be doing a month or year from now.	Agree	Disagree
15	When I think back over my life, I didn't get most of the important things I wanted.	Agree	Disagree
16	Compared to other people, I get depressed too often.	Agree	Disagree
17	I've gotten pretty much what I expected out of life.	Agree	Disagree
18	In spite of what some people say, the lot of the average person is getting worse, not better.	Agree	Disagree

After you have answered all the questions, count a point for every answer matching the ones below. Remember, if your answer does not match, it's not "wrong." This tool is simply a way to note perspectives that may work against your happiness. Your overall point value will help you gauge how satisfied you are with life. The average score from a sample of people 60 years of age or older was 12.33.

1. Agree
2. Agree
3. Disagree
4. Agree
5. Disagree
6. Agree
7. Disagree
8. Agree
9. Agree
10. Disagree
11. Agree
12. Agree
13. Agree
14. Agree
15. Disagree
16. Disagree
17. Agree
18. Disagree

SOURCE: Hoyt & Creech, 1983; Liang, 1984; McCulloch, 1992. Used with permission.

WORKSHEET 3. WHAT DO YOU VALUE IN LIFE?

If you have a partner, photocopy the worksheet ***before*** writing so you and your partner can each fill a worksheet out. Then compare the worksheets and discuss differences.

Listed below are elements of life. Look over the list and add elements that are not on the list but that are important to you.

On the satisfaction scale provided, ***circle*** the number that best reflects the way you feel about each of them ***now***.

Then, place a ***square*** around the number that reflects how you ***would like to feel*** about it. The bigger the gap between the circle and the square, the more attention you will want to give to changing the situation currently and/or to planning how you can move toward changing that situation as you retire.

What we value may change as we progress through life, so it is wise to review your worksheet periodically.

		Very Dissatisfied						**Very Satisfied**
1	Spouse or significant other	1	2	3	4	5	6	7
2	Friends	1	2	3	4	5	6	7
3	Physical activities	1	2	3	4	5	6	7
4	Pets	1	2	3	4	5	6	7
5	Hobbies	1	2	3	4	5	6	7
6	Travel	1	2	3	4	5	6	7
7	Work	1	2	3	4	5	6	7
8	Education	1	2	3	4	5	6	7
9	Health	1	2	3	4	5	6	7
10	Religion/Spirituality	1	2	3	4	5	6	7
11	Outdoor activities	1	2	3	4	5	6	7
12	Financial matters	1	2	3	4	5	6	7
13	Shelter (house, apartment, condo, etc.)	1	2	3	4	5	6	7
14	Family (grandchildren, children)	1	2	3	4	5	6	7
15	Other family (parents, siblings, etc.)	1	2	3	4	5	6	7
16	Sports	1	2	3	4	5	6	7
17	Politics	1	2	3	4	5	6	7
18	Community involvement	1	2	3	4	5	6	7
19	Intimacy	1	2	3	4	5	6	7
Other *(write your own)*								
20	______________________	1	2	3	4	5	6	7
21	______________________	1	2	3	4	5	6	7
22	______________________	1	2	3	4	5	6	7

WORKSHEET 4. IDENTIFYING PRIORITIES

A. Go back to Worksheet 3. Of the items listed, write the 5 items that are most important to you. Rank them in order, with your highest priority on line 1.

1 ______________________________

2 ______________________________

3 ______________________________

4 ______________________________

5 ______________________________

B. Now, look at the list again in Worksheet 3. Write below the items where there is the biggest gap between the circle and the square. List them, starting with the biggest gap.

1 ______________________________

2 ______________________________

3 ______________________________

4 ______________________________

5 ______________________________

C. Answer the following set of questions.

1 Are there any items in B that are also in A? _______ Yes _______ No

2 If the answer is yes, what can you do to reduce the gaps? Can you reduce them now, or do you have to wait until retirement?

____

____

____

Setting Goals

In order to spend time in retirement on the aspects of life you most value, it is crucial to set goals now.

For our purposes, goals are defined as achievable things you want for your future, that give direction and meaning to actions you take now. Defining your goals will help you think about whether you really want the goals you're stating, and spell out what resources you will have to achieve them.

State your goals in specific terms. For instance:
"I am going to save $50 a month toward retirement," rather than, *"I am going to save money."*

"I will take a course in financial management this spring," rather than, *"I want to manage my money better so I have more retirement income."*

Long- and Short-Term Goals

It is wise to consider both long- and short-term goals. Personality, family life stages, and economic well-being influence whether you label a goal long-term or short-term.

Short-term goals are those you want to accomplish immediately, or at least within the next year or two. Short-term goals require immediate action. Sometimes the results are immediate as well. Sometimes the results contribute to and provide checkpoints for long-term goals.

Goals are long-term when resources must be accumulated. They take a greater commitment of time, focus, energy, and money. Long-term goals are those things you want to accomplish in 5, 10, or more years down the road.

Both long- and short-term goals are needed to put retirement plans into effect.

Setting Goals and Priorities with a Partner

To effectively plan ahead for retirement, both people in the relationship must be active in assessing their individual values and formulating individual goals. But in order to effectively carry out those goals, partners need to communicate regularly. They need to build in mutual short-term goals that will support their long-term goals as a couple.

First, use Worksheets 1-5 to think about the aspects of your present and future life. Then share your worksheets with each other as a starting point for setting mutual short- and long-term goals. Notice the similarities between lists. Notice the points your partner brought up that you hadn't thought of but would like to include. Point out the goals that are clearly important to both of you and enjoy the agreement.

It is likely you will have areas of disagreement or conflict as well. Don't worry. Nearly every couple has some things to work out before coming to a shared vision. What is important is not that there is disagreement; it's how you handle the disagreement that counts.

Managing Conflicts

Conflict is something almost any two people who have been together for a while will experience. Among other things, couples can clash over roles (who does what), values (differing views over what is right, good, or best), or priorities (how important is this to our lives?). Some couples learn to manage their conflicts, at least in some areas; others struggle. When it comes to goals and priorities for retirement, it pays to have a process in place for

Seven Steps For Managing Conflicts:

1. *Write the problem down in a single sentence.*
2. *Check the sentence to make sure it's an "I" statement.*
3. *Identify the feelings you have about the problem and build them into your statement.*
4. *Get together with your partner and find a place where you agree.*
5. *Sift through the points of disagreement.*
6. *Come up with at least two possible solutions to the conflict.*
7. *Decide together which possible solution you would like to try and for what period of time.*

WORKSHEET 5. SETTING GOALS

Review the priorities you listed in Worksheet 4. Then write a short- and long-term goal for each priority.

Priority	Short-Term Goal	Long-Term Goal

working through whatever conflict may arise.

Two essential ingredients are needed to manage tensions caused by conflicts:

1. Partners need to agree on what the problem is.
2. Partners need to agree to work on the problem.

Here are the basic steps we recommend for managing conflicts as you plan your retirement.

1. Individually, identify the problem and write it in a single sentence. Don't worry at this point whether your partner agrees. Sometimes only one half of the couple sees a problem, perhaps by sensing or feeling discomfort, fear, or uncertainty. Other times what people first think is the problem is not, in fact, the root problem. Take some time to think about the real nature of the problem and how the problem is creating conflict for you.

2. Check your statement to see whether it is an "I" statement; in other words, that you have stated what you feel rather than what your partner feels. For instance, "I become anxious because we have no savings," helps to start a fruitful discussion. "You never think ahead" is much more likely to start an argument than a problem-solving discussion.

   If you are having a hard time writing an "I" statement, try skipping to Step 3 and then returning to Step 2.

3. Identify the feelings you have about the problem. Some common feelings have been identified on the chart below. Add any others you may have. Then circle the number that best describes the intensity of your feelings.

   Now think about what is causing each feeling. This may lead you to change your statement.

   Build your feelings into your problem statement. You may need to use more than one sentence at this point. Still, keep it as brief as possible. Using the example above, you may end up with a statement like this: "I am anxious and angry that we empty our savings account regularly instead of putting money aside for retirement. I'm afraid we'll end up a financial burden to our children just as my grandmother was to my parents."

4. If possible, identify a solution that would be acceptable to you. Do not worry at this point whether your partner would agree with the solution. Be clear yourself about what you want. Add another sentence to your statement that best says what solution you would like. For instance, "I want us to save $100 a month in an account we never touch until retirement."

   Don't worry if you cannot come up with a solution. It is even possible that not having a solution may give you a more open mind as you

IDENTIFY YOUR FEELINGS

a. Not at all **Angry**	0	1	2	3	4	5	Very **Angry**
b. Not at all **Frustrated**	0	1	2	3	4	5	Very **Frustrated**
c. Not at all **Excited**	0	1	2	3	4	5	Very **Excited**
d. Not at all **Anxious**	0	1	2	3	4	5	Very **Anxious**
e. Not at all **Confused**	0	1	2	3	4	5	Very **Confused**
f. Not at all **Resentful**	0	1	2	3	4	5	Very **Resentful**
g. Not at all **Hopeful**	0	1	2	3	4	5	Very **Hopeful**
h. Not at all **Hurt**	0	1	2	3	4	5	Very **Hurt**
i. Not at all ______________ (other) ______________	0	1	2	3	4	5	Very ______________ (other) ______________

brainstorm solutions together. But if you can identify a solution that works for you, it can be a helpful starting point.

5. Now you are ready to talk about the problem as a couple. Your partner may respond in any number of ways, including agreeing with you. But suppose your partner does not agree there is a problem; doesn't agree with the problem as you state it; agrees with the problem but says it cannot be solved; or agrees with the problem but says your solution won't work.

   All these responses are perfectly normal. There are as many ways to disagree as there are people. In retirement planning, a few common points of disagreement include whether to sacrifice today for something in the future; whether to value making more money over having more leisure time; whether to be spontaneous or practical; and how much structure to build into your financial life. Sometimes it is difficult to disagree without blaming each other. It may also be hard to listen to unpleasant suggestions without becoming tense and withdrawing emotionally.

   Using our example, you have presented your statement about saving for retirement. Suppose your partner rejects both the problem you saw and the solution you offered, saying, "We have our pensions and social security. Retirement is a long way off and if we want to save later, we can. Right now we have enough problems making it from paycheck to paycheck. Where's that extra hundred going to come from? If we had it, I sure wouldn't spend it that way."

   At this point it is most helpful to find where in the situation you do have some agreement, and proceed from there. Human tendencies lead us to concentrate only on points of disagreement, forgetting that there are probably many aspects of the situation where we do agree. If you and your partner are having trouble locating your common ground, go through questions such as the ones suggested below. Agree that each of you will use "I" language, answer one at a time with mutual respect and without interruption, and then discuss together before moving on to the next question.

   - What are we each hoping for?
   - What is most important to each of us?
   - How can we relieve the tension between us right now and keep talking?
   - Where do we both identify a problem?
   - What do I want my partner to understand about my position?
   - Which parts of the problem are individual, and which parts are shared?

   Using our example, you think about your partner's reply to your initial statement. You explore potential common ground and realize you both see a need to provide for yourselves during your retirement years. Perhaps this would lead you to studying your pensions more closely and, using projections, gauge whether they will, in fact, provide adequate income. Other chapters in this book can help you do this.

   Say you both agree that the pensions are not adequate, but also come to agree that saving $100 a month is not possible in your present circumstances. Using these agreements, a number of potential solutions can be explored. For instance, you may decide to take money management classes together to learn how to reallocate your income. One or both of you may decide to look for another job with a better salary and/or pension plan. You may agree that from this point, a portion of all tax returns, gifts, inheritance, and other windfalls will go in a separate retirement savings account. Many other solutions may present themselves as well, depending on your values and circumstances.

fly uoe pxreeicn e arpboel moyrup rantrec naon tes erow li lon tgaer eota ddersst goteeh,ry uos itllh va epoitno.sF roi snatcn:e

✔oY uac ndaujts y uo rivweo fht e isuttaoi.n4
✷ uoc naa jdsu ty uo rercaitnot o ht eisuttaion.
✔ You can seek financial or other kinds of education that may apply to your situation.
✔ You can seek financial or other kinds of counseling.
✔ You can adjust a part of the budget over which you have sole control.

When deciding on a solution, it is often helpful to place a timeframe on it. For instance, you might decide $100 dollars a month cannot be put aside, but $75 a month might be possible. You open a new savings account with the agreement that you will "pay" this account $75 a month before paying anything else, and commit to doing that for 6 months and then review the plan together. Placing a timeframe on a new plan gives you a chance to try another solution if the first one doesn't work. It also gives you a chance to celebrate if the first solution worked.

Save all the potential solutions you have brainstormed. If the first one doesn't work out, you've got more ideas at your fingertips.

A Final Word

Remember, this is a process of managing conflict, not resolving conflict. Resolving conflict implies that there is an end to both the problem and the feelings surrounding it. In fact, you may always disagree to some extent. Don't give up on finding a solution if you try one out and you still disagree. Adjust your solution until it is comfortable for both of you, or try a new approach. When you manage conflict rather than try to resolve it, you are open to redefining or restructuring the situation over time. Without trying to change each other's minds, thoughts, or reactions, you can try solutions until you find one you both can live with.

This conflict management process can be useful for many situations throughout your life.

CHAPTER 2

WILL YOU BE ABLE TO AFFORD THE LIFE YOU WANT?

PLANNING AHEAD FOR RETIREMENT

***Matching dollars to dreams:* Go to www.ebri.org/pdf/aarpretire.pdf to take a self-assessment to find out what your retirement dreams might mean in dollars and cents. It's called the "Retirement Roadmap Self-Assessment Tool."**

As you plan for retirement, how can you estimate what you post-retirement life will cost? How will you know when to retire? Will you be able to afford the life you want?

hTre era e aunbmreo fhtnisgt oocsndirea soy uebig nota snew rhtese questions. You'll want to look at goals for your later years. Expenses attached to the life you're planning must be taken into account. You'll want to consider your current net worth, and whether you need to increase it to fund your future. How early or late you want to retire will also be a factor in determining what you can afford to do.

REVIEW YOUR GOALS

Begin by reviewing your goals. Chapter 1 guides you through the process of deciding on goals and priorities. Knowing your own goals and priorities shapes all the decisions you make regarding retirement.

HOW TO ESTIMATE THE AMOUNT OF MONEY YOU WILL NEED IN RETIREMENT

Step 1: List your current expenses *(Worksheet 6, Column 1)*

Many people want to maintain a post-retirement lifestyle similar to the one they have in their working years. Because expenses are typically somewhat lower later in life, a retirement income that is around 80 percent of your current working income may be enough to maintain your present lifestyle. However, that is only a rule of thumb. By working through the following exercises, you will be able to more accurately assess how much you will need to save to be prepared for your retirement years.

Begin by filling out Worksheet 6, Column 1. Use your financial records to figure out current expenses. All you need for this are a pencil, a notebook, and possibly a calculator. If you pay and withdraw cash by check or debit card, all the information you need will be in your account record. If you also charge purchases, you will need your charge receipts or statements, as well. If you have not kept expense records before, you may want to do so for several months so that your figures in Column 1 are fairly accurate.

Step 2: Will your retirement expenses increase or decrease?

(Worksheet 6, Column 2)

(If you are under 50, skip ahead to Step 3.)

Completing Column 2 is a helpful exercise for those 50 or over. You should complete Column 2 of Worksheet 6 and indicate for each expense category whether you expect the expense to increase (+) or decrease (-). People's answers will vary depending on their goals, situations, and values. These expenses commonly change when people retire:

Increased Expenses

- ✔ Health care
- ✔ Physical needs resulting from health problems
- ✔ Health insurance
- ✔ Recreation
- ✔ Travel
- ✔ Other leisure activities

Decreased Expenses
✔ Taxes
✔ Work-related expenses (dues, license fees, work clothes, commuting, parking, meals, etc.)
✔ Transportation (many eventually stop driving and use easier, cheaper modes of transportation)
✔ Savings and investments
✔ Housing costs
✔ Supporting dependents

Other possible savings may result from spending time instead of money. For instance, you may decide to cook more food and eat out less; you may use public transportation more and drive less; you may do more routine home maintenance tasks yourself rather than hire others to do them.

Step 3: Estimate retirement expenses *(Worksheet 6, Column 3)*

As noted above, the general rule of thumb states that approximately 80 percent of your current working income may be enough to maintain your present lifestyle after retirement. You may choose to simply use this calculation for the total estimate figure at the bottom of Column 3 (multiply your total in Column 1 by .80). A rough estimate such as this may be close enough if you are 15 or more years away from retirement.

However, the closer you are to retirement the more accurately you can determine your potential retirement expenses. If you are 50 years old or older, fill out every line of Column 3 as best you can. That way, you can also be more accurate in determining your income needs after retirement. Estimate your average monthly spending in retirement based on today's prices; that is, calculate as though your retirement were beginning today. Later in this process you will find out how to adjust your projections for future inflation.

As you estimate retirement expenses, don't overlook large, irregular expenses. Appliances and furnishings will still wear out over the course of your later years. For as long as you drive, vehicles will need to be serviced or replaced. Include an allowance for them in your projections. Also give thought to the expenses that may come up in the earlier years of aging. For example, you may need to change your living space to accommodate disability; hire cleaning help; or require personal assistance or special transportation.

Total Column 3 to get your estimate of monthly expenses after retirement in today's prices. Then multiply that amount by 12 to get your total annual estimate of post-retirement expenses.

Step 4: Calculate your adjustment for annual inflation *(Bottom of Worksheet 6)*

Now that you have estimated your total post-retirement expenses, you can adjust that amount for inflation. Though we can't know the exact future inflation rate, we can start with the average annual rate over the last 25 years, which is about 4 percent. You may choose to work with this figure or you may want to use a slightly higher rate to be sure to have enough income.

For example, suppose that based on current prices you estimate your *monthly* retirement expenses (Column 3) at $1,100 and multiply that by 12 to an *annual* estimate of $13,200 ($1,100 x 12 = $13,200). Say you plan to retire in 16 years and you don't want to risk having an inadequate income at retirement. So to be safe you may decide to figure the inflation rate at 5 percent rather than 4 percent. You would then use Table 1, *Inflation Factors*, and follow the left-hand column (years to retirement) down to 16, the years you have until retirement. Follow across the row to the column headed by the inflation rate of 5 percent. You'll find an *inflation adjustment factor* of 2.18. The inflation adjustment factor is the number you use to figure more closely how much your expenses will be, accounting for future cost increases. Multiply your total projected retirement expenses, $13,200, by the inflation adjustment factor of 2.18, to get your final figure of $28,776.

Now use this process for your situation. First, take your annual estimated retirement expenses (Column 3) and multiply that amount by the inflation adjustment factor you choose from Table 1 (based on your calculated years to retirement and your selected inflation rate). That amount will give you an estimate of the income you will need your first year of retirement. Write this figure in the line labeled, *Total First Year Retirement Expenses*. Keep in mind that this expense amount for the first year will rise each year of retirement due to continued inflation.

TABLE 1. INFLATION FACTORS

Years to Retirement	Annual Rate of Inflation									
	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%
1	1.03	1.04	1.05	1.06	1.07	1.08	1.09	1.10	1.11	1.12
2	1.06	1.08	1.10	1.12	1.15	1.17	1.19	1.21	1.23	1.25
3	1.09	1.13	1.16	1.19	1.23	1.26	1.30	1.33	1.37	1.41
4	1.13	1.17	1.22	1.26	1.31	1.36	1.41	1.46	1.52	1.57
5	1.16	1.22	1.28	1.34	1.40	1.47	1.54	1.61	1.69	1.76
6	1.19	1.27	1.34	1.42	1.50	1.59	1.68	1.77	1.87	1.97
7	1.23	1.32	1.41	1.50	1.61	1.71	1.83	1.95	2.08	2.21
8	1.27	1.37	1.48	1.59	1.72	1.85	1.99	2.14	2.30	2.48
9	1.31	1.42	1.55	1.69	1.84	2.00	2.17	2.36	2.56	2.77
10	1.34	1.48	1.63	1.79	1.97	2.16	2.37	2.59	2.84	3.11
11	1.38	1.54	1.71	1.90	2.11	2.33	2.58	2.85	3.15	3.48
12	1.43	1.60	1.80	2.01	2.25	2.52	2.81	3.14	3.50	3.90
13	1.47	1.67	1.89	2.13	2.41	2.72	3.07	3.45	3.88	4.36
14	1.51	1.73	1.98	2.26	2.58	2.94	3.34	3.80	4.31	4.89
15	1.56	1.80	2.08	2.40	2.76	3.17	3.64	4.18	4.78	5.47
16	1.61	1.87	2.18	2.54	2.95	3.43	3.97	4.60	5.31	6.13
17	1.65	1.95	2.29	2.69	3.16	3.70	4.33	5.05	5.90	6.87
18	1.70	2.03	2.41	2.85	3.38	4.00	4.72	5.56	6.54	7.69
19	1.75	2.11	2.53	3.03	3.62	4.32	5.14	6.12	7.26	8.61
20	1.81	2.19	2.65	3.21	3.87	4.66	5.60	6.73	8.06	9.65
21	1.86	2.28	2.79	3.40	4.14	5.03	6.02	7.40	8.95	10.80
22	1.92	2.37	2.93	3.60	4.43	5.44	6.66	8.14	9.93	12.10
23	1.97	2.47	3.07	3.82	4.74	5.87	7.26	8.95	11.03	13.55
24	2.03	2.56	3.23	4.05	5.07	6.34	7.91	9.85	12.24	15.18
25	2.09	2.67	3.39	4.29	5.43	6.85	8.62	10.83	13.59	17.00
26	2.16	2.77	3.56	4.45	5.81	7.40	9.40	11.92	15.08	19.04
27	2.22	2.88	3.73	4.82	6.21	7.99	10.25	13.11	16.74	21.32
28	2.29	3.00	3.92	5.11	6.65	8.63	11.17	14.42	18.58	23.88
29	2.36	3.12	4.12	5.42	7.11	9.32	12.17	15.86	20.62	26.75
30	2.43	3.24	4.32	5.74	7.61	10.06	13.27	17.45	22.89	29.96

WORKSHEET 6. ESTIMATED COSTS OF PRE-RETIREMENT AND POST-RETIREMENT LIVING

	COLUMN 1 Current Expenses per Month	COLUMN 2 Expected Change in Expenses After Retirement (+ or -)	COLUMN 3 Expenses After Retirement per Month
Shelter			
Rent or mortgage payments			
Real estate taxes			
Insurance			
Other			
Household Operation and Maintenance			
Home repair, yard care			
Water, electric, gas, fuel oil			
Telephone, internet/cable			
Waste disposal			
Other			
Home Improvement and Upkeep			
Furniture, fixtures			
Floor coverings			
Kitchen equipment			
Garden, yard equipment, supplies			
Other			
Vehicle and Transportation			
Car payment			
Repairs			
Gasoline and oil			
License registration			
Insurance			
Other transportation			
Food and Beverages			
Food at home			
Food away from home			
Entertaining expenses			
Other			
Clothing			
New clothing			
Laundry not done at home			
Dry cleaning			
Shoe repair			
Other			
Personal			
Cosmetics and toiletries			
Barber and beauty shops			
Smoking supplies, alcohol			
Stationery, postage			
Exercise costs			
Other			

WORKSHEET 6. ESTIMATED COSTS OF PRE-RETIREMENT AND POST-RETIREMENT LIVING

	COLUMN 1 Current Expenses per Month	COLUMN 2 Expected Change in Expenses After Retirement (+ or -)	COLUMN 3 Expenses After Retirement per Month
Medical and Health			
Medications	______	______	______
Physician, dentist	______	______	______
Eyeglasses, hearing aids	______	______	______
Health insurance	______	______	______
Other	______	______	______
Recreation and Education			
Books, newspapers, magazines	______	______	______
Club memberships, dues	______	______	______
Movies, sports events, concerts	______	______	______
Sports and hobby equipment supplies	______	______	______
Vacations, celebrations, weekend trips	______	______	______
Continuing education	______	______	______
Miscellaneous			
Pets: care, food, license	______	______	______
Contributions	______	______	______
Gifts	______	______	______
Other	______	______	______
Taxes, Insurance, Legal			
Federal, state income taxes	______	______	______
Life insurance	______	______	______
Property insurance (not homeowners)	______	______	______
Legal fees	______	______	______
Other	______	______	______
Savings, Investments			
Banks, savings and loan	______	______	______
Company pension, profit-sharing plan	______	______	______
Stocks, bonds, real estate	______	______	______
Retirement: Keogh, IRA	______	______	______
Other	______	______	______
Total	______		______

To determine your Total First Year Retirement Expenses, multiply your Total Annual Estimated Retirement Expenses (Column 3) by 12. Then multiply that figure by the Inflation Adjustment Factor. In other words:

Annual Estimated Retirement Expenses $___________ X 12 = $___________ X Inflation Adjustment Factor =

Total First Year Retirement Expenses $________________ .

The biggest item on most people's net worth statement is their home. There are two ways to get a current market value for your home:

1) Real Estate Appraisal. *Realtors often give free estimates on the current market value of homes. Get estimates from one or two real estate firms for a general estimate. Reduce the estimate by 10 percent to account for commissions and fees real estate firms often add.*

2) Professional Appraisal. *For a more accurate assessment of your home's value, get a professional appraisal and inspection. Most lenders can recommend several appraisers to you.*

How to Estimate Your Net Worth

Now that you have established what you will need to cover expenses in that first year of retirement, it is also important to establish what assets you have to fund those expenses. A net worth statement describes your financial condition on a specified date.

Net worth tells you how much money you would have if you sold all your *assets* (everything you own) and paid off all your *liabilities*, or debts. It is the total dollar amount of your current estate.

Worksheet 7 is a tool to help you estimate your current net worth. Make extra copies of this worksheet *before* you begin so you can fill one out every year as finances change. Filling out net worth statements annually will help you plan your retirement because you can measure your progress toward financing your post-retirement years and see what needs to be changed to raise your net worth.

For those close to retirement it can be a surprisingly positive experience to calculate your net worth. By this point you are likely to own a home and perhaps other items that increase in value over time, such as antique furniture or a coin collection. If you have steadily put money into savings, or bought insurance policies or investments, it's exciting to realize how much your money has grown over the years. If, on the other hand, your net worth amount is not what you had hoped, your worksheet becomes a useful warning to make changes now to prevent serious problems later.

The first time you fill out the worksheet, gathering information will take time and effort. Don't be discouraged! After the first time you'll know the process and can simply update those figures. Filling out your annual statement is especially easy if you set up and maintain a filing system so worksheet information is at your fingertips.

How to Estimate Your Assets

Begin filling out Worksheet 7 by listing all your assets. Assets include tangible items such as your home or other real estate, vehicles, and household items that could be sold for $100 or more. Assets also include bank accounts, the cash value of insurance policies, and investments such as stocks, bonds, mutual funds, 401ks and IRAs.

After you have made a complete list of your assets, estimate the current *market value* of each; that is, what price each item would bring in its current condition.

Your home and such items as antiques, collections, or jewelry, usually have *appreciating value*; that is, value which increases with time. Other kinds of property have *depreciating value* because over time they are worth less than you paid for them, rather than more. Items of depreciating value include such things as vehicles, household items, or ordinary furniture. For instance, a sofa purchased five years ago for $1,500 might now be worth $100 in very good condition.

Some assets may vary in value, such as stocks and bonds. Be conservative when estimating their value by using 50 to 70 percent of their current market value. Even if their value is very high today, it may not stay high over time.

After listing all your asset amounts, total them at the bottom of the assets column. This is the *gross value* of everything you own; that is, it's what you own without taking into account your debt.

How to Estimate Your Liabilities

Continue to fill out Worksheet 7 by listing all your liabilities, that is, money you owe to other businesses, agencies, or individuals. They include mortgage balances, installment loan balances (e.g., vehicle loans, student loans, home furnishings loans, etc.), credit card balances, bills owed to particular businesses, and other debts. Liabilities are easier to estimate than assets, since bills, account statements, and repayment schedules give you the exact amount you owe on any particular date.

After listing all your liability amounts, total them at the bottom of the liabilities column.

Your Estimated Total Net Worth

Once assets and liabilities have been listed and totaled, the final step in completing Worksheet 7 is to subtract liabilities from assets. This gives you an estimate of how much you have saved for your retirement.

WORKSHEET 7. ESTIMATED NET WORTH STATEMENT

Make copies of this worksheet ***before*** writing on it, so you have blank worksheets to fill out annually for your progress records.

Assets

Cash on hand ____________
Checking account(s) ____________
Savings account(s) ____________
Cash value of life insurance ____________
Certificates of deposit ____________
Money market funds ____________
US savings bonds ____________
US government securities ____________
Mutual funds ____________
Market value of home(s) ____________
401ks ____________
Other investments ____________
Stocks and bonds ____________
Automobile(s) and other vehicles ____________
Furniture ____________
Appliances, tools ____________
Jewelry ____________
Collectibles ____________
Business or farm assets ____________
Debts owed to you ____________
Other tangible assets ____________

Total Assets $ ____________

Liabilities

Credit card balances ____________
Balances on other loans ____________
Home mortgage balance ____________
Balances on other real estate mortgages ____________
Bills payable ____________
Gifts promised ____________
Pledges to charitable organizations ____________

Estimated taxes payable this year ____________
Other liabilities ____________

Total Liabilities $ ____________

Total Assets $ ____________ **- Total Liabilities $** ____________ **= NET WORTH $** ____________

as of ____________ (Date)

Caution:
If you have a cash value life insurance policy, remember that its cash value is not the same as its face value. Be sure you're using the correct figure according to the insurance company's cash value table. See the chapter on Health and Life Insurance for a more complete explanation of this and many other insurance terms and considerations.

How to Increase Your Net Worth

When you review your net worth statement you may be pleased and quite assured that you can meet your retirement goals. Or you may find you're making good progress, but need to make changes in order to have the future life you want, or retire as early as you would like.

You may even have found your net worth was a negative figure, that is, you have more debts than assets. It is not always obvious to people that they are sliding further into debt or that their assets are steadily decreasing until they have completed a net worth statement for several years in a row. Changes in saving and spending patterns can be subtle and gradual. It usually takes two or more years of poor management before you face serious financial problems. That's why it's a good idea to note trends in your spending, saving, or borrowing annually, so you have an opportunity to change your patterns before money becomes a significant problem. Here are some things you can do to increase your net worth.

- Write goals such as increasing your total net worth by a certain percentage or reducing debt to a certain level by next year. Setting specific goals makes your commitment more firm and clear throughout the year, and helps you evaluate your annual net worth progress.

- Make good, steady progress towards paying off your mortgage, since for most homeowners, property is the biggest asset.

- Examine any investments you may have and see whether they are yielding more than the interest you would make from a standard savings account. If they are not, consider moving some or all your investment money into accounts that typically earn at a higher rate, such as money markets or certificates of deposit.

- Consider whether it makes sense to *liquidate* any of your assets. This means to sell them for cash either to invest in something else or to use to pay off debt or save.

Can You Afford To Retire Early?

Many dream of retiring early to travel, take classes, participate in recreational activities, spend more time with family and friends, do volunteer work, or start a second career. Younger spouses often want to quit working when their older spouse does, or work part-time once the older spouse retires.

What age is considered "early retirement" these days? Past standard retirement ages have been 62 or 65, with any age under 62 being considered "early retirement." But the standard retirement age is increasing. Because people are living longer now, Social Security has changed the age at which it pays full benefits. The age of full Social Security retirement benefits gradually increases until it reaches age 67 in 2025.

If early retirement is one of your goals, you may need to rethink the estimated post-retirement expenses total in Worksheet 6, as well as the net worth estimate you completed in Worksheet 7. Be sure you take into account these additional impacts of retiring early:

- The final years of employment are often the highest-earning years of work life. The Social Security Administration uses your highest earning years as a basis for determining the amount of your benefits. As a result, along with forfeiting those years of income, early retirees often receive Social Security benefits that are based on a lower income level than they would have otherwise received.

- The current Social Security benefit reduction for people who retire at age 62 (compared with age 65) is 20 percent. Once the age of eligibility for retirement increases, however, the benefit reduction for early retirement will also increase; eventually those who retire at 62 will have their benefits permanently reduced by 30 percent under the amount given to people who retire at 67.

- There are age requirements attached to other potential income sources as well, such as IRAs. Be sure to account for any gaps between your age and the point at which these income sources can be drawn.

- Medicare coverage currently begins at age 65. Among those who retire at a younger age, some are able to continue their employer's group insurance plan or they might be able to convert to an individual policy from their employer's plan. Either of these options would probably give you coverage for less than you would pay if you bought a plan on your own. Still, early retirement will likely mean you will have to pay more for health care.

- Early retirement may reduce company pension benefits, profit sharing, and other kinds of benefits.

- Early retirement means that you will have more post-retirement years to finance.

If you are thinking about early retirement, you may want to read *Thinking Over an Early Retirement Offer* on the Web at:

www.extension.iastate.edu/finances/personal/retirement/early_retirement.htm.

How Many Post-retirement Years Will You Need to Finance?

At this point you have information about how much retirement costs, how much money you have in your current estate to finance retirement, and what to consider if you plan on retiring early. With this in hand, you probably have a pretty good idea of when it would be best for you to retire.

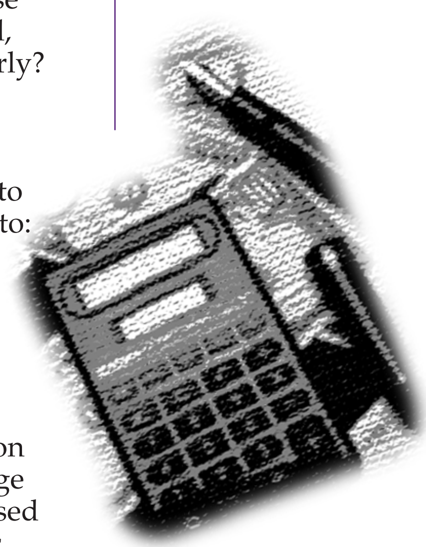
Now it's time to think objectively about how long your post-retirement life will last even though it may be difficult. Once you become aware of the number of years you are likely to live post-retirement, you may find it all the more important to be sure you have the financial security to make the years comfortable.

A number of factors influence each person's life expectancy. Heredity is important. Consider how long your closest relatives have lived, and whether your health so far is similar to theirs. See what your healthcare professional says about your overall health and nutrition. How well do you handle stress, in your current job or in the rest of your life? Do you exercise regularly? Do you consume alcohol, nicotine, or any other drugs regularly? Are you male or female?

If you would like to go through an interactive exercise on the internet to determine your life expectancy, go to: ***www.ces.purdue.edu/retirement***
Then click on:
Begin Modules
Are You Ready to Retire
Life Expectancy Calculators

You may want to consider Table 2 on the next page which projects average life expectancy for Minnesotans based on gender. Minnesotans live longer than the national average.

*Chapters in this book, **Developing Income Sources** and **Saving and Investment Options** can help you increase your assets by outlining what is available to you and providing more unbiased information about how to best use your money now to raise your future net worth. Doing so will help provide greater security as you enter your retirement years.*



Minnesotans live considerably longer than the national average and are living longer than ever before.

Overall life expectancy (average for males and females) in the United States is 77.6 years, 2.2 years less than in Minnesota. By subtracting your anticipated retirement age from your life expectancy age, you will get an idea of how many years your retirement income will need to last.

For example, a woman who is 57 can expect to live almost to age 86. If her own parents had long lives and she is in good health, she might add, say, 3 years to her expected longevity; that would give her a life expectancy of 89 years (86 + 3). If she plans to retire at age 66, she needs to plan for 26 years of retirement income (89 years - 66 = 28 years). She has 9 years (66 - 57 = 9 years) to save more money for her financial security outside of the income sources already in place.

Your Guiding Information

Congratulations! Now you have this key information at your disposal:

1) You know how you currently spend your money.
2) You have an estimate of what you may continue to spend post-retirement.
3) You have an estimate of your current net worth.
4) You have taken into account financial factors that will impact a decision to retire early.
5) You have a means of calculating how long your post-retirement life may be.

You can give your retirement goals real substance by working towards having the money to back them up. Watching your progress encourages you to continue building for the future you want. In this way you can make your retirement plans realistic and secure.

TABLE 2. LIFE EXPECTANCY FOR MINNESOTANS

	Life Expectancy	
Current Age	**Male**	**Female**
0	77.3	82.2
20	78.2	82.7
45	79.6	83.5
65	82.7	85.6
80	88.1	89.9

Source: McMurry, M. (2006). Minnesota State Demographic Center

CHAPTER 3

DEVELOPING INCOME SOURCES

Check the Social Security website at www.ssa.gov for publications that will keep you up to date. If you don't have a computer to access the Internet, many libraries, churches, and nonprofit organizations provide access to the public.

Planning for retirement income in your working years will likely make your later years freer of anxiety. An income that will meet your needs will add more life choices to your retirement years, and likely more enjoyment.

It is never too early to generate income for your retirement. As a matter of fact, the earlier you begin, the better. Money takes time to grow.

It is also never too late to consider retirement income. Even five year's worth of planning is worth doing.

Possible retirement income sources include:

- Social Security
- public and private pensions and retirement plans
- personal savings and investments
- earnings received by working after retirement
- liquidating assets

This chapter discusses the first three of the five, since the last two depend more on personal circumstances and are difficult to address in a general way.

SOCIAL SECURITY

Social Security is a government program intended to provide a base level of income for most retired people. It is not intended to replace the money you make in your earning years, and it is not adequate as your only source of retirement income. The benefit is intended to provide a financial base only.

Work Eligibility

You are eligible to receive Social Security benefits if you have been employed (including self-employed) for the equivalent of 10 full-time years (or married for 10 years to someone who has been).

Age Eligibility

The age at which retirees are eligible for full Social Security benefits increased by two months per year for persons who reached age 62 between 2000 and 2005, and remained fixed at age 66 for ten years (see Table 3). It increases again by two months per year for those reaching age 62 in 2017-2022 and is then set at age 67.

Note: The change in retirement age does not affect age of eligibility for Medicare. If you delay your retirement, be sure to sign up for Medicare at age 65.

Though the age of eligibility for full benefits has been raised, people will still be able to retire with reduced benefits at age 62. However, the amount of their benefits is gradually decreasing (see Table 3). Benefits at age 62 will gradually be reduced to 70 percent of full benefits.

How Your Earnings and Years of Working Are Combined

Social Security is run on a system of credits. You earn credits through a combination of the amount of time you work and how much money you make. Time worked accumulates in equivalents of full-time work. Each additional year's worth of time you work adds another year of earnings to your Social Security record.

The amount you earn also affects the credits you accumulate. There is a certain amount of money you need to earn each year for one credit, and this amount changes every year. Higher lifetime earnings may result in higher benefits when you retire.

In addition, if you delay retirement, your Social Security amount will be increased by a certain percentage. These increases will be added in automatically from the time you reach your full retirement age until you start taking your benefits, or until you reach age 70. The percentage varies depending on your year of birth.

You can request a Social Security statement at any time by calling 1-800-772-1213, using their website at www.ssa.gov/mystatement or contacting your local Social Security office.

How Working After Retirement Affects Your Social Security Payment

You can continue to work and still get your Social Security. Before age 70, however, your benefits will be reduced if your earnings exceed certain limits. If you are under full retirement age, $1 in benefits will be deducted for each $2 in earnings above the annual limit. In the year you reach full retirement age, your benefits will be reduced $1 for every $3 you earn over the annual limit until the month you reach full retirement age. Then you can work without reduction in the amount of your monthly benefit no matter how much you earn.

TABLE 3. SOCIAL SECURITY ELIGIBLE RETIREMENT AGE CHANGES

	Retirement age (years/months)		Age 62 benefits as percent of PIA*	
Year of Birth	**Worker or Spouse**	**Widow(er)**	**Worker**	**Spouse**
1937 (same as prior law)	65/0	65/0	80.0	37.5
1938	65/2	65/0	79.2	37.1
1939	65/4	65/0	78.3	36.7
1940	65/6	65/2	77.5	36.2
1941	65/8	65/4	76.7	35.8
1942	65/10	65/6	75.8	35.4
1943-54	66/0	65/8	75.0	35.0
1955	66/2	66/0	74.2	34.6
1956	66/4	66/0	73.3	34.2
1957	66/6	66/2	72.5	33.8
1958	66/8	66/4	71.7	33.3
1959				
1960 and after	67/0	66/8	70.0	32.5

**Primary insurance amount, determined on the basis of workers' indexed earnings.*

Estimating Social Security Benefits

About three months before your birthday each year, you are sent a Social Security statement that displays your earnings record.

Be sure to check the earnings record carefully and pursue changes that need to be made. The Social Security website also has an area to click on called *Benefit Planners*. If you have new information about your future earnings or retirement date, click here to find out how these changes will affect your Social Security payments.

How to Start the Application for Social Security Benefits
You can apply up to three months before the month you want benefits to start. Applying early helps ensure that you will get your first payment when you need it.

Choose one of three methods to apply:
1. File online at www.ssa.gov on the Internet.
2. Call 1-800-772-1213 toll-free to file by telephone.
3. Call 1-800-772-1213 to make an appointment to visit your local Social Security office.

Once you make the initial application via the web or telephone, you will need to provide the Social Security office with a number of documents in person.

How to Complete the Application Process
In order to complete the application process, the Social Security office will need these items from you:

1. Your own Social Security card or a record of your number. If your claim is on another person's record, you will need that person's card or a record of the number.

2. Proof of your age: a birth certificate or baptismal certificate.

3. Your marriage certificate if you are applying for wife's, widow's, or widower's benefits. Divorced people may need their divorce decree to establish the length of their marriage, because in order to claim benefits you must have been married ten years.

4. Your Form W-2 for the last year or a copy of your last federal income tax return if you are self-employed. **This is important because these earnings will not be in the Social Security Administration records and cannot be included when they figure your benefit unless you provide these forms.**

5. Your checkbook or bank statement with your bank account number on it, so that your Social Security benefits can be paid by direct deposit.

Employer-Sponsored Pension Plans

Pension plans sponsored by your employer usually include contributions to the plan by both you and your employer. For some plans, however, contributions are made only by the employee. The Employee Retirement Income Security Act (ERISA) is a federal law that sets minimum standards for pension plans in private industry.

Employer-sponsored pension plans are classified as either defined benefit plans or defined contribution plans. The features of these plans could have a major impact on your financial circumstances during retirement. The contributions and earnings on contributions are tax deferred until you receive them.

Defined Benefit Plans

Defined benefit plans spell out the amount of your benefit – usually a percentage of your wages – to be paid after retirement. Under this system, the amount contributed by your employer varies each year, depending on:
- mortality expectations for employees participating
- the number of years remaining until each employee retires

Retirement Timeline

Age 50: *Begin making catch-up contributions to 401ks and other retirement accounts.*

Age 50 1/2: *No more tax penalties on early withdrawals from accounts.*

Age 62: *Minimum age to receive Social Security benefits.*

Age 65: *Eligible for Medicare.*

Age 66: *Eligible for full Social Security benefits if born between 1943 and 1954.*

Age 70 1/2: *Required to start taking minimum withdrawals from most retirement accounts by this age.*

- current salaries
- the income earned on invested funds.

These plans are structured to ensure that the contributions made each year will provide enough money to fund the promised amount of benefits. All defined benefit plans are insured by the Pension Benefit Guaranty Corporation, which is a federally chartered corporation.

Defined Contribution Plans

Defined contribution plans focus on the amount of money to be contributed annually to the retirement fund. These plans are not insured as the defined benefit plans are. But they have another advantage: they are portable, meaning they may be taken out when you leave the job. There are four major types of defined contribution plans:

1. ***Salary reduction plans, called 401(k) plans or 403(b) plans in tax-exempt or nonprofit institutions***
   The employer makes tax-deferred contributions to the plan for your benefit by reducing your salary by that amount. The employer's contributions are optional and they may change.

2. ***Money-purchase pension plans***
   The employer promises to set aside a certain amount for you each year, generally a percentage of your earnings.

3. ***Stock bonus plans***
   The employer's contribution is used to buy stock in the company for you. The stock is usually held in trust until retirement, when you can receive your shares or sell them at their fair market value.

4. ***Profit sharing plans***
   Your contribution depends on the company's profits.

Understanding 401(k) Plans
Employees of profit-making companies may be eligible to participate in a 401(k) plan. Increasing numbers of employers have chosen 401(k) plans, which are a type of profit-sharing plan usually designed to supplement an employer's primary pension plan.

If you enroll in a 401(k) program, you can put a maximum amount of your gross salary (your salary before taxes) into an account. The maximum amount is established by law and adjusted each year to account for indexed inflation.

Here are some distinguishing features of a 401(k):
- The funds are not taxed until you withdraw them for retirement, which you can do starting at age 59 1/2.
- If you withdraw your funds early, you will pay income tax on the money and a penalty fee. If, however, you put the money into another retirement plan, the penalty fee is waived.
- An employee's contribution to a 401(k) account is 100 percent vested. A minimum of five years on the job is required to vest the employer's contribution.

If you are thinking of considering an employer-sponsored 401(k) savings plan, you will need to do some research to make a good decision. Consider these questions:

1. Can I afford to part with a percentage of my pay without upsetting my budget or my family's budget?
2. Can I commit funds to the plan for a long term to maximize my investment?
3. Does my company plan allow me to invest in alternative areas such as stocks, bonds, or a money market fund? How easy is it to switch funds?
4. What do I expect my retirement income to be, counting pension benefits, Social Security payments, and any other retirement income I expect to have?
5. What is the right contribution amount that will allow me to produce extra income at retirement without entering a higher tax bracket?

6. Will my employer allow me to reduce contributions without delay if I have financial trouble and need the money?
7. Does my employer's plan allow me to borrow against my 401(k) funds for improving my house or buying a car? If so, what are the conditions?

Vesting Schedules

If your employer has contributed to your retirement account, the employer has a *vesting schedule*. Vesting refers to the date when you are entitled to money your employer has contributed to your account. If your pension rights are not vested with your employer (meaning you have not yet put in enough working time to receive them), you will get back only your own contributions. If you are fully vested because you have worked the required number of years for your employer, you probably will be eligible for full benefits.

Your employer's vesting schedule determines the amount of working time required, and employers vary. The majority of plans must provide for either 100 percent vesting after five years of service or 20 percent after three years and 20 percent each year thereafter until full vesting is achieved in seven years. There are some conditions that require a slower vesting and others, a faster one.

Find out how your employer's retirement plan defines a "year of service" and how breaks in employment can affect your accumulated benefits. Generally, plans require you to work or have paid leave for 2000 hours (a 40-hour work week less 2 unpaid weeks) in a year to receive credit for a year of service.

Breaks in employment can affect benefits for those who are not fully vested, especially if the number of one-year breaks in service equals or exceeds a worker's years of service. To calculate participation and vesting, employers typically count all years of service, but not breaks in service. However, if the break in service is five years or more, the years prior to the break will no longer be counted as years of service. (Note: a year of unpaid maternity or paternity leave is not considered a break in service.)

Make sure you have your employer's vesting schedule and know the employer's calculations for your years of service. Do not wait till you are about to retire to reconcile any differences between your records and your employer's. Talk to your compensation representative as soon as possible if you see any discrepancies or have any questions.

Know Your Pension Plan

The best source of information about your employee pension plan is the compensation administrator. Your employer's human resources staff should be able to clarify provisions of the plan, or direct you to someone who can. Worksheet 8 provides questions to use as a guide when you talk to the plan's administrator.

Individual Retirement Income Products

If you are self-employed, if you do not favor the retirement plan(s) your employer has to offer, or if you would like to supplement your employer's plan, there are things you can buy to boost your planned retirement income. The most common of these are outlined here.

Individual Retirement Accounts (IRAs)

An IRA is a personal retirement savings plan available to those who receive taxable compensation during the year. It allows working individuals to make contributions to their own private investment fund.

WORKSHEET 8. PENSION PLAN QUESTIONS

1 What type or types of plan do I have? ______

2 When will I become eligible? ______

3 When will I be vested? ______

4 What happens if my employment is interrupted? ______

5 What provisions are there for early retirement? ______

6 How much would I receive if I decide to retire early? ______

7 Can I receive benefits if I keep working after age 65 (or eligible retirement age)? ______

8 Is there any inflation protection? ______

9 Are disability benefits provided? ______

10 Are death benefits provided? ______

WORKSHEET 8. PENSION PLAN QUESTIONS

11 How is the plan funded? ______________________________

____

12 How do benefits accrue? ______________________________

____

13 What is the current financial condition of the plan? ______________________________

____

14 Do I anticipate any difficulty paying benefits? ______________________________

____

15 Do I have any say in how my share of money is invested? ______________________________

____

16 Will the starting pension amount be reduced by Social Security benefits and if so, by how much? How much will it be reduced if I decide to give my spouse part of the income?

____

____

____

____

17 How many hours of work are required annually to remain in the plan and accrue benefits? ______________

____

18 What are the pay-out options? ______________________________

____

____

Traditional vs. Roth IRAs
There are two kinds of IRAs: *Traditional IRAs* and *Roth IRAs*. Traditional IRAs and Roth IRAs are similar in some ways and different in others.

Traditional IRAs are *pre-tax* accounts into which you can deposit money that will not be taxed until retirement (or whenever you withdraw your money). Contributions made to a Traditional IRA are tax deductable if you meet certain criteria (see Table 4). Roth IRAs allow you to place *post-tax* money into the account, and since you have already paid taxes on this money, you do not pay taxes upon the withdrawal of the funds at retirement.

Given this information, an important question to consider when deciding between Traditional and Roth IRA is: When do you want to pay the tax–upon contribution or upon withdrawal?

IRAs were created to encourage people to save for retirement. They are intended for ordinary working people; thus, there are requirements and rules for Traditional and Roth IRAs such as who is allowed to contribute to one, as well as how much you are allowed to contribute (see Table 4).

IRA Contribution Limits
Currently, a person's maximum annual IRA contribution, whether made to just one or to multiple IRAs (Traditional and Roth), is limited to $5,500 if you are 49 or younger and $6,500 if you are age 50 or older. Starting in 2010, the contribution limits will be indexed to inflation.

Traditional IRA Contributions as Tax Deductions
If you contribute to a Traditional IRA product, you may be able to take a tax deduction on your annual contributions. To be eligible, you must meet one of the two following criteria:

1. You cannot be covered by an employer-sponsored pension plan. If you are married and filing a joint return, your spouse cannot be covered.
2. Your adjusted gross income must be less than $59,000 if you are single, or, if you are married, your combined adjusted gross income must be less than $95,000.

Under certain combinations of these conditions, you might be entitled to a prorated partial deduction. If you hire a tax preparer, check with that person on the current tax regulations.

TABLE 4. MAIN DIFFERENCES BETWEEN TRADITIONAL IRA AND ROTH IRA

	Contributions deductible?	Taxes due on withdrawals?	Withdrawal provisions	Minimum required distributions age $70^1/_2$?
Traditional IRA	Yes	Yes	After age $59^1/_2$	Yes
Roth IRA	No	No	After holding account for five years and reaching age $59^1/_2$	No

The money in your Traditional IRA account is tax-deferred whether or not you are eligible for a tax deduction on your contributions.

Investing IRA Funds
IRAs are self-directed accounts; that means you are free to make whatever investment decisions you want with the funds in your IRA. The key to making your IRA profitable is diversification. Diversification is a strategy designed to reduce exposure to risk by combining a variety of investments (such as stocks and bonds), which are unlikely to all increase or decrease in value all at the same time. Thus, you allow for more consistent performance under a wide range of economic conditions. To do this, you should divide your IRA funds among various investments that have a history of performing well. A transfer rather than a withdrawal of your IRA funds from one type of account to another (called a rollover) may or may not be tax-free. Your financial institution may also charge you a fee for the rollover.

Annuities

An annuity is a contract purchased from an insuring company. To buy an annuity you pay a premium in a single lump sum or in a series of installment payments, as you might for any purchase. In return, the annuity gives you specific payments at specified intervals. These intervals can be for a fixed period or for the remainder of your life. Unlike other assets or payments you may outlive, many annuities provide guaranteed income for life. They are widely used as a supplemental source of income by retired people.

You can buy an annuity as supplemental retirement income and begin payouts immediately. However, most begin payouts at a later date such as when you purchase an annuity as your IRA. Annuities are sold by insurance agents, stock brokers, and financial planners. They provide income in two ways:

1. ***Immediate income***. You purchase it with a single payment and it matures immediately. Income payments can then begin in one month. The rate of return is usually guaranteed for the entire period specified.

2. ***Deferred income***. You may pay for the annuity in a single payment, annual installments, or monthly installments. The annuity begins making payments to you at a specified time. The rate of return is guaranteed for the first year only and after that, the rate depends on investment results. With a single premium annuity, you pay a lump-sum premium which accumulates interest on a tax-deferred basis until you redeem the policy for its cash value or convert it into an annuity paying a monthly income.

Tax Advantages of Annuities
When you buy a deferred annuity, the interest on the principal builds up free of current income tax. Once you (the annuitant) start to receive a monthly payment, however, the part of the payment that is interest is taxed as ordinary income. The other part is principal and is not taxed. This is true for both deferred and immediate annuities.

Annuities have tax-deferred interest. The longer you invest, the higher your yield will be. The higher your tax bracket, the more benefit you receive from the tax deferral. A 10% annual yield compounds at that rate with the tax-deferral status.

To understand what that means, it is first important to understand how federal taxes are figured. If you earn $1,000 and are in the 28% federal tax bracket, the federal taxes you pay on those earnings is $280.00 ($1,000 x .28). If the annuity were not tax-deferred, federal taxes would reduce the annual yield of the annuity by the same percentage as your tax bracket.

Annuity purchase costs can vary a lot, so shop around. Consult *Best's Life and Health Insurance Reports*, a reference book found in many public and business libraries. It rates the financial standing of hundreds of companies as well as the states in which they are licensed. Buy an annuity only from a company rated "A" or "A+."

Let's start with figuring a 10% yield on a tax-deferred annuity of $1,000 which would be $100 ($1,000 x .10 = $100 - tax-deferred yield). However, if the annuity was not tax-deferred, and you were in the 28% tax bracket, you would need to reduce the yield of $100 by the amount of taxes you owe on that yield ($100 X .28 = $28.00 - amount of federal taxes owed on yield). That $100 yield would thus be reduced to $72.00 after taxes ($100 - $28.00 = $72.00) The yield after taxes is $72.00.

Although the tax deferral status is an advantage of deferred annuities, you forfeit liquidity and flexibility for your investment. If you withdraw money from your annuity before age 59½, interest earned on your contributions must be withdrawn before the principal and is subject to personal income tax. In addition, there is a 10% penalty tax on such premature withdrawals, except in certain circumstances, such as disability or death. Annuity contracts often include surrender charges for early withdrawal as well.

Types of Annuities
The two types of annuities you can buy are ***fixed*** and ***variable***.

- A ***fixed annuity*** earns interest at a rate set by the insurance company, much as though you invested in bank certificates of deposit and continually rolled the money over at whatever rate was in place at the time. Within fixed annuities, there are four variations:

  1. *Straight-life annuity*, which pays a fixed amount every month until your death.
  2. *Installments-certain annuity,* which guarantees you (or, if you die, your beneficiary) monthly payments for a fixed number of years (e.g., 5, 10, 15, 20, etc.)
  3. *Cash-refund annuity*, which pays your beneficiary a lump sum if you die before collecting the original invested money.
  4. *Joint and survivor annuity*, which pays a lifetime income to you and a named person; these types of annuities are most often used by married couples.

- A ***variable annuity*** adjusts your payments upward or downward according to the success of the insurance company's investments. It is riskier than a fixed annuity but can pay higher rewards.

Cost of Annuities
The cost of annuities varies considerably, depending on:

- your gender (since on average, women live longer than men)
- your age when purchasing the annuity
- your age when your annuity payments begin
- how proceeds from the annuity are distributed
- how many lives are covered by the annuity
- the institution from which you purchase

Ask about other costs and conditions associated with annuities, such as:

- ***payment rates***, including the current rate, the guaranteed minimum rate, and how often the company declares a new rate.

- ***sales charges*** referred to as load. Load is a sales charge collected by the plan. A no-load plan has no sales charge. A front-end load plan has a sales charge on the amount invested. A back-end load plan assesses a charge on the redemption of funds in the plan regardless of the length of time you have had the plan.

- ***early withdrawal penalties*** charged if you withdraw from your annuity before age 59½.

- *surrender fees* charged if you withdraw more than 10% of your money from an annuity in one year.

- *other fees* charged, including administrative, management, maintenance, mortality and expense-risk fees.

- ***your ability to borrow against your principal*** before the payout period begins. If this is allowed, how is the interest rate determined?

Self-Employment Pension Plans

Simplified Employee Pension (SEP)

SEP-IRA
Simplified employee pensions (sometimes known as **SEP-IRA**) are special retirement plans for the self-employed and their employees. They permit small businesses and people who work for themselves to contribute a discretionary amount into employees' IRAs each year. Each participant can make tax-sheltered contributions representing 0 to 25% of net self-employment income or up to a specified maximum amount in the tax law. Participants may vary the percentage of earned income they place in the SEP-IRA each year, or skip a year if desired.

SIMPLE-IRA
A SIMPLE-IRA plan is a salary reduction plan for employees of the self-employed. The employer can make a tax-deductible contribution, and employees are allowed to defer a percentage of their income into the retirement plan. The funds will grow in the SIMPLE-IRA on a tax-deferred basis. A SIMPLE-IRA is owned by the employee and belongs to the employee, even if employment is terminated. It is possible for someone to have both an IRA to shelter wages and a SEP to shelter self-employment income.

Keogh Plan

A Keogh plan allows self-employed people to make large tax-deferred payments (as much as 25% of self-employment income) for themselves and their eligible employees to a pension-plan fund. Any individual who is self-employed, either full-time or part-time, is eligible to set up a Keogh account. Not only can self-employed business people use Keoghs, they can also be used by individuals who hold full-time jobs and "moonlight" on a part-time basis.

Keogh accounts can be opened at banks, insurance companies, brokerage houses, and other financial institutions.

Annual contributions must be made at the time your tax return is filed or by April 15 of the following calendar year. Though a designated financial institution acts as keeper of all the funds held in a Keogh account, the actual investments held in the account are under the complete direction of the individual contributor. The income earned from the investments must remain in the account, but it accrues tax-free until withdrawal.

There are several types of Keogh plans. The first three are defined contribution plans.

1. ***Profit sharing***, where discretionary contributions are based on profits, although that contribution cannot exceed a fixed percentage of business profits.
2. ***Money purchase***, where contributions are a fixed percentage of compensation and must be made each year.
3. ***Combination of purchase and profit-sharing***.
4. ***Defined benefit***, where contributions are made based on a percentage of earnings. The annual limit imposed is higher than the defined-contribution plans and the amount contributed each year can vary greatly.

HECM Borrower Eligibility

- ✔ Be 62 or older
- ✔ Own home property
- ✔ Occupy as primary residence
- ✔ Participate in counseling session
- ✔ Meet FHA property standards
- ✔ Maintain home with needed repairs, property taxes and insurance

All Keogh contributions and investment earnings must remain in your account until you turn 59 1/2, unless you become seriously ill or disabled. However, you are not required to start withdrawing the funds at age 59 1/2. You can stay with the plan and continue to earn tax-deferred income until age 70 1/2 at which time you must begin withdrawals. Once you start withdrawing funds from your Keogh account, all withdrawals are treated as ordinary income and subject to income taxes. However, taxes tend to be lower than when you were working because you may be in a lower tax bracket after retirement.

Home Equity Conversion

Home equity is the most important asset for many older people. Because most tend to have relatively low income and high net worth, some could benefit from converting their home equity into income.

Reverse-annuity mortgages (RAMs) are the most common form of home equity conversion. “HECM” refers specifically to reverse mortgages that are insured by HUD (Department of Housing and Urban Development) and the FHA (Federal Housing Administration-a part of HUD).

The American Association of Retired Persons (AARP) has several good publications on home equity conversion. For these and another good publication by Fannie Mae, see the web site list provided.

Reverse-Annuity Mortgage (RAM)

A Reverse Annuity Mortgage (RAM) allows a homeowner to borrow against the equity in a fully paid home. This option is designed to enable you to remain in your home while using some of the equity in it.

Usually people receive the proceeds of a RAM in a series of monthly payments. No interest is charged during the time period of the loan. The home is sold to pay the accrued interest and principal at the end of the loan period, which is usually set to be the owner’s death.

A risk of this type of loan is that you may outlive the loan agreement and find yourself with no home and no equity.

Difference between a Reverse Mortgage and a Home Equity Loan
A home equity loan is a second mortgage or home equity line of credit. It has strict requirements for income and creditworthiness. As with other traditional loans, the homeowner must still make monthly payments to repay the home equity loan. A reverse mortgage has no income or credit requirements and instead of making monthly payments, the homeowner receives payments.

FOR MORE TRUSTWORTHY INFORMATION ON REVERSE MORTGAGES, CHECK OUT THESE WEBSITES:

Source	Web Address
AARP Home Equity Information Center	www.aarp.org/money/personal/articles/newloan.html
Fannie Mae, The Home Keeper Mortgage	www.fanniemae.com (then search for reverse mortgages)
Federal Trade Commission	www.ftc.gov/bcp/edu/pubs/consumer/homes/rea13.shtm
HUD, Top Ten Points	www.hud.gov (then search for reverse mortgages)
Senior Resource, Reverse Mortgages	www.seniorresource.com/finance.htm#reverse

TABLE 5. THE IMPACT OF TIME VALUE OF MONEY AT 6% INTEREST

Age	Contributions Made Early		Age	Contributions Made Later	
22	2000	**Total of $22,000 Invested**	22	0	
23	2000		23	0	
24	2000		24	0	
25	2000		25	0	
26	2000		26	0	
27	2000		27	0	
28	2000		28	0	
29	2000		29	0	
30	2000		30	0	
31	2000		31	0	
32	2000		32	2000	**Total of $68,000 Invested**
33	0		33	2000	
34	0		34	2000	
35	0		35	2000	
36	0		36	2000	
37	0		37	2000	
38	0		38	2000	
39	0		39	2000	
40	0		40	2000	
41	0		41	2000	
42	0		42	2000	
43	0		43	2000	
44	0		44	2000	
45	0		45	2000	
46	0		46	2000	
47	0		47	2000	
48	0		48	2000	
49	0		49	2000	
50	0		50	2000	
51	0		51	2000	
52	0		52	2000	
53	0		53	2000	
54	0		54	2000	
55	0		55	2000	
56	0		56	2000	
57	0		57	2000	
58	0		58	2000	
59	0		59	2000	
60	0		60	2000	
61	0		61	2000	
62	0		62	2000	
63	0		63	2000	
64	0		64	2000	
65	0		65	2000	
Amount available at age 65	**$217,120**			**$208,368**	

Counseling Requirement
There is a federally mandated feature of the reverse mortgage process that requires reverse mortgage applicants to meet with a government-approved housing agency counselor before completing the reverse mortgage application. HUD certifies housing counselors across the country to give homeowners impartial education about reverse mortgages. After the counseling sesion, the counselor mails a signed copy of the HECM Counseling Certificate to the homeowner. This certificate is presented to the lender with the reverse mortgage application.

TABLE 6. AMOUNT YOU MUST INVEST EACH MONTH AT DIFFERENT INTEREST RATES TO HAVE A $10,000 LUMP SUM AT RETIREMENT

Years Before Retirement	6%	8%	10%	12%
5	$149	$136	$130	$129
10	63	55	50	47
15	36	29	25	21
20	23	17	14	11
25	15	11	8	6
30	10	7	5	3

TABLE 7. HOW LONG WILL YOUR MONEY LAST?*

Starting with a lump sum of	...you can withdraw this much each month for the stated number of years, reducing the capital to zero					...OR you can withdraw this amount each month and always have the original capital intact
	10 yr	15 yr	20 yr	25 yr	30 yr	
$10,000	$ 116	$ 89	$ 68	$ 70	$ 66	$ 59
15,000	174	134	116	106	99	88
20,000	232	179	155	141	133	118
25,000	290	224	193	176	166	142
30,000	348	269	232	212	199	179
40,000	464	359	310	282	266	237
50,000	580	448	386	352	332	285
60,000	696	538	464	424	398	360
80,000	928	718	620	564	532	467
100,000	1160	896	772	704	668	585

(Based on an interest rate of 7% per year, compounded quarterly.)

WORKSHEET 9. ESTIMATED ANNUAL INCOME AFTER RETIREMENT

		Yearly Income
1. Social Security		____________
Man's at age _______		
Woman's at age _______		
2. Pension and Employer Benefits	Company	____________
	State or federal government	____________
	Veteran's	____________
	Union or other	____________
	Profit sharing	____________
	Deferred pay	____________
	Other	____________
3. Savings and Investments	IRA	____________
	Keogh	____________
	Savings account (interest)	____________
	Money market (interest)	____________
	Treasury securities (interest)	____________
	Mutual funds (dividends, capital gains)	____________
	Stock (dividends)	____________
	Bonds (dividends)	____________
	Real estate	____________
	Farm/business rent or installment payments	____________
	Home equity conversion	____________
	Annuities	____________
	Other	____________
4. Earnings	Salary, wages	____________
	Commissions, royalties, fees	____________
	Partnership income	____________
5. Assets that could be liquidated	Real estate	____________
	Mutual funds	____________
	Stocks	____________
	Bonds	____________
	Antiques, collectibles	____________
	Farm/business	____________
	Anticipated gifts or inheritance	____________
Estimated Total Gross Income		____________
Possible deductions from income	Federal income tax	____________
	State/city tax	____________
	Social Security tax	____________
Total		____________

(Subtract total tax deduction from total gross income to estimate your total net income.)

Total Estimated Net Income ____________

Saving and Investing

Even if you will receive benefits from Social Security and payments from other types of retirement plans, you may still not have enough income to live comfortably. This gap is the reason a retirement savings program is so important.

The earlier you begin to save, the better off you will be. It is often difficult to save because current needs and wants keep popping up – new clothes for the children, health care costs, car or home repairs, education, a trip. But saving is worth the effort. Every dollar you can set aside today could mean $3 or $4 in retirement because of compounding of interest and the number of years it is saved.

Table 5 dramatically shows the impact of saving early in life and then stopping (but not touching the account), versus not saving at all until later. This table indicates that if you saved $2,000 from age 22 through age 32 (a total investment of $22,000) and then did not save after that, you could have $217,120 at age 65 with compounding of interest at 6%. With that same compounding rate, if you saved $2,000 yearly starting at age 32, the total accumulated at age 65 would be $208,368. Despite the fact that you save more in total later, you actually save less overall than if you began early.

But if you did not begin to save for retirement early, take heart. It is always better to save now than never save at all.

How Much Should I Save for Retirement?

How much to save depends on how many years you have until retirement and what interest rate you think you can earn on your savings. Table 6 gives the amount you must invest each month at different interest rates to have a $10,000 lump sum at retirement. For example, if you plan to retire in 15 years, you will need to save $36 per month and earn 6 percent interest to accumulate $10,000.

Once you have retired, you can use savings in two ways: use the interest income only or use both interest income and principal. Using only interest guarantees you will not outlive your income source, but you need much greater savings to do so. If dipping into your capital is necessary, consider such factors as how well insured you are against medical and other financial catastrophes. Also consider how much you want to leave your children in gifts or inheritances.

As people continue to enjoy longer life spans, many retirees fear outliving their savings. Use Table 7 as a guideline to estimate how long your money will last if you start drawing it out. Here is an example using the two scenarios in Table 7:

If you had $25,000 in an account, you could withdraw $193 per month and the money would be gone in 20 years. Or you could withdraw $142 each month and the original amount would remain intact. (As indicated in the table, these figures are based on an interest rate of 7 percent, compounded quarterly. Your interest rate may be different and you will need to adjust accordingly.)

Estimating Your Retirement Income

Worksheet 9 can help you estimate your total retirement income from various sources, many of which have been discussed in this chapter. Compare these figures to the projected annual retirement expenses you have estimated from Worksheet 6 in Chapter 2. These annual income and expense figures will help you locate gaps between retirement spending and income. You can then set up a savings program to reduce or eliminate these gaps. When developing your savings plan, be sure to use the decision criteria and the product characteristics provided in Chapter 4.

Chapter 4

Saving and Investment Options

Many people procrastinate when it comes to saving and investing for retirement. Too many say, "I'll start tomorrow. I can hardly make ends meet now." The result is that by the time they get serious about generating retirement income, their money doesn't have enough time to grow. This chapter examines ways to accumulate money beyond the retirement income sources discussed in Chapter 3. If you are unfamiliar with some of the terminology used, please see the Glossary.

First Things First

Some people are very attracted to the idea of making money fast, even when there is no guarantee it will turn out that way. They invest money before they have done other basic things to build a financial foundation. If an investment doesn't work out as planned, they find themselves in serious financial trouble. You must build a solid financial foundation ***before*** you start saving and investing. Such a foundation consists of these eight building blocks or components:

BUILDING BLOCKS OF A SOLID FINANCIAL FOUNDATION

1. Solvency
2. An emergency reserve
3. Access to credit
4. The right amount and type of insurance protection
5. Home ownership
6. Savings and investments
7. A retirement plan
8. An estate plan

1. **Solvency:** Solvency means having enough income to meet current expenses. Make sure you have a budget that allows you to do this before you think of investing, rather than thinking an investment you can't afford will make you solvent. If you have questions about developing a spending plan or would like help in balancing your budget, go to the website below which has a number of helpful resources.
   www.extension.iastate.edu/financial/management.html#Planning and Tracking

2. **Emergency Reserve:** You need to establish an emergency fund to pay for unexpected bills. Paying the emergency fund should be considered a standard monthly payment just like paying any other bill. An ideal emergency fund is two or three months' worth of take-home pay. This emergency reserve needs to be liquid, meaning you can access this cash quickly.

3. **Access to Credit:** Be sure you have access to credit. While accumulating too much debt is never a good idea, it is still important to be able to get credit when you need it, whether you are financing a car or replacing a furnace. Credit may be a personal loan from a bank or a credit card. You can develop a good credit history by paying credit card and all other bills on time and repaying any personal loans according to the terms of the loan contract. Developing a good credit history is essential for getting any additional credit you may need in the future such as a mortgage.

4. **Insurance Protection:** Everyone must have an insurance plan that guards against financial loss due to premature death, disability, illness, property damage, and liability. Chapter 6, ***Protecting Against Risks with Health and Life Insurance*** gives you the information to tailor an insurance plan to your needs.

5. **Home Ownership:** If you are nearing retirement and your home mortgage is not paid off, you need to be making good progress toward that goal. Though home ownership is not for everyone, it is a good investment (especially during periods of inflation) because it *appreciates*, or gains value, over time. It also provides financial security through the *equity*. Equity is the market value of your home minus any amount remaining on the mortgage. The equity builds over time, making your home not just your shelter but also a smart investment. For those who do not want to own a home, buying other property or something else that appreciates at a comparable rate of return will also work.

6. **Savings and Investment:** In order to save, you need an original amount of cash that you do not withdraw. This money earns a guaranteed rate of interest. It is expected that you will get back everything you put in, plus the guaranteed earnings. This is known as a fixed-dollar feature.

   Unlike savings, investments have a variable-dollar feature. In other words, the initial amount you put into an investment often depends on when you buy it. From there, how much of your investment you recover or make money on will vary. The value of an investment can go up or down and there are no guarantees that you will make any money. There have been changes in the financial industry so that now some saving options have a variable-dollar rate of return, just as a standard investment has. It is important to consider your financial situation, your tolerance for risk, and your stage of life when considering saving and investing options.

7. **Retirement Plan:** A sound retirement plan is one that makes clear where you're going to retire, and how you will get there financially. Once you have a plan, review it regularly to see whether your goals have changed and ensure that your finances are arranged to allow you live the later part of your life as you wish. This book provides information on several important topics you will need to consider when developing a retirement plan.

8. **Estate Plan:** You will want to develop an estate plan that leaves legal instructions of how you would like your net worth divided for your loved ones' inheritance. Communication with your partner about how assets will be distributed and talking through areas of disagreement is essential before developing a plan with an expert or estate planner.

It isn't necessary to build your foundation in exactly this order, but it is crucial to be sure you are solvent and have at least an emergency reserve and insurance protection before establishing an investment plan. After these essential building blocks are in place, other components of a financial foundation can be worked on simultaneously.

Methods of Saving Money

Some people find it easier to save than others, but nearly anyone can save. What may work well for you might not work for someone else. Pick a saving method that best fits your temperament and circumstances. Don't be afraid to try another method if your first one doesn't work. It's never too late to try new options. Saving in regular, smaller amounts is usually more successful than putting aside larger amounts sporadically. This small habit pays large dividends.

Pay Yourself First. One way to save is to pay yourself first. Consider the monthly amount as a fixed expense like a house payment or utility bill, necessary, regular, and at the top of your bill-paying list. If you wait until the end of the month to save, chances are that there will not be anything left. Paying yourself keeps you consciously aware of what you're doing and why, so you can experience the satisfaction of sticking to your decision.

Deduct money directly from your paycheck. Some people find that paying themselves only makes them conscious that this is money they could spend instead, and have a hard time remaking the decision to save each month. If this is the case, try having an amount automatically deducted from your paycheck and put into savings. You may find the process easier if it happens invisibly and automatically.

Save loan payments after the loan is paid. You may also choose to save monthly loan payments after a loan is repaid. You got along without it before, so why not save the extra money?

Save windfalls. Saving *windfall* income is another alternative. Windfall income is money you receive that is not normally part of your budget such as an unexpected bonus, a tax refund, a gift, or overtime pay. When that extra money is received, place it immediately into your savings.

Cut back on a regular expenses and save the difference. Another saving method is to decide on a set amount of time to save money you routinely spend. Cut back on something you can easily postpone or eliminate. A period of more modest living can help you save quickly and perhaps eventually change your lifestyle. If you have children, make the decision of what to cut as a family so you can support each other as you save. Children can learn a great deal about money by the example set by family members and often enjoy being included.

Deciding How Much to Save

In order to decide how much to save, you'll want to think through your reasons for saving and set specific goals. Goals give direction and meaning to your actions. Goals are most easily reached when they are compelling, specific, realistic, and flexible. They reflect your values and what you really want out of life.

Begin filling out Worksheet 10 by listing your short-term goals. These are goals you can reach in six months or less. Saving for vacation, a computer upgrade, or new pieces of furniture are some examples. Continue by listing your long-term goals. These are saving goals that take anywhere from half a year to many years to achieve. Such long-term goals might include saving for an emergency fund, for retirement, for a new car, or for a child's college education. If you have a partner, make a copy of Worksheet 10 before writing on it. Each partner should fill out a sheet separately and then figure out together how to combine your individual goals.

With your goals in hand, calculate how much money you need to put aside monthly in order to achieve them. If you are calculating a short-term goal, simply take the total amount you need to save and divide it by the number of months you have to save for it.

Ways to save:

- ✔ *Pay yourself first.*
- ✔ *Have money deducted directly from your paycheck.*
- ✔ *Save monthly loan payment after the loan is paid.*
- ✔ *Save windfalls.*
- ✔ *Cut back on a regualr expense and save the difference.*

WORKSHEET 10. SAVING GOALS

If you have a partner, make copies of this worksheet so you can each fill one out. Then fill one out together as you decide how to combine your goals.

Short-Term Goals

	Target Date	Estimated Cost
e.g., Christmas Shopping Money	December 1	$250

Long-Term Goals

	Target Date	Estimated Cost
e.g., New Car	in 3 years	$10,000

TABLE 8. MONTHLY SAVINGS NEEDED TO REACH A GOAL

Total Dollars Needed	Years to Achieve Goal			
	5 yrs.	10 yrs.	15 yrs.	20 yrs.
At 3% rate of return				
Monthly Savings Needed to Reach Goal				
$ 5,000	$ 78.48	$ 36.35	$22.40	$15.51
$10,000	156.96	72.69	44.81	31.01
$15,000	235.45	109.04	67.21	46.52
$20,000	313.93	145.38	89.61	62.02
At 6% rate of return				
Monthly Savings Needed to Reach Goal				
$ 5,000	$ 74.40	$ 31.57	$17.88	$11.32
$10,000	148.81	63.13	35.77	22.64
$15,000	223.21	94.70	53.65	33.97
$20,000	297.62	126.26	71.53	45.29
At 9% rate of return				
Monthly Savings Needed to Reach Goal				
$ 5,000	$ 65.80	$ 25.65	$ 13.11	$ 7.43
$10,000	131.60	51.29	26.23	14.86
$15,000	197.39	76.94	39.34	22.29
$20,000	263.19	102.58	52.46	29.72

If you are calculating a long-term goal, Table 8 will help you determine how much to save each month, *without skipping months or withdrawing any cash*, to accumulate the necessary money by a certain date. For example, if you decide you need $5,000 in five years to replace a car, you must put $74.40 each month in a savings account with a 6 percent rate of return – that is, earning a 6 percent interest rate – in order to reach your goal in five years. If you want to have $10,000 accumulated in a retirement fund 10 years from now, you must save $51.29 monthly at a 9 percent rate of return. Keep in mind that depending on how the economy is doing, interest rates can vary a lot.

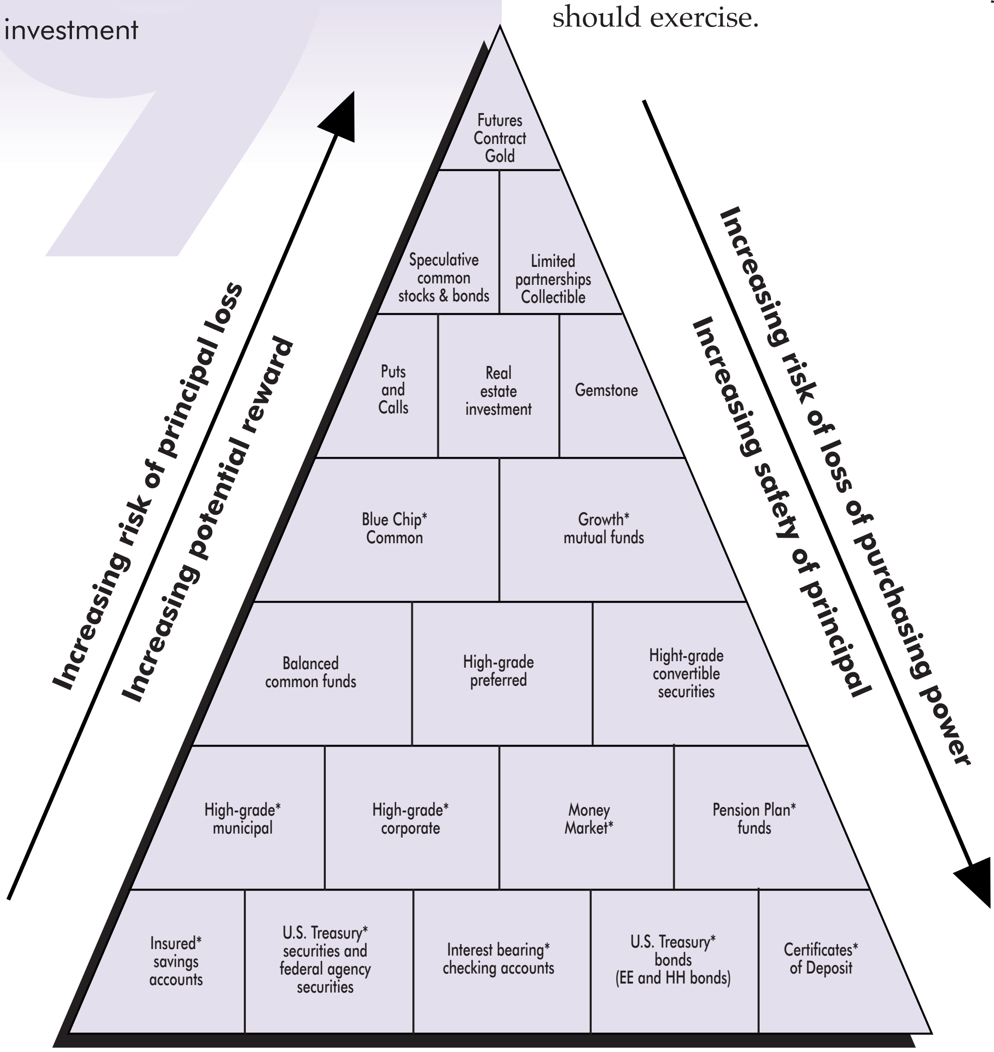
Deciding to Invest

Once saving goals are met, consider investing. There are many ways to invest, but which one should you choose? Here are the things you should take into account.

Nine Factors to Guide Your investment Decisions:

1. Degree of risk
2. Rate of return
3. Liquidity
4. Management requirements
5. Maturity
6. Fluctuations in the economy
7. Tax consequences
8. Minimum deposit
9. Costs and fees of investment

Degree of Risk. The *degree of risk* you want to take with an investment is your first guiding factor. Each person has a different risk tolerance. When deciding, take into account your age, health status, family responsibilities, job stability, and the current state of the economy. For instance, if worrying about an investment is going to disturb your sleep or state of mind, you are definitely at a risk level that is beyond your tolerance. If you have a partner and share your money, it is crucial to talk together about the risk tolerance each of you is willing to take and make sure that your investment choice reflects the risk you, as a couple, are willing to take. The closer you are to retirement, the less risk tolerance you should exercise.



*Best for Beginning Investors

FIGURE 1. INVESTMENT RISK AND RATE OF RETURN

Adapted from: Investment Alternatives for the Beginning Small Investor, M. A. Goetting, Montana State University Cooperative Extension Service, #2P014, 2000.

Although you cannot eliminate the risk factor of investing, there are two ways to reduce it: diversify your holdings and become more knowledgeable. To diversify your holdings is to have your money in several kinds of investments rather than just one. Learn what the differences are among investments. Absorbing the information in this publication is a good start; the references provided at the end will give you more information. You may need the guidance of a trustworthy financial consultant as well.

Rate of Return. The *rate of return* is another factor to consider. The rate of return on any investment is, in turn, affected by several factors: your tax bracket, whether the return on your investment is taxable, whether there are commissions or fees, and the rate of inflation. There are fixed rates of return and variable rates of return. If an investment has variable rates of return, review the index that determines the rate of return. If the degree of risk is high, the rate of return is usually high as well.

Figure 1 illustrates how risk and return are related. As you move toward the top of the pyramid, the risk of losing the money you put into the investment is greater, but the potential for making more money is also greater. As you move from the top of the pyramid downward, your risk level is lower, but so is the amount of money your investment can make. The starred items in the pyramid are good options for beginning investors because they have less risk than the items near the top of the pyramid.

Liquidity. How readily you can turn the current value of your investment into cash is called the *level of liquidity*. Be sure some of your investments are fairly liquid. The amount of investment that should be liquid will depend on your family and financial circumstances.

Management Requirements. Unlike savings, *managing investments* takes time and attention. Time is scarce for many people, and some investments require higher maintenance than others. On the pyramid in Figure 1, the starred items with lower rates of return and lower risk are also items that require less time, knowledge, and experience to manage. You can hire a professional for help, but it is important that you also have time, knowledge, and skills to manage investments effectively. Consider how much time you have and how much help you'll need with each investment. The public library has extensive information on investing as well as saving. In addition to understanding the basics, stay current on general business trends. *The Wall Street Journal*, *Barron's*, and other periodicals like *Money*, *Changing Times*, *Business Week*, and *Fortune* are useful sources.

Maturity Level. The point when an investment company must pay the face value of your investment is known as its *maturity level*. Shop around to find the most favorable maturity level for your circumstances because deregulation has affected many investment options. Not all saving and investment options have a maturity level. Usually, if there are specified maturity levels, there is a lower rate of return.

Fluctuations in the Economy. Fluctuations in the economy or the inflation rate affect your rate of return on any investment. Investments whose value moves with price changes are most profitable during inflationary times. When prices go down, however, you are better off with investments that have fixed return rates.

Taxes. Both inflation and taxes affect the *real rate of return* on your investments. The real rate of return is the profit you make after both inflation and taxes are taken into account. Find out whether an investment is taxable, tax exempt, or tax deferred until some later time such as after you retire. Know your income bracket, which is

Remember: Unlike savings, an investment always carries the risk of losing money rather than making it.

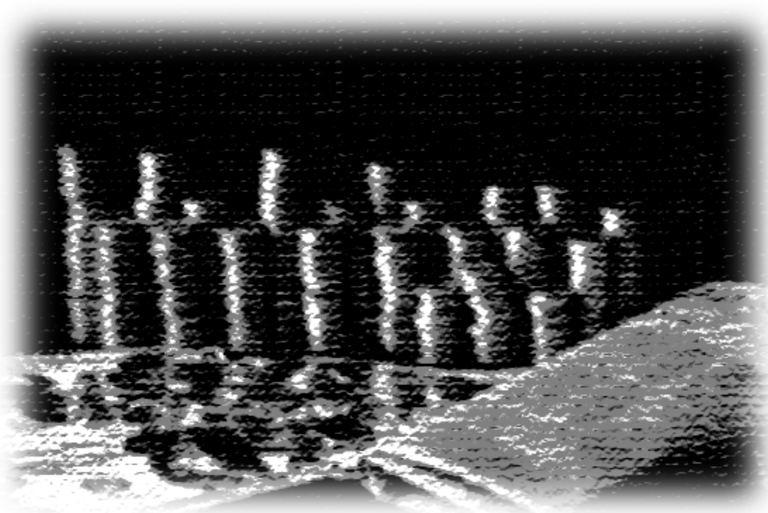
sometimes known as your *marginal tax bracket*. When your marginal tax rate goes up, more of your earnings and profits are taxed by the government. This, in turn, lowers the amount you have to save, spend, or re-invest.

Minimum deposit. The minimum deposit your investment requires is another factor to consider. This cash deposit needs to be readily available. If this is a stretch for you, it may also be the wrong investment.

Costs and Fees. There are often additional costs and fees you'll also be expected to pay in addition to the initial deposit. Ask about service charges, transaction fees, early withdrawal penalties, commissions, and annual maintenance fees involved in the investment.

Your Investment Priorities

Among the nine factors we have discussed, consider which are most important to you. Know what you want and what you're willing to put into an investment before you buy. By having clear priorities, you can sift much more easily through the vast amount of investment information that confuses many people.



Say, for instance, you realize your goal requires that you have an investment with a medium degree of risk, money that is fairly liquid, and few management requirements. You have narrowed down your options already, and have a much better idea of where to begin.

Your priorities are likely to change with time. Earlier in life you many want an investment with low risk and easy liquidity so you can access it for emergencies. By midlife you may be earning more and perhaps you have children who are now off on their own, so you have more time and money for investment. Then the rate of growth and tax consequences may become greater priorities. As you grow closer to retirement, lower risk is likely to be important again, because your earning days are nearing an end and it becomes important to preserve the capital you've built.

How to Compare Your Saving and Investment Options

Now you are ready to begin making an informed decision about saving and investing. Start with Table 9 which gives you basic information and an overall view. On some options listed in the table, the rate of return rate is left blank because that information changes frequently and often varies. Check the current rate from your local financial institution.

TABLE 9. SOME SAVINGS AND INVESTMENTS OPTIONS

Option	Principal Risk Potential	Liquidity	Minimum Amount Required	Maturity Period	Rate of Return	Capital Growth	Tax Advantage	Management Required
PASSBOOK/ SHARE DRAFT SAVINGS ACCOUNTS	Fixed	Excellent	Very Low	NA	Fluctuates	None	None	None
MONEY MARKET SAVINGS ACCOUNTS	Fixed	Excellent	Varies	NA	Fluctuates	None	None	None
MONEY MARKET MUTUAL FUNDS	Fluctuates	Very Good, Excellent	Varies	NA	Fluctuates	None	None	*Low
CERTIFICATES OF DEPOSITS	Fixed	Fair	Varies	3 mos. - 60 mos.	Fixed	None	None	None
U.S. SAVINGS BONDS	Fixed	Fair			Fixed	None	State	None
Series EE			$50	12 years				
Series HH			$500	20 years				
U.S. TREASURY BONDS	Fixed**	Good	$1,000	30 year	Fixed for term**	None**	State	Low
U.S. TREASURY NOTES	Fixed**	Good	$1,000	1-10 years	Fixed for term**	None**	State	Low
U.S. TREASURY BILLS	Fixed	Good	$1,000	1 year 3 or 6 mos.	Fixed for term**	None**	State	Low
STOCKS	Fluctuates	Varies	Varies	NA	Varies	Varies	None	High
CORPORATE BONDS	Fixed**	Varies	$1,000	Varies	Varies	None**	None	Medium
MUTUAL FUNDS	Fluctuates	Varies	Varies	NA	Varies	Varies	None	Medium
REAL ESTATE	Fluctuates	Low	Varies	NA	Varies	Varies	Depreciation	High
COLLECTIBLES	Fluctuates	Low	Varies	NA	Varies	Varies	None	Varies

NA Not applicable
* *Some money markets are made up of tax-exempt bonds. If this is the case, the earnings would be tax exempt.*
** *The interest payments and the return of principal are fixed (unless sold prior to maturity and then could experience gain/loss on original investment).*

Table 10 gives you more information on the chief features of each savings and investment option, along with its advantages and disadvantages. Match these up with the factors you've decided were priorities to further narrow the options.

TABLE 10. SAVINGS AND INVESTMENT CHOICES

Investment Choices	Main Features	Advantages	Disadvantages
Savings accounts – Regular passbook	Frequency of compounding the interest varies.	Can use as collateral for a loan. Usually insured by FDIC for up to $250,000 per depositor per bank. Interest credited from day of deposit to day of withdrawal & gives greatest flexibility.	Interest rates are regulated by law and are relatively low. Interest is subject to federal & state income tax. There is a maximum amount that will be insured. Earns low interest compared to other choices.
Certificates of deposit and time savings accounts	Depositor decides number of months or years she or he wants to agree to.	Interest can be added to the account or paid quarterly to customer. Interest rates are higher for the long time periods.	Penalty for withdrawal before maturity date. The minimum deposit may be too large for some customers.
Money-market certificates	Six months to maturity is the common time period. Interest rate when purchased depends on the price of six-month U.S. Treasury bills.	Buyer has security of having fixed interest and certificates are insured by federal gov't up to $250,000.	May not redeem certificate before six months without penalty. The minimum amount of $10,000 to buy a certificate may discourage some buyers.
Share accounts (credit unions)	Similar to savings accounts in banks and S&L associations.	Can use as collateral for a loan.	Interest is usually figured monthly on amount that stays for whole month or from 10th through rest of month.
U.S. savings bonds Series EE	Purchased often by payroll deduction. Face value ranges from $50 to $10,000. The purchase price is 50% of face value (i.e., $25 for a $50 bond).	Safety backed by U.S. government. Replaced free if lost or stolen. Can be redeemed before maturity. No fee for buying or redeeming.	Can't use as collateral. Interest is subject to federal income tax. There is a maximum limit that can be bought in 1 year. Long time until mature – 12 years – but can be redeemed after 6 months.
Corporate bonds	The certificate a buyer receives represents a loan to a company. On the certificate are printed interest rate, maturity date, and its face value (the amount to be received at maturity by the bondholder).	Two independent services, *Moody's* and *Standard and Poor* rate bonds regarding their safety. Buyer may be able to purchase a bond at discount (below its face value) and/or sell it at premium (above face value) before its maturity date. The usual face value is $5,000.	They may have a long period until they mature unless buyer purchases older bond which is nearer maturity. Buyer should ask broker whether bond is callable (company has right to redeem before maturity date).

Investment Choices	Main Features	Advantages	Disadvantages
Municipal bonds (often called tax-exempt bonds)	They are loans by an investor to a state or local government or related agency. They are bought through a broker. These certificates also have their face value, maturity date and interest rate printed on them. Interest is usually paid twice a year.	The information on corporate bonds applies to municipal bonds. In addition, interest from these bonds is exempt from federal income tax. Check whether these bonds are exempt from state tax. Some bonds have a face value as small as $500.	Since the interest rate is fixed, the buyer may receive more interest or less than other investments are paying during the same period. Degree of risk varies considerably.
Corporate stocks	Buying shares in a company means partial ownership of it. A broker having access to a stock exchange must place the order. A commission fee in most cases is charged for buying or selling. Orders for 100 shares are called round lot; fewer than 100 are odd lot orders. Prices are quoted in dollars and eighths of dollars (72-7/8, 14-1/2, 36-1/8).	If stockholder sells for more than was paid, there's a gain on the investment. No time limit on owning shares of stock. Stock certificates have owner's name on them; dividends are posted quarterly.	Dividends are subject to federal and state income tax. Shareholders of common stock have no guarantee of dividends. If stockholder sells at a lower price than it was purchased at, the stockholder loses on the investment.
Mutual funds	Buyer gets a share in mutual fund company which may own a diversified group of stocks, bonds & other investments. They charge an annual management fee. They may have a sales charge.	Can buy through broker or fund's sales representative or directly. Some funds select their portfolios for a particular objective – high capital gains or liberal income or long-term growth. "No load" funds do not have a sales charge, but are subject to management fees.	There is no agency that directly* insures safety of investors' funds. Yield fluctuates with changing economic conditions.

**SEC has requirements that provide certain protection (SEC=Security Exchange Commission)*
Adapted by Dr. Sharon M. Danes, Professor and Family Economist from a similar document by Dr. Cindy Fletcher, Family Resource Management, Iowa Extension Service.

Investment Choices	Main Features	Advantages	Disadvantages
Money-market funds	Available from brokers, private investment companies and directly from fund. Usually a minimum amount is required when opening the account. Smaller deposits allowed after that. Some funds send monthly statements.	Withdrawal of part or all of buyer's investment permitted without charge. Interest is figured daily. Yields tend to be higher than other saving choices.	There is no agency that directly* insures safety of investor's funds. Yield (interest) fluctuates with changing economic conditions.
U.S. Savings Bonds **Series HH**	HH Bonds are bought at their face value of $500; $1,000; $5,000; or $1,000	Semi-annual interest checks are mailed to bondholders. Interest rate is 6%. HH bonds can be obtained in exchange of owner's existing E or EE bonds.	Bonds redeemed early are cashed in at slightly less than face value.
U.S. Treasury bills	Minimum amount is $1,000. Treasury sets up a book entry account for buyer who receives a receipt (not a certificate) as evidence of purchase. It should be kept in safe place. New bills are sold at scheduled auction; prices are set by investors' bidding. Buyer chooses 3, 6, or 9 months to maturity and may renew it.	Safety is backed by U.S. Gov't buyer gets a check promptly for the interest which is the difference between $10,000 and auction price. Interest is exempt from Minnesota income tax.	Buyer may be unable to make such large loan. Interest is subject to federal income tax. Buyer sends purchase money without knowing the price until after auction is over.
U.S. Treasury notes & Bonds	Maturity of notes range from 2 to 10 years. Bond maturities are usually 10 years or longer. Notes & bonds are issued in $1,000; $5,000; $10,000 and higher amounts.	Registered certificates have owner's name on them and semi-annual interest is mailed to that person. Interest is exempt from Minnesota income tax.	Buyer doesn't know price of new notes and bonds until after competitive bidding at auction. Bearer notes and bonds are unregistered and certificates have coupons attached to be cashed by buyer to get interest payment.

**SEC has requirements that provide certain protection (SEC=Security Exchange Commission)*
Adapted by Dr. Sharon M. Danes, Professor and Family Economist from a similar document by Dr. Cindy Fletcher, Family Resource Management, Iowa Extension Service.

Tax-Deferred versus Taxable Options

Compare the after-tax return of taxable and tax-deferred investments. Some consumers find this comparison confusing. There are a couple of simple equations that can make this comparison easier.

If you want to convert a *tax-deferred* yield to its *taxable* equivalent, use this formula:

Tax-Deferred Yield ÷ (1 - Federal Tax Bracket) = Taxable Equivalent

For example, if you are in the 28% tax bracket, a tax-deferred yield of 9% would be equivalent to a taxable yield of 13%.

$.09 \div (1 - .28) = .13$ or 13% or $\frac{.09}{(1 - .28)} = .13$

If you want to convert a *taxable* yield to its *tax-free* equivalent, use this formula:

Taxable Yield X (1 - Federal Tax Bracket) = Tax-Deferred Equivalent

For example, a person in the 28% tax bracket investing in a bond with a 13% taxable yield would have an equivalent tax-deferred yield of 9%.

$.13 \times (1 - .28) = 0.09$ or 9%

Putting It All Together

Now that you have the basic tools for decision making, you are ready to apply them to your own situation. You can make the saving and investment choices that best reflect your present needs, keeping in mind your long-term goals. No choices are best for everyone. Tailor your decisions to your own needs and make adjustments as your circumstances change.

GLOSSARY OF INVESTMENT TERMS

Bear market: A market in which stock prices are generally declining.

Blue-chip stock: Stock of a company with a well-regarded reputation and a long history of both good earnings and consistent cash dividends.

Bull market: A market in which stock prices are generally increasing.

Call: An option contract that gives the option holder the right to buy the optional asset from the option writer at a specific price (the striking price).

Capital: Funds invested in a business enterprise.

Capital gain: Income received from the sale of a capital asset above the costs incurred to purchase and sell the asset.

Capital loss: A financial loss on an investment that occurs when the selling price (plus expenses) is lower than the original amount invested (plus commissions).

Certificate of deposit (CD): A form of fixed-time period savings that pays greater interest rates than regular savings accounts because financial institutions can count on having the funds for a fixed period and can make longer-term investments accordingly.

Common stock: Gives its owners a variable rate of return, depending on how well a company did in a given year.

Compound interest: The calculation of interest on reinvested interest as well as on the original amount invested.

Corporate bond: Money you are lending to a corporation, usually for a considerable period of time, that is used to finance long-term investments such as the expansion of a plant or the addition of equipment. These bonds do not represent a share in the business as common stock does.

Discount brokers: Firms that offer lower rates because of fewer customer services, smaller sales staff, or fewer investment analysts. They just buy and sell stock for you. May be worth using if you have an investment of at least $5,000.

Diversification: A stock portfolio strategy designed to reduce exposure to risk by combining a variety of investments which are unlikely to all move in the same direction, which reduces both the upside and downside potential and allows for more consistent performance under a wide range of economic conditions.

Dividends: Cash profits distributed to shareholders of corporations.

EE bonds: A type of appreciating bond issued by the federal government at a 50 percent discount to reflect the wait to maturity. This means you purchase the bond at a value less than what it will be worth at the end of 10 years. When you redeem (cash in on) the bond, you receive the maturity price. The difference between what you paid for the bond and what you receive at redemption is your interest.

Face value: The value of a bond as stated on the certificate that is also the amount the investor receives when the bond matures.

Front-end load: An arrangement in the purchase of mutual funds specifying that total commissions and other fees will be deducted on an accelerated basis from the amounts invested (usually in the first two years).

Futures contract: A marketable contract that requires the delivery of a specific amount of a commodity at a certain future date.

Growth stocks: Stocks the company reinvests in research and development to bring about more growth. Generally, they do not pay a high percentage of their earnings in dividends.

HH bonds: U.S. government bonds that are purchased only by exchanging Series EE bonds. They pay semi-annual interest in addition to the return of principal when the bond reaches maturity. They are purchased at face value.

Income stocks: Stocks from companies that characteristically have paid a cash dividend higher than that offered by most companies year after year because the company has fairly high earnings and chooses to retain only a small portion of the earnings.

Liquidity potential: The ease with which your investment could be turned into cash if you needed it.

Limit order: An instruction to a stockbroker to buy at the best possible price but not above a specified limit, or to sell at the best possible price but not below a specified limit.

Limited partnership: A form of owning real estate investment property involving two classes of partners. The general partner operates the syndicate and has unlimited financial liability. Limited partners (the investors) receive part of the profits and the tax-shelter benefits but have no voice in management of the business and no personal liability for the operations of the partnership beyond their initial investment.

Load (sales charge): A commission earned for selling a mutual fund.

Maturity time: The date when the issuing agency or company must pay the face value of the savings or investment.

Money market deposit account: A government-insured money market account offered through a depository institution such as a bank, credit union, or savings and loan association.

Money market fund: A mutual fund that pools the cash of thousands of investors and specializes in earning a relatively safe and high return by buying securities that have very short-term maturities, generally less than one year.

Municipal bonds: Money you are lending to local or state government to finance construction or repair of highways, hospitals, schools, or other public facilities. State and local governments then pay the debt as the facilities are used. Generally, the longer the maturity, the greater the yield and also the risk.

GLOSSARY OF INVESTMENT TERMS

Mutual fund: An investment company that combines the funds of investors who have purchased shares of ownership in the investment company and invests those monies in a diversified portfolio of securities issued.

No-load fund: A mutual fund that does not have a sales charge.

Option: A contract that gives the holder the right to buy or sell a specific asset, e.g., real estate or common stock, at a specified price.

Par value: The dollar amount assigned to a share of stock by a corporation when issued.

Preferred stock: Gives the owner superior rights on dividend distribution; that is, dividends must be paid to preferred stockholders before they are paid to common stockholders.

Principal: The original amount placed in a savings or investment instrument.

Put: An option contract that gives the option holder the right to sell an optioned asset to the option writer at the striking price.

Rate of return: The profitability of an investment or saving option as a percentage over a certain time period, usually a year.

Real return on investment: The yield after subtracting the effects of inflation and taxes.

Risk averse: Opposed to risk; efforts are made to avoid it wherever possible.

Saving instrument: A financial option in which the saver puts money and expects virtually no risk for either the principal or the interest.

Speculative investment: An investment transaction involving considerable risk of loss for the chance of large gains.

Speculative stock: A stock with a spotty earnings record but apparently with potential for substantial earnings sometime in the future, even though such earnings may or may not be realized.

Stock option: A contract giving the holder the right to buy or sell a specific number of shares (normally one hundred) of a certain stock at a particular price (the striking price) before a specified date (the expiration date).

Stocks: These are shares in a company which means you have partial ownership in the company. They have no maturity or expiration date. There are no guarantees that your investment will be repaid or that dividends will be paid.

US treasury securities (bills, notes, and bonds): U.S. Treasury sells these securities to raise funds to cover the difference between revenues and outlays and to help repay maturing government debt. The interest payments and the return of principal are fully guaranteed.

Chapter 5

Should You Hire A Financial Planner?

Have you ever asked yourself the question, "Do I need a financial planner?" It may be more appropriate to ask: "Do I need only financial advisers or do I need a financial planner?" Everyone needs financial advisers sometime in life, but not everyone needs a financial planner.

What Is a Financial Planner?

A financial planner is a generalist who takes a broad view of your financial situation and designs an overall strategy that best helps you meet your financial objectives. A financial planner works with you to establish financial objectives and to meet your financial needs. Planners can also provide information on tax savings, insurance coverage, investment plans, and referrals for more complicated legal matters.

If you have a family, you have probably wondered about using a financial planner at some point. The need among families has developed because, overall, families today have greater assets. This is particularly true in families where both partners are employed. The number of decisions to be made and the complexity of those decisions are increasing. More complicated tax laws, banking deregulation, and a greater variety of saving and investment options can make a family's financial decisions difficult.

A financial planner will not know the details of every aspect of family finances, but should have contacts with specialists in those areas. If you already have specialized financial advisers, a competent financial planner would be willing to work with them.

Finding and learning to work with the right financial planner can help you keep pace with the changing financial services available in the marketplace, as well as the changing economy. A professional can also help you and your family take control of your finances.

Do You Need a Financial Planner?

To help you decide whether to hire a financial planner, complete Worksheet 11. The more questions to which you answered "no," the more strongly you may want to consider hiring a financial planner. If you answer "no" to any of the questions, consider talking to a financial planner.

Answering "no" to one or more questions does not mean that with some time and study, you couldn't manage your own finances, but it would take some effort on your part.

Here are circumstances that will also impact your decision:

- If there is a major change in your life – a new job, a raise, marriage, parenthood, divorce, widowhood, or substantial inheritance or other windfall, you may need to consult a financial planner.
- If you are within 30 years of retiring, a financial planner can help you plan for adequate retirement income.

- If you have no discretionary income, (income that is not already committed to expenses) you may need help with budgeting and money management skills, rather than the services of a financial planner. Financial planners work primarily with families that have some discretionary income for investment.

Hiring a Financial Planner

If you hire a financial planner, be prepared to explain your current financial situation, your financial needs and goals, and the planning techniques you presently use. Also, become familiar with common financial planning terms and techniques. This will help you communicate with your planner. It is also a built-in safeguard for detecting whether you have hired a trustworthy planner.

Anyone can call himself or herself a financial planner. There are no state or federal regulations that govern the use of this title. In Minnesota, however, there is a regulation stating that people who identify themselves as financial planners must tell clients the types of products and services they sell and how they are paid.

Since financial planning is still a relatively new career field, it is common for financial planners to have had a previous, perhaps related, profession, including law, accounting, insurance, brokering, banking, or real estate.

Making an Informed Decision

Where do you begin to find a competent financial planner? Start by knowing the critical characteristics of good financial planners. Here are some things you will want to learn:

- credentials
- experience working in the financial field
- level and type of education
- how they are paid
- what is included in their plans
- professional memberships and certifications

WORKSHEET 11. DO YOU NEED A FINANCIAL PLANNER?

Read each question and check the appropriate response.

	YES	NO
1. Am I confident about making financial decisions?	________	________
2. Am I knowledgeable enough to begin my own long-range financial planning?	________	________
3. Do I know enough about my investment alternatives to work effectively toward my short-term and long-term objectives?	________	________
4. Do I expect my present income and investment approach to provide for my retirement years?	________	________
5. Am I comfortable with my level of debt?	________	________
6. Is my household income less than $50,000 a year?	________	________
7. Do I have enough time and knowledge to devote to analyzing my family’s financial situation?	________	________

TABLE 11. CREDENTIALS OF FINANCIAL PLANNERS

Institution	Academic Requirement	Designation*
College for Financial Planning Denver, CO www.cffp.edu	5-course program Pass two-day, 10-hour case-problem examination 3 years of work experience in the field with undergraduate degree; 5 years without the degree	Certified Financial Planner (CFP)
American College Bryn Mawr, PA www.theamericancollege.edu	9-course program (7 required core courses, 2 electives) 3 years full-time business experience	Chartered Financial Consultant (ChFC)

**Public programs of a sort also exist. The Securities and Exchange (SEC) Commission requires that anyone receiving money in return for investment advice must register with it. There is no educational requirement. The designation RIA, Registered Investment Adviser, can then be used.*

A financial planner who scores high in these areas is most likely to be a knowledgeable and competent planner.

Credentials
There are private programs that test and certify financial advisers and planners. When giving their credentials, financial advisers and planners often use initials such as CFP or ChFC. Table 11 lists the academic requirements corresponding to those initials.

People or firms that get paid to give advice about investing in securities generally must register with either the Securities and Exchange Commission (SEC) or the state securities agency where they have their principal place of business.

Some investment advisers employ representatives, the people who actually work with clients. In most cases, these people must be licensed or registered with the state in order to do business with you. So be sure to check them out with your state securities regulator.

You can find out how to get in touch with your state securities regulator through the North American Securities Administrator's Association. Their website is www.nasaa.org.

The Cost of Hiring a Financial Planner

Financial planners are paid by different methods, according to their business arrangements. Ask those you interview how they charge. Possibilities include:
1. An hourly rate
2. A flat fee for specific services, as agreed
3. A percentage of annual income or total assets
4. A commission on financial products you purchase
5. A fee that can be offset by commissions on investments made for you.

There are advantages and disadvantages with each type of compensation.

Planners Who Are Paid by Fee Only
Fee-only financial planners are usually more expensive, but they can be more objective, since their fee does not go up

These websites may help you locate a financial planner in your area:

1. *The Financial Planning Association- www.fpanet.org, phone: 800-322-4237*

2. *American Institute of Certified Public Accountants (AICPA)- www.aicpa.org, phone: 888-777-7077*

3. *National Association of Personal Financial Advisors (NAPFA)- www.napfa.org, phone: 847-483-5400*

or down according to whether you buy certain products. It can cost anywhere from $150 to $2,000 to hire this kind of financial planner, depending on your situation. If your planner charges a fee only, with no personal consultation or continuing service, the charge will be on the low end of the range. A custom-developed plan for a family with income between $35,000 and $65,000 may cost from $750 to $2,000. Although the cost may seem high, financial planners who use this fee-only system claim their objectivity and lack of personal interest in any particular firm's products justify the higher price.

Planners Who Are Paid on Commission
If you choose a commissioned financial planner, the cost may be lower, or it may be similar but less visible to you. The cost may be less visible because it is often folded into the cost of products you are buying. The important thing is to ask your planner how much commission you will pay on each product proposed to you. An advantage commission-based planners claim is that they have more motivation to follow through and make sure you implement your plan.

However your financial planner is paid, check your bills to make sure you haven't been charged for something you did not agree to, such as phone calls added to a per-hour charge.

Gauging a Planner's Commitment

Since anyone can call himself or herself a financial planner, you will want to be sure the person you choose is committed to you and to the profession. Here are some pointers to help you make that determination.

1. Ask about their memberships in professional organizations, or the certifications they hold. Neither ensures competence but both indicate a measure of commitment by staying current in the field.

2. Ask how much time financial planners will spend with you and whether they are the ones who will write your plan. Planners usually spend three or four hours with most clients. Half of that time is spent in gathering facts and the rest in discussing the plan. All of this should happen before any selling takes place.

3. Ask them about the amount of communication they will have with you. Do they commit time to listening to your opinions and goals? Do they make recommendations and produce documentation for decisions made?

4. How clear are they about what will happen after you get your plan? Will the planner regularly review your progress? What will they charge to come back if your financial circumstances change?

Where to Find a Financial Planner

Be prepared to shop as carefully for a financial planner as you would for a new car. Ask friends, relatives, or business associates for recommendations. Check with instructors teaching personal finance at a local college or university. You may want to ask people you already hire in another capacity, such as an attorney or accountant, for a recommendation (though it may create an awkward situation if they recommend themselves for the job).

Start with at least three candidates. Before interviewing them, get a detailed statement of their fees and services, a résumé, and professional references, including past clients. Check with past clients before you interview.

Most good financial planners will see you for a half hour to an hour to be interviewed at little or no charge. Worksheet 12 has a list of questions you may want to ask in an interview.

Creating a Financial Plan

There are several steps to the financial planning process.

1. Gather data for your planner, including:

   - Names, addresses, birth dates, etc., of your partner and dependents
   - Names and phone numbers of your lawyer, accountant, and banker
   - A list of all bank accounts, stocks, bonds, and any other assets, along with the purchase date and current value of each
   - A description of all your financial commitments: how much money, for how long, and reason for the commitment
   - Copies of appraisals of property and other valuables
   - Salary records, recent tax returns, and your expectation of your (and if applicable, your partner's) future earnings
   - Your budget, including your fixed and variable expenses
   - Your retirement plans, regardless of your current age
   - A statement of your long- and short-term goals, including how much and whether you want to invest, and if so, what risk

2. Meet with your planner to review your financial situation and talk about your goals and objectives. A good planner will help you get specific by putting estimated costs and timelines to your goals.

3. Work with your planner to determine your financial trouble spots. Insurance, taxes, access to credit, investments, retirement income potential, and emergency funds should all be reviewed.

4. Once you have a plan that makes sense to you, get whatever help is appropriate from your financial planner to put the recommendations into effect.

5. Decide when you will review your plan to make sure it is still appropriate, or whether you need to alter it due to changing circumstances.

WORKSHEET 12. QUESTIONS TO ASK WHEN INTERVIEWING A FINANCIAL PLANNER

1. What is your professional training? What education do you have in financial planning? ____________

2. What was your occupation before you became a financial planner? ____________

3. What licenses do you hold? Are you registered with the SEC? ____________

4. How long have you been a financial planner? ____________

5. How do you keep up-to-date with developments in your field? ____________

6. Are your other clients in an income bracket similar to mine? ____________

7. Are your other clients in an age bracket similar to mine? ____________

8. What is your attitude toward financial risk? ____________

9. Do you keep in touch with your clients after you give them a plan? ____________

10. Will you inform me of new developments that affect my plan? If so, how? ____________

11. How often do you handle cases like mine? ____________

12. Will you actually do the work? May I meet the person who will be doing the work, if you will not do it directly?
____

WORKSHEET 12. QUESTIONS TO ASK WHEN INTERVIEWING A FINANCIAL PLANNER

13 What references can you provide? ______________________________

____

14 How long will the work take? ______________________________

____

15 How do you charge for your work? ______________________________

____

16 Is your fee for the plan only, or does it include periodic review? ______________________________

____

17 What products, if any, do you sell?
Do you have a comprehensive range of products and companies from which to choose?

____

____

18 What companies, if any, do you represent? ______________________________

____

____

19 Is the analysis done entirely by a computer program or do you give it individual attention?
What kind of individual attention is provided?

____

____

20 Will you be working closely with other professionals such as an attorney or an accountant?
What are their names? Will they provide you with a professional reference?

____

____

21 Would you work with my current attorney or accountant? ______________________________

____

22 Will I be able to implement this plan with or without you? ______________________________

____

____

Where to Find a Financial Planner

A good financial plan will be easily understood and very clear to you. Included in a good plan are these elements:

1. A statement of your total net worth
2. An analysis of where your money currently goes
3. A statement of your goals and risk tolerance to meet those goals
4. Recommendations for cash flow adjustments
5. Saving and investment recommendations
6. An analysis and recommendations regarding insurance
7. A tax analysis and recommendations
8. Retirement planning recommendations

Above all, a good financial plan is a plan you can live with. Without your commitment, no plan can succeed.

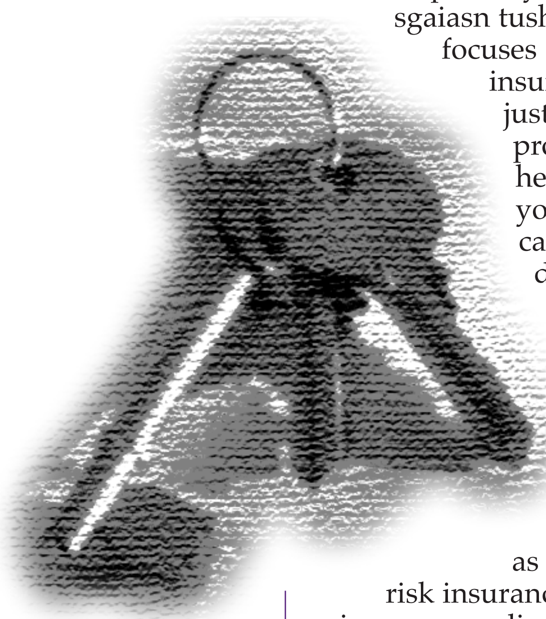
If you can make and follow good financial plans on your own, then you don't need a financial planner. If you are confused about money, cannot decide on goals and how to achieve them, or don't know how to get beyond living from paycheck to paycheck let alone saving for retirement, a good financial planner could be very helpful.

CHAPTER 6

PROTECTING AGAINST RISKS WITH HEALTH AND LIFE INSURANCE

PLANNING AHEAD FOR RETIREMENT

nUxeeptcdee evtn sac nhtertanet ehp alsny uom ka ena dht esaessty uoa ert yrni gotp orettcf ror terimene.tR *si krptoceitno*i s aetmru es dof r alpnat ah trptocesty uo rafimyls'a sste sgaiasn tushcl so.sT ih shcapter focuses on life and health insurance, but insurance is just one aspect of risk protection. For example, health insurance can help you manage rising health care costs, but by itself does not promote good health. Making sure that each family member has a nutritionally balanced diet, weekly exercise, and reduced levels of prolonged stress is as important to your total risk insurance plan as a health insurance policy.



AN INSURANCE RISK PROTECTION PLAN

Dangers that can be insured against include illness, death, property loss, liability, and disability. In your middle years the possibility of illness and death are the greatest threats, especially if you have a family. As you study health insurance and life insurance on the following pages, ask yourself: How do I protect myself (or family) while I am in my middle years? How do I adapt the protection I have as I grow close to my retirement years?

There are several steps involved in making an insurance risk protection plan.

1. Identify the risks that pose a threat to your assets.

2. Determine what impact each type of risk could have on you or, if applicable, your family. You can never cover all risks, so you must select those that could have the greatest long-term effect on you and any dependents.

3. Insure against potential financial loss and lessen the chances of the loss occurring.

4. After implementing, re-evaluate your plan when your situation changes.

HEALTH INSURANCE

The cost of health care has increased dramatically in recent years, becoming a major concern in many budgets. Good nutrition, regular physical activity, and periodic medical examinations are essential.

But although sound health practices will help you keep costs low, health-related problems can still increase as you grow older.

Also, people generally live longer today, which increases the possibility of illnesses such as arthritis or Alzheimer's disease that require long-term care. At some point in your life, you may need partial medical or supportive services such as transportation or personal assistance, but yet not need skilled nursing care. Even these intermediate services can be expensive, so it is important to plan for them in your total risk protection plan.

The older you grow, the more important it is to understand the benefits your present health insurance provides. The guidebook for your plan (available from your employer's human resources department) can help. If there are two income earners in your household, compare plans and coordinate benefits.

A whole new set of questions needs to be addressed as you draw close to retirement, such as:

- Can I transfer my present health insurance policy to a Medicare supplemental policy?
- How do I coordinate my Medicare supplemental policy with Medicare?
- What do I need in a Medicare supplemental policy?
- How do I plan for long-term care, if needed?

People over 65 are eligible for Medical Assistance if their income is low and their assets are within certain limits. Medical Assistance, also known as Medicaid or M.A., is a combined federal-state program that pays for medical services for people with low incomes and limited resources. If you think you might be eligible, go to www.dhs.state.mn.us then click on: "Health care," "Minnesota Health Care programs" and then "People Age 65 and older."

Medicare

Medicare is a federal health insurance program for people 65 and older. You are eligible for Medicare insurance coverage if you are 65 or older and eligible for Social Security or Railroad Retirement benefits. There are also some provisions for coverage under Medicare for those with disabilities.

Medicare has several parts. The parts that apply to the majority of people are breifly described here. If you are receiving Social Security checks at age 65, you will automatically be covered by Medicare Part A. If you are not receiving Social Security checks at age 65, enroll for Medicare coverage at any Social Security office at least 3 months before you turn 65.

Medicare Part B, medical insurance, requires that you are eligible for Part A. Unlike Part A, Part B also requires that you pay a monthly premium (cost to you).

Medicare Part D plans allow seniors to receive their prescription drugs at a reduced cost out of their own pockets. The plans allow common prescription medications to be covered or paid in full through the use of generics or name brand medications that are commonly prescribed to seniors. Part D plans are not provided directly by the government so you should shop around and find the plan that covers the drugs that you are taking.

Supplements to Medicare

Medicare does not pay for all health care expenses. As a result, many seniors take out health insurance policies to cover the gaps in their Medicare coverage. Those policies are often called *Medicare Supplemental Policies* or *Medigap Policies*.

It takes time and effort to pick a good supplemental Medicare policy. There is a government website that provides a great deal of good information to assist you in learning what you need to know. It is www.medicare.gov. When you get to the site, type in "Medigap" in the search box. The options will get you to a publication entitled, "Choosing a Medigap Policy: A Guide to Health Insurance for People with Medicare."

Long-term Care Options

Many people think long-term care insurance is the only way to prepare for long-term care needs. Planning in advance for the possibility of changing health and the need for long-term care allows time to gather information, compare options and determine which of these options best meet your needs. For more information and a decision making toolkit go to www.financinglongtermcare.umn.edu.

Health-Related Risk Protection Documents

Another part of a risk protection plan is creating instructions for your next of kin in the event your health should fail sometime during retirement.

A ***Power of Attorney*** is a legal document that allows you to name another competent adult to act on your behalf in your property and financial matters. While you are well, it is wise to choose a trusted family member or friend to manage your personal affairs in the event that you are unable to do so.

A ***Declaration of Living Will*** is also a legal document. This allows you, while capable, to give specific written instructions to health care providers about the medical procedures you do or do not want if your condition is terminal and you can no longer communicate. Within a *Declaration of Living Will* you can also name a proxy to make such medical decisions.

A ***Health Care Power of Attorney*** is a legal document that allows you to appoint someone to make your health care decisions any time you are unable to do so, not just at the point of near-death. This document can specify the kinds of decisions you want your appointed person (called "agent") to make for you, and can be much more detailed and specific than a *Declaration of Living Will*.

Life Insurance

Another element of a good risk protection plan is life insurance. The main function of life insurance is to provide enough coverage for the family in event of the policyholder's death so that their level of living may remain similar to what it was previously. The need for life insurance is greatest if you have a family and your dependents are young. As you grow older and prepare for retirement, your needs and your responsibility to survivors change.

Evaluate your life insurance coverage in relation to retirement planning. You may need to consider changing or adjusting present policies. If you are selecting policies for the first time, keep retirement in mind. The type of policy you choose should be based on whether life insurance will primarily be used as the means to protect survivors, increase savings, or a combination of the two.

A significant proportion of insurance coverage is group life insurance. This is the kind that employers provide as an employee benefit. Although this insurance often ends or is reduced at retirement (or when the worker leaves the job), count it in your life insurance plan. Group insurance often provides a conversion privilege to individual coverage.

Term Life Insurance

Term life insurance means that its coverage lasts for a specific time period or term, such as one, five, or ten years. If you are up-to-date paying the policy's premiums and should die within the time period, your designated survivors (beneficiaries) receive the face value of the policy upon your death. The *face value* of term life insurance is the amount stated on the policy to be paid in case of your death.

Premiums and benefits change periodically. Visit the Medicare website at www.medicare.gov. It will give you the current benefits covered under Medicare A and B and premium costs for Medicare B. The site also has other valuable Medicare information such as Part D prescription drug information. It also has a list of publications you can download.

There are good reasons for using term policies for both your permanent and temporary life insurance requirements. These policies provide the most protection for your premium dollar. You can probably get a higher rate of return buying term life insurance coverage if you can save and invest in something other than insurance.

Generally, a term policy pays a death benefit only; it does not accumulate cash value. This is what makes term policies different from *cash value policies*, which are called *permanent policies* (see below). Some term policies are *convertible policies*, which means they can be exchanged for cash value (permanent) policies without a medical exam at a higher premium.

Premiums remain the same for the duration of a term. However, if you renew your policy for another term, the cost will increase because as you age your death becomes more likely. Some newer policies are *revertible*, which means that if you pass a medical exam at the end of the term, your premium rate does not increase.

Many policies are ***Annual Renewable Term*** (ART), which means that you are assured your policy will be renewed. Others have an age limit, such as age 65, on renewability.

Some term policies have ***decreasing term insurance***. With these policies the amount paid out declines with time. For instance, you may choose a decreasing term contract as coverage for a mortgage loan balance on your house. The coverage would decrease as your mortgage balance decreases.

Credit life insurance is a type of term insurance used only under certain circumstances. The policy is issued through a lender or lending agency to cover payment of a loan, installment purchase, or other financial obligation in the case of your death. Credit life insurance is usually very expensive. It is illegal for anyone to require you to buy this insurance as a condition of the getting the loan.

Permanent Life Insurance

Permanent life insurance (previously known as cash value policies), unlike term insurance, accumulates *cash value* over time. Because the premium is higher than the cost of protection, a portion of this premium is actually a type of savings account.

The cash value is not the same as the policy face amount (the amount to be paid at the time of your death). The cash value is the amount available if you drop the policy before maturity or the time of your death.

If you have trouble saving money or managing investments, buying a permanent policy can help because of its built-in "forced savings" feature. Though it is not the best way to multiply your assets, it can provide life insurance protection and a structured way to save money at the same time. However, it is not the same thing as a savings account. If you withdraw the money you have accumulated in a policy, you lose the insurance protection; or the protection may be reduced by the amount of withdrawal.

You can use the cash value of a permanent policy many ways. When your policy matures you can use the money to buy reduced insurance benefits, or as annuity payment for use in retirement. You can also borrow money against the cash value of your policy at current interest rates. (If you borrow against your policy, it is considered a loan. If the loan was not paid off at the time of your death, the loan amount remaining would be deducted from the payout.)

There are a number of types of permanent insurance, including *whole-life, adjustable life, universal life,* and *variable life*. As you consider which policy to buy, keep these three variables in mind:

1. the cost of your premium (payment)
2. the face amount of the policy (how much is paid out at the time of your death)
3. the rate of your cash value accumulation.

Adjustable life insurance allows you to change any of these three variables with corresponding changes in the other two. If you think, for instance, that inflation has increased your need for life insurance, you could increase the face amount of this policy. As a result your premiums could go up or the cash value accumulation could slow, or both.An adjustable life policy allows these changes with no additional proof of insurability.

Variable life insurance allows you to share in the losses and gains of the insurance company. As companies collect premiums they invest funds that are not immediately needed to pay losses. So the cash value of your policy will rise or fall with the rate of return on your insurer's investments. The face amount of the policy will usually not drop below an originally agreed-upon amount; the cash value will fluctuate. Because you are continually paying premiums, the cash value will increase; but it may increase more slowly if your insurance company makes poor investments.

TABLE 12. SUMMARY OF LIFE INSURANCE CHARACTERISTICS*

Type of Insurance	Death Benefit	Premiums	Cash Value
Term	Fixed	Start out low, but increase every year or every few years on a preset schedule	None
Whole Life	Fixed	High, but usually stays constant	Rises according to preset schedule shown in policy
Universal Life	Can vary (within limits) at discretion of policyholder	Fairly high, but can vary (within limits) at discretion of policyholder	Grows at variable rate depending on several factors, including the interest rate paid on the cash value, which the company can change from time to time
Variable Life	Can vary, but never dips below initial face amount	High; fixed	Can vary, depending on investments in underlying accounts
Adjustable Life	Can vary (within limits) at discretion of policyholder	Fairly high, but can vary (within limits) at discretion of policyholder	Can vary depending on the combination of premium and coverage decisions of policyholder

**Table shows typical policy features; unusual policies may vary.*

When you buy life insurance, you have a "10-day free look," a window of time when the policy can be returned at full refund. Use these 10 days to read the policy very thoroughly, consult with others if helpful, and be sure the policy fits your needs.

Holders of variable life policies are considered investors. They have some control over the types of investments made with their premiums. A *prospectus* provides the history of the investments attached to the insurance policy; you will receive one when you buy this kind of policy. As with all investments, you will need to pay taxes on earnings. If you are unfamiliar with stock and bond markets or money market securities, you may want to avoid this type of life insurance.

Universal life insurance provides almost complete flexibility in face amount, premium, rate of return on cash value, withdrawal of cash value, and time period. This kind of policy combines the purchase of annual term insurance with buying and selling of investments.

Universal life insurance policies tell you what part of the premium is applied toward insurance benefits, the cash value, and the insurance company's expenses. Since your primary reason for buying a life insurance policy is the insurance component, the cost of that should be your primary consideration.

Use caution when considering a universal life policy. Some offer a high rate of return on the cash value but charge a high price for the insurance element. Some apply excessively high company expenses to your premium.

Whole-life insurance is the most straightforward type of permanent insurance. It protects you throughout your whole life, does not need to be renewed, accrues cash value, and is simply maintained by paying your yearly premium. It offers simplicity rather than flexibility.

How to Decide Which Life Insurance Policy to Buy

Because there are so many options, figuring out what to buy can be a daunting task. These steps are designed to help you make an informed decision.

1. ***Decide which type of insurance best suits your needs***
   Table 12 compares the basic types of life insurance described in this chapter and outlines the basic features of each kind of policy. You can compare costs between different types of term and permanent policies.

2. ***Research insurance companies***
   There are a couple of things you can do to investigate the reliability of a life insurance company. In Minnesota, be certain that the Minnesota Insurance Department licenses the company. In other states, check with state insurance licensing departments.

   Then consult ***Best's Life and Health Insurance Reports***, a reference book in many public and business libraries. It rates the financial standing of hundreds of companies and indicates in which states they are licensed. The companies with the highest ratings earn a grade of A+ by Best's reports.

   Cost comparisons need to be done differently with term and cash value policies. With term insurance, it is usually enough to compare annual premiums. With whole life insurance, be sure to ask the insurance agent for the "interest-adjusted" cost. "Interest-adjusted" cost measures the cost of the life insurance, taking into account the interest that would have been earned had the premiums been invested rather than used to buy insurance. Check it against the same figure for other insurance companies. Permanent policies have more variables and are more complicated to compare.

3. ***Determine the amount of life insurance you need.***
   Most people calculate these costs when thinking about life insurance:

- Cash for immediate needs such as expenses for final illness and burial, taxes, and debts.
- Readjustment money, meaning interim funds for family members who will need time to make important decisions about moving or looking for a job.
- Replacement income, or funds to help replace your income to your next of kin or other dependents upon your death.

If you are raising a family, your financial situation and the age(s) of your child(ren) will also determine how much life insurance coverage you need.

There is no one formula that tells you how much life insurance to buy. The American Council of Life Insurance advises having protection five or seven times you or your family's after-tax yearly income. For example, if your after-tax annual income is $25,000, your life insurance coverage should be between $125,000 and $175,000.

This method of deciding how much to buy may or may not be accurate, because so much of the need for life insurance depends on how old you are, whether you have dependent children, if you have a partner and what your partner earns, and how much money you have saved.

A second method for figuring out how much life insurance to buy is outlined in Worksheet 13. This method helps you consider all the relevant factors when estimating life insurance needs to protect your dependents from financial hardship resulting from your death. You may have to adjust the worksheet to fit your own or your family's situation.

You may want to use both methods to calculate your life insurance needs and then compare the recommendations.

Life Insurance Decisions as Retirement Nears

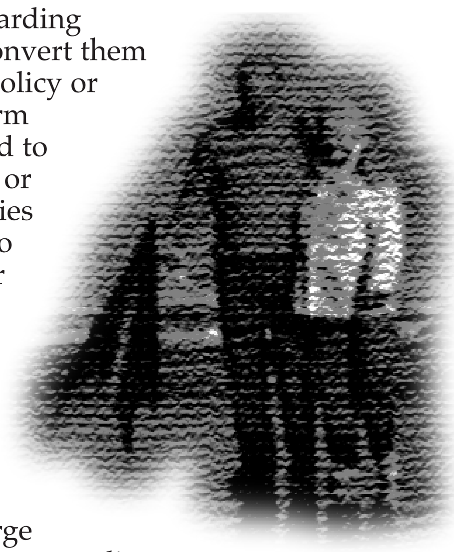
You will probably not buy life insurance in your retirement years, though if you still have dependents, it is important to keep life insurance in place. Otherwise, think about what to do with the policies you own.

Do you still need life insurance? Life insurance is most often purchased to protect survivors who are dependent upon your income. If you no longer have dependents, you may not need life insurance, or just enough insurance to pay for the expenses of your death. If you have permanent insurance you may choose to take the cash value (less income tax due) and invest it or use it to supplement your living expenses.

First, get the facts. Contact your company's insurance agent and ask for a written statement that includes:

- what policy or policies you own
- who the beneficiaries are
- if there is cash value
- if there are loan options
- if there are conversion options

Term Policies
Most term policies are straightforward regarding retirement: either convert them to another type of policy or drop them. Most term policies are designed to end either at age 65 or 70. Some term policies permit conversion to a whole life or other cash value policy without evidence of insurability. Some term policies can be renewed, though the premium is likely to be quite large because with age, the mortality rate increases.



Permanent Policies
If you own one or more permanent policies, your choices are more complicated. Check the chart called "Nonforfeiture values" in your policy. It generally outlines four options at retirement:

1. Continue paying premiums as always, and keep the insurance in force.

2. Terminate the policy, receive the cash value that's built up in it, and endyour insurance coverage. You couldpurchase an annuity to save, spend, or invest. Be sure to ask questions about the tax implications as you consider cashing in the cash value of these policies.

3. Elect an option called *extended term*. With it, you pay no more premiums. You continue to be insured for the full amount but only for a specified number of years, months, and days. Your policy spells out how much time your extended term can be, determined by your age at the time you stop paying premiums and the amount of cash value you have accumulated. After the specified period of extended term expires, you have neither insurance nor cash value.

4. Elect an option called *reduced, paid-up insurance*. With it, you again pay no more premiums. You continue to be insured, but for a s maller amount han before. The new, reduced death benefit remains in force indefinitely. The amount of cash value in it will increase from year to year, but will be relatively small compared with what your cash value was before you elected this option.

Here is how the four conversion options for cash value policy could be applied for a 65-year-old man. He has been insured by one major company for the past 30 years and has paid $475 a year for a $25,000 whole life policy.

He could:

1. Keep paying $475 a year and keep the insurance.

2. Cancel the insurance and get the cash value of $12,000.

3. Elect an extended term option and be covered for $25,000 for another 13 years and 28 days.

4. Elect reduced, paid-up insurance and have a cash value policy with a death benefit of $19,400.

Which option is best? That depends on your circumstances. The choice should be discussed with your life insurance agent and a financial adviser outside your family. Choose the option that reflects *your* situation and *your* needs.

Life Insurance Settlements

The process of a life settlement (sometimes called senior settlements) is one in which a senior sells an unwanted or unneeded life insurance policy to a third party for a lump sum of cash. This amount is usually significantly larger than the cash surrender value of the policy. The actual value of the policy is determined by numerous factors including the premium expense of the policy and the health condition of the insured.

This process generally includes the seller's trusted financial advisor, a licensed life settlement broker, and a licensed life settlement provider (policy buyer). From beginning to end, a settlement can take up to 6 months.

Not every policy qualifies for a settlement. The minimum age of an insured is usually 65. Policies should be permanent individual or joint life insurance policies that have been in force for at least 2 years and often have a minimum face value of $100,000.

WORKSHEET 13. CALCULATION METHOD FOR DETERMINING THE AMOUNT OF LIFE INSURANCE YOU NEED IF YOU HAVE A PARTNER AND/OR DEPENDENTS

Expenses at Time of Death

A. Medical expenses not covered by insurance $ ________

B. Debts not covered by credit life insurance $ ________

C. Burial expenses $ ________

D. Estate settlement $ ________

E. $ ________ (Total of A-D)

Survivor Adjustment Expenses

F. Short-term income need $ ________

G. Education/training fund $ ________

H. Child care expenses $ ________

I. Other short-term adjustment expenses $ ________

J. $ ________ (Total of F-I)

Long-term Income Needs

K. Income needed until youngest child is 18 $ ________

L. Additional income for partner from time youngest child turns 18 until partner's retirement $ ________

M. Additional income for partner from retirement until death $ ________

N. $ ________ Average Annual Income Needed (K + L + M ÷ number of years of partner's life expectancy)

O. Partner's income from now until retirement (include Social Security benefits until youngest child reaches 18) $ ________

P. Annual income of partner after retirement (Social Security, IRAs, pensions, investments, etc.) $ ________

Q. $ ________ (Average annual income expected (O + P ÷ number of years of partner's life expectancy)

WORKSHEET 13. CALCULATION METHOD FOR DETERMINING THE AMOUNT OF LIFE INSURANCE YOU NEED IF YOU HAVE A PARTNER AND/OR DEPENDENTS

Years Income Needed	Investment Factor
25	20
30	22
35	25
40	27
45	30
50	31
55	32
60 (and more)	35

R. $ ____________________
Average annual income to be provided by life insurance proceeds (N-Q)

S. $ ____________________
Investment Factor (from chart at left)

T. $ ____________________
Total needed for long-term income needs (Q x S)

U. Grand total of money needed $ ____________________ (E + J + T)

V. Assets and present investments already owned which could be used (not included in P) $ ____________________

W. Estimated amount of life insurance needed $ ____________________ (U - V)

X. Value of present life insurance $ ____________________

Y. Total additional life insurance needed $ ____________________ (W - X)

SOURCE: Kathy Prochaska-Cue, *Insurance Insights*, Nebraska Extension Publication, LH 87-15-16.
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GLOSSARY OF LIFE INSURANCE TERMS

Accidental death benefit: A benefit, in addition to the face amount of a life insurance policy, to be paid if the insured dies as the result of an accident. It is sometimes referred to as "double indemnity."

Actuary: A person professionally trained in the technical aspects of insurance and related fields, particularly in the mathematics of insurance (calculation of premiums, reserves, etc.)

Adjustable life insurance: A type of insurance that allows the policy holder to change the plan of insurance, raise or lower the face amount of the policy, increase or decrease the premium and lengthen or shorten the protection period.

Agent: An insurance company representative licensed by the state, who sells insurance and provides service to the policyholder for insurance company. Also known as Life Underwriter.

Annual renewable term policy: A term policy that assures the policy will be renewed for the duration of the term, without a medical exam.

Beneficiary: The person named in a life insurance policy to receive the insurance money at the death of the insured.

Cash surrender value: The amount of cash available when a policy owner voluntary terminates a policy before it becomes payable by death or maturity.

Convertible term insurance: Term insurance that can be exchanged for another plan of insurance at the option of the policyholder without evidence of insurability.

Credit life insurance: Term life insurance issued through a lender or lending agency to cover payment of a loan, installment purchase, or other obligation in case of death.

Decreasing term insurance: Insurance that pays out a decreasing amount of money the closer the policyholder draws to the end of the term.

Dividend: A return of part of the premium on participating insurance, which reflects the difference between the premium charged and the combination of actual mortality payouts, expenses, and investments experienced by the company. Such premiums are calculated to provide some margin over the anticipated cost of the insurance protection.

Double indemnity: See "Accidental death benefit."

Extended term: A type of permanent life insurance policy that allows the policyholder to pay no more premiums past a certain point, give up the cash value of the policy, and instead continue to be fully insured for a specified number of years, months, and days.

Face value: The amount stated on the face of the policy that will be paid in case of death or at the maturity of the policy. It does not include additional amounts payable under accidental death or other special provisions, or acquired through the application of policy dividends.

Insured or insured life: The person on whose life the policy is issued.

Lapsed policy: A policy terminated by the insurance company because premiums were not paid.

Life Underwriter: See "Agent."

GLOSSARY OF LIFE INSURANCE TERMS

Mortality table: A statistical table showing the death rate at each age, usually calculated as so many per thousand.

Nonparticipating policy: A life insurance policy in which the company does not distribute to policyholders any part of its surplus. Premiums for nonparticipating policies are usually lower than for comparable participating policies. Some nonparticipating policies have both a maximum premium and a current lower premium. The current premium reflects anticipated experience that is more favorable than the company is willing to guarantee, and it may be changed from time to time for the entire block of business to which the policy belongs.

Participating policy: A life insurance policy under which the company agrees to distribute to policyholders the part of its surplus that its Board of Directors determines is not needed at the end of the business year. This distribution reduces policyholder's premium.

Permanent life insurance: A policy that provides both life insurance and a cash value.

Premium: The payment, or one of the periodic payments, a policyholder agrees to make for an insurance policy.

Prospectus: A history of investments provided by an insurance company when purchasing variable life insurance.

Renewable term insurance: Term insurance that can be renewed at the end of the term, at the option of the policyholder and without evidence of insurability, for a limited number of successive terms. The rates increase at each renewal as the age of the insured increases.

Revertible term insurance: A policy that allows the policyholder to continue insurance at a stable premium rate as long as the insured passes a medical exam.

Term insurance: Life insurance payable to a beneficiary only when an insured person dies within a specified period.

Underwriting: The process by which a life insurance company determines whether it can accept an application for life insurance and, if so, on what basis.

Universal life insurance: A flexible premium life insurance policy under which the policyholder may change the death benefit from time to time (with satisfactory evidence of insurability for increases) and vary the amount or timing of premium payments. Premiums (less expense charges) are credited to a policy account from which mortality charges are deducted and to which interest is credited at rates that may change from time to time.

Variable life insurance: Life insurance with benefits that relate to the value of assets behind the contract at the time the benefit is paid. Under most policies, the amount of death benefits payable would never be less than the initial death benefit payable under the policy.

Whole-life insurance: Life insurance payable to a beneficiary at the death of the insured, whenever that occurs. Premiums may be payable for a specified number of years (called "limited payment life") or for life (referred to as "straight life").

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