How to Retire

Part I – Funding Retirement

Questions and Concerns:

- When can I retire?
- What types of retirement savings programs are available?
- Are my retirement investments positioned to provide income as well as inflation protection?

When can I retire?

Actually several other questions could be a substitute for that question, such as “When can I become financially independent?”, “When can I travel?” “When can I work for a small non-profit?” or “When can I write a book?” The dreaded answer is -- it depends.

There are six factors that affect when you can retire: when you start to save, the amount you save, the investment return, inflation, retirement living expenses, and reduction in debt. Of those factors only three are certain: the time you start to save, the amount and debt reduction.

Starting to Save – Starting early in your life to save is more impactful than the amount you save. Below is an annual savings comparison of two individuals who want to have $500,000 at age 60, one is age 25 and the other is age 45. The 45 year old will have to annually save 5.5 times more than the 25 year old to meet the savings goal of $500,000. This illustration also shows three investment returns assumptions because there is no way to predict future investment returns.

Age	Savings Goal at Age 60	Annual Savings at 7% Return	Annual Savings at 6% Return	Annual Savings at 5% Return
25	500,000	3,617	4,486	5,535
45	500,000	19,897	21,481	23,171

Amount You Save – The amount you save annually obviously has an impact on the amount you accumulate. Below is a chart that compares annual amount saved over 20 years:

Amount Saved	Balance in 20 Years at 7% Return	Balance in 20 Years at 6% Return	Balance in 20 Years at 5% Return
1,000	43,865	38,992	34,719
2,500	109,662	97,481	86,798
5,000	219,325	194,963	173,596
10,000	438,651	389,927	347,192
20,000	887,303	779,854	694,385

Investment Return – As illustrated in the tables above, the investment return has a significant impact on the outcome over a period of time. It is recommended having an allocation in fixed income, stocks and other types of investments. One should remain relatively consistent in their asset allocation structure

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and contributions. Changes in asset allocation structure over time should be measured and deliberate and not include emotional factors. The Investment Accumulation and Preservation write-up discusses such strategies.

Lifestyle Upon Retirement and Living Expenses – This is an important factor to consider for individuals. Some individuals live a frugal, yet very satisfying lifestyle. This may mean hiking, reading, writing, volunteering and other activities. Others wish to travel, engage in philanthropy and perhaps live a more lavish retirement to make up for lost time while working. It is all over the board, but is a significant aspect of retirement planning. In terms of living expenses, health insurance coverage is a major consideration. Many postpone retirement or take on part-time employment with companies primarily because of health insurance.

Inflation – Inflation is an unknown aspect in retirement that individuals need to consider. Investment advisors attempt to mitigate inflation using various investments that provide an inflation hedge. For example, since most individuals rely on fuel to drive their cars and heat their homes, the purchase of energy stocks makes sense. The primary purpose of home ownership in the past was to control shelter expenses especially since most areas do not have rent controls.

Debt Reduction – Prior to the 1980s it was common to consider retirement after the residential mortgage was paid off. This changed as individuals became more affluent and home ownership was viewed as an investment. The recent past trend was to continually purchase a larger home along with leverage since home prices continued to climb. This came to an abrupt end in 2007 as house prices began to fall. Housing price declines were exacerbated during and after the 2008 economic meltdown. There appears to be a trend to pay off mortgages as it is apparent that real estate does not always maintain an upward price trajectory. Retirement planning often involves paying off debt as well as saving for retirement.

Given these factors, a retirement calculator will help provide projections to give you an estimate on when you can retire as well as how much you need to save to retire in the future. The CNN Money calculator is one of many tools you can use to provide this projection. Please understand that there are many unknowns and this is at best a ballpark estimate.

CNN Money Retirement Calculator	http://cgi.money.cnn.com/tools/retirementplanner/retirementplanner.jsp

What types of retirement savings programs are available?

This all depends on how you are employed and whether you are employed by a firm that has a retirement plan. For individuals who are employed with a company that does not have a retirement plan, an Individual Retirement Account (IRA), Roth IRA or an annuity are the options available. For self-employed individuals there are Simple IRAs, Simplified Employee Pension plans (SEP) and HR-10(Keogh) plans. For large businesses and non-profits a 401(k), 403(b) and deferred savings programs are available. Finally, there are still traditional pension programs sponsored by governments and some corporations that provide a lifetime retirement based on a percentage of your past salary. Corporations have been trending away from these pension plans and governments are contracting out many services to avoid the high pension costs. Below are information links from Investopedia on the various retirement plans.

Retirement Plans	Plan Serves	Link
Individual Retirement Plan	Individuals	http://www.investopedia.com/terms/i/ira.asp#axzz24a9aAtER
Roth IRA	Individuals	http://www.investopedia.com/terms/r/rothira.asp#axzz24a9aAtER
Simplified Employee Pension	Firms, Self-employed,	http://www.investopedia.com/terms/s/sep.asp#axzz24a9aAtER
Simple IRA	Firms, Self-employed,	http://www.investopedia.com/terms/s/simple.asp#axzz24a9aAtER
Keogh (HR-10), Qualified Plans	Firms, Small Companies	http://www.investopedia.com/terms/k/keoghplan.asp#axzz24a9aAtER
401(k) Plan	Many Large Companies	http://www.investopedia.com/terms/1/401kplan.asp
403(b)Plan	Non-Profits	http://www.investopedia.com/terms/1/403bplan.asp#axzz24a9aAtER

Tax Benefits of Payroll Retirement Contributions – Congress provides tax incentives to individual and business to provide for their own retirement. Some plans allow a deduction on their tax return. Other plans, such as the SIMPLE, 401(k) and 403(b) allow payroll deductions to contribute retirement savings before taxes are calculated. Below is an example of a person in a 25% Federal tax bracket and a 3.7% New Mexico tax bracket contributing to a retirement plan. As you can see, if a person withholds $100 of their paycheck to contribute to retirement they would save $28.70 (saving $25 Federal plus $3.70 New Mexico) in taxes. The actual payroll would be $71.30 to contribute $100. Over a year the retirement savings based on 26 pay periods would be $2,600 and a total tax savings of $746.20.

Bi-Weekly Payroll Contribution						
403(b) Contribution	50.00	100.00	150.00	200.00	250.00	300.00
Federal Tax Savings 25%	(12.50)	(25.00)	(37.50)	(50.00)	(62.50)	(75.00)
New Mexico Tax Savings 3.7%	(1.85)	(3.70)	(5.55)	(7.40)	(9.25)	(11.10)
Net After-tax Impact on Take Home Pay	35.65	71.30	106.95	142.60	178.25	213.90
Annual Impact						
403(b) Contribution	1,300.00	2,600.00	3,900.00	5,200.00	6,500.00	7,800.00
Federal Tax Savings 25%	(325.00)	(650.00)	(975.00)	(1,300.00)	(1,625.00)	(1,950.00)
New Mexico Tax Savings 3.7%	(48.10)	(96.20)	(144.30)	(192.40)	(240.50)	(288.60)
Net After-tax Impact on Take Home Pay	926.90	1,853.80	2,780.70	3,707.60	4,634.50	5,561.40

Employer Match – Do not leave money on the table. This is a boost to your retirement savings goal. Most employers provide an incentive to participate in your retirement plan. For example, many employers match 50 cents to every one dollar contributed to a 401(k) plan with a limitation of matching contributions up to 5% of your compensation. That means if your annual salary is $52,000 and you contribute $100, the employer will match $50. In the illustration above, that would mean an additional $1,300 would be added to your $2,600 contribution for a total of $3,900 annually. This is like a 50% return on your investment. Some employers are more or less generous in their matching program.

Part II – At Retirement

- Are you concerned about the "void" in your life upon retirement?
- Do you know if your retirement resources will provide for a comfortable retirement?
- Are your retirement investments positioned to provide income as well as inflation protection?
- Are you concerned about outliving your retirement? Are there foreseen and unforeseen expenses that may trip up your retirement resources?
- Do you know the best order in which to tap into your retirement resources?

Are you concerned about the "void" in your life upon retirement?

For some individuals retirement is not a consideration because their line of work is fun and they love the "work" and will continue as long as they are able. For others, retirement is an opportunity to do the things they have always wanted to do. Still for others, who have dedicated their lives to specialized skills, retirement can be an anxious event because of a desire to continue to use their wealth of knowledge and skills. In addition, the social and team environment of employment will be missed. What's Next in Your Life.Com link below is one of many resources you can refer to assist in retirement transition.

What's Next in Your Life	http://www.whatsnextinyourlife.com/

Do you know if your retirement resources will provide for a comfortable retirement?
To prepare for retirement there are several factors to consider. A major consideration is to estimate your living expenses. This usually means providing a cash flow statement on your current living expenses that exclude, income taxes, general savings and retirement savings. Also, as individuals pay off debt, that portion of living expenses is excluded. Other factors to consider are resources such as retirement savings, pensions, Social Security, general savings (investments), home equity and other sources. There are several free calculators to help assist in providing guidance. Such calculators are not perfect but most are forthright in disclosing that some of their assumptions can be flawed. One of the better retirement calculators is from CNN Money. This calculator considers your retirement goal, Social Security, pension plan income, annuity income, retirement savings, taxes and return based on the asset allocation mix. One of the notable omissions on this calculator is that it does not factor inflation, CPI adjustments, general savings and other resources such as residential real estate. Still, it does provide general guidance. Below is the link:

CNN Money Retirement	http://cgi.money.cnn.com/tools/retirementplanner/retirementplanner.jsp

Calculator	

Are your retirement investments positioned to provide income as well as inflation protection?
At one time there was a simple concept one would use to determine his/her asset allocation mix: set the fixed income percentage to match your age and the remaining amount to equities. For example, if you are 60 years of age this concept would suggest 60% in fixed income and 40% in equities. However in recent years we have seen interest rates below 3% on ten year treasury notes. That makes it difficult to stay ahead of inflation. In addition, life expectancy has increased. Therefore many investment advisors do not adhere to the age based asset allocation mix but instead recommend a broader asset allocation mix that includes high yield bond funds, international bond funds, preferred stocks, emerging market stocks and commodity funds. This is done to provide income, appreciation and further diversification. Most investment firms have asset allocation strategy reports to guide an individual based on their stage of life. You and your investment advisor should review these reports to properly structure an asset allocation suitable to your needs.
Are you concerned about outliving your retirement? Are there foreseen and unforeseen expenses that may trip up your retirement resources?

This is a justifiable concern for many individuals especially when they run a retirement projection calculation and realize there is a shortfall in their retirement resources. There are several options or combination of options that you can consider to remedy this short fall.

Deferring Retirement - This means working longer than your assumed retirement age. This helps out two fold: by adding to your retirement savings while delaying drawing on your retirement saving.
Increasing Retirement Savings – Maximizing retirement savings while you are working will provide three benefits. The first obvious benefit is increasing your retirement savings. The second benefit is the reduction of taxes on your retirement contribution. Finally, the third benefit is that it prepares you to adapt to a budgeted lifestyle upon retirement.

Part-time Work – Many individuals have no desire to completely retire and often work in seasonal jobs, part-time positions and temporary jobs. Often this is beyond simply earning additional income but to utilize skills and to use the job as a social connection. Of course the benefit of receiving the additional income means you tap less into your retirement savings.

Decrease Retirement Expenses – This is common for many retirees and often welcomed. This may mean downsizing to a smaller and more economical home. This may also include moving to a place that has lower taxes and a milder climate. A more difficult acclimation is to adapt to not eating out and/or going out less often.

Review Retirement Investments – Often adjusting your asset allocation mix to ensure it is positioned for optimal return is necessary. One other consideration is to place funds in a fixed annuity to ensure that you do not outlive your retirement savings. Unfortunately, there are tradeoffs with any path you choose. Consult with your investment advisor to review the pros and cons of each available option.

One other consideration is to have an expense reserve to cover major anticipated expenses as well as unexpected expenses. This may mean keeping additional cash savings to cover expenses such as the cost of a roof, replacement of a car or an unexpected deductable expense due to health care costs. It is good planning to have separate savings set aside to cover those costs. This will prevent you from a forced draw on your retirement investments at an inopportune time in the market or create a taxable event.

Do you know the best order to tap into your retirement resources?

As you draw from your general savings, investment accounts, Roth IRA or Roth 401(k) you are not taxed on the withdrawals. However, in tax deductable retirement savings, such withdrawals are indeed taxable. In addition, estate planning may be a factor because remaining assets in a retirement account can be double taxed in both estate taxes as well as income taxes. Therefore, it is important to consult with your tax advisor to determine the best order on your assets to withdraw for your retirement.

How can a financial planner help you retire?

Retirement planning is a major component of the Certified Financial Planner™ program. This is an area where they will do an in-depth analysis to consider the six factors that must be considered to prepare a client for a comfortable retirement. Upon retirement, they will consider the assets and income resources to monitor and inform a client as to whether they are on track. Adjustments are made if there are significant market fluctuations or unexpected major expenses. In addition, a planner can identify a tax efficient strategy to draw on the various resources.