



## **Retire SMART: A Simple Guide to Retirement**

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Provided to you by:

**Victoria Woods & Damon King**

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Written by Financial Educators

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# Introduction

While many Americans have spent years planning for their retirements, a great many of them have made a basic discovery once they reach that plateau. Namely, that there are some issues that simple math and time will not necessarily resolve. If you are near retirement or have retired, listed below are several common mistakes that occur in the arena of financial planning for retirement that you can plan now to avoid. The remainder of this booklet will explain potential ways to deal with these issues.

# Common Retirement Financial Mistakes

**Underestimating your life expectancy:** A generation ago, it was probably safe to assume that men would live to approximately age 70, and women to perhaps 75. But advances in medical science have pushed those ages up at least fifteen to twenty years. Realistic financial planning for seniors should probably assume that at least one spouse will live to age 90 or beyond.<sup>1</sup> To make sure your money lasts, you may need to annuitize your assets to create a sufficient income (explained later).

Are you thinking that you'll be able to retire when you want? In financial planning for retirement, many workers plan on working into their 70s—until illness, disability, or mere fatigue forces them to reconsider. If you plan on working past the normal retirement age, do not count on the extra money earned to pay for essential expenses. Sound financial planning for senior years would have you save a sufficient nest egg by age 65 in case health reasons prohibit you from working longer.

**Neglecting to adequately factor in health care costs:** Failure to do this can be disastrous, especially if long-term care treatment is needed. And don't count on the government to pick up the bill for you either. Make certain that your health coverage is adequate and that you have a plan to cover other elder care needs. This is the #1 error in financial planning for seniors, as it's estimated that half of the bankruptcy in the US is caused by health failures and the accompanying costs.<sup>2</sup>

**Settling for low returns:** Don't let your fear of risking principal leave you with a guarantee of running out of money prematurely. Sensible asset allocation may lower the risks of investing—including the chance that your money will not grow enough to meet your needs. Although asset allocation may reduce risk, it does not insure a profit or guarantee against loss. But if you insist on keeping money in three month CDs and T-bills as many seniors do, your earnings will be so low that you increase the likelihood of running out of money. Sound financial planning for seniors means that your investment horizon should match your actuarial life expectancy. In simple English, if you are age 70 with an expected life expectancy of 16 more years, your investment portfolio should be constructed to serve you for 16 years, not 6 months.

**Failure to monitor or control your distribution rate:** Your financial advisor should be able to run some basic calculations based on the size and allocation of your portfolio that show a safe rate of withdrawal. A general rule of thumb is somewhere between three and five percent per year, depending on your portfolio's allocation between equity and fixed income investments. We have seen some financial planning disasters when people spend beyond this level.

**Refusing to get a fresh perspective:** No matter how effective your advisor or plan is, getting a second opinion on it will never hurt. Different advisors have different areas of expertise, such as taxes or mutual funds. Therefore, having a different set of eyes review your situation may provide insights that you would otherwise miss.

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<sup>1</sup>For a married couple where both have reached age 65, there is a 39% chance that at least one will live to age 90  
[www.kitces.com/wp-content/.../09/Joint\\_Life\\_Mortality\\_Calculator.xls](http://www.kitces.com/wp-content/.../09/Joint_Life_Mortality_Calculator.xls)

<sup>2</sup>The American Journal of Medicine: Medical Bankruptcy in the United States, 2007: Results of a National Study. Five states found that medical problems contributed to at least 46.2% of all bankruptcies.

The following articles provide guidance on ways to potentially address these issues.

## Generating Retirement Income

Financial planning prior to retirement is focused on asset accumulation, tax minimization, and maintaining a budget that allows for maximum savings. Retirement financial planning, however, is focused on these different objectives: maintaining an adequate income without salary or wages, maximizing pension and social security, having adequate health and long-term care protection and minimizing financial risk.

You can't know for sure if you have adequate resources until you do some number work. If you find this nitty gritty retirement financial planning stretching your patience, then hire a retirement planner.

### Here are the steps:

1. Estimate your retirement spending needs: housing (including new furniture and updating), food (including dining out), insurance (including long-term care), personal expenses, vacations, entertainment, utilities, transportation, taxes (income and property), etc. Add to this list anything that applies to your desired lifestyle. Add up the total and now you know how much you need, which is Step 1 of your retirement financial planning. Let's say this figure is \$50,000.
2. Next, you want to see how much you have and create a retirement income plan. Add your sources of retirement income including social security, pensions, and annuities. An example follows but please note that the illustration is hypothetical and not indicative of the performance of any particular product. From any savings such as IRAs and 401k and other investment accounts, assume a withdrawal rate of 5%. So if you have a nest egg of \$500,000, assume that you can take 5% annually and the nest egg should be fairly safe at least for 30 years.<sup>3</sup> Note that just to maintain your standard of living, you need to always leave some earnings behind in your nest egg to account for inflation. An item that costs you \$10,000 this year will cost you \$10,300 next year. Even if you don't care about having anything left and want to spend more, you don't have much wiggle room. For example, if your nest egg were to earn a constant 6% annually and you withdraw 8% annually of your beginning balance, you exhaust the fund in 24 years (online calculator from CalcXML <http://www.calcxml.com/calculators/how-long-will-my-money-last>). You could easily outlive your money and that's why it's important to stick to the retirement financial planning 5% rule
3. Compare your total sources of income from Step 2 and your expenses from Step 1. If you have excess income, congratulations—you've done good retirement planning.
4. If you have a deficiency, you have a few options:
  - Adjust your lifestyle and spend less.
  - Maintain your lifestyle, but move to a less expensive area of the country or out of the country.
  - Work part time in retirement.
  - Retire later—by working a couple more years, a \$500,000 nest egg growing at 6% accumulates an additional \$61,000 ( $6\% \times \$500,000$  compounded for 2 years = \$61,000 Texas Instruments BA 54 or any financial calculator). That additional principal provides an additional \$3,050 of spending money annually (assuming 5% annual retirement return x 61,000).

Note that later in life, say at age 75, you may switch your strategy and decide to "annuitize" some of your assets i.e. spend them down to zero and give yourself more income today. One way to annuitize your assets is with a life annuity, as payments will last as long as you do. (Get details from your financial or insurance advisor).

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<sup>3</sup> Trinity Study: Sustainable Withdrawal Rates From Your Retirement Portfolio; Philip L. Cooley, Carl M. Hubbard and Daniel T. Walz 1998, updated 2010 <http://wpfau.blogspot.com/2010/10/trinity-study-retirement-withdrawal.html>

## Retirement Income Sources<sup>4</sup>

Many retirees lack control over 50% or more of their retirement income. For example, if a retiree has income of \$50,000 annually, and \$30,000 comes from social security and employer pension, the retiree controls less than half of his retirement income – making those sources somewhat useless to discuss. So let's focus on the sources of retirement income you can control and how to boost them.

Let's work up the ladder of rates that you can get from guaranteed retirement income sources.

**Bank Certificates of Deposit:** Terms from three months to five years. Generally, the longer the term, the higher the rate. Interest is available monthly for a guaranteed retirement income or can compound. A one year CD is 1.15% at the highest paying bank as of 12/22/14.<sup>5</sup> After inflation and taxes, you actually lose money. Therefore, holding large sums for long periods in CDs is financially foolish.

**Annuities:** Guaranteed by the issuing insurance company, safest companies rated AAA by Standard and Poor's. Large companies like Prudential and New York Life actually lent money to the US Government during the depression. Use deferred annuities (paying 3.50%)<sup>6</sup> if you don't need the income or immediate annuities if you need the income. A 70 year old male can get \$639/month for life on a \$100,000 deposit (equal to 7.67% cash on cash return)<sup>7</sup>. Payments end at death and nothing is left. Some immediate annuities provide a feature for payments to heirs in case of early death, but the monthly payments will be less.

The above paragraph describes an immediate annuity—a one-time payment of a premium to an insurance company. In return, you receive payments for a specified term or for life. Under the life option, payments cease when you die. Note that immediate annuities may have fees or commutation charges and generally cannot be surrendered for value. Payments you receive are subject to IRS rules which consider each payment part principal and part interest. The payments are guaranteed by and subject to the claims-paying ability of the issuing insurance company.

**Federally Backed Mortgage Notes:** Although you've heard a lot in the news about Fannie Mae and Freddie Mac, the US government has backed their securities 100% – giving them AAA safety. The same goes for Ginnie Mae Securities. Your money is loaned for mortgages, and the government agency guarantees your investment – at 15 years, rates approximate 3.12%.<sup>8</sup> Actual term is uncertain as people can pay off their mortgages early. Income is monthly.

**Corporate Bonds and Preferred Shares:** These can be a reliable source of guaranteed retirement income from corporations. Again, for safety, buy those that are highly rated, at least A. Bonds pay interest twice annually, and preferred shares pay dividends quarterly.

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<sup>4</sup> The tax issues and risk issues of the investment options mentioned in this section are as follows: bank certificate deposits are FDIC insured to \$250,000 and interest is taxed as ordinary income. Annuities are backed by the claims paying ability of the issuing insurance company. The portion of the payment that IRS considers interest is taxed as ordinary income. There is a 10% penalty for withdrawals before age 59½. Federally-backed mortgage notes will fluctuate in value and have an implicit guarantee as to interest and terminal value by the federal government and interest is taxed as ordinary income. Municipal bonds will fluctuate in value, are guaranteed by the issuing municipality or issuing agency and interest is free from federal tax and may also be free from state tax if you are a resident of the state where the bond is issued. Corporate bonds and preferred shares are issued by public companies, will fluctuate in value and carry risk of loss. Interest on corporate bonds is taxed as ordinary income; dividends on preferred shares are generally taxed at the 15% rate. Mention of these securities does not constitute an offer to buy or sell.

<sup>5</sup> Bankrate.com 1 year CD for Alostair Bank of Commerce.

<sup>6</sup> Midland National Life 12/22/14 MNL Guarantee Ultimate 10 (200k). <sup>7</sup> [www.immediateannuities.com](http://www.immediateannuities.com) 12/22/14.

<sup>8</sup> Representative example 12/22/14: Federal Home Loan Mortgage Corporation 1/15/26, 4% coupon, <http://www.mortgagenewsdaily.com>

**Municipal Bonds:** A source of guaranteed retirement income from cities, states or municipal districts. Buy those rated AAA for best security. Income is paid twice annually. Or, for another idea of guaranteed retirement income, build a ladder of zero-coupon municipal bonds. Interest and principal is paid all at once at maturity. Example: male age 52 buys \$75,000 face value of municipal bonds to mature starting at age 62, and for each year thereafter for 20 years, to provide \$75,000 of tax free income annually. The cost today of each bond averages less than 50 cents per dollar of face value – yields up to 4.7% tax free currently.<sup>9</sup>

Dividend income from stocks and mutual funds can be an important and significant source of retirement income, however, it is not assured as corporations may change their common stock dividends at any time. If you own mutual funds, there are funds oriented toward paying a consistent dividend income and those that do not. Are you in the right funds? Similarly, there are value stocks that pay dividends averaging 3.6%<sup>10</sup>, while many growth stocks pay no dividends at all. By your selection of stocks and funds, you control this important source of retirement income.

## Protecting Your Assets

While everyone needs car, homeowners and health insurance, there are specific types of insurance that are very pertinent to seniors or retirees. These senior insurances are detailed below, and the failure to have any of these protections could be the difference between a comfortable retirement and years of heartache.

**Life Insurance:** While the common reason to get life insurance is to replace income for the family should we die and our income stops, seniors or retirees are not dependent on their labor for income. Therefore, it seems that senior life insurance would be superfluous. But life insurance for seniors has other uses to solve other problems, such as providing liquidity at death for a surviving spouse, ease of estate settlement and division, creating a pool of money for special needs – to create an estate and to pay estate taxes.

**Health Insurance:** No one should go without health insurance. However, senior health insurance is different in that private insurance is required in combination with government coverage. A typical senior health insurance program would include Medicare to cover 80% of health care costs and private insurance, or Medigap coverage, to cover the other 20%.

**Funeral Insurance (burial insurance):** While it's true that a funeral can easily cost \$20,000, most people of any means have the financial resources to cover their funeral, so special insurance may not be necessary. However, it is an excellent idea to have a funeral program structured so that your heirs don't need to take on this burden at their greatest time of grief. It could make sense to combine your funeral arrangements with funeral insurance as a package that relieves heirs of all financial and funeral planning concerns.

**Long-term Care Insurance:** Typically, in our working years, we have disability insurance to provide income in the event of our disability. Since we are no longer working in our retirement, it's wise to obtain long-term care insurance in the event of disability due to age. Long-term care insurance policies provide income to cover the extra expenses for the help you need for shopping, cleaning, cooking, bathing, dressing, driving and getting round.

As you can see, there are many types of senior insurance issues that apply specifically to retirees past 65 years of age.

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<sup>9</sup> Representative example: as of 12/22/14 METROPOLITAN PIER & EXPOSITION AUTH ILL 00.00000% 06/15/2043DEDICATED ST TAX REVBDS MCCORMICK, PL Rated AAA, S&P [www.fixedincome.fidelity.com](http://www.fixedincome.fidelity.com)

<sup>10</sup> [www.dogsofthedow.com](http://www.dogsofthedow.com), average yield of top 10 yielding stocks of the Dow Jones Industrial Average 12/22/14.

# Other Retirement Issues

Retirement is not just about the size of your nest egg. There are several considerations for a comfortable retirement experience in addition to a financial retirement plan. These considerations extend to where you live, housing options, and healthcare quality and choices. Most importantly, what activities will you do in retirement to stay mentally and physically fit? Here's a short list of considerations to add to your retirement checklist.

## Healthcare Needs for a Healthy Retirement Experience

1. Do you have insurance that will cover catastrophes?
2. Do you live in proximity to medical specialists you may need to consult?
3. Is your HMO or health plan available where you plan to have a second home or move?
4. If you plan to travel outside of the US, does your health plan cover you?
5. Do you have long-term care insurance? (Don't make the mistake of thinking that Medicare pays.)

## Retirement and Moving Your Residence

1. What are the tax rates in the new community—property taxes, state income taxes, state sales tax – and do they tax retirement income and social security income differently than other income?
2. If you reach an age where you cannot drive, will the public transit take you to your favorite places?
3. Is the climate satisfactory in all months? How about allergy months (e.g. spring time)?
4. Is there an adequate selection of senior housing complexes, assisted living facilities and nursing homes and what is the cost?
5. Is there an active population of retirees in the new area and people you can befriend?

## Retirement income structure

1. Does one spouse have a pension that ends upon death? Your retirement consultant can show you how to possibly replace that income.
2. If both spouses are eligible for Social Security income, there may be ways to maximize the benefit—check with a retirement planner.

## Estate planning

Estate planning is not just for the rich. It is for anyone that cares about their heirs. In fact, most aspects of estate planning basics have little to do with money.

Estate planning basics do address the eventual and economical distribution of your possessions and authority but more importantly, how you take care of your loved ones. Many of you may think you don't have an estate plan – but you do! Federal and state rules will determine who gets what and how much, and how you will be treated if you become very ill. If not prepared with basic estate planning knowledge, it costs money and heartache.

Putting your estate in order can be complex. It depends on how many assets you have, where they are, your family structure – children, divorced and previous children, state laws – and more. But, no matter how small or large your estate is, here are the four tools of basic estate planning:

1. Will or trust
2. Durable power of attorney
3. Living will
4. Health care proxy (medical durable power of attorney)



Your will shows your wishes for disposition of your assets and names a guardian for minors. In it, state how property in your name should be distributed, name an executor to be in charge of carrying out your wishes, and provide for payments of costs incurred in settling your estate. And for your minor children, designate a guardian and name a trustee to protect their inheritances. One estate planning basic is to use a trust in place of a will because it maintains privacy and avoids court involvement in the settlement of your estate. Additionally, trusts typically contain conservatorship provisions. If you should lose your mental capacity in your old age, do you want your family to be in court about your care, or would you rather have a written plan in advance? Estate planning basics call for planning ahead.

Your Durable Power of Attorney gives someone else permission to manage your affairs if you become disabled or incapacitated. With it, as soon as you become incapacitated, your designated person, i.e. your spouse, adult child or anyone you trust, can manage (pay bills, make decisions) your affairs or you can restrict that power to only particular assets or accounts. Don't wait! You can't create a durable power of attorney once you've become incompetent.

Your Living Will – expresses your wishes to your doctors when they must consider use of life-sustaining measures. This is your declaration on what life-sustaining medical treatments you will (or will not) allow if you become incapacitated. For example, you may request that artificial nourishment be (or not be) withheld if you become terminally ill. You may recall the Mary Schiavo case on this issue which became a national news story only because these estate planning basics were ignored.

A Medical Durable Power of Attorney (or health care proxy) is a crucial and basic estate planning tool that designates someone to make health care decisions on your behalf in the event you no longer can. It's a document that gives a person you designate permission to make health care decisions on your behalf if you are unable to do so in the future, and perhaps, consistent with your living will. Talk to the person before appointing him, and be sure he or she understands and is comfortable with your wishes, and is strong enough to carry them out despite some family members' objections.

Seek professional help in planning your estate – consistent with your state laws and your particular circumstances. No one will tell you about the estate planning basics. Be proactive and ASK your retirement advisors what you need to do to get your estate in order.

## Summary

These are only **a few ideas** to help you better protect your assets and make the most of what you worked hard to accumulate.

**Financial and retirement planning can have an impact on your estate, even if your estate is of modest size.**

- Find an advisor who is knowledgeable in senior matters.
- Find an advisor who will answer your questions, as well as answer questions that you have not thought to ask.
- Find an advisor who will point out opportunities and caution you about risks, and one who is knowledgeable about the special needs of retired individuals.

**With the sound advice of experience and a conservative retirement plan, you and your family can get the most out of your assets.**

## About Victoria Woods & Damon King



Victoria Woods is Chief Investment Advisor and President of ChappelWood Financial Services. As a premier advisor to affluent clients for over 25 years, she is recognized as a leader in the Investment Advisory industry. You may have seen her featured in Newsweek magazine's "Financial Planning Guide". She is the author of the book *It's All About the \$Money, Honey!* and has appeared on the Today show, Fox News, Fox Business, and CBS, NBC, and ABC affiliates across the nation. She can be heard on NewsRadio 1000 KTOK as host of "It's All About the \$Money, Honey!" Saturdays at 4:00 p.m. and Sundays at 6:00 a.m. Clients have benefited from Victoria's experience in working with High Net Worth households and Mid-Tier Millionaires.

Damon King, CFRE is an Advisor with ChappelWood Financial Services. Regarded as a leader in the charitable planning community as a fundraising professional by his peers and donors, he continues his work as a financial advisor developing strategies for affluent households to achieve their financial goals and preserve their values and legacy for future generations. You may have heard him as a co-host on "It's All About the \$Money, Honey" on NewsRadio 1000 KTOK. Individuals and families have used Damon's advice to establish tax-efficient gifting strategies, guarantee lifetime income, and preserve family wealth.

# About Financial District of Oklahoma - ChappelWood Financial Services

ChappelWood Financial Services is a premier Independent Registered Investment Advisory firm that was founded more than 25 years ago by our Chief Investment Advisor, Victoria Woods. Our success has been built on long term client relationships, our reputation, and consistency.

- **Customized Financial Solutions** - Mid-Tier and potential Mid-Tier millionaires; those seeking comprehensive income solutions, estate planning services, asset management, and tax preparation from one provider.
- **Retirement Planning** - Accumulation (IRA, Roth IRA, 401k), Protection, Distribution, Business Succession Planning, Estate Planning, Life Insurance Analysis, Document Vaulting
- **Financial Services** - Investment Management Analysis, Comprehensive Financial Plans, Continual Monitoring, College Funding
- **Tax Return Preparation** - Tax Preparation and Filing, Planning for Upcoming Changes, Access to a CPA
- **Social Security Planning** - Optimization, Timing Strategies, Benefits Planning, Coordination with Other Retirement Plans
- **Goal and Strategy Meetings** - Discovery, Clarity, Implementation and Monitoring; Cash Flow and Net Worth Analysis, Re-balancing, Access to a Financial Advisor Team

**Phone today with questions or to see if we can help you.  
There is no charge for an initial meeting.**

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