FINANCIAL BACKGROUND REPORT

COUNTDOWN TO RETIREMENT

As your retirement date approaches, there are a number of items to consider. Forethought will reduce stress, save money and increase your retirement security. Some items will require family discussion. Facing the decisions one at a time will help - as will the services of a financial advisor when appropriate.

FIVE YEARS (or more) TO GO

You may be sitting on a portfolio that is top-heavy with growth stocks. With retirement dead ahead, it is time to change course slightly, but not to abandon the equity ship.

The mistake that some people make is allocating all assets to fixed-income investment. If leaving the job at age 55 or 60, one could spend the next 20 or 30 years in retirement, so there is still a need to invest for the long haul.

That may mean sticking with some stocks and equity mutual funds. To get a rough estimate of what percentage of a portfolio should be devoted to those investments, subtract your age from 100. If someone is 55, about 45% - 65% of his/her assets should be in equities. Consider paring that down to 40% - 50% by the time age 60 is reached.

Some people in their mid fifties, who are heavily invested in equities, may want to begin shifting out of aggressive-growth stocks and funds, with the aim of putting together a portfolio balanced specifically for retirement. Typically, it would be divided equally among the following four asset categories: growth stocks or funds (with a tilt toward blue chips rather than small companies); growth and income (or balanced) funds; bonds, possibly tax-exempt if warranted, and certificates of deposit with staggered maturities.

It may be best to ease out of riskier holdings gradually by using dollar-cost averaging. Suppose that a 55-year-old has a total of $200,000 in retirement assets that he/she controls - such as IRAs and 401(k) tax-deferred retirement plans for employees - and which of that, $50,000 to $100,000 is in aggressive-growth mutual funds. Over the next five years, while maintaining the tax-deferred status of the money, $10,000 a year, or about $850 a month, can be shifted into assets that are less volatile. However, some retirement plans do not permit monthly shifts, so contact the plan trustee for the guidelines.

Use the same strategy if the current holdings fit the ratio but are heavily weighted toward the person’s own company’s stock or that of any other single company. By diversifying into broad-based equity mutual funds, it can reduce the volatility of a nest egg.

With today’s rock-bottom interest rates, portfolio balance and diversification are even more critical. Going conservative used to be getting 9% or 10% in fixed annuities or government bonds. Now, one may have to look to preferred stock or utilities to get a higher income stream.

Suppose a current portfolio is performing well and a person is not inclined to adjust it. If sizable payout is expected at retirement, sit tight and use the lump sum distribution to give equal representation in the four asset categories.

Is there an employee stock ownership plan? Take advantage of a special provision in federal law that allows one to shift out of the company's stock and into other investments beginning at age 55. Diversify 25% of your account balance at first and another 25% five years later.

FOUR YEARS TO GO

With an investment plan in place, turn one's attention to where you may want to spend your retirement years. "The key is to try before you buy," says Helen Dennis, a lecturer at the University of Southern California's Gerontology Center. Use vacation time to travel around with an eye toward another area of the country where you might what to live.

Get a feel for the area during vacations and take time making the decision to move. Often people are sorry that they sold their primary residence now that they have the time to enjoy it.

Another thing to keep in mind if planning to sell the house or relocate: avoid paying taxes on the profit from the sale of the home.

For specific information on places to retire, take a look at Retirement Places Rated, by David Savageau (Paperback, new or used: $3.49-$6.99 online), 50 Fabulous Places to Retire in America, by Arthur Griffith and Mary Griffith (Career Press: $16.49-$24.99 online), or Where to Retire, 6th Edition, by John Howells ($12.21-$17.95 online).

THREE YEARS TO GO

Some pre-retirees use a spreadsheet or budgeting software program to help them create retirement budgets based on different assumptions. Start with current expenses and then anticipate how those costs will change once retirement comes.

In general, expect some costs - travel, entertainment and health insurance, for example - to increase, while other expenses - clothing, taxes and perhaps housing - fall. Keep in mind that active retirees are likely to spend more in the first five or so years of retirement than they will later.

When figuring your retirement budget, do not forget about saving. Continue to accumulate wealth during the first seven or eight years of retirement before starting to dip into the principal.

Chances are most will worry less about outliving their resources than about health insurance costs, inflation and social security - wild cards that could throw a wrench into careful planning.

Request a copy of your Social Security earnings statement and benefit estimate. Call the Social Security office at 800 772 1213 and ask for Form 7004. After you fill out and mail back the form, it takes four to six weeks to receive the statement and estimate. If both spouses have been employed, submit two forms.

Have a financial advisor calculate how long this saving will last - based on reasonable assumptions. If the savings fall short of projected expenses, you may have to take on more investment risk in search of higher returns, plan to spend less after retirement or even postpone retirement.

Consider whether to drop your life insurance or take paid up values. If you have a whole-life policy and no longer need it to provide income in the event of death, cash it in or draw down the cash value gradually before starting to tap IRAs. However, evaluate life insurance needs in combination with the defined benefit pension options that reduce benefits to provide for survivors.

Make sure there is adequate umbrella liability insurance. Are there grandkids driving your car, and you do not want that liability to be over-exposed?

TWO YEARS TO GO

Retirement is not exclusively a financial decision. Now is the time to devote some thought to how the one or two of you is going to spend all those leisure hours - or even whether there be will time spent in leisure. Plan to continue networking with business associates after retirement - just in case there is boredom with fishing and canoeing. Is there a little consulting to do in the future?

The trend toward working part-time in retirement is not just a way of filling up the day. Many retirees need the income or want to build future financial security. An increasing number of companies are keeping retirees on retainer for part-time work or special projects, so even if the retirement is not voluntary, it pays to leave on good terms in case there is a need to get future assignments.

Retirees often underestimate how difficult it is to become a consultant or run another small business. If considering taking the plunge, get those feet wet by enrolling in one of the pre-business workshops held at local Small Business Administration offices.

The Senior Citizens' Freedom to Work Act of 2000 eliminated the retirement earnings test for persons who have attained full retirement age (FRA).

A limit on earnings from current work continues to apply to beneficiaries under FRA. The earnings limit is a retirement test and is a separate issue from income taxes. If you earn more than the exempt amount (see below), your benefits and your family members' benefits that are based on your work record will be reduced.

ONE YEAR TO GO

Lump sum or annuity? It can be a tough decision. The most common type of annuity, the joint-and-survivor option, pays a monthly check to the retired employee for life. After the employee's death, the spouse receives a portion of the original benefit for life. An annuity frees the account holder of the responsibility of managing the money, but his or her decision to annuitize is irrevocable. It is possible to lock in a fixed rate of return.

One alternative may be to take part of this distribution, perhaps 50%, as an annuity and the remainder as a lump sum. Investing the lump sum can help keep pace with inflation, since very few annuities have cost-of-living adjustments built in. Another option is to take the lump sum, even if it means dipping into the principal for current income, and then flip the balance into an annuity if interest rates go up.

If you opt for the lump sum, arrange to have the employer roll it directly into an IRA to avoid having 20% of it withheld for taxes if the money passes through the owner's hands. Follow the advice given earlier for allocating the funds among investments with different levels of risk.

Set the optimal retirement date. By waiting until the end of the year, say, or the employment anniversary month, this owner could add a full year of service for the purpose of calculating your pension. Plans vary, so contact the retirement plan administrator. Contact former employers to check eligibility for any other pensions.

Consolidate rollover IRAs with regular IRAs to cut down on paperwork and reduce fees. However, keep non-deductible IRA accounts totally separate.

SIX MONTHS TO GO

Medical insurance is a top priority. Find out whether the company provides benefits for retirees or whether a monthly premium can be paid to stay on the group policy. Law allows people to remain in their employer’s medical plan for 18 months after retirement, but the full cost of coverage plus a small administrative fee will have to be paid.

Legislation enacted in 2010, to be refined and implemented over the next few years will certainly impact the cost and availability of plans. Be sure to stay abreast of the latest developments.

Once age 65, Medicare will be available, but Medigap coverage is also needed. Following a 65th birthday there is a six-month open enrollment period during which any Medigap policy can be chosen, and the person can be accepted by the insurer, regardless of his or her health.

If not in good health now, you may be better off postponing retirement until at least age 63 ½, when the 18-month extension of your employer’s group insurance can be relied on until eligible for Medicare.

FINAL CHECKLIST

Apply for Social Security benefits about three months before you want them to begin. Take a copy of your birth certificate and the number of your bank account if you would like to have your checks automatically deposited.

If you will be moving to another state, have an attorney there review your will to make sure it will still be valid. Draft a durable power of attorney naming someone to handle your financial affairs should you become incapacitated. Also, make a living will expressing your wishes about what kind of medical treatment you would want.

Source: www.ssa.gov
The Circle of Wealth Company