Who Wants To Be A Millionaire?

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This article was originally written for NYS teachers who are also members of the NYS Teachers' Retirement System (NYSTRS). This is a defined pension system that, upon retirement, pays retirees a monetary benefit based on their average salary and number of years of service. If you work for a company, or are self-employed, and have no pension system, you can skip the NYSTRS section.

When I started teaching in 1972, WGTA President Jim Ridgeway took me aside and strongly suggested I start investing for my retirement in a Tax Sheltered Annuity (TSA). At the time, I didn't know what a TSA was, nor was I thinking about retirement! Today, 43 years later and almost 7 years into retirement, there isn't a week that goes by that I don't think of Jim and that valuable information he shared with me. While I did not retire a millionaire (starting salaries in 1972 were around $7,000), my wife and I are fiscally comfortable because of Jim's advice.

I would like to pay that valuable information forward and share with you some of the insights that I have learned about retirement and money. This is especially useful information for beginning teachers because, with a little bit of planning, you might be able to retire as a millionaire!

RULE OF THUMB

One rule of thumb from the New York State Teachers' Retirement System -- to retire comfortably you should have at least 75% of your pre-retirement income coming in once you retire. And the MORE income you have -- the more financially comfortable you will be.

Where will that money come from? Think of your retirement income as a four legged stool. The four sources are:

1. The New York State Teachers' Retirement System (NYSTRS). The district (and almost all of you) are currently investing into the Retirement System. How much you will ultimately get back in retirement benefits depends on the Tier you are in and how long you have taught. As a Tier 1 member I taught until I was I 59 years old and had teaching credit and some other NYS jobs totaling 39.4 years of Retirement System service. Under Tier 1 this entitled me to 78.8% of the average of my final 3 years salary!

While this sounds GREAT, there are some caveats. While you do NOT have to pay NYS tax, nor Social Security, on your retirement check, you DO have to pay Federal Income Tax! So, poof, there goes 15-20% back to the Federal Government. There are also NYSTRS options you can elect which will affect the actual amount you will receive (a death benefit for your spouse, for example). Many of these death benefits can be thought of as an insurance policy, which will allow your spouse to continue receiving your NYSTRS benefit should you predecease them.

There is also a NYSTRS cost of living adjustment, but it DOES NOT come close to covering the real cost of living. Thus, for all of you, poof – each year you lose more of your benefits spending power.

2. The second source of your income will be from Social Security (SS). Although many people fear it won't be around, the reality is that Congress won't let it die -- but they may change the retirement collection age (to later) or decrease the benefits -- or both. Everyone receives from SS a summary of payments they have made into their account and an estimate of how much they will receive upon retiring. I started receiving SS benefits when I turned 62 (your age may vary depending on many factors).

Your SS benefit also comes with a few caveats. While, again, you do NOT have to pay NYS tax or SS on this benefit, you DO have to pay Federal Income Tax! Also, at age 65, you must join Medicare (health insurance for the over 65 crowd), which currently takes out of your SS benefit $104 per month. For your $104 you get Parts A and B, which does NOT cover all your medical bills, so you will probably end up buying additional “supplemental” coverage (Parts C and D – prices for this vary widely). Federal tax, Medicare and related insurance costs can easily eat up 30% or more of your SS benefit. Poof. Yet again, a loss of income you may have incorrectly anticipated.

Typical monthly payments for recently retired teachers at age 65 are around $2,200 (MINUS $700 per month in Federal taxes and $104 in Medicare). Thus a retired teacher MIGHT receive a monthly payout of around $1,400 (your figures WILL indeed be different). This does NOT include what you will likely pay for supplemental Medicare insurance.

3. The third source, and most often ignored, is personal savings. A lot of teachers assume that the combination of NYSTRS and Social Security will give them all the money that they will need for retirement. As you can see, getting to the 75% figure is difficult to achieve using only NYSTRS and Social Security. This is particularly true if in you are NOT in Tier I, and will especially be true if they raise the Social Security pay out age and/or decrease the monthly benefit. From this total you must also figure in the alwaysincreasing cost of health insurance AND your lost spending power due to inflation. For more information about personal savings, see the next section titled “Saving for Retirement.”

4. A fourth source of income after your retire is that you can work after you leave teaching to supplement your retirement income. While this may seem counter-productive to actually “retiring”-- many teachers work after retiring. There are rules and regulations regarding how much you can earn before your retirement allowance is affected -- so check this out with the Teachers’ Retirement System if you plan on working after retirement.

Saving for Retirement

I suggest that ALL teachers STRONGLY consider investing into a Tax Sheltered Annuity (TSA), a Roth IRA or some other 401k-type retirement savings plan. (If your company does not have a pension system, you will HAVE to save for your own retirement.) Basically a TSA works as follows: if you invest $100 per paycheck into a TSA, that $100 is taken out of your pay BEFORE state and federal taxes are paid. This gives you several benefits. First, although your TSA savings increases by $100 each pay period, your paycheck does NOT go down by $100!! Your actual paycheck reduction will only be around $70 (depending on your tax status). The "other" $30 is the tax you would have paid if you weren't in the TSA. It's kind of like a "gift" from the government for saving for your own retirement.

Investing into a TSA also lowers your gross income for the year, usually putting you into a lower tax bracket. This lowers the amount of taxes that you will have to pay. You DO have to pay taxes on this TSA money when you withdraw it. However, this is usually well after you have retired and are in a lower tax bracket. The interest you earn on your TSA is also tax-free until withdrawal.

Roth IRA’s and 401k’s (and other retirement vehicles) are similar, except you pay taxes on your investment BEFORE it goes into your retirement account. The good news is that you DO NOT have to pay taxes on it when you pull it out during retirement.

Where can you Purchase a Retirement Vehicle?

TSA's are usually obtained through insurance companies. The district has a list of companies that the accounting office deals with. Roth IRA’s and 401k’s (as well as other retirement investment vehicles) can be purchased independently from any investment broker.

These plans earn money by investing in the stock marker, bonds and/or offer a flat interest rate. The interest rates, and rate of stock returns, vary significantly by company and the plan you select. There may also be contract, load and administrative charges, as well as early withdrawal penalties. Shop around before you invest in any plan. Also realize that these are long-term investments and are NOT vehicles for short-term savings.

While this can get a bit confusing, NYSUT offers (for an annual fee), the Full-Service Financial Counseling Program, which offers up to six hours per year of toll-free telephone consultations with Stacey Braun Associates Certified Financial Planner® or Registered Investment Advisor. Consultations address your various financial questions and situations. You can read more about this at: http://memberbenefits.nysut.org/program-service/legal-and-financial/financial-counseling-program/full-service-program

The Bottom Line

The bottom line is to INVEST IN YOUR RETIREMENT starting as early as you can in your working years. The reason for this is COMPOUNDING INTEREST. Too many teachers wait until the last 10 years of their working life and then try to "catch up" by investing big chunks of money into a retirement vehicle. The problem with this is that they don't get the year after year of compounding interest that early investing builds up.

So, How Do You Become a Millionaire?

If you start investing at age 22 and retire at age 62, you will have 40 years of compounding interest working in your favor. If you invest $200 every paycheck (21 paychecks in a year for a teacher) into a TSA starting at age 22 and your TSA earns 8% interest every year, it will be worth around $1.21 million at age 62. (And remember, if you invest in a TSA, your paycheck will only decrease by approximately $140 per pay, the rest of the investment is from Uncle Sam!) (If you are a yearly worker, you would have to save $350 per month for 40 years at 8% interest to reach the $1.2 million target.)

To show you the power of compounding interest, if you wait until age 32 to start investing in a TSA (30 years of savings), you will have to invest $450 per paycheck at 8% interest to end up at age 62 with $1.17 million. For a yearly employee this equates to $787.50 saved per month. **(NOTE: Figures taken from an http://www.bankrate.com/calculators/savings/simple-savings-calculator.aspx, interest rate compounded monthly.)**

Finding an investment vehicle today that pays 8% is difficult. The lower the interest rate you can get, the more you will have to save. If you can get an investment vehicle that pays 6% a year for 40 years, you would need to save $505.00 per month (12 month year) to reach a million dollars saved in 40 years.

The REAL Goal

Although it would be nice, the goal really isn't to amass a million dollars by the date of your retirement. Your goal should be to enter retirement knowing that you will have enough money to maintain your lifestyle plus extra money so that inflation will not have a negative effect on your retirement plans.

If you actually do retire with a million dollar investment, how much can you spend? Many advisors recommend the "4% rule" as a benchmark. The 4% rule, based on early-1990s research, holds that a retiree with a balanced (stock-and-bond-mix) portfolio could safely pull out 4% in the first year of retirement — then that same dollar amount each subsequent year plus an inflation adjustment, and it wouldn't exhaust the portfolio even after 30 years. In today's financial climate, this 4% estimate may be too HIGH.

Even at 4%, a million dollars would translate into a retirement income of $40,000 per year. Add in Social Security and any other investments and then ask yourself, is that an amount that I can live on?

If you are a NYS teacher, you will probably have your NYSTRS pension as your primary retirement vehicle. Add into that amount Social Security PLUS your own savings. If you acquire the right planning with an investment counselor you should be able to retire quite comfortably.

The Fine Print

I am not an investment counselor. The figures presented are as accurate as I can calculate, but your actual figures and financial situation will be different. Seek help from a certified financial consultant before making any financial decisions.