Short- and long-term planning for retirement, college, financial flexibility

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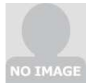

By **Karin Price Mueller/The Star-Ledger**

Steve and Debbie have a lot on their financial minds. They're concerned about retirement savings, college savings and debt reduction.

"I am limited to saving only 5 percent in my 401(k) since I am a 'highly compensated employee' and the company's plan did not pass the nondiscrimination testing," says Debbie, 42. "We also would like to be able to pay down our mortgage by the time Steve retires, which we are hoping will be when he is 65 in 12 more years."

When they retire and the kids, 8 and 5, are done with college, Debbie and Steve, 53, would like to sell their New Jersey home and buy a smaller place.

The couple, whose names have been changed, have saved $135,300 in 401(k) plans, $458,400 in IRAs, $10,500 in mutual funds, $11,200 in money markets and $8,000 in checking. They've also set aside $45,700 for college savings.

The Star-Ledger asked Andrew Novick, a certified financial planner with Condor Capital in Martinsville, to help Debbie and Steve consider their short- and long-term financial goals.

"One important objective in financial planning is to contemplate the risk of loss and to financially plan for it," Novick says. "While there are several reasons to own life insurance, the most important reason is as an income replacement tool."

Life insurance can protect the surviving family from the loss of one's income. When you retire, you no longer generate income, so your need for insurance is significantly reduced. Thus, term insurance works perfectly, Novick says. Because term insurance is relatively inexpensive, Novick feels families should make it a priority to have adequate coverage.

As a rule of thumb, Novick says primary income earners in this couple's age group should have approximately seven to 10 times salary.

This couple needs more than what they have. Debbie has $433,000 of coverage and Steve has $164,000 — both through their employers. Should they lose their jobs, that coverage would be gone.

Novick says Debbie should have $1.25 million of coverage while Steve should have about $850,000. Based on their

retirement dates, he recommends Debbie look at 20-year term policies, and Steve look at 15-year term policies.

"I always prefer that people maintain independent coverage instead of employer-sponsored group coverage if possible," he says. "Not only is it often less expensive, but it eliminates the risk of losing your job and your life insurance at the same time."

Next, Debbie and Steve want to pay three years of college for each of their children.

Assuming an annual college cost of $31,048 in today’s dollars based on data by the College Board and a college inflation rate of 5 percent, Novick says more savings is needed.

The projections show they should save $5,366 per year for their older child and $4,972 for their younger child. They are currently saving $4,800 a year for each child.

If they pay for three years of school, the children would borrow the rest. Rather than pay for three full years and borrow for one full year, Novick says it is probably more economical for the children to borrow under the federal Stafford Loan program each semester while they are in college.

"One reason I like the Stafford Loan program is that the children are responsible for repaying the debt," he says. "As such, it encourages them to take college and the job search after graduation seriously." Additionally, the size of the loan isn’t too overwhelming for someone new to the work force, the interest rate is reasonable and the repayment terms are very flexible, he says.

Steve and Debbie say they’d like to pay off their mortgage by the time Steve retires in about 12 years. Novick says they’re on the way to that goal because they pay extra on the loan each month. Paying off the mortgage will help lower their overall retirement expenses.

In the meantime, refinancing could save them some additional money, Novick says. Their current mortgage has a 4.625 percent rate, and their home equity loan is at 3 percent. Based on current rates for 15-year mortgages, which average at 3.8 percent according to BankRate.com, Novick says they could roll their home loans together, cutting their overall monthly costs and still have both loans paid off around the time Steve retires.

"This approach should offer them more financial flexibility to save for the new car, children’s college fund and pay for the new life insurance," he says.

Novick ran some retirement projections to see how much the couple could afford to spend after they stop working, assuming they continue to save. Their portfolio, in conjunction with Social Security, can provide gross maximum annual expenditures of $137,322 in today’s dollars, he says.

"We recommend spending less than the maximum since some income taxes will have to be paid out of this amount," Novick says. "Most of their investments are in tax-deferred accounts so most portfolio distributions will be taxable. Assuming a combined average federal/state tax rate of 20 percent on the maximum recommended portfolio withdrawal leaves $109,857 in today’s dollars for yearly living expenses."

This isn’t much lower than their current living expenses and should be sufficient considering their mortgage should be paid off and both college savings and life insurance premiums will be substantially eliminated in retirement, Novick says.

Moreover, if they downsize as they’re considering, their monthly expenses will go even lower.

Get With the Plan is designed to illuminate personal-finance concepts and isn’t a substitute for actual financial planning or dedicated professional advice. To participate, contact Karin Price Mueller at kmueller@starledger.com

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