Managing Your Own Money: Retirement

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As a public manager, you face the challenge of overseeing tight budgets while meeting the growing service expectations of the public. It's a difficult balancing act that requires experience, diplomatic skills, a little bit of luck, and the ability to draw effectively upon the skills of professionals with expertise in finance, accounting, law, and other areas.

But while you successfully handle municipal, county, or departmental budgets, managing your own money may have become increasingly difficult. Your portfolio may include many account types ranging from a pension plan, to a 457 deferred-compensation plan, to an IRA, to personal savings, or perhaps even to real estate holdings.

In addition, over time you might have experienced changes in your life that have dramatically affected your finances. Some may have been dramatic changes, such as marriage, a child's enrollment in college, an inheritance, a serious illness, the death of a spouse, or an unexpected employment transition. Some may have been less dramatic, more gradual but just as important, like getting a bit older.

After giving your all at the office, do you have enough time and energy left for your own financial planning? With a shortage of time and expertise, you may have investments that don't feel right anymore. Recent stock market performance has not helped many of us. And to make matters even more complicated, a host of new tax laws that became effective in 2002 have substantially changed how these plans operate and can fit into your personal plan. Getting a handle on your personal planning may be even more daunting than managing municipal or county resources.

You're not alone. Many public managers find that managing their personal financial plans is a thorny task. Successful public managers recognize that, just as they rely on professionals at work, they might need to rely on professional financial planners who understand their public sector plans and benefits.

Perhaps, you've been thinking of seeking the advice of a professional financial planner. But where do you turn? What do you need in a financial plan to meet your goals? What can a professional planner do for you?

This article takes a look at financial planning, with a special emphasis on retirement planning, the central lifetime financial issue for most of us. It discusses elements that may make up a retirement plan and how these elements can help you make informed decisions.

After reading this article, you may be more motivated to get your finances in order. This article is not intended to provide specific financial planning advice. Rather, it serves as an overview for

developing a plan that will guide you toward intelligent investment and financial planning decisions.

Retirement Planning for You

As the saying goes, a journey of a thousand miles begins with just one step. One of the best places to begin your journey is with retirement planning, as that is the key financial goal for most of us. There are two distinct phases of retirement planning: the first for those who are accumulating wealth and the second for those who are about to retire or are retired.

During the accumulation phase, when you may have 10, 20, or even 30 years before retirement, your focus should be on accumulating retirement benefits and saving and investing for long-term growth. At the same time, you have many competing financial goals, from meeting the bills to saving for your kids' college. Your emphasis is typically on maximizing contributions to your tax-deferred accounts, such as your 457 and IRA plans, and making any additional investments in taxable accounts.

The ultimate goal is to build an asset base large enough to provide a reliable monthly income from your investments to supplement your Social Security income (should you have any) and, if you're lucky, a pension.

For persons in this accumulation phase, a professional planner should be able to develop multiple computer-generated "what-if" scenarios that will illustrate realistic outcomes under a variety of different circumstances. Professional planning in the accumulation phase can help you to understand that the consequences of financial decisions you make now affect the probability of achieving your dreams. Early planning, with occasional reviews, will help you direct your actions so you can feel secure in knowing that your plan is on track to meet your financial goals.

The distribution phase of retirement begins as you withdraw money from your investments to support your retirement lifestyle. This is the time when you realize the benefits of all of those years spent preparing for financial independence. Many critical decisions are made as you approach retirement and begin your transition into it: when and how to take your pension, how much and when to withdraw funds from various accounts, life-expectancy questions, insurance needs, the purchase of service credits, and a sustainable level of spending. Many of these matters are complex, some are daunting, and all could benefit from consultation with a professional planner.

From accumulating assets, at retirement your focus will shift to managing spending and investing so you will not unduly deplete your nest egg. Instead of deciding which account to put money into, you now are deciding which account to draw down. Your overall portfolio investments are driven by how much investment return you will need to sustain your desired retirement lifestyle throughout a long retirement.

In this retirement planning phase, individuals typically have complex and demanding financial planning requirements and require realistic projections and critical planning help. Your time of retirement may not just be one date but many years of active living and learning, combined, of course, with elements of the unexpected.

As noted, professionally assisted retirement planning helps establish a sustainable spending plan, assess the probability of financial success, maximize income and flexibility, and minimize taxes. This type of planning places a particular emphasis on coordinating income distributions from a variety of asset sources, as well as on the tax issues relating to each asset source.

Whether you need basic planning services or require more sophisticated help because of the complex nature of your assets, you will need to understand the elements that make up your financial report.

The Retirement Plan Report and Its Contents

Your financial planner will first collect essential financial information from you and understand your retirement objectives. A written report should combine conservative but realistic assumptions, your objectives, and your financial data, to project your financial situation into the distant future. The written plan should include summaries of this information to help you understand the foundation on which your plan has been built.

Today's technology allows planners to include a means of calculating a "comfort level" at which your plan is achievable, even given such substantial unknowns as future investment returns. In addition, your financial plan should include a series of reports that will help you visualize the potential changes in your income and assets by projecting your needs and resources on a year-by-year basis. Here's a look at some of the reports that might be included in your retirement plan.

Net worth statement. Especially for pre-retirement planning, a financial report may start with determining your net worth. Your statement of assets and liabilities is your yardstick. Tracking changes in your net worth can help determine if you are making progress toward your financial goals or falling behind over time. A current budget or cash-flow statement may help you identify money that can be reallocated into savings and investments to meet your financial goals.

Investment allocation report. You may also find in your report your current investment allocations. Studies show that the most important decision an investor can make, after putting a regular savings plan in place, is the one governing how he or she allocates assets among different asset classes, such as stocks, bonds, and cash equivalents. Combining regular saving with the right asset allocation—balancing risk and reward—will meet your investment goals. Based on your objectives, risk tolerance, and other factors, your planner may discuss a new asset allocation to match your newly developed plan.

Retirement capital projection. This report shows the growth and depletion of your retirement assets throughout your life expectancy. It should include all retirement assets (separating tax-advantaged and taxable accounts), all expenses, plus other income, defined-benefit pensions, and Social Security benefits. This projection will be the base for setting a sustainable level of retirement spending while minimizing taxes.

Monte Carlo retirement simulation. This powerful computer modeling tool statistically predicts your chances of achieving your retirement goals. The basic report will use constant rates of investment return and inflation to calculate a middle-of-the-road estimate for your retirement

plan. But we all know that return and inflation vary from year to year. This variation will have significant consequences for your retirement finances. Monte Carlo technology randomly varies rates for thousands of test scenarios to calculate a range of foreseeable financial outcomes. This sophisticated financial modeling tool helps establish a level of confidence in the plan itself and can lead to actions you can take now to raise this confidence level.

Tax modeling. Retirement planning must consider taxes. Multiple sources of income will raise tax questions. Your planner might devise a plan to minimize tax consequences while maximizing income. A tax modeling report will be critical in taking a comprehensive approach to retirement income planning.

Understanding how these reports fit into your financial plan will give you a better understanding of the steps you can take as you prepare for retirement and then make your transition into it.

Other Considerations

This article has focused on retirement planning, but comprehensive financial planning encompasses a number of critical areas, including estate planning, insurance, tax planning, investment management, cash management, and budgeting. Depending on your needs, it also may include education funding, charitable and planned giving, trust management, and long-term health care concerns.

Estate planning. Estate planning involves making legal decisions in advance of your death about the use, maintenance, and disposal of your real estate, investments, cash, life insurance, and any business ownership(s) you may have as assets.

If you don't have an up-to-date and properly prepared will that makes clear your decisions about your estate, it could be years before your property is awarded to your heirs, or it could be distributed in ways you didn't intend. A well-designed estate plan can save thousands of dollars in death taxes and estate settlement costs. Remember, though, that assets in a qualified plan, IRA, or deferred-compensation plan are distributed according to your beneficiary designations within the plan, not the terms of your will.

Protecting your estate will require careful planning. Because it involves wills, trusts, and other legal documents and matters, estate planning is usually done by an attorney in your state of residence.

College savings. If you have children, helping to pay their college expenses may be a goal. If you start saving early, you may be able to meet the challenge of funding a college education.

The cost of higher education has dramatically increased over the past 20 years. Some families make the mistake of saving for college at the expense of retirement saving. There are plenty of ways to pay for college—grants, loans, work, etc.—but no one gets a scholarship or a loan to retire! Setting realistic savings goals for varied purposes may require the help of a financial planner.

The first step in planning for a college education is determining how much the family will contribute. Your financial planner can run an education funding illustration that will help you develop a schedule for funding educational investments while meeting your other goals as well.

Insurance coverage. In the event of an untimely death, survivors may be left without the household income needed to sustain their existing lifestyle. Life insurance coverage usually is recommended, in an amount that will ensure sufficient ongoing income as well as cover such immediate needs as final expenses.

Your financial planner may include in your financial plan an illustration of projected life insurance (and disability insurance) needs so that you may shop for insurance coverage with an independent understanding of your needs before meeting with an insurance agent.

Help from financial planners who specialize in the public sector. Public employees considering using a financial planner can look to ICMA-RC for assistance. Whether you are just beginning your career or are seriously thinking about your retirement, you can look to certified financial planners and retirement plan specialists at ICMA-RC, who can help you find answers to planning concerns and take control of your financial future.

Taking the Next Step

Professionally assisted financial planning can be a rewarding process for anyone who wants aid in determining strategies to meet financial goals. With the help of a financial planner, you can overcome unforeseen life changes while still working to achieve your life goals. Remember that no plan is successful unless you stick with it and adjust it when needed. Once you start your plan, monitor it regularly to ensure that you're still meeting your goals.

New Law In Effect Governing Retirement Plans

Public managers now can take advantage of one of the most sweeping changes to the laws governing retirement plans, as a result of the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

Whether your emphasis is on maximizing contributions to such tax-deferred accounts as 457 plans and IRAs, or on deciding how much investment return you need to sustain your retirement lifestyle during a long retirement, you can benefit from EGTRRA.

The $1.35-trillion tax bill, which became effective January 1, 2002, contains provisions that make dramatic improvements to public sector Section 457 deferred-compensation plans and to Section 401 defined-contribution plans. Among these provisions are measures that provide for higher contribution limits and for retirement plan portability.

The retirement measures included in the tax package:

- Significantly increased the 457- and 401(k)-plan contribution limits. The legislation

raised the 457 normal contribution limit and 401(k) elective deferral limit to $11,000 in 2002 and, incrementally, to $15,000 by 2006. The 457 plan's 25 percent-of-compensation limit was also raised to 50 percent.

- Increased the 401 defined-contribution plan limit (Section 415 limit). Increased the dollar limit on overall contributions to a 401 defined-contribution plan from $35,000 to $40,000 and raised the 25 percent-of-compensation limit to 100 percent.
- Raised the "pre-retirement" 457 catch-up limit. The pre-retirement catch-up limit will be twice the normal contribution limit in effect for that year (see the first item described). This means that a participant using the pre-retirement catch-up provision in 2002 will be able to contribute as much as $22,000 in total to his or her 457 plan (increasing to $30,000 by 2006).
- Allowed 457 and 401(k) participants aged 50 and over to make additional salary reduction contributions each year. The additional contribution limit is $1,000 in 2002, increasing incrementally to $5,000 in 2006. This "age 50 catch-up provision" could be used each year beginning when the participant reaches age 50 until he or she leaves employment, except in the year(s) that the participant uses the "current" 457 catch-up provision (see the previous item).
- Allowed 457- and 401(k)-plan "Sidecar IRAs." Under a Section 457 or 401(k) "Sidecar IRA" or "Deemed IRA," contributions can be made to a separate IRA account (traditional or Roth) that is part of a 457 or 401(k) account. (This provision will become effective on January 1, 2003).
- Provided for less restrictive 457-plan withdrawal rules. Participants now can change their distribution schedules in response to changes in their retirement income needs (as in current 401-plan rules).
- Allowed rollovers between retirement plans in the public, educational, nonprofit, and private sectors (457, 403(b), and 401 plans), as well as traditional IRAs.

These improvements to public sector pension and retirement plans clearly help public managers meet their retirement planning and savings goals. For more information, visit ICMA-RC's Retirement Reform Resource Center on VantageLink at www.icmarc.org.

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