

3. Planning for Retirement

Are you going to retire someday? Will you be financially able to retire? Retirement planning is essential for everyone because most people would like to live more comfortably than their Social Security will allow.

Begin by establishing your retirement goals. Retirement goals are individual and subjective. Should you even plan to retire? If you do, at what age? Answers, of course, depend on many factors, including opportunities for employment in the future, personal temperament, health, lifestyle, interests, pursuits, and perhaps even climate.

The next step is to determine how much income you will require upon retirement. You may want to consider two levels, the bare minimum you think you will need and the level at which you would be able to enjoy your current standard of living. To really enjoy retirement, most people find they need at least 70% of their current income.

Anticipating Future Living Costs

List the monthly expenses you anticipate during retirement. Here are eight categories:

- Housing, either rent or mortgage payments, house insurance and real estate taxes. Take into account where you would like to live during retirement.
- Utilities
- Clothing
- Food, household supplies, and transportation
- Anticipated non-reimbursed medical expenses
- Entertainment and vacations
- Gifts
- Income taxes

Look at your lifestyle and ask, “If I were not working, what expenses could I avoid? If I were not working, what would I want to do and what would that cost?”

Considering Your Retirement Income

Once you decide on your retirement age and the amount of targeted income, examine your existing income sources. Start by listing the following:

- Social Security benefits
- Individual retirement accounts (IRA)
- Stocks and bonds
- Savings accounts
- Rental property
- Employer- or union-sponsored retirement benefits

Note: This discussion assumes that you have an employer and are not self-employed. Self-employed people have other opportunities for saving.

Sources of Retirement Income

Social Security. Social Security is often an important component of your retirement income. At your request, the Social Security Administration will estimate your individual benefits at retirement age. (For more detail, see related article on Social Security.)

Retirement Plans. Everyone today has the opportunity to establish his or her own Individual Retirement Account (IRA). An IRA lets you set aside up to \$2,000 of earned income each year in a tax-deferred retirement savings plan. You can make an additional contribution for a non-working spouse of up to \$2,000. Earnings in an IRA accumulate free of income tax. Depending upon your income, some or all of the contribution to a traditional IRA may also be deductible. You can withdraw amounts (you choose the level) from your IRA at any time, but if you do so before you are age 59 ½, you are usually subject to a 10% penalty in addition to income tax on the amount withdrawn.

The new Roth IRA is similar to the traditional IRA in that income accumulates tax-free. The primary differences are: (1) a tax deduction is not allowed for contribution to the account; (2) qualified distributions from the account are no included in income; and (3) distributions are not required when you reach age 70 ½.

In addition, you may participate in an employer-or-union-sponsored retirement plan. These plans allow you to accumulate savings, generally tax deferred, for your future retirement. They can also provide you a monthly income during your retirement.

The 2001 Tax Act increases the allowable contributions to both traditional and Roth IRAs as shown in the chart below. If you are at least age 50, you are allowed to make additional contributions to these accounts. Depending upon your income, the contributions may be deductible.

<i>Year</i>	<i>IRA Contribution Limit</i>	<i>IRA Age 50 Additional Contribution</i>
2002 through 2004	\$3,000.	\$500.
2005 through 2007	\$4,000.	\$1,000.
2008 and later	\$5,000. *	\$1,000.

* After 2008, the contribution limit will reflect cost-of-living adjustments.

The 2001 Tax Act increases the annual contributions you may make to elective-deferral employer-sponsored retirement plans such as 401(k) plans, 403(b) annuities, SEPs, and SIMPLE-IRAs. Contributions to all of these plans are based on earned income and are subject to other plan provisions. If you are at least age 50, you are allowed to make additional contributions to these plans that are not subject to income limitations.

<i>Year</i>	<i>Contribution Limit</i>		<i>Age 50 Additional Contribution</i>	
	<i>401(k), 403 (b), and SEP</i>	<i>SIMPLE-IRA</i>	<i>401(k), 403(b), SEP</i>	<i>SIMPLE- IRA</i>
2002	\$11,000.	\$7,000.	\$1,000.	\$500.
2003	\$12,000.	\$8,000.	\$2,000.	\$1,000.
2004	\$13,000.	\$9,000.	\$3,000.	\$1,500.
2005	\$14,000.	\$10,000. *	\$4,000.	\$2,000.
2006 and later	\$15,000. *	\$10,000. *	\$5,000. *	\$2,500. *

* After 2006 (2005 for the SIMPLE-IRA contribution) the limits and additional contribution amounts will reflect cost-of-living adjustments.

Personal Savings and Investments. Stocks, bonds, and savings accounts offer excellent sources of monthly income during retirement. In addition, these accounts help establish an emergency reserve fund because they are liquid. It is important to make sure you have the equivalent of about six months of income set aside as a reserve fund to cover unusual expenses such as major repairs on your home or car, or large medical expenses.

Rental Property. Rental property can provide a monthly income generated from the net rental income. Also, if larger amounts are needed, the property can be sold or mortgaged.

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Employer- or Union-Sponsored Retirement Plan. Employer- or union-sponsored retirement plans vary greatly. Be sure you take the time to understand how the plan that applies to you works. Contact your employer or union for a complete description of the retirement benefits that are available to you. From this information, you and your advisors should determine the answers to the following where relevant:

- Can you make voluntary contributions to the plan? How much and how often?
- Does your employer or union match any part of your contribution?
- How is your retirement benefit determined? Is it based on your share of the fund accumulation as of your retirement date? Or is the plan designed so that you receive a certain percent of current salary at your retirement? Your employer or union may have a combination of both types of plans and may be able to help you determine what benefits may be available at retirement.

- At what age can you begin receiving retirement benefits? If that age does not match your chosen retirement age, how can you compensate for that when determining your income needs?
- How will your retirement benefits be paid? Will you receive a lump-sum or monthly payment? You may have a choice.

Making Up the Shortfall

Now that you have determined your estimated income needs during retirement and your current retirement funds, you will likely find, like most people, that you face a shortfall. How do you make up the difference? First determine how you can make your existing sources of retirement funds grow:

1. Determine the maximum amount you could contribute to your retirement plan and what, if any, matching contribution the employer will make. Then decide how much of that maximum amount you can afford to contribute. If you can't contribute the maximum amount, start with a smaller amount and slowly increase your contributions to the maximum.

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2. Contribute as much as possible into either a traditional or Roth IRA.
3. The balance of your retirement funds will come mainly from personal savings. Starting and continuing a savings/investment program is the foundation to your financial plans. How you invest those funds depends on your income tax situation

and your comfort zone for financial risk. Your investments may vary from low risk, such as passbook accounts at a savings bank, to high risk investments, such as commodity futures. Your comfort with various levels of risk will also depend on how many years you have until retirement. The longer the time until you retire, the more time available to make up for a loss, if that should occur with an investment. The shorter the time period until retirement, the less risky your investments should be.

4. Consider long-term care insurance plans for future medical needs, such as nursing home care. Such plans protect your income-producing capital when such expenses exceed your income.

Having reviewed the above items, you may determine that your retirement income falls short of your financial needs. Making up the shortfall may seem impossible, but it's usually not. You may need to go back and adjust the variables, such as the retirement age and your plans after retirement. Are they realistic?

As with any plan, your retirement goals need to be periodically reviewed and updated. Your health, work, or family situation may change, requiring adjustments in your program.

Some Final Comments—Inflation and the Time-Value of Money

An element that cannot be overlooked is the effect inflation will have on the income you will need in the future. Assuming an inflation rate of only 3%, the purchasing power of a 1997 dollar will be reduced to \$.54 over the next 20 years. The amount of inflation may vary greatly over the period you have until retirement, so when you consider the dollars needed in the future, consider changes in inflation.

Your retirement plan will be developed over time. The earlier you start, the better. A little time and common sense can be a major step forward in planning for your "golden years." The bottom line is, start your plan—now!