

**First Affirmative Financial Network
Arc Advisers, LLC**

Financial Plan and Recommendations

Personal Information

For: Lucille Ball

Birthdate: (age) April 15, 1953 (57)

Analysis Date: September 2010

Employer(s): Program Director, Local Office of National Nonprofit

Status: Divorced with one son, Ricky, born 6/2/1988 (22)

Bankruptcy/lawsuits: None

Goals, Objectives, and Concerns

- 1) You are concerned about having enough money to retire, particularly given the freezing of your defined benefit pension plan. Because of the demanding nature of your job, you are concerned about working until 65-67.
- 2) You want to be able to pay for the last two years of college for Ricky so that he does not have significant debt when he finishes college. He will finish his second year of community college this year.

Summary Findings and Recommendations

You can pay for Ricky's college and reach your retirement goals, but need to reduce your expenses so that your income pays all of your annual expenses and contributes to savings, rather than relying on your credit line. Making this change now will have an enormous impact on your financial situation through retirement. Your willingness to work longer before retirement, or work part-time after retirement, allow you to build a stronger financial position with more flexibility for your later years. You earn a good salary and have very marketable skills, such that your earnings capacity is your biggest asset as you prepare for retirement.

- 1) Controlling your current expenses so that you live within your means and save each year, rather than using your credit line, is the most important step you can take to meet your retirement goals. Reducing the balance of your credit line will have a significant impact on resources you will have available for retirement.
- 2) Carefully review the beneficiaries on your life insurance and retirement accounts and ensure that they reflect your wishes. Develop a living will, power of attorney for health care, and durable power of attorney. These documents are extremely important for someone in your situation. You should also ensure that Ricky has these documents in place.

There are additional recommendations in each section and they are listed together as a checklist beginning on page twelve of this narrative.

ANALYSIS AND RECOMMENDATIONS

The *Sample Plan Illustration* accompanying this narrative includes charts, tables and additional information about this analysis, and is referred to *in italics* throughout this narrative. The page numbers are on the upper right hand corner of the document.

See the *Personal Information and Summary of Financial Goal, pages 2-3*) to review your situation and goals.

Net Worth and Cash Flow (see *Net Worth and Current Assets pages 4-7*)

You have net worth of approximately \$252,000 with your house (recently appraised at \$320,000) as your largest asset. You recently refinanced your mortgage with a balance of \$154,000 and have a home equity line with a balance of about \$71,000. Nearly 90% of your investment assets are in retirement plans/IRAs, with the only exception being the \$15,000 CA Muni Bond. You have approximately \$3,800 in checking and savings accounts. This net worth statement does not include the \$10,000 tax refund that you expect to receive in 2011.

The budget that you provided indicates that you have an operating surplus of about \$22,000 per year, after making the maximum contribution to your 403(b). You generally withhold about \$10,000 extra each year for your federal taxes, and then use your refund to pay down your equity line of credit. It does not appear that you actually save the other \$12,000 and you indicated that it probably goes to paying expenses for your son. You use your equity line of credit as an emergency fund.

Managing your cash flow better so that you do *not* increase the balance of your line of credit except in a true emergency will be critical as you try to prepare for retirement. You anticipate funding Ricky's college with the equity line, and want to have \$30,000 available for that expense. With 6% annual college inflation, \$30,000 now would total nearly \$33,000 at the time of payment, which means that you should have a balance of less than \$67,000 when you begin paying for college.

You need to accumulate cash in an account that allows you to pay periodic expenses without using your equity line, similar to the way you save for your property tax. It is too easy to draw funds from the equity line instead of truly living within your means. To prepare for retirement you need to begin covering all of your expenses (including those for Ricky) with your income, and begin accumulating additional savings. The amount that you need to save varies based on different assumptions that we will discuss when we examine your different retirement scenarios.

Net Worth and Cash Flow Recommendations

- Do not borrow any additional funds from the equity line of credit. Pay the balance down to less than \$67,000, continue making interest payments, and forget that you have access to the line of credit.
- Build a savings fund with sufficient cash to pay periodic expenses so that you do not have to access the line of credit. Because you have about \$22,000 in "unaccounted for" expenses, you should probably accumulate savings of about \$22,000. Once you have adequate savings, begin to pay down the balance on your equity line as aggressively as you can.
- You will need to take a close look at your budget and the "unaccounted for" \$22,000 in expenses to determine how you can reduce expenses. When you do this analysis and identify

ways to reduce your expenses you may find that you need less than \$22,000 in your savings account, and you can begin paying down the equity line sooner.

- If the interest rate on your credit line begins to rise significantly you will want to use your savings to pay down the balance. But, you should leave enough in your savings to cover your expenses. The more you reduce your expenses the more quickly you will be able to pay down the credit line.

Tax Analysis

You paid approximately 14% of your AGI in Federal taxes in 2009, and are in the 28% tax bracket. You contribute the maximum amount allowable to your 403(b) which has a beneficial impact on your taxable income each year. You take advantage of deductions for mortgage interest, property and other taxes, and contributions. You also take advantage of your employer's Medical FSA. All of these actions help you minimize your federal income taxes. Your income puts you above the eligibility levels for other typical tax-favored accounts or credits, such as a Roth IRA or education tax credits.

Tax Recommendations

- Continue to take full advantage of the tax management strategies that you are already employing. Every \$100 that you contribute to your 403(b) or FSA saves you \$28 in taxes.
- As you indicated, you are essentially providing an interest free loan to the federal government each year by withholding \$10,000 more than your tax liability. You could set up a direct deposit from your paycheck, and have your withholding amount (or more) contribute to a savings account instead. You should only do this if you are confident that you will not access the funds.

Education Planning

One of your most important goals is to help pay for Ricky's remaining 2 years of college beginning in 2011. You would like to be able to pay \$25,000 per year, but would be okay with paying only \$15,000 per year. College expenses tend to increase at a rate of 6% per year, so \$15,000 now would be \$15,900 for 2011, and \$16,854 for the following year.

Actual college expenses will depend on which school Ricky chooses and whether his father pays some of the expenses. While you do not want Ricky to have significant debt by the time he finishes school, you recognize that he might need to assume some loans to go to the school of his choice.

You anticipate using your line of credit to pay college expenses. Your line of credit has a \$100,000 maximum so you would need a balance of \$67,000 or less to borrow enough to pay \$33,000 in college expenses. If Ricky decides to attend a more expensive school there could be up to \$10,000 more in expenses per year. That could be paid by you or through student loans, leaving Ricky with a debt of about \$20,000 by graduation.

Given your current financial situation and the importance of paying for Ricky's college, using your credit line is a reasonable strategy. However, you should be aware of some risks with this strategy. Many banks have cut off or reduced equity lines of credit in the recent economic downturn. Because you have just refinanced your mortgage and the worst of the downturn

appears over, it does not appear likely that your bank is going to reduce or cut off your credit line. A much more likely scenario is that you keep your credit line but the interest rate increases significantly over the next 10 years making it much more difficult for you to pay off this loan. Your equity line interest could increase to 18% according to the loan documentation. The only way to mitigate this risk is for you to do everything possible to keep the balance of the credit line as low as possible before college, and borrow as little as possible for college.

The projections assume that you max out your credit line to \$100,000 to pay college expenses in 2011 and 2012, pay interest monthly (out of your income), and then begin paying down the \$100,000 balance aggressively beginning in 2013. If you pay the balance off in 7 years it would be entirely paid off by 2020, when you turn 67 (your latest acceptable retirement age). Although your current interest rate is 3.25%, the projections assume that the interest rate from 2013-2020 is 4.5%, so that your monthly payment would be \$1,390. Of course, the interest rate could be significantly higher than that which would increase the payment needed to pay off this loan. For example, a 6% rate would require payments of \$1,460 per month; 8% would require \$1,558 per month, and; 10% would require \$1,660 per month.

As we will see in the financial projections, the amount of college expenses that you assume, the balance of the credit line, and interest rates will all impact your retirement goals.

Education Recommendations

- Pursue all opportunities to reduce your need to borrow from your credit line to pay college expenses.
- Recognize that if interest rates go up the cost of your credit line will increase. While borrowing from the credit line is inexpensive right now, it is likely to become significantly more expensive over the next few years.

Insurance Analysis (see *Insurance Inventory page 8*)

This analysis focuses on whether you have sufficient insurance in place, not on the quality or appropriateness of that insurance, as none of your policies was reviewed in detail.

Health: Adequate health insurance is currently provided by your employer through an HMO plan with a \$40 co-pay for which you pay about \$600/year. This appears to be a reasonable policy for you, depending on your health expenses (which I did not review). You also receive dental and vision insurance. Ricky is currently on his father's COBRA policy but you anticipate adding him to your policy as a dependent in 2011. You would then consider moving to an H.S.A high-deductible policy. Depending on a comparison of premiums and likely medical expenses, the high-deductible policy could make the most sense.

As you consider retirement keep in mind that you do not become eligible for Medicare until you turn 65. As you are aware, health insurance is going through significant changes right now and the availability and price of individual health insurance could change significantly by the time you retire. You should make sure that you have sufficient health coverage in place before leaving your job.

At 65 you will become eligible for Medicare. You do not need to be receiving Social Security to be eligible for Medicare. Complete coverage requires adoption of Medicare Part A, Medicare Part B, Medicare Part D, and Medigap policies. Medicare Part A is the only free part of this package, and mainly covers hospital costs; it does not cover physician costs. Medicare Part B, which mainly covers physician costs, requires a premium payment (approximately \$94 per month for most

recipients in 2010). In addition, many people require a Medigap policy to fill the gaps not covered in either Medicare Part A or B. Medigap policies are private and require a premium payment. Medicare Part D is private as well, and would also be an additional expense. Keep in mind these potential additions to your post-retirement expenses.

Life (See *Life Insurance Needs Analysis pages 9-11*): You have a group life policy with a benefit equal to your annual salary, approximately \$150,000. Assuming that Ricky is your beneficiary (and you should verify this), and that he would also receive approximately \$50,000 from your house (after paying the mortgage and credit line), and your muni bond fund, this amount would support him for about 3 years at \$50,000 in expenses per year, and pay for college expenses of \$50,000 over 2 years. He would also receive your 403(b) and IRA accounts (if he is the beneficiary) from which he would be required to take distributions based on his life expectancy. If Ricky is listed as the beneficiary on your pension plan, he would receive your monthly benefit of \$1,190 for ten years (if you died before retiring).

When you leave your job you will no longer have this group life insurance (although you may have an option to purchase an individual term policy from the provider). If you would like to provide additional support to Ricky should you die prematurely, or have some life insurance in place even after you leave your job, you should consider purchasing additional life insurance.

Disability (see *Disability Needs Analysis pages 12-14*): Disability insurance helps cover the loss of income if you become disabled. For most individuals, the chance of becoming disabled prior to retirement is greater than the chance of death. The only safe way to be assured of adequate protection against a loss of income due to long or permanent illness is to purchase a disability income policy.

You have a group long-term disability insurance policy that is paid by your employer. You could receive a monthly benefit of up to \$6,000 which would be taxable (because the premium is paid by your employer), and the elimination period is 6 months. This would provide you with an annual income of \$72,000. You also have a personal disability policy that provides a benefit of up to \$2,000 monthly after a 13-week elimination period. Together, the two policies could provide you with a benefit of up to \$96,000 per year which is almost 65% of your current salary. In general, 65%-70% of salary is the maximum amount that disability insurance will cover, so you have appropriate coverage. However, you should be aware that your personal disability policy is quite restrictive on the definition of disability and will only pay benefits if you are unable to work at any job. Policy benefits do not increase with inflation. While this is not optimal disability coverage, because you are planning on retiring in about 5 years it is adequate.

Automobile: You have AAA-CA auto insurance on your two cars for which you pay about \$1,950 per year. You drive the Honda and Ricky drives the Chevrolet. Your liability coverage is: \$100k/person and \$300k/occurrence bodily injury, \$5k medical payments, \$30k/person and \$60k/person uninsured motorists, and \$50k property damage. These are reasonable amounts of liability coverage.

You have comprehensive coverage on both cars with \$50 deductibles, and collision coverage on the Honda with a \$250 deductible. You have decided that collision coverage on the Chevrolet (which Ricky drives) is too expensive and that he should be responsible for any collision damage to that car. You should consider giving Ricky the option of paying for his own collision coverage versus being responsible for any collision damage to his car. For both your collision and comprehensive coverage, you should talk to your agent about the implications of raising your deductibles. As long as you have sufficient savings to pay the deductibles, you can consider higher deductibles as they should decrease your premiums.

Property & Casualty (Homeowners): You have homeowners insurance through AAA-CA and pay about \$1,000 per year in premiums. This provides you with reasonable personal liability coverage of \$500,000. You have Special Form HO-3 coverage which covers you for all perils except those that are specifically excluded (Broad Form coverage only covers the most common risks). You have Limited Replacement Cost Coverage which pays replacement costs up to 150% of your policy limit of \$288,400. You have a \$250 deductible and should discuss with your agent the implications of increasing your deductible to at least \$1,000 as you are unlikely to file a claim for an amount less than that. You have a personal property endorsement (for which you pay \$134) that provides additional coverage for your musical instruments. You indicated that you also have earthquake insurance.

You should review your policy with your agent annually to ensure that you are always covered at 100% current replacement costs. In addition, review the values for your personal property coverage to make sure all your property is adequately insured.

Homeowner's coverage should be covered at a minimum of 80% of the current replacement cost, but only 100% coverage will provide you with the coverage needed in case of a catastrophic loss of your home and property. In addition, if you do not have coverage equal to at least 80% current replacement cost, most insurance companies have a co-insurance provision that will reduce your coverage for partial losses, after your deductible is met. Because of the potential for rapidly changing home values, homeowners' coverage should be reviewed with your agent annually to make sure that you are always covered at 100% current replacement cost. Reviewing this regularly will prevent you from being underinsured, or from paying too high a premium.

You also have earthquake insurance which I did not review.

Long Term Care (see *Long Term Care Needs Analysis page 15*): You have a group long-term care policy for which you pay \$960 per year. This policy provides you with a monthly benefit of up to \$3,000 for a nursing facility, \$2,100 for residential care, or \$50/day for home care, with a \$108,000 maximum over a three year benefit period. You have a 90-day elimination period and this policy does not have any inflation protection.

As the *Long Term Care Needs Analysis* indicates, your insurance would cover you fully for about one year, and then you would begin spending down your investment portfolio to pay the expenses. The average nursing home stay is 2-3 years. As you are well aware, long term care coverage is quite expensive. You also indicated that you have been denied additional coverage due to high blood pressure. While it would be beneficial to increase your long-term care coverage, it is probably more important for you to save for retirement at this point. You could explore the possibility of getting more coverage through your current policy (or getting inflation protection) for the same price by increasing your elimination period or reducing your benefit period. Of course, this would mean that you would have to be prepared to pay your own long-term care costs for more than the current 90-day elimination period, or for longer than the benefit period.

Umbrella Liability: You do not have umbrella liability insurance. Umbrella liability insurance provides an extra layer of liability protection over your homeowners' and auto coverage. It is designed to provide coverage once the limits of these underlying coverages are reached, and to fill in gaps created by exclusions. While it is unlikely that you would be sued, any potential lawsuit puts all of your assets at risk. Umbrella liability policies should be purchased from the company that holds your homeowners and auto insurance to avoid any disputes regarding who is the responsible payor should you have a claim. Umbrella insurance is very reasonably priced so you should consider a policy with a benefit equal to your net worth.

Insurance Recommendations

- Review your homeowners and automobile insurance coverage with your agent to verify that you are appropriately insured. Raising your deductibles might decrease your premiums, although you will need to be prepared to pay the higher deductibles. You may also want to consider letting Ricky pay his collision insurance instead of being responsible for damages from an accident (which could be far more expensive). Consider the impact on you (as well as Ricky) if Ricky could not afford to fix his car after an accident.
- Verify that you have the appropriate beneficiary(ies) on your life insurance, your retirement accounts and your pension plan.
- If you are concerned about Ricky's financial stability should something happen to you, you should consider purchasing additional life insurance. Purchasing an individual policy will also allow you to have life insurance even after you retire.

Estate Planning Analysis

You indicated that you have never had a will, power of attorney or health care power of attorney. At a minimum your estate plan should include:

- **Living Will and Power of Attorney for Health Care:** A living will allows you to specify your preference with regard to the administration of nutrition and hydration and the removal of life support systems. The power of attorney for health care allows you to designate an agent to make health care related decisions for you and to carry out the wishes of your living will if you are incapacitated. Ricky should also have both of these documents in place.
- **Durable General Power of Attorney:** This power of attorney designates an agent to make decisions and act on your behalf regarding financial and other matters. If this power is considered "durable" the authorization and powers are extended if you become incapacitated or incompetent.
- **Will:** A Will specifies your preferences with regard to the distribution of your property upon death. A person who dies without a will is considered "intestate" and the state determines how to distribute their property and the guardianship of their children. Wills are useful to, among other things: specify the transfer of specific properties or assets to specific people; plan for disabled or incompetent children or parents; nominate guardians, conservators, and/or custodians for minor children; appoint a personal representative for the estate, and; plan for the distribution of property to minor beneficiaries or heirs.

There are two basic ways to transfer assets at death: through probate as directed by your will or by automatic transfer, examples of which are joint tenancy with right of survivorship (JTWROS), paid on death (POD) and transferred on death (TOD) registrations, living trusts, and beneficiary designations on life insurance policies and retirement accounts.

The probate process is designed to assure that the deceased's properties are collected and protected, that debts and taxes are paid, and that the beneficiaries receive the assets promptly. When someone dies their "personal representative" submits the will to the court and asks that it be probated. Assets that transfer automatically (as mentioned above) do not go through the probate process but pass directly to the named beneficiary.

You should ensure that your life insurance policy and your retirement accounts reflect your chosen beneficiary(ies) and a contingent beneficiary. You may also be able to put a beneficiary(ies) and contingent beneficiary on your bank, credit union, and other investment account(s) which would enable them to pass to beneficiaries without going through probate. You should also consider carefully what you would like to happen to your house and any special possessions (such as your antique clock collection) if something were to happen to you.

Given current estate planning laws, which are in flux, you are unlikely to owe federal taxes on your estate when you pass away.

Estate Planning Recommendations

- Carefully review the beneficiaries on your life insurance and retirement accounts and ensure that they reflect your wishes.
- **Develop a living will, power of attorney for health care, and durable power of attorney. These documents are extremely important for someone in your situation. You should also ensure that Ricky has these documents in place.**
- While you are required to have beneficiaries on your retirement accounts, you can also put beneficiaries on your other investment accounts by filing a TOD (Transfer on Death) or DOD (Distribute on Death) form for these accounts. There is no cost to filing such a form and the form will supersede directives in your wills and will allow these assets to pass directly to beneficiaries without going through probate. You should review the beneficiaries and contingent beneficiaries on your accounts periodically to ensure that they continue to reflect your wishes.
- Work with an estate planning attorney to develop a valid California will to communicate clearly how you would like your other assets handled upon your death.

Investment Analysis *(See Asset Allocation pages 16-17)*

You have approximately \$118,000 in investment assets, nearly 90% of which is in retirement accounts. Both your old 403b (\$9,300) and your current 403b (\$87,000) are in the form of variable annuities. Variable annuities tend to have significantly higher expenses than mutual funds outside of annuities. In addition, one of the primary advantages of an annuity--tax-deferred earnings-- is irrelevant because your retirement account is already tax-deferred. You should investigate the expenses, particularly in your current 403b, and research any non-annuity investment options that you might have.

If the fees are high and investment options in your 403(b) are very limited, you may want to consider investing some of your salary outside of your 403(b). All distributions from your 403(b) and IRAs will be taxed as income, and may also make a significant portion of your social security benefit taxable. Currently, if your AGI plus "provisional income" is greater than \$34,000, then 85% of your social security benefits would be taxed. Although it is impossible to predict, it is possible that tax rates will be significantly higher after you retire (although you are likely to be in a lower tax bracket). You could contribute enough to your 403(b) to get the full match scheduled to begin in 2011, and then invest the rest in a non-deductible IRA (up to \$6,000) and/or a taxable account. The non-deductible IRA could then be converted to a Roth. Diverting some income from your 403(b) would increase your current taxable income but would give you increased flexibility in retirement to manage your tax liability somewhat. Having some retirement funds in a taxable account is a hedge against higher future taxes. **You should only consider**

this option if you are sure that you can maintain the discipline of investing these funds and not using them before retirement.

You should consider rolling your old 403b into your SEP IRA as that would give you fewer accounts to manage, increased investment options and, probably, lower fees. Before you move any funds you should make sure you are fully aware of any possible penalties or fees and that you do your rollover correctly to preserve the tax-deferred nature of the accounts.

While the percentage of equities in your portfolio is appropriate given your goals and responses to the risk tolerance questionnaire, your portfolio could be improved by increased diversification. The Target Portfolio on the *Asset Allocation – Results Comparison* page shows an example of a diversified portfolio with very similar risk/return characteristics to your current portfolio, but with increased diversification.

You are currently invested in a CA Muni bond and you do not have to pay either federal or state taxes on the earnings. This holding could continue as part of your bond portfolio.

Investment Recommendations

- Find out what fees you are paying for your 403(b) and investigate your 403(b) investment options. Consider moving your funds and contributions to a non-annuity account if that is possible. If the fees are reasonable and you have reasonable investment options, continue making the maximum possible contribution to your 403(b). If your 403(b) investment options are both expensive and limited, consider contributing enough to receive the full match, and investing the rest in a non-deductible IRA (up to \$6,000) and/or a taxable account. This non-deductible IRA can then be converted to a Roth IRA.
- Consider rolling your old 403b account into your existing SEP IRA.
- Increase the diversification of your investments so that you have exposure to small cap, mid cap, and international asset classes. Maintain an asset allocation that allows you to feel comfortable during market ups and downs, and rebalance your portfolio to the allocation periodically.

Financial Goal Analysis (see *Overview page 18 and following pages*)

When we meet we will walk through these pages together and discuss them, as they may be difficult for you to interpret without an explanation. We will also adjust different variables and create additional scenarios so that you can see how the results are affected.

The *Preferences* (pages 19-20) indicate the ideal and acceptable amounts for your goals, and the relative importance of each goal. The *Bottom Line* (pages 21-22) show how we analyze the likelihood of you reaching your goals from three different perspectives, and that you have a high likelihood of reaching your goals in "What If Scenario 1." The *Preferences with Suggested Changes* (pages 23-24) compare the detail of each goal in your ideal scenario (where you are unlikely to reach your goals) with Scenario 1 where you are more than 80% likely to reach your goals. The *Loss Cushion* (pages 25-26) indicate that if you set all your goals to the minimal acceptable level you would be more than 90% likely to reach them, and 70% likely even if your portfolio lost 75% of its value.

The *Inside the Numbers (pages 27-29)* show your portfolio value over time using different assumptions.

The *What If Worksheet – Scenarios (pages 31-35)* show the likelihood of success for three different scenarios:

- > The **Current Scenario** reflects your current investment portfolio, your ideal retirement age of 62, and the ideal (maximum) amounts for all of your financial goals.
- > **Scenario One** uses the preferences and ranges that you placed on each goal to find the best scenario that provides an 80% probability of you meeting all of your goals within the acceptable range. As noted above, this scenario has you paying \$5,000 per year for additional college expenses beyond the credit line.
- > The **Play Zone Scenario** shows a different strategy for you to have a high likelihood of reaching your goals, based on our discussions. It assumes that you retire from your current job at age 65 and then take on periodic consulting work to earn \$24,000 per year until the age of 72.

There are two goals related to Ricky's college expenses. The "College-Ricky" goal does not impact your projections because we are assuming that you are borrowing from the equity line to pay these expenses; all of the scenarios have you paying back a \$100,000 equity line over a 7-year period from 2013-2020 with 4.5% interest. The \$100,000 equity line includes a pre-college balance of \$67,000 plus \$33,000 in college expenses.

The "College – Ricky with no student debt" goal is for possible expenses above \$33,000 (if he decides on a more expensive school, his father does not pay, and you pay more of his expenses rather than him borrowing). This amount is held at \$5,000 per year in Scenario One (allowing for total college expenses of \$20,000 per year without him assuming any debt), and adjusted to \$0 in the Play Zone Scenario (assuming he chooses a cheaper school or his father pays some).

Note that all of the scenarios assume that you continue to live in your current home throughout retirement and do not use any of the equity in your home. You make scheduled payments on your mortgage and pay it off by 2025.

All of the scenarios also have you saving \$17,000 per year *in addition to* contributing the maximum to your 403b plan. You are currently saving \$10,000 per year through your extra withholding and indicated that you could save more than that. This \$17,000 per year is what you would use to pay down your equity line beginning in 2013.

As these scenarios reflect, there are many different variables that you control that will impact your ability to make your resources last through retirement, and an infinite number of combinations to reach your goals. There are also many variables that you do not control that will impact your retirement financial situation – inflation could be higher or lower, your tax rate could be higher or lower, the return on your investments could be higher or lower, etc. Keep in mind that this is a static projection and you will need to update it periodically to ensure that you are on track to meet your goals.

After these detailed *What If* pages you will find graphs and tables illustrating the results of Scenario 1 (*pages 36-44*). These pages (and more) are also available for the other scenarios if you would like to see them. The pages after from *page 45* on include disclosures and explanations.

Financial Goal Recommendations

- Controlling your current expenses so that you live within your means and save each year, rather than using your credit line, is the most important step you can take to meet your retirement goals. Reducing the balance of your credit line will have a significant impact on resources you will have available for retirement.
- Begin thinking about what you see yourself doing in retirement, and whether you would rather retire early and earn income through part-time work, or work longer at your current job. If you are willing to work part-time, and depending on how much you could earn, you could have increased flexibility about when you retire.
- Update these projections periodically to help ensure that you stay on track to reach your retirement goals.

Summary of Recommendations

Net Worth and Cash Flow Recommendations

- Do not borrow any additional funds from the equity line of credit. Pay the balance down to less than \$67,000, continue making interest payments, and forget that you have access to the line of credit.
- Build a savings fund with sufficient cash to pay periodic expenses so that you do not have to access the line of credit. Because you have about \$22,000 in “unaccounted for” expenses, you should probably accumulate savings of about \$22,000. Once you have adequate savings, begin to pay down the balance on your equity line as aggressively as you can.
- You will need to take a close look at your budget and the “unaccounted for” \$22,000 in expenses to determine how you can reduce expenses. When you do this analysis and identify ways to reduce your expenses you may find that you need less than \$22,000 in your savings account, and you can begin paying down the equity line sooner.
- If the interest rate on your credit line begins to rise significantly you will want to use your savings to pay down the balance. But, you should leave enough in your savings to cover your expenses. The more you reduce your expenses the more quickly you will be able to pay down the credit line.

Tax Recommendations

- Continue to take full advantage of the tax management strategies that you are already employing. Every \$100 that you contribute to your 403b or FSA saves you \$28 in taxes.
- As you indicated, you are essentially providing an interest free loan to the federal government each year by withholding \$10,000 more than your tax liability. You could set up a direct deposit from your paycheck, and have your withholding amount (or more) contribute to a savings account instead. You should only do this if you are confident that you will not access the funds.

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- Pursue all opportunities to reduce your need to borrow from your credit line to pay college expenses.
- Recognize that if interest rates go up the cost of your credit line will increase. While borrowing from the credit line is inexpensive right now, it is likely to become significantly more expensive over the next few years.

Insurance Recommendations

- Review your homeowners and automobile insurance coverage with your agent to verify that you are appropriately insured. Raising your deductibles might decrease your premiums, although you will need to be prepared to pay the higher deductibles. You may also want to consider letting Ricky pay his collision insurance instead of being responsible for damages from an accident (which could be far more expensive). Consider the impact on you (as well as Ricky) if Ricky could not afford to fix his car after an accident.

- Verify that you have the appropriate beneficiary(ies) on your life insurance, your retirement accounts and your pension plan.
- If you are concerned about Ricky's financial stability should something happen to you, you should consider purchasing additional life insurance. Purchasing an individual policy will also allow you to have life insurance even after you retire.

Investment Recommendations

- Find out what fees you are paying for your 403b and investigate your 403b investment options. Consider moving your funds and contributions to a non-annuity account if that is possible. If the fees are reasonable and you have reasonable investment options, continue making the maximum possible contribution to your 403b. If your 403b investment options are both expensive and limited, consider contributing enough to receive the full match, and investing the rest in a non-deductible IRA (up to \$6,000) and/or a taxable account. This non-deductible IRA can then be converted to a Roth.
- Consider rolling your old 403b account into your existing SEP IRA.
- Increase the diversification of your investments so that you have exposure to small cap, mid cap, and international asset classes. Maintain an asset allocation that allows you to feel comfortable during market ups and downs, and rebalance your portfolio to the allocation periodically.

Financial Goal Recommendations

- Controlling your current expenses so that you live within your means and save each year, rather than using your credit line, is the most important step you can take to meet your retirement goals. Reducing the balance of your credit line will have a significant impact on resources you will have available for retirement.
- Begin thinking about what you see yourself doing in retirement, and whether you would rather retire early and earn income through part-time work, or work longer at your current job. If you are willing to work part-time, and depending on how much you could earn, you could have increased flexibility about when you retire.
- Update these projections periodically to help ensure that you stay on track to reach your retirement goals.

Some Things Might Want to Know

Life Insurance

The purpose of life insurance is to transfer the risk of a catastrophic loss from the policy holder to the insurance company. There are two types of life insurance, term and permanent. Term life is “pure” life insurance; the only thing you buy is a promise from the company to pay your beneficiaries a death benefit if you die. If you survive the term, the contract expires and the insurance company is relieved of any obligation to you. The premium payments of those who survive the term are used to pay the death benefits of those who don't. Since most who buy term life insurance survive the term, it is relatively inexpensive.

Permanent life insurance bundles a term life policy with a savings vehicle, called the cash value (CV). The CV is allowed to grow tax-deferred; no taxes will be due on the interest earned until it is permanently withdrawn. Permanent life insurance policies are significantly more expensive than term policies because they include the cost of the term insurance as well as the CV. These policies are attractive to people in high tax brackets who have contributed the maximum amount to all other tax-deferred vehicles, and to those who find it difficult to save.

The most common form of permanent insurance is whole life. Generally, in a whole life insurance policy, the life insurance company guarantees you a certain percentage return on the CV so that they are assuming the risk of return on the CV. You are generally allowed to cancel the policy and withdraw the CV, use the CV to pay premiums, and borrow from the CV.

Variable appreciable life insurance products provide investment options from which the policy holder chooses for the CV, such that the risk of return is borne entirely by the policy holder (not the insurance company) and is dependent on the markets. This type of purchase has the same net effect of purchasing term life insurance and investing the savings in securities markets, but generally at additional cost.

Long Term Care Insurance

Long term care is a service that you need if you can no longer perform everyday tasks by yourself due to a chronic illness, injury, disability, or aging. It includes the supervision you might need due to severe cognitive impairment such as Alzheimer's disease.

Most long term care needs are not covered by Medicare, Medicare-supplement insurance, or health insurance. Medicare pays for long term care only when your care follows a hospital stay of at least three days, is given in a skilled-nursing facility approved by Medicare, is given pursuant to a physician's written plan, and meets other conditions. Even if you meet all of the Medicare requirements, Medicare will only pay for 100 days of skilled care per benefit period.

Long term care can span years and be expensive, depending on the type of care you need and location. Long term care insurance is an effective way to pay these expenses so that you can afford the care you need, or pay for care without depleting your own assets. The choices that greatly influence the price of long term care insurance are: the “elimination period” which is the time from when you begin receiving care until the insurance benefits start, and functions like a deductible; the daily benefit, or the amount of money you will receive per day; the benefit period, which is how many years of care the insurance will cover; and, whether your benefit increases with inflation.

Medicare

At 65 you will become eligible for Medicare. You do not need to be receiving Social Security to be eligible for Medicare. Complete coverage requires adoption of Medicare Part A, Medicare Part B, Medicare Part D, and Medigap policies. Medicare Part A is the only free part of this package, and mainly covers hospital costs; it does not cover physician costs. Medicare Part B, which mainly covers physician costs, requires a premium payment (approximately \$94 per month for most recipients in 2010). In addition, many people require a Medigap policy to fill the gaps not covered in either Medicare Part A or B. Medigap policies are private and require a premium payment. Medicare Part D is private as well, and would also be an additional expense. Keep in mind these potential additions to your post-retirement expenses.

Investing

The purpose of investing is to achieve a rate of return that is greater than what we could achieve if we kept our money in cash or cash equivalents, such as a CD. When creating a portfolio the goal is to construct a portfolio that balances the required rate of return with the minimum amount of acceptable or necessary risk.

Generally, when investing in the markets, a higher rate of return over time is achieved with more aggressive securities, as shown in the table below:

<i>1926 – 2009 Performance</i>	<i>Small Stocks</i>	<i>Large Stocks</i>	<i>Gov't Bonds</i>	<i>Treasury Bills</i>
Compound Annual Return	11.9%	9.8%	5.4%	3.7%
Standard Deviation (measure of volatility or risk)	32.8%	20.5%	9.6%	3.1%
Highest Return (rolling 12 mos.)	316.4%	162.9%	54.4%	15.2%
Lowest Return (rolling 12 mos.)	-75.9%	-67.6%	-17.1%	0.0%
% Periods w/ Negative Returns	28.6%	27%	21.9%	1.6%
<i>Data from Morningstar, 2010.</i>				

Theoretically, portfolio volatility or risk can be reduced by combining asset classes that respond to market conditions in different ways. Diversification can minimize the effects of a significant downturn in one asset class (such as small stocks) if another asset class (such as bonds) has a positive return during the same period. Even by adding a "riskier" asset class to a portfolio (such as stocks to a portfolio of cash and bonds), the increased diversification can *decrease* the portfolio's overall risk (or increase its return with the same level of risk).

Diversification is also important because different asset classes perform differently each year, and it is impossible to predict which ones are going to perform well or badly during any given period. For example, international stocks had the lowest returns of all asset classes in 2000 and 2001 (-14% and -21.2% respectively) and then the highest returns from 2004-2007, and then the lowest return (-43%) in 2008. Long-term government bonds had the lowest return in 2006 and the highest return in 2008.

An appropriately diversified portfolio allows an investor to benefit from market upswings while reducing losses in market downturns.

Estate Planning

Estate planning helps ensure your wishes (regarding assets and children) are carried out, provides a legal means for closing your estate, and may even save you on taxes. Because of the

complexity of estate planning issues, they should be handled by an attorney who specializes in estate planning.

You may also want to include a Letter of Instruction with your estate planning documents. It is a non-legal document that provides the executor of your estate and your beneficiaries with some additional and more personal information about your estate, as well as the location of necessary information and documents. The Letter of Instruction should be updated periodically and should include detailed information about: your burial instructions; the location of your will and all estate planning documents; detailed information about all of your assets and financial accounts; the location of all important documents and papers; a list of people to be notified of your death; and, any other pertinent information or instructions that you wish to convey. You should give a copy of your Letter of Instruction to your executor and anyone to whom you have provided a power of attorney (general or for health care), and anyone else who you think should have it. Be discriminating with whom you share it and be sure to store it securely.

Identity Theft

Identity theft is the act of using someone's personal information (such as name, account number, drivers license, or social security number) without that person's knowledge, and using the assumed identity to commit fraud or theft. Often, the personal information is used to get loans or open credit-card accounts. Identity theft victims and financial experts have offered a variety of precautions to help protect against this crime, including:

- Monitor your credit. By law you are entitled to one free credit report each year from each of the three national credit reporting agencies (Equifax, Experian, and TransUnion). Request your free credit report at www.AnnualCreditReport.com or by calling 877-322-8228. Look for any unfamiliar changes, such as new accounts, inquiries, or public records.
- Only share personal information with a company that is known and trusted.
- Protect your Social Security number and mother's maiden name. Avoid giving personal information out over the phone. Avoid posting your Social Security number on checks, the outside of envelopes, etc.
- Minimize the number of identification information and financial cards carried in your wallet and sign all new credit cards upon receipt. Write "Check ID" after your signature as a note to shopkeepers to ask for identification.
- Keep new and canceled checks in a safe place, and report lost or stolen checks to the issuing financial institution immediately.
- Never leave receipts at bank machines, bank counters, public trash receptacle or gas pumps. Save them to match against your monthly bills and then shred them.
- Buy only from security internet sites. Look for the closed lock icon to appear at the bottom of your browser or "https" to display in the URL to check the site's security status.
- Shred any documents that have any personal information or credit account numbers on them, including tax returns and unwanted credit card offers.
- Report all lost or stolen credit cards. If you applied for a new credit card and it has not arrived in a timely manner, call the bank or credit card company that is issuing the card.
- Follow up with creditors if bills do not arrive on time. A missing credit card bill could mean an identity thief has changed your billing address to cover his/her tracks.
- Notify credit card companies and financial institutions in advance of any change of address or phone number.
- Review your Social Security Earnings and Benefits Statement annually to check for fraud. If you haven't received one lately, you can call: 1-800-772-1213.

If you have an actual or suspected case of fraud:

- Review your credit reports.
- Dispute inaccurate or fraudulent items and close fraudulent or compromised accounts.
- File a police report, a complaint with the Federal Trade Commission, and your state Attorney General.
- File an identity theft insurance claim (many homeowners' policies include some coverage for fraud).