



*Beyond the Hospital Walls -
Managing Your Transition to
Life*

An Evening Seminar on Financial Planning for
CHMC's Clinical and Research Fellows

Presented by:

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This Evening's Topics

- *What is Financial Planning?*
- *What are some things I should know about getting married, buying a home, and the cost of parenthood?*
- *How should I save for my children's education?*
- *What should I know about retirement savings plans and saving for my retirement?*
- *How do I create a solid portfolio of investments?*
- *Questions and answers*

A photograph of a beach scene. In the foreground, a child wearing a bright red hoodie is crouching on the sand, playing. The beach is wide and sandy, leading to gentle waves with white foam washing onto the shore. The ocean extends to the horizon under a clear blue sky. The text 'What is Financial Planning?' is overlaid in the center in a blue, serif font.

What is Financial Planning?



Personal Financial Planning

The Standard Definition

*The on-going process of
defining your financial and non-
financial goals,
assessing your financial situation,
and
then creating a plan of action to reach
those goals.*



Which Really Means...

*How do I achieve the life I want with
the money I have?*


-Or Conversely-

*How do I make my money work to
create the life I desire?*



A Financial Plan is a Roadmap

- Financial and non-financial goal setting
- Retirement planning (& increasingly health care planning)
- Education planning
- Cash flow and savings analysis
- Insurance & risk reduction
- Tax planning
- Estate planning



Taken one at a time, most people can handle each of the elements of financial planning.

The Challenge:

Coordinating all the pieces throughout time, while having a limited amount of resources available to you to allocate to these oftentimes competing needs and desires.

(And you also have a day job.)

A photograph of a child in a red hoodie playing on a sandy beach. The child is crouching on the sand, looking down. In the background, the ocean waves are breaking onto the shore. The sky is clear and blue. The text "I Do Diligence" is overlaid in the center of the image in a blue, serif font.

“I Do Diligence”



5 Financial Tips for Newlyweds

Not exactly a Lord Byron love poem, but financial accord does matter.

2006 study by Opinion Research and Fair Isaac showed that a lack of financial responsibility is greater cause of marital stress than infidelity.

1. **Discuss financial goals and attitudes.**

What does money mean to each of you? Here, opposites may not attract.

2. **Review your credit history and debt.**

If one or both have bad credit, work to get this cleaned up before buying a home. Be honest with each other.



5 Financial Tips for Newlyweds, continued

3. Update beneficiaries, wills and legal docs

Although most things automatically go to the spouse, beneficiary designations on 401(k)s or estate planning docs remain in effect until changed. POA and Health Care proxies also needed.

4. Create a budget together

Tedious but important. Helps bring each spouse's spending habits more in-line with the other's. Look at it as empowering rather than restrictive.

5. To commingle or not to commingle

Does not have to be all-or-nothing decision.

One important area to consider combining: **INSURANCE**. If both have employer-provided medical insurance, compare the plans to see who has better benefits for the costs.

Grim reality is a 50% divorce rate so some separate assets may be prudent.

A photograph of a beach scene. In the foreground, a child wearing a bright red hoodie is crouching on the sand, playing. The beach is wide and sandy, leading to gentle waves with white foam washing onto the shore. The ocean extends to the horizon under a clear blue sky. The text 'Buying Your First Home' is overlaid in the center of the image in a blue, serif font.

Buying Your First Home



Home Ownership

Common Reasons to Own a Home

- To achieve the “American Dream” - *Non-monetary* decision; a place to “nest” and call your own.
- To save taxes by deducting a portion of your mortgage interest and real estate taxes
- To earn a solid investment return



Home Ownership

Disadvantages of Owning A Home

- There are no guarantees; despite popular belief, you can lose money in real estate. It is like any investment – there is risk & reward
- Being a homeowner is usually more costly than renting after adding in home maintenance and added utilities
- In times of financial trouble, may be difficult to sell home quickly
- Makes moving more complicated so may reduce career flexibility



Top Things to Know About Home Ownership

Don't buy if you can't stay put.

Usually need to stay in a home 3-4 years for it to be cost-effective due to high transaction costs. Plus, capital gains if own less than two years.

May make more sense to rent.

Rule of thumb - If you pay 35% or less in rent than you would buying, including mortgage, taxes & insurance, it is financially better to rent.



Renting vs Buying: Assumptions

Monthly rent = \$3500; annual rent increase 4%

Home purchase price = \$750,000; annual price appreciation = 1%

Down payment = 20%

Mortgage interest rate = 6.25%

Annual property taxes = 1.35%

Cost of buying = 4%

Cost of selling home = 6%

Length of mortgage = 30 years

Annual renovation costs = 0.5%

Homeowners insurance rate = 0.46%

Capital gains exclusion = \$500,000

Additional monthly utilities = \$300

Rent deposit = 1 month

Renter's insurance rate = 1.32%

Rate of return on investments = 5%

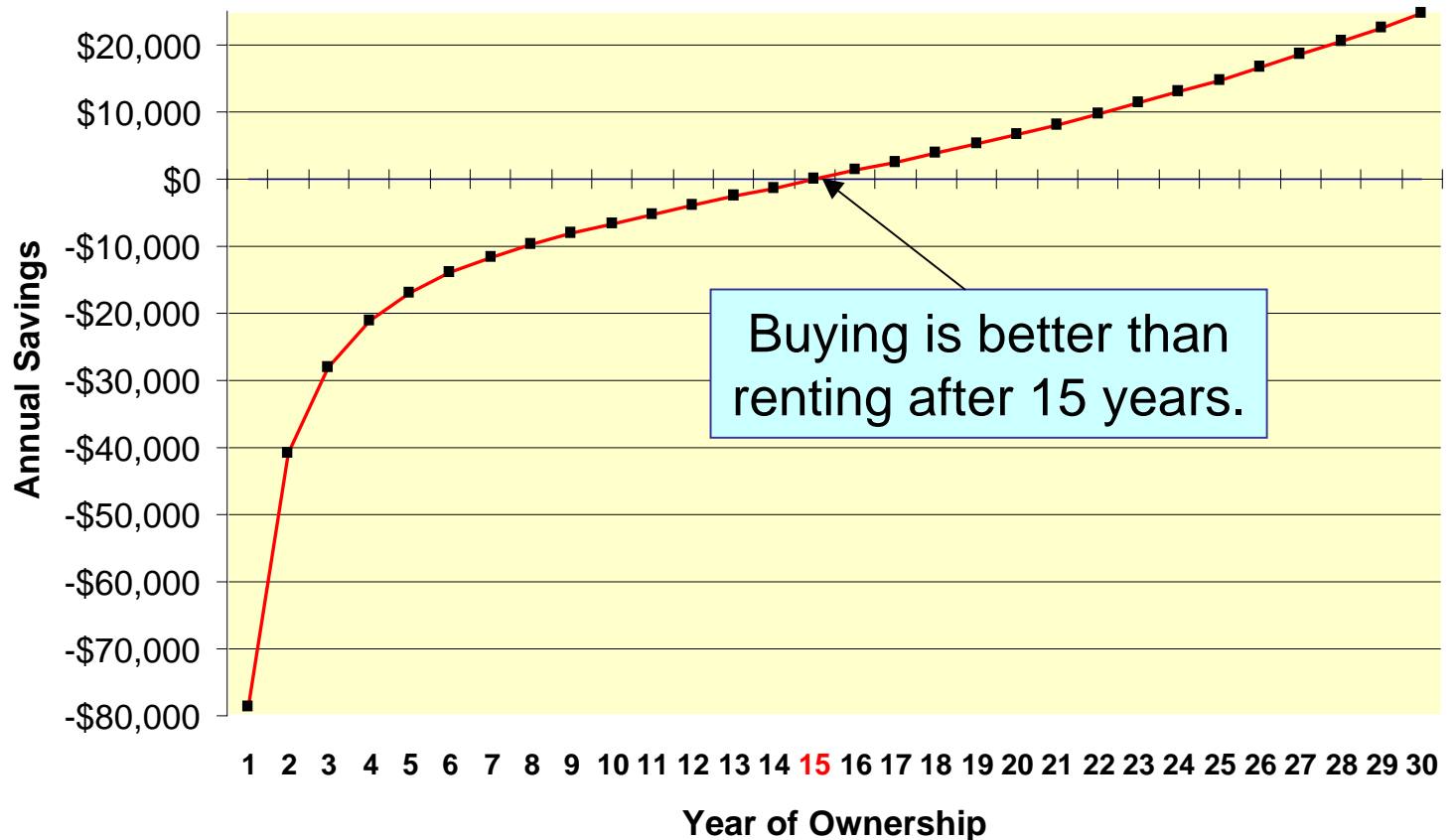
Marginal income tax rate = 20%

Inflation rate = 2.5%

www.nytimes.com/2007/04/10/business/2007_BUYRENT_GRAPHIC.html

Financial Comparison of Renting v Buying

Better to Rent or Buy?





Steps to Home Ownership

- *Determine if you want to rent or buy*
- *Determine the price you can afford – old rule of thumb was 2.5 X annual income. Now??*
- *Get pre-qualified*
- *Begin house hunt/select a home*
- *Apply for a mortgage*
- *Inspect the house*
- *Make an offer*
- *Get a professional inspection*
- *Close the loan*
- *Move in!*



How Much House Can You Afford?

ASSUMPTIONS:

\$200K income

\$150K down payment

Monthly debt other than mortgage = \$1500

Mortgage interest rate = 6.25% 30 yr fixed

Annual property taxes = \$10K Homeowners ins = \$1000

HOUSE RANGE YOU CAN AFFORD:

\$732,000 - \$786,000

Monthly Payment (with taxes & insurance) = **\$4500 - \$4850.**

<http://cgi.money.cnn.com/tools/houseafford/houseafford.html>



Miscellaneous Home Information

- Closing costs – generally not tax deductible but added to basis of home to reduce gain when sold
- Points – fully deductible in year paid if loan is secured for your home, loan is for purchase or improvement of primary residence, points are used for money and not for a service charge.
- Home equity loans and lines of credit – interest paid generally deductible.
- Second homes – mortgage interest is also generally deductible, provided primary and secondary mortgages do not exceed \$1M.
- Married couples can exclude up to \$500K of gain when home sold if lived in for 2 of 5 prior years.
- Losses from a home sale are NOT deductible.

A young child wearing a bright red hooded sweatshirt is crouching on a sandy beach, looking towards the ocean. The child is positioned on the left side of the frame. The background shows a vast expanse of blue ocean with white-capped waves breaking onto the shore. The sky is a clear, pale blue.

And Then There Were
Three....



Financing Baby - The Costs of Parenthood

- **Health Insurance**

Review your health care policies – deductibles, co-pays, policy limits. Good resource: [Getting Organized for Your New Baby](#)

- **Life and Disability Insurance**

Each wage earner should have life insurance equal to 6-7 times annual income. A stay-at-home parent should have enough to cover the cost of child care, cleaning services & other services.

Do you have enough insurance to cover a long-term disability? May need to supplement your employer-provided disability coverage with a private policy.



Financing Baby - The Costs of Parenthood, cont.

- **Emergency Fund**

Should have (or be able to accumulate as quickly as possible) 3-6 months' living expenses in the event of layoff or disability.

- **First-Year and On-Going Expenses to Age 18**

According to the book, Baby Bargains, the average family spends \$6,200 on baby things in the first year.

Birth to age 18: High income (avg. gross income \$105K) household spends \$269,520. This does not include the cost of private primary &/or secondary education. (*April, 2005 data*)

- **Estate Planning**

At a minimum, you will need a will to name a guardian for the baby.

- **Retirement Planning**

Do not sacrifice retirement savings for college savings. Financial aid is available for college – not retirees.

A photograph of a beach scene. In the foreground, a child wearing a bright red hoodie is crouching on the sand, playing. The beach is wide and sandy, leading to gentle waves with white foam washing onto the shore. The ocean extends to the horizon under a clear blue sky. The text 'Education Planning' is overlaid in the center of the image in a blue, serif font.

Education Planning



Cost of College

Harvard: 2007-08 Total Cost = \$42,675

- Average annual tuition increase is 6%
 - Est. annual Harvard cost in 2026 =
\$121,808
- Assume your investments earn 8% annually

To save enough for college between birth and age 18, beginning today, you will need to save \$1,110 per month.



Education Funding

Savings Plans

- Section 529 Plans – Qualified Tuition Programs
- Coverdell Education Savings Account (ESA)
- Education Savings Bond Program

Education Tax Credits & Deductions

- Hope and Lifetime Learning Credits
- Deduction for Higher Education Expenses

Loans

- Student Loans
- Parent Loans



529 Plans

- Currently the best way to save for college
- Contributions are made on behalf of a designated beneficiary
- *Contributions are made after-tax but earnings are withdrawn TAX-FREE if used for education*
- No income limits – anyone can contribute
- Contributions are not deductible on the federal form; may or may not be on state form. *(MA does NOT allow a deduction.)*

A vertical photograph on the left side of the slide shows a young child in a bright red hoodie and dark pants, bent over and playing with sand on a beach. The ocean waves are visible in the background, and the sky is overcast.

529 Plans, continued

- Distribution of earnings NOT used for qualified education expenses are subject to ordinary income tax (not cap gains) and a 10% penalty, unless beneficiary dies, becomes disabled or receives a scholarship.
- Assets can be rolled over, tax-free, to another plan for the same beneficiary once every 12 months.
- The beneficiary can be changed to a relative of the beneficiary (which is very broadly defined). No age restrictions on the beneficiary.



529 Plans, continued

- \$12,000 per year contribution per beneficiary (\$24K per couple) before gift tax may kick in.
- Can front-load contributions: \$60K contribution (\$120K per couple) can be made in one year and treated as if spread out over 5 years to avoid gift tax.
- 529 plans, if the account owner is a parent, are considered assets of the parents. Only 5.6% in 529 plan will be counted towards college costs. (35% of student's assets are expected.)
- Qualified distributions are NOT counted towards either the child's or the parent's income in determining financial aid eligibility.



529 Plans, continued

- Education tax credits can be taken in same year as tax-free 529 distributions, but not for same expenses.
- Account may be seized by donor's creditors (depending on the state).
- Choose a plan with LOW expenses and the MOST flexibility in investment choices. Be careful of plans with set age allocations – depending on the capital markets, being “more conservative” by having a higher allocation to bonds may actually be more risky.
- May make most sense to fund the oldest child's account the most as you can change the beneficiary and “roll” unused assets to the younger children.

529 Plans, continued

Good 529 Plans Comparison Website:

<http://www.savingforcollege.com/>

See handout for sample comparison of three plans offered.





Coverdell Education Savings Accounts

- Contributions can only be made if child under age 18 or special needs
- Total contributions cannot exceed \$2000 per year per child, no matter how many people contribute
- Can contribute to both a 529 and a Coverdell
- Contribution is not tax deductible
- MAGI must be less than \$110K (single) or \$220K married filing jointly, to make contribution
- Distributions not made for education subject to ordinary income tax + 10% penalty, with same exceptions as 529s
- Considered asset of the parents (or account owner)
- Balance must be withdrawn no later than 30 days after beneficiary's 30th birthday.



UGMA/UTMA Accounts

- UGMA/UTMA – Uniform Gift/Uniform Transfer to Minors Account
- No contribution limits (over \$12K subject to gift tax)
- Some tax benefits but much less so now that “kiddie tax” extends to age 19 (age 23 if student) in 2008. Unearned income over \$1700 is taxed at parents’ rate.
- Becomes property of child at age 18, 21 or 25, state-dependent.
- Gifts are irrevocable and withdrawals must be for benefit of child.
- Assets are in child’s name which may reduce financial aid eligibility. Can transfer to 529 plan, but be careful. Account owner is still the child so cannot change beneficiary!

A vertical photograph on the left side of the slide shows a young child in a bright red hoodie crouching on a sandy beach. The child is looking down at the sand. In the background, the ocean waves are breaking onto the shore under a clear sky.

Hope and Lifetime Learning Credits

- Income limits apply – No credit if income > \$114K MFJ
- Hope Credit = 100% of first \$1,100 plus 50% of next \$1,100 (max of \$2,200). Applies to first 2 yrs only.
- Lifetime Learning = 20% of first \$10K college expenses. Max credit is \$2K per year; no limit on number of years you can claim.
- Cannot claim both Hope and Lifetime Learning for same child in same year.



Education Savings References

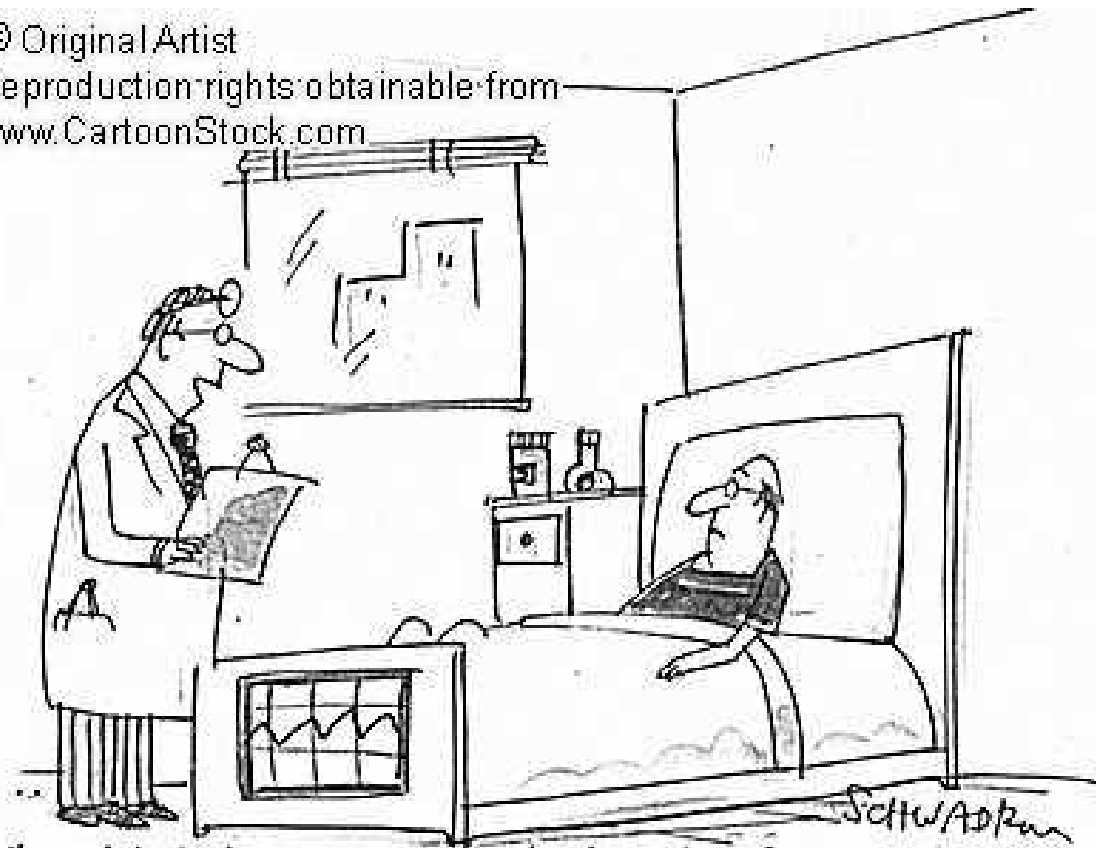
- “Tax Benefits for Education” IRS Publication 970
- Saving for College website
<http://Savingforcollege.com/>
- “The SmartStudent Guide to Financial Aid” (FinAid)
<http://www.finaid.com>
- “Student Loan Funding” (Sallie Mae)
<http://www.studentloanfunding.com/>

A photograph of a beach scene. In the foreground, a child wearing a bright red hoodie is crouching on the sand, playing. The beach is wide and sandy, leading to gentle waves with white foam washing onto the shore. The ocean extends to the horizon under a clear blue sky. The text 'Retirement Planning' is overlaid in the center of the image in a blue, serif font.

Retirement Planning

Retirement Planning

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"WE DID A FULL WORKUP -- HEART, LUNGS, BANK ACCOUNT, CREDIT... YOU CAN AFFORD TO LIVE ANOTHER 19 YEARS."




First Things First...

- Maximize your annual employer-provided retirement plan savings contributions.
- If this is not possible, at least contribute up to any employer-match amount so you do not leave “free money” on the table. If 5% match offered on \$200K salary, add at least \$10K of your own money to receive maximum match.
- 2007 401(k) and 403(b) limits:
\$15,500 +\$5,000 catch-up over age 50.



Individual Retirement Accounts (IRAs)

- **\$5,000 / year beginning in 2008 plus \$1,000 if over age 50.**
- Tax-deductible contribution depending on income and participation in employer-sponsored retirement plan
- **AGI Deduction phase out limits:**
\$52K-\$62K single; \$83K-\$103K MFJ
- “Nonparticipant” spouse can make deductible IRA contribution if couple’s AGI < \$166K



Roth Individual Retirement Accounts (IRAs)

- **\$5,000 / year beginning in 2008 plus \$1,000 if over age 50.**
- AGI Deduction phase out limits:
\$99K-114K single; \$156K-166K MFJ
- Contributions to a Roth IRA are AFTER-tax.
- Distributions are TAX-FREE if withdrawals are made after 5 years of initial contribution and you are at least age 59 ½.
- No minimum required distributions at age 70.5 as with IRA.



Roth IRAs, continued

- Can convert an existing IRA to a Roth IRA if your MAGI is below \$100,000 in the year of the conversion.
- In 2010, this income restriction will be lifted; everyone will then be allowed to convert.
- Conversions are treated as distributions so you pay income taxes on the converted IRA amounts.
- If you convert, it is best to pay the required taxes from monies outside of the IRA to maximize the future tax-free earnings growth potential.



Roth 401(k) & Roth 403(b)

- Unlike Roth IRAs, Roth 403(b)/401(k)s have NO income restrictions
- Roth 403(b)/401(k)s are subject to the more generous salary deferral limits of traditional 401(k)s and 403(b)s - \$15,500 in 2007, plus \$5K catch-up after age 50.
- Employee Contributions are made with AFTER-TAX dollars.
- Employer matches cannot be put into the Roth 403(b)/401(k). Matches must go into a traditional 403(b) or 401(k).



Roth 401(k)/403(b) – What to Defer?

Important consideration

**Same net pay but less deferred to the Roth
OR**

Less net pay but maximized Roth deferral

Assume:

2006: High Income Taxpayer, Age 51, Single, Earning \$350K, marginal tax rate = 35%, 7% rtn, 3% infl, 5 years of contributions, distributions begin at age 66, life exp = 81. Equal periodic pmts beginning at retirement.

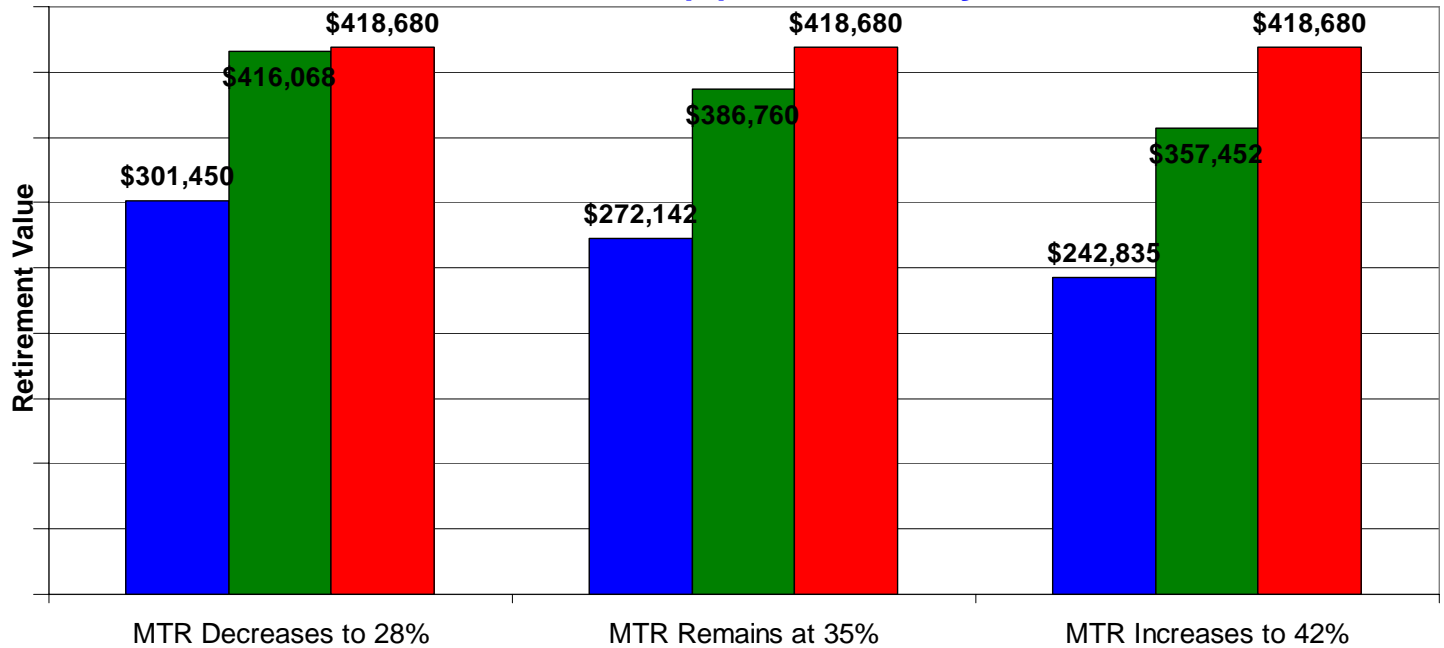
Can either elect to defer \$13,000 after-tax to the Roth to make it equivalent to \$20,000 pre-tax 401(k)

– OR –

Can elect to defer \$20,000 to the Roth, which would decrease his paycheck by \$30,775.

Roth 401(k)/403(b): Equivalence at Retirement

Roth 401(k) MTR Analysis



MTR


- \$20,000 pre-tax 401(k) contribution
- \$13,000 Roth plus \$7K taxable invested
- \$30,769 pre-tax / \$20K after-tax maximum Roth



Roth 401(k)/403(b) – What to Defer?


CONCLUSIONS:

1. Even if the MTR decreases from 35% to 28%, it is still more favorable to select the Roth 401(k) option over the traditional 401(k).
2. It is significantly better to select the Roth 401(K) if you expect your MTR to either stay the same at 35% or increase to 42%.
3. It is BEST, as long as you can afford it, to contribute the higher after-tax payment to the Roth account, when saving for retirement. (In this example, \$30,769 pre-tax for \$20,000 Roth contribution.)



Roth 401(k)/403(b) – Should You Switch?

1. Can you afford to make the Roth contribution and pay the additional taxes? **Yes/No**
2. How long do you plan on leaving the money in the retirement account? **<10yrs / >10yrs**
3. Do you want to avoid mandatory withdrawals at age 70.5? **Yes/No**
4. Can your Roth portfolio earn an average annual return of 5% or more to take advantage of the tax-free growth potential? **Yes/No**
5. Will your tax rate be as high as it is now or higher when you retire? **Yes/No**



Roth 401(k)/403(b) – Should You Switch?

TALLY YOUR SCORE:

- 50 points for answering “Yes” on questions 1 and 4.
- 10 points for “Yes” on 3 and 5.
- Question 2: 10 points if you have >10yrs before withdrawing

LESS than 110: Stick with traditional pretax 401(k)

110 or more: Contribute to a Roth 401(k)/403(b)

Still unsure? Split the contribution, especially if on border of tax brackets. 401(k) contribution could put you in lower bracket now. Put rest in Roth.

(Source: *Business Week* October 22, 2007)

A photograph of a beach scene. In the foreground, a child wearing a bright red hoodie is crouching on the sand, playing. The beach is wide and sandy, leading to gentle waves with white foam washing onto the shore. The ocean extends to the horizon under a clear blue sky. The text 'Investing to Meet Your Goals' is overlaid in the center of the image in a blue, serif font.

Investing to Meet Your Goals

Investments

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“Stocks can be risky, and you’ve got to be able to sleep at night. We’ll set aside half your money for sleeping pills.”



The 7 Truths of Investments

1. Diversify, Diversify, Diversify
2. The 3 R's: *Risk, Returns, Rebalancing*
3. It's not about timing the market, it's time in the market
4. Not too many investors need to own individual stocks.
5. Indexing increases your odds of success versus actively managed mutual funds
6. Expenses and taxes do matter
7. Everyone needs help with investing – education is key



1. Diversify, Diversify, Diversify

- Proper asset allocation is the key to long-term investing.
- Ibbotson Associates has found that 90% of the variability of returns over time is due to asset allocation.
- Diversifying your portfolio means investing in a wide range of asset classes that do not always move in tandem. Doing so reduces the overall risk of the portfolio, while enhancing the return.
- Diversification is NOT owning 5, 6 or 15 mutual funds if they are all large cap growth and value. Correlation between these two groups is over 96%.
- Stocks beat bonds, bonds beat cash, small stocks beat large stocks...but not all the time and with the same risk profiles at any particular point in time.



2. Risk, Returns & Rebalancing

RISK: “Can You Sleep at Night?”

How much risk can you live with? How much time do you have for your goals? How old are you? How close are you to retirement? Is college right around the corner for your children?

RETURNS: Expected returns are positively correlated with the level of risk taken.

The expected return on stocks is NOT 15% unless you take on a high level of risk.

Real return is actually 7% for the past two centuries. (Jeremy Siegel, *Stocks for the Long Run*.)

REBALANCING: Essential for proper asset allocation

Recent studies show the average investor never rebalances after his/her initial retirement plan investment. You need to trim winners and invest in the losers to stay properly balanced.



3. It's Not About Market Timing, But Time in the Market

“Patience is a necessary ingredient of genius”

Benjamin Disraeli

- 2001 study by Financial Research Corp found that the average investor's \$10K investment in mutual funds over 25 years would grow to \$123K without any trading, but only \$70K with trading. (Not including rebalancing)
- Vanguard study found that from 1984 to 2000, the S&P500 returned 16.32% per year, but the average stock fund investor had an average annualized return of 5.32%. Reason – active trading chasing performance.

A vertical photograph on the left side of the slide shows a young child in a bright red hoodie and dark pants, bent over and playing with sand on a beach. The ocean waves are visible in the background.

4. Who Needs to Own Individual Stocks?

- Most investors can retire comfortably without ever owning or short-selling an individual stock.
- It's a lot more difficult to pick an individual stock than a blend of stellar funds.
- Trading individual stocks is not bad – just do it with a small amount of your money that you are willing and able to lose.
- If you do buy individual stocks – do your own research. Don't listen to pop sound bites on TV or call your broker.



5. To Be or Not Be the Market: Indexing vs Active Management

We cannot all get above average returns but the surest way to get above-average returns over the past 30 years is to buy index funds.

A Random Walk Down Wall Street - \$10K in S&P500 index fund in 1969 would have grown to \$327K by end of 2002, with dividends reinvested.

That same \$10K invested in the average actively managed mutual fund would have had \$213K.

The index fund returned 50% more.

Index funds (and ETFs) are also very low cost, keeping even more of your money in your pocket.

6. Expenses and Taxes Matter

Annual Expenses (%):
ETFs, Index Funds & Actively Managed Mutual Funds

ASSET CLASS CATEGORY	TYPICAL EXPENSES:			Index Name	ETF Ticker
	Average Active Fund	Average Index Fund	ETF Total Expenses		
US Taxable Bond	1.14	0.48	0.20	Lehman Agg	AGG
Large Cap Equities	1.41	0.25	0.10	S&P 500	SPY
Small Cap Equities	1.66	0.50	0.20	Russell 2000	IWM
International Equity	1.79	0.75	0.35	MSCI EAFE	EFA

Source: Morningstar, BGI

A shares: Front load fee assessed with initial purchase (~3-6%) + 12b-1

B shares: Back-end fee assessed if fund sold before 5-8 yrs (~6%) + 12b-1

C shares: Annual fee assessed (12b-1 fee of 1-2%)



6. Expenses Matter, continued

Recent Lipper study found investors lose as much as 25 cents of every \$ of their annual returns to Uncle Sam.

\$100K invested for 10 year @ 10% annual return:

S&P Index fund with expense ratio = 0.25%

S&P Mutual fund with expense ratio = 1.41%

After 10 years:

Index fund = \$271,019

Mutual fund = \$244,519

Index fund returned \$26,500 (11%) more, due to expenses alone.



7. Educate Yourself About Investing

Four great investing books to get you started:

[The Intelligent Investor](#), by Benjamin Graham

[A Random Walk Down Wall Street](#), by Burton Malkiel

[Stocks for the Long Run](#), by Jeremy Siegel

[The Four Pillars of Investing: Lessons for Building a Winning Portfolio](#), by William Bernstein

One of the best ways to avoid trouble when investing:

If you do not understand what you are buying and why you are buying it, do not buy it! Never be afraid to ask questions until you fully understand.

If it sounds too good to be true...it is.


A vertical strip on the left side of the image shows a child in a red hoodie crouching on a sandy beach, looking towards the ocean. The rest of the image is a wide shot of a beach with waves breaking on the shore under a clear blue sky.

Finally...



The 10 Commandments of Successful Personal Financial Planning

1. *Thou shall take action – now*
2. *Thou shall pay off all credit card debt – start with the highest interest and work down*
3. *Thou shall understand the difference between wants and needs*
4. *Thou shall live on less than you earn (starting once you have a “real job”)*
5. *Thou shall pay yourself first*
6. *Thou shall set financial goals*
7. *Thou shall educate yourself and be responsible for your decisions*
8. *Thou shall save and invest*
9. *Thou shall protect your finances – insurance*
10. *Thou shall give thanks for the luxury of being able to financially plan for your life.*



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