

**Retire Ready:  
Financial Planning For Later Life  
An eXtension Webinar for Military  
PFMP Professionals**



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**Disclaimer**



- The intent of this Webinar is to provide accurate, research-based information
- The Webinar in no way purports to render legal, financial, or other professional services
- Viewers should consult an advisor who specializes in military retirement benefits if expert assistance is required



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**Workshop Objectives**

- Explore current U.S. retirement trends
- Discuss retirement planning tools
- Discuss ten timeless retirement planning tips
- Review sources of retirement income
- Review military retirement benefits
  - Junior personnel who may not qualify for pension
  - Career military with 20+ years service



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## Different Messages



### Junior Personnel

- Time is on your side
- Start saving TODAY!
- The TSP is your BFF
- Don't count on a 20-year military career!!

### Career Military

- Time is STILL on your side
- Keep on saving
- The TSP is your BFF too
- Know your pension and health insurance benefits




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## Time + Money = Magic



**The Advantage of Starting Early**  
(at 9% interest)

Age	Saving Early	Age	Saving Later
22	\$7,000	32	\$7,000
24	\$2,000	34	\$2,000
26	\$2,000	36	\$2,000
28	\$2,000	38	\$2,000
30	\$2,000	40	\$2,000
32	\$2,000	42	\$2,000
34	\$2,000	44	\$2,000
36	\$2,000	46	\$2,000
38	\$2,000	48	\$2,000
40	\$2,000	50	\$2,000
42	\$2,000	52	\$2,000
44	\$2,000	54	\$2,000
46	\$2,000	56	\$2,000
48	\$2,000	58	\$2,000
50	\$2,000	60	\$2,000
52	\$2,000	62	\$2,000
54	\$2,000	64	\$2,000
56	\$2,000	66	\$2,000
58	\$2,000	68	\$2,000
60	\$2,000	70	\$2,000
62	\$2,000	72	\$2,000
64	\$2,000	74	\$2,000
66	\$2,000	76	\$2,000
68	\$2,000	78	\$2,000
70	\$2,000	80	\$2,000

**Amount Available at Age 65:**  
 Starting Early: \$719,471  
 Starting Later: \$470,249  
**Difference Due to Starting Early: \$109,222**




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## Start Early... Small Amounts Add Up



<http://www.dinkytown.net/java/CompoundSavings.html>




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## The Rule of 72

Source: Garman/Forgue, PERSONAL FINANCE, Fifth Edition




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## Benchmark: "Wealth Test" From *The Millionaire Next Door*

- Multiply age by pre-tax income (excluding inheritances)
- Divide by 10
- Result is what your net worth should be for your age and income
- Example: age 35 with \$40,000 income
  - $35 \times \$40,000 = \$1,400,000$
  - $\$1,400,000/10 = \$140,000$  minimum net worth




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## Sobering Statistics

- 45% chance one spouse in 65-year old couple will live to 95
- EBRI: Typical U.S. retired couple at 65 (includes civilian and military) living average life expectancy can expect to spend \$295k on health insurance and out-of-pocket medical expenses
- 30% of unmarried women age 65+ live solely on Social Security; 13% of age 75+ in poverty (vs. 6% for men)
- **Disconnect:** Only 27% of all retirees (includes civilian and military) actually work for pay; 70% of pre-retirees say they plan to work (EBRI Retirement Confidence Survey, 2012)
- 25% of women and 20% of men age 55-64 have a health problem that limits ability to work
- NEFE: "About 50 million at-risk middle American households" (*Journal of Financial Planning*, July 2009)




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## Trends in Retirement



- Senior Citizens Freedom to Work Act (2000)
  - Repealed earnings limit on full retirement age (FRA) workers
  - 2012 earnings limit: \$14,640 (\$1 for \$2 reduction for earnings over)
- More defined contribution (DC) plans available (e.g., 401(k)s)
- Increased life expectancy; medical advances
- More older workers saying they plan to work longer
  - Many jobs allow work through age 70
- Some workers retire gradually (e.g., phased retirement)



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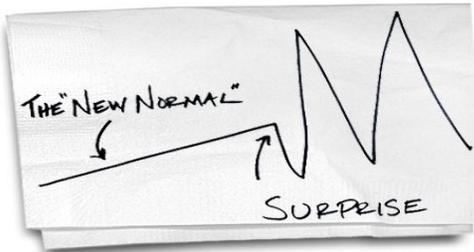
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## Recent Retirement Trend: The New Normal



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## New Normal Retirement Challenges

- Slow U.S. economic growth
- Flat or decreasing incomes; high unemployment
- Broken promises:
  - Reduced employer retirement plan benefits
  - Reduced employer health care benefits
- Struggling housing market
- Proposed changes to Social Security and Medicare
- Low returns on savings and investments



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## Era of Broken Promises

- Increasing numbers of retirement plans are being deemed “unsustainable” and being overhauled
- Targets include
  - Defined benefit (DB) pensions and pension formulas
  - Retiree health insurance
  - Retiree pension benefit COLAs (cost of living adjustments)
  - Public employee and retiree benefits
  - Military retiree benefits (?)
- Lower benefit tiers for new hires



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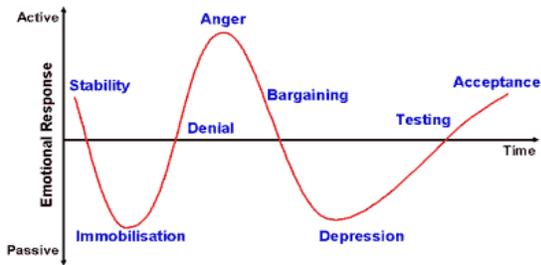
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## How People Receive Bad News (Kubler-Ross DABDA Model)



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## Key Retirement Planning Factors

- Current age
- Planned retirement age
- Estimated life expectancy
- Source(s) of retirement income
- Amount of income needed each year
- Amount of money already saved
- How comfortable you are taking investment risks



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## Other Important Factors

- Worker's and spouse's health
- Family considerations (e.g., care-giving)
- Employment options
- Eligibility for pension benefits
- Access to and cost of health insurance
- Financial assets
- Personal choice (i.e., desire to retire...or not)




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## Life Expectancy Reality Check

- Type "Life Expectancy Calculator" in Internet search engine
- Try at least 3 calculators; many are from insurance companies
  - The Longevity Game:  
<http://www.northwesternmutual.com/learning-center/the-longevity-game.aspx>
  - How Long Will I Live?:  
<http://gosset.wharton.upenn.edu/mortality/per/CalcForm.html>
  - How to Calculate Your Life Expectancy:  
[http://www.msrs.state.mn.us/info/Age\\_Cal.htmls](http://www.msrs.state.mn.us/info/Age_Cal.htmls)
- Look for calculators with "lifestyle questions"
- Social Security calculator is very basic; based on averages




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## Social Security Life Expectancy Calculator




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## Other Online Resources

- Planning For a Secure Retirement (Purdue Extension)
  - <http://www.ces.purdue.edu/retirement/>
- Center For Retirement Research (Boston College)
  - <http://crr.bc.edu/>
- Retirement Confidence Survey (EBRI)
  - <http://www.ebri.org/surveys/rcs/>
- Retirement Readiness Rating (R<sup>3</sup>) (EBRI)
  - [http://www.ebri.org/surveys/rcs/2000/dis\\_rrr.cfm](http://www.ebri.org/surveys/rcs/2000/dis_rrr.cfm)



What is Your R<sup>3</sup>?




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## The Ball Park Estimate

- Six easy steps; can do online or download paper worksheet
- Tells savings amount to reach retirement goal
- Can do on paper or online at [www.choosetosave.org](http://www.choosetosave.org)
- Flexible annual retirement income and life expectancy figures
- Assumes a 3% constant real rate of return
- Can use various life expectancies




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## Common Retirement Planning Errors

- RPS (Retirement Postponement Syndrome)
- Counting on “unsure” things
  - Employer pension and health benefits
  - Inheritance
  - Certain profit on sale of home
  - Certain investment account balance
- Counting on an “econo-retirement”
  - Spending by retirees often increases
  - Go-go, slow-go, and no-go years



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## More Retirement Planning Errors

- Not saving as much as allowed
  - Maximum tax-deferred savings amount
  - Catch-up savings for workers age 50+
  - Maximum amount to earn employer match
- Not getting help when needed
  - Retirement savings calculations
  - Retirement withdrawal calculations
  - Required minimum distributions (RMDs)
  - Estate planning considerations



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## Retirement Misconceptions

- *You have plenty of time to start saving for retirement*
- *Saving just a little bit won't help*
- *You'll spend less money when you retire*
- *Retirement will only last 10 or 15 years*
- *You can depend on Social Security and a company pension to pay your basic living expenses*
- *Your family will take care of you*
- *Your pension benefits will increase to keep up with inflation*
- *Your employer's health insurance plan and Medicare will cover most of your medical expenses when you retire*



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## Ten Timeless Retirement Planning Tips



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### 1. Start Saving Early

- Time is an investor's biggest ally
- Compound interest is awesome
- To accumulate \$1 million:
  - 20 year olds must save \$67/month
  - 30 year olds must save \$202/month
  - 40 year olds must save \$629/month
  - 50 year olds must save \$2,180/month
- For every decade someone delays, the required amount of savings approximately triples.



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### 2. Save the Maximum Allowed

- 401(k), 403(b), TSP Maximum
  - \$17,000 if under age 50
  - \$22,500 if over age 50 (\$5,500 catch-up)
- Roth and/or Traditional IRA
  - \$5,000 if under age 50
  - \$6,000 if over age 50 (\$1,000 catch-up)



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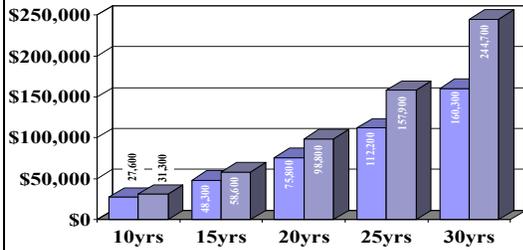
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### 3. Invest Tax-Deferred



Taxable Returns (at 28%) - LOWER Number  
 Tax-Deferred Returns - HIGHER Number  
Garman/Forgue, PERSONAL FINANCE, Fifth Edition, Tax-Sheltered Returns are Greater than Taxable Returns (Illustration: 8% Annual Return and \$2,000 Annual Contribution)

See <http://www.calcxml.com/do/inv07>




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### 4. Analyze Your Finances

#### Net Worth (Assets – Debts)

- Ideally net worth should increase each year
- Pay off loans and debts
- See <http://njaes.rutgers.edu/money/pdfs/networthcalcworksheets.pdf>



#### Housing

- If large equity, reverse mortgage could provide retirement income
- Sell your home, buy a less expensive one, and invest the difference

#### Life Insurance

- May reduce coverage near retirement as children become self-sufficient
- Consider needs, earnings, and assets of spouse/partner

#### Investments

- Consider gradual refocus from growth to income




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### What if You Haven't Saved Enough?

- Postpone retirement
  - Build benefits from employer retirement plan
  - Build benefits from Social Security
  - More years to save; fewer non-working years needing income
- Work part-time in retirement
- Reduce living costs
  - Lower cost housing
  - Less expensive geographic area
- Convert assets into income (e.g., reverse mortgage)




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## 5. Estimate Retirement Living Costs

Spending patterns will probably change...



### •Some expenses may go down or stop:

- ↓ 401(k) retirement fund contributions
- ↓ Work expenses - less for gas, lunches out
- ↓ Clothing expenses - fewer and more casual
- ↓ Housing expenses - mortgage payment will end if house is paid off
- ↓ Federal/state income taxes will probably be lower

### •Other expenses may go up:

- ↑ Life and health insurance unless employer continues coverage
- ↑ Medical expenses increase with age
- ↑ Expenses for leisure activities
- ↑ Gifts and contributions

Inflation will increase ALL expenses during retirement



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## 6. Carefully Evaluate an Early Retirement

- Time is an enemy (twice) for early retirees
  - Fewer working years to save and earn benefits
  - More non-working years to finance
- Years prior to retirement may be period of peak earnings
- By retiring early, peak catch-up period from age 55-65 is reduced
- Need to consider benefit reductions
- Need to consider penalties on early distribution (< age 59 ½)



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## 7. "Retire" While You Work

- **Standard Strategy #1**- Retire at a planned age with less money than anticipated due to New Normal events and risk running out of money due to benefit cutbacks, increased health care costs, longevity, etc.
- **Standard Strategy #2**- Retire later and risk "waiting too long" (e.g., after age 65-70) so that death, health "issues," widowhood, etc. hinder planned retirement lifestyle and/or quality of life.
- **New Strategy #3**- Keep working BUT use money that had been going into savings (i.e., suspend or reduce 401(k) or 403(b) contributions) to begin enjoying "retirement activities" NOW without actually retiring.



[https://www2.troweprice.com/iws/wps/wcm/connect/d2edab0046d7ab10a87eb899d35c25cc/0477923\\_P1.pdf?MOD=AJPERES&CACHEID=d2edab0046d7ab10a87eb899d35c25cc](https://www2.troweprice.com/iws/wps/wcm/connect/d2edab0046d7ab10a87eb899d35c25cc/0477923_P1.pdf?MOD=AJPERES&CACHEID=d2edab0046d7ab10a87eb899d35c25cc)  
(Fahlund, C. *Delaying Retirement, But Not Your Retirement Dreams*)



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## Big "Red Zone" Decision: Where Do I (We) Want to Live?



WSJ Article (3/21/11): BIG issue among couples; communication is key

<http://online.wsj.com/article/SB10001424052748704254304576116471507613288.html>




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## Sources of Retirement Income

- Social Security
- Employer pension plans
  - Defined benefit (DB) pension plans
  - Employer salary reduction plans (e.g., 401(k), 403(b), TSP)
- Personal retirement plans (e.g., Roth and Traditional IRAs)
- Other personal savings (e.g., taxable accounts)
- Annuities
- Employment
- Other (e.g., rental property, family support, reverse mortgage)




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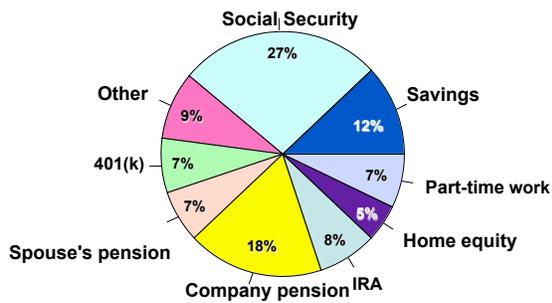
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## Sources of Retirement Income



Source: Social Security Administration chart from Focus on Personal Finance (2010)




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## Social Security

- Most widely used source of retirement income
  - Covers 97% of U.S. workers
- Meant to be *part* of retirement income, *not* the sole source
- Full retirement benefits at age 65 to 67
  - Depends on year of birth
  - Full retirement age (FRA) is being increased in gradual steps
    - Born in 1938: Age 65 + 2 months; then pro-rated
    - Born 1943-1954: Age 66; then pro-rated
    - Born 1960 and later: Age 67



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## More About Social Security

- Comprehensive Web Site: <http://www.ssa.gov/>
- Must generally earn 40 quarters of coverage to be fully insured (a quarter = \$1,130 in 2012; can earn 4 quarters in a year)
  - Must be work “on the books” and not “money under the table”
- Paid for by FICA tax withheld from wages (6.2% of pay; 4.2% in 2012)
- Benefits may begin at age 62 but are *permanently* reduced
  - Born 1943-54- Benefit is 75% of FRA amount; then pro-rated
  - Born 1960 and later- Benefit is 70% of FRA amount
- Benefit estimates: <http://www.ssa.gov/mystatement/>



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## More About Social Security

- Can earn delayed retirement credits up to age 70
  - 8% for every year delayed if born in 1943 +
- Over a third of recipients pay tax on SS benefits received
  - Single: \$25 k-\$34k (50%); \$34k + (85%)
  - Married filing jointly: \$32k -\$44k (50%); \$44k+ (85%)
- “Break-even” age is generally late 70s
  - Age at which someone earns more benefits by waiting until FRA than by claiming reduced benefits at 62



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## Employer Salary Reduction Plans: 401(k), 403(b), 457 plans, TSP

- **Tax Advantages**- Tax-deferred earnings on deposits made with pre-tax dollars
  - **Example:** \$40,000 gross income; \$3,000 contribution; \$37,000 federal taxable income
- **Automation**- Deposits deducted from pay
  - A common form of dollar-cost averaging
- **Matching Contributions**-% of workers' pay
  - Common in 401(k) plans; some 403(b) plans, some TSPs
- **Portability**- Can take money when leaving a job
  - Example: Rollover IRA



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## Thrift Savings Plan (TSP)

- Defined contribution plan for service members and federal employees
- Agency match for civilian workers
- Can join immediately upon starting work
- 5 individual funds and 5 Lifecycle (L) funds
- L funds comprised of G, F, C, S, and I funds
- Default is 100% G Fund (government securities)
- VERY low expense ratios (0.024% to 0.025%)
- Web site: [www.tsp.gov](http://www.tsp.gov)



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## Individual Retirement Accounts

- Regular (Traditional)
- Roth
- Rollover
- Spousal



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## Individual Retirement Accounts

### Regular (a.k.a., Traditional or Classic) IRA

- Maximum \$5,000 deposit in 2012 from earned income
- Worker must select own IRA investment products
- Contribution may be tax-deductible depending on tax filing status and income (2012: \$58k - \$68k singles; \$92k - \$112k mfj)
- Interest accumulates tax-deferred until withdrawal
- May begin withdrawing (penalty-free) at age 59½
- **Must** begin withdrawing at age 70½ (RMDs)
- Withdrawals are taxable income



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## Individual Retirement Accounts

### Roth IRA

- Maximum \$5,000 deposit; worker selects investments
- Contributions are NOT tax deductible
- Maximum income limits to make contributions
  - \$110k - \$125k singles; \$173k - \$183k married filing jointly in 2012
- Withdrawals are tax-free and penalty-free, if:
  - You are at least age 59 ½ AND IRA account is open at least 5 years
- Can convert Regular IRA to Roth IRA; must pay taxes due



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## Small Business Retirement Accounts

- **Simplified Employee Pension (SEP-IRA)**
  - Funded by freelancers and small business owners
  - Annual contributions up to \$50,000 (2012)
  - Simplest retirement plan for the self-employed
- **SIMPLE Plans**
  - \$11,500 worker contribution + \$2,500 catch-up (2012)
- **Keogh Plans**
  - Annual contributions up to \$50,000 (2012)
  - Most difficult plan to administer

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## Defined Benefit (DB) Plans

- Employers pay monthly benefit when workers retire based on:
  - Pre-retirement salary (e.g., “High-3” or “High-5” average)
  - Number of years of service
- Employers make investment decisions; assume risk
  - Workers’ get benefit regardless of how plan investments perform



### ERISA (*Employee Retirement Income Security Act of 1974*)

- Sets minimum standards for private sector pension plans
- Federal government insures part of the payments promised by DB plans (Pension Benefit Guarantee Corp)
- Does not cover public sector DB pensions



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## Typical DB Plan Formula

- NYSLRS (NY State and Local Retirement System)
- Membership tiers based on hiring date
- Final Average Salary (FAS) = average of 36 highest consecutive months of earnings (usually last 3 years of work)
- FAS limitations for large annual income increases
- Benefit =  $\frac{\text{Years of service} \times \text{FAS}}{50}$
- **Example:**  $\frac{30 \times \$31,400}{50} = \$18,840/\text{yr} = \$1,570/\text{mo}$



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## Vesting Period

- Amount of time worked to be entitled to employer retirement plan contributions
- Benefits cannot be forfeited
- Two vesting formulas under ERISA (Private Sector)
  - Graded vesting: 20% a year during years 2-6 of work
  - Cliff vesting: 100% after 3 years of work
- Public Sector vesting varies (new tiers may have longer vesting time)
  - NYSLRS: 5-year or 10-year (Tier 5) vesting period
- Military Retired Pay: Must meet 20 year service requirement
- Workers should always consider vesting before job change
  - BUT job tenure may not always be in their control



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## Military Retired Pay



- Arguably the best retirement plan in the U.S.
- 50% of base pay as early as age 38 with COLA
  - Annual COLA can > double retired pay over time
- Requirement: armed forces service of 20+ years
  - 40 year career: eligible for 100% of basic pay
- Three different military retirement systems:
  - Final Pay- (entered service before Sept. 1980)
  - High 36 (entered service 9/8/80 to 8/86)
  - Career Status Bonus/REDUX OR High 36 (after 8/86)
    - BIG decision at 15-year mark of career



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## More About Military Retired Pay

- About 17% of service members stay 20 years
  - 83% leave with no retired pay (would be illegal in private sector)
  - TSP and Savings Deposit Program **very** valuable
- Average retired pay amount: \$26,000
- Prior 75% benefit cap was lifted in 2007
- Big debate: future benefit sustainability?
  - Military pensions and health care cost \$100b/year and rising
  - Proposed changes to COLAs, vesting; no current personnel?
  - Concerns about incentivizing a 20-year exit
  - Concerns about retention of troops with benefit changes
  - Drawdown could accelerate benefit changes



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## Retired Military Health Insurance

- 20 years of service: eligible for lifetime health insurance through TRICARE
  - Fraction of private insurance cost (\$520/family in 2012 vs. \$4,000 +)
  - Many working veterans use instead of employer insurance
  - Large premium increases are proposed
- Types of TRICARE
  - TRICARE Prime- Managed care (military health facilities)
  - TRICARE Extra- < age 65; use in-network civilian providers
  - TRICARE Standard- < age 65; choice of civilian providers
  - TRICARE-for-Life- Supplemental to Medicare for age 65+; no enrollment fee (sliding scale fees proposed)



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## Retirement Savings Withdrawals

- Backed up by 2 decades of research
  - <http://www.moneysmartsblog.com/4-percent-withdrawal-rule-for-retirement/>
- Withdraw 4% of retirement assets annually with annual inflation adjustment
- High probability of money lasting 30 years
- Example: \$200,000 of savings
  - \$8,000 in year 1 ( $\$200,000 \times .04$ )
  - \$8,240 in year 2 ( $\$8,000 + \$8,000 \times .03$  [\$240])
- Assumes that 50% of portfolio is in stock
  - More conservative investors should withdraw less (e.g. 3%)



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## Let's Use Some Numbers

For every \$1,000 of desired monthly income (above SS and/or a pension), you need \$300,000 saved

- $\$300,000 \times .04 = \$12,000$
- $\$12,000 \div 12 = \$1,000$



- \$2,000/month = \$600,000
- \$3,000/month = \$900,000
- \$4,000/month = \$1.2 million
- \$5,000/month = \$1.5 million

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## Key Messages: Service Members in Their 20s

- Don't have to sacrifice a lot: even modest regular deposits will have high impact
- Time is on your side (compound interest)
- Pay off high-interest debt quickly
- Begin funding a Roth IRA and/or TSP account
- For simplicity, consider an index or life-cycle fund
- Focus on growth



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## Key Messages: Service Members in Their 30s and 40s

- Maintain an adequate emergency fund
- Time is still on your side: still focus on growth
- Increase retirement savings when income increases
- Bank all or part of windfalls (e.g., Savings Deposit Program)
- Fund college saving(s) plans for children after funding retirement savings plan(s)
- Carefully consider CSB/REDUX vs. High 36 decision



– [http://militarypay.defense.gov/retirement/calc/04\\_compare.html](http://militarypay.defense.gov/retirement/calc/04_compare.html)



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## Key Messages: Service Members in Their 50s

- Try to contribute maximum allowed (with catch-up) to TSP
- Use IRAs, taxable accounts, annuities to invest even more
- Consider gradually decreasing growth allocation
- Consider postponing retirement if short on cash:
  - Accumulate more in investment accounts
  - Earn higher Social Security and/or pension benefit
  - Postpone tapping assets
  - Maintain employee benefits longer
- Make “Red Zone” decisions (e.g., housing)



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## Key Messages: Service Members in Their 60s & Beyond

- Could have 20-30 years in retirement so keep a portion of portfolio invested for growth
- Consider income-oriented investments
  - dividend-paying stock or preferred stock
  - investment grade corporate or municipal bonds
  - U.S. Treasury securities
- Develop a plan to create a retirement “paycheck”
- Plan for RMD withdrawals after age 70 ½
- Consider LTC insurance or alternatives



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## In Summary



- It is easy to calculate savings for a retirement goal
- Retirement decisions depend on many individual factors
- The earlier someone starts saving, the better
- Tax-deferred investments result in higher accumulated assets than the same investments in taxable accounts
- Social Security is a retirement income base to build on
- Tax laws dictate savings limits and minimum withdrawals
- Military retired pay benefits are currently very generous but their future status is uncertain



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## Action Steps

- Do one or more retirement savings calculations
- Get an online Social Security benefit estimate
- Visit retirement planning Web sites
- Learn more about the TSP at <https://www.tsp.gov>
- Start or increase retirement savings
- Consider non-financial retirement decisions
  - Example: How will you spend your time?
- Consider hiring an “hourly” financial advisor



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