WALL STREET, CALIFORNIA; MONEY MAKE-OVER: Southern Californians Learning How to Succeed in Personal Finances; Couple Hope to Avoid Pain of Long-Term-Care Costs; [Home Edition]

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Full Text (1998 words)

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Tom West and his wife, Jennie Walters-West, didn't worry much about retirement until they witnessed firsthand the danger of facing the golden years without ample savings.

It pains them to see Tom's father struggle to care for Tom's mother, who is in a nursing home with Alzheimer's disease. Tom's father, a retired school principal, has about $100,000 saved, but it's not likely to be enough to pay for his wife's long-term care--now running about $42,000 a year--and then carry him through retirement without government help.

That scenario scares Jennie, 39, and Tom, 48, who like his father is a veteran public school educator. As parents of two girls, the Simi Valley couple want to make certain they have enough tucked away so they won't face a similar plight later.

"I think if my father had done things differently, maybe set aside more money, he would be able to have in-home care for my mother, which is what he really wanted," said Tom, who has taught physical education for the Simi Valley Unified School District for the past 24 years.

"Because of what he's going through, we want to make sure we can take care of ourselves and not become a burden on our children."

The couple top priority is to set aside a large amount of retirement funds from their $67,000 gross annual income. In addition to Tom's $63,000 teaching salary, he earns extra income as a part-time sports broadcaster for a local cable station. Jennie stays home to care for the children.

"So many people think they have so much time to save, but now I know you have to start early," Tom said.

Despite their worries, David Little, a fee-only certified financial planner in Fullerton, said the couple will be on track for a comfortable retirement--if they increase their savings rate soon.

Currently, the couple's net worth is about $345,000. The bulk of that is $248,000 in equity in two homes in Simi Valley, one their residence and the other a rental.

They have about $26,000 in short-term savings as an emergency fund and about $52,000 in two annuity contracts.

The rest of their portfolio is in stock mutual funds and individual stocks.

Backing up their net worth is Tom's expected pension, administered by the California State Teachers' Retirement System (CalSTRS).

"It's the envy of everyone participating in Social Security," Little said of CalSTRS.

Assuming Tom receives a 3% pay raise each year, Little calculated that Tom will receive a $73,000 annual pension if he retires at age 65.

Still, given the effects of even modest inflation between now and then, the planner estimated that the couple will

need close to $100,000 in annual income to maintain their lifestyle in retirement.

They could live on much less, of course, if they cut expenses. In any case, Tom and Jennie made clear that they want to accumulate an unusually large nest egg and are willing to embark on a more aggressive savings regimen than would most people at their income level.

Little encouraged them to boost their annual savings for retirement immediately to $7,700 a year, or $642 a month. Tom currently contributes $300 a month to his 403(b) tax-deferred retirement plan, which is similar to a 401(k) plan.

The planner suggested that $4,000 each year, or $2,000 for each of them, be directed to investments sheltered within Roth IRAs.

Little recommended funding Roth IRAs first because Roth withdrawals in retirement are tax-free. Roths are also easier to tap in an emergency than 403(b)s.

The remaining $3,700 a year could be saved through Tom's 403(b) plan, which would represent a small increase from what he is already contributing to the plan.

Tom only recently began saving through the 403(b) plan. The couple's biggest single financial investment is the $51,000 Tom has in a tax-deferred annuity through American Investors Life Insurance. But it earns just 5.1% a year in interest.

Tom said he shifted assets to the annuity in 1997 because he got 8.25% interest the first year. He said he didn't realize the rate was a teaser, good for only one year.

Since then, Tom has withdrawn 10% of the annuity's value, the maximum annual sum he can pull out without paying a surrender fee. He put the money into mutual funds in his 403(b) plan, which allows transfers from annuities.

Little suggested that, despite the hefty annuity surrender fee--about $5,000--Tom should roll the annuity balance into his 403(b), either immediately or during the next two years. The surrender fee is now 9.8%, but it drops slightly each year.

Little noted that if Tom keeps his money in the annuity earning 5.1% a year, he'll have about $85,000 after 10 years. If he instead invests the money in stock mutual funds and earns 8.5% a year, he'll have $104,000 in 10 years even after subtracting the surrender charge.

Moving the money all at once to the 403(b) most probably would be better than continuing to transfer it in 10% chunks, Little said, although if stocks were to decline sharply in the next few years the annuity obviously would look more attractive.

Overall, though, "It'll be painful to pay the surrender charge, but in the long run, you should be better off and you'll feel better to get out of the annuity," the planner said. Doing the transfer all at once would also relieve the couple of the paperwork of consecutive annual transfers.

As for their stock investments, the couple conceded that they were investing neophytes. Little suggested that they pay more attention to their portfolio mix.

Their holdings now include three big-company stock funds: Janus Twenty, Vanguard Index 500 and Vanguard U.S. Growth. To better diversify, Little advised, the money the couple contributes to Roth IRAs should be invested in different types of stock funds, including funds that focus on small-company stocks, and also in some bond funds.

"The market moves in cycles which are unpredictable," Little said. "The best way to deal with this is to diversify into different areas of the market."

Overall, Little recommended that 20% of their portfolio be invested in bonds and 80% in a diversified selection of equities. He gave the couple a specific recommended portfolio allocation if they choose to move the annuity sum into mutual funds within Tom's 403(b).

Tom and Jennie wondered if they should sell their rental property and invest the money or hold on to the house, which essentially breaks even. They want to maximize their assets, not only for retirement but also to pay for college for their daughters, who are now 12 and 4.

The house rents for $1,400 a month. They have about $120,000 in equity in the property and only eight years left on an $80,000 mortgage.

Little said the couple have two good options. They could keep the property and, once the mortgage is paid off, use the rental income to help pay the college costs.

Or they could move into the house for two years, then sell it and invest the proceeds. Because the rental would have served as their primary residence, up to $500,000 of any gain wouldn't be taxed.

Unless Jennie and Tom are anxious to get out of the rental business, Little said his choice would be for them to keep the property as a way of diversifying their assets. That also would avoid the disruption of a move.

The couple agreed. They like their current, larger home too much to move back into the rental, where they lived until six years ago, and they like the idea of getting regular income from the property once the mortgage is paid.

"I don't particularly want to sell the rental property, unless there's a huge financial benefit to do so," Tom said.

Addressing their specific fears about old age, Little said the couple will eventually be good candidates for long-term-care insurance, because they have too many assets to qualify for government help but too few to afford the costs of a long-term illness or nursing home care.

Medicare, the federal program that covers many medical costs for people 65 and older, does not cover most nursing home costs. The poorest Californians can get their nursing home bills paid through Medi-Cal, a state program for low-income elderly, but only if they are in a Medi-Cal-approved facility and have met strict asset requirements.

To qualify, people who haven't been indigent previously must spend all but $2,000 of financial assets. If one spouse goes into a nursing home, the other can keep their home and financial assets worth $81,960. Because of the high cost of his wife's care, Tom's father may soon qualify.

To avoid their elders' fate, Little suggested Tom and Jennie consider nursing home insurance when they are in their 60s. Although the premiums rise with age, Little said the likelihood the couple would need in-home or nursing care before that age is remote, and they are likely to be better off putting the money that would go for insurance premiums into their retirement savings instead.

Generally, Little doesn't recommend long-term care insurance to people with limited assets because they'll probably qualify for government assistance, while people with a net worth of more than $1.5 million (in today's dollars) can typically afford care if they need it without the insurance, he said.

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"But people who fall in the middle need insurance because if they need to pay for nursing care, it would put a huge burden on them," Little said.

Diane Seo is a regular contributor to The Times. To be considered for a published Money Make-Over, send your name, age, phone number, income, assets and financial goals to Money Make-Over, Business Section, Los Angeles Times, Times Mirror Square, Los Angeles, CA 90053 or to money@latimes.com. You can save a step and print or download the questionnaire at http://www.latimes.com/HOME

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Information on choosing a financial planner is available at The Times' Web site at http://www.latimes.com/finplan. The site offers stories, phone numbers, addresses and links to related sites.

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The Situation

Investors: Jennie Walters-West, 39, and Tom West, 48

Gross annual income: $67,000

Goal: Large retirement nest egg

Solution: Double savings rate

This Week's Make-Over

Investors: Jennie Walters-West, 39, and Tom West, 48

Gross annual income: $67,000

Goals: Devise a retirement savings plan; evaluate real estate holdings

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Current Portfolio

Short-term savings: About $26,000

Real estate: $128,000 equity in home (after $167,000 remaining on mortgage), $120,000 equity in rental property (after $80,000 remaining on mortgage)

Other debt: About $10,000 owed on a car

Investments: $52,466 in two annuities; $13,200 in a regular taxable account (including $7,000 invested in individual stocks Oracle, Lucent Technologies, Zainy Brainy, Cais Internet and Sequent; $2,800 in Janus Twenty fund; and $3,400 in Vanguard Index 500 fund); $6,943 in 403(b) plan (invested in Vanguard U.S. Growth and Vanguard International Growth funds); $8,900 in various IRAs (including $2,100 in Vanguard Index 500, $2,500 in Putnam Voyager, $1,800 in Putnam International Growth, $2,500 in a limited partnership)

Net worth: $345,700

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Recommendations

Hold on to rental property.

Double retirement savings to at least $642 a month.

Use bulk of new savings to fund Roth IRAs each year.

Transfer funds from annuity to 403(b) account, with the following asset mix: 25% in Vanguard Total Bond Market Index fund; 30% in Windsor II large-value-stock fund; 20% in Vanguard International Growth stock fund; 15% in Vanguard Capital Opportunity aggressive-growth fund; and 10% in Vanguard Small-Cap Index fund.

Meet the Planner

David Little is a fee-only certified financial planner and chartered financial analyst at Eclectic Associates in Fullerton. He has lectured at Biola University and Pepperdine University's Graziadio School of Business and Management.

[Illustration]
CAPTION: PHOTO: Tom West and Jennie Walters-West live in Simi Valley with daughters Olivia, right, and Hilary. The couple are willing to sacrifice now by saving more to avoid "becoming a burden on our children."; PHOTOGRAPHER: ANNE CUSACK / Los Angeles Times; GRAPHIC: This Week's Make-Over, Los Angeles Times

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