The Kelemen, Way & Hanslits

FINANCIAL PERSPECTIVE

Creators of The Planning Vision Process®

Ron Kelemen, CFP®

Mary Way, CPA, CFP®

Larry Hanslits, CFP®

September 2012 / Vol. 21, No. 3

CREATING CLARITY & CONFIDENCE IN A COMPLEX WORLD

Basic Strategies for Repaying Student Loans

As this year's crop of college graduates hit the job market, student loans loom large on their minds and that of their parents. According to FinAid.org, graduates of the class of 2011 have an average of $27,200 in debt, up from about $17,600 in 2001. Statistics for this year aren't available yet. It is even worse for medical and graduate professional students. According to the American Academy of Medical Colleges, the today's medical school graduates enter residency with a mean debt of $158,000 if they attended a public institution, and more than $176,000 for private schools. How to deal with them takes thought and planning. But first, the basics of student loans.

SUBSIDIZED, NON-SUBSIDIZED, AND PRIVATE LOANS

All the recent news about raising the interest rate on government student loans to 6.8% pertains only to <u>subsidized</u> student loans for <u>undergraduates</u>. These subsidized loans account for only 30% of lower-income borrowers (with family incomes of less than $50,000) starting on new money <u>borrowed after July, 2012</u>.

The unsubsidized loans already have a fixed interest rate of 6.8%, which accrues interest <u>immediately</u>, while the student is in school. Most private bank loans typically have higher variable rates that rise and fall with a benchmark. They offer fewer repayment options, no forgiveness possibilities, and fewer consumer protections. Unlike using a series of credit cards, they cannot be discharged by bankruptcy.

BASIC STRATEGIES

1. Choose the right repayment plan

Four major student loan plans—Stafford, Perkins, PLUS, and Direct Consolidation Loans—make up 85% of the total US education debt. They have different repayment options. These range from a standard plan which requires a minimum payment of $50 per month for 10 years, extended payments that can stretch out for 25 years, to the new income-based plan that caps the monthly payments at a "reasonable percentage" of income. After 25 years any remaining debt is forgiven. According to the calculator at studentaid.ed.gov, the monthly payment would be $295 on a $30,000 loan if the graduate makes $40,000.

2. Consolidation

Consolidating multiple government loans will simplify the repayment schedule and may lower monthly payments, especially if one selects a long pay-out period. The fixed interest rate is based on a weighted average of the loans, rounded up to the highest 1/8% to a maximum of 8.25%. But, like the difference between a 30-year mortgage and a 15-year mortgage, it will cost far more in interest payments. And it doesn't provide the ability to triage loan payments by placing a higher priority on paying off the higher interest loans first. Any deferment options that may have existed with other loans are eliminated and payments must begin within 60 days. **It generally doesn't make sense to consolidate private loans. This is because the more student debt one has, the lower one's credit score, and thus the higher the interest rate.**

3. Pay the private loans first

If a borrower consolidates government loans, the best approach is usually to focus any extra cash flow allocated to loan repayments on the private ones first. They most likely have higher interest rates and the possibility of rate increases when overall interest rates go up. Once the private loan is retired, one can focus upon extra payments on the government loans.

4. Sign up for Auto deduction

Many lenders will reduce your interest rate by 0.25% if you arrange to have your payment automatically deducted from the borrower's checking account.

5. Consider special forgiveness programs

The newest forgiveness option is the Public Service Loan Forgiveness program (PSLF). Anyone who works in certain nonprofit, tax-exempt 501(c)(3) organizations or for federal, state, local, or tribal government (including the military and public schools and colleges), as well as AmeriCorps and the Peace Corps, is eligible. The loans can be completely forgiven in 10 years. However, the pay is generally much

Continued on page 3

500 Liberty Street SE, Suite #310
Salem, OR 97301
(503) 371-3333

www.planningvisionprocess.com

Providing Fee-Only Wealth Management and Creative Planning for Your Family, Business and Estate

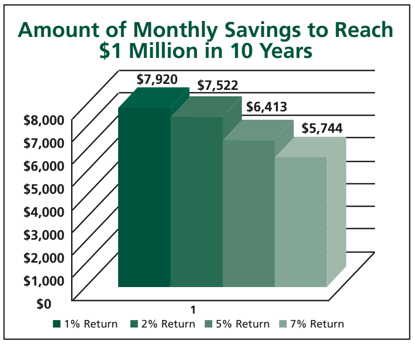
THE H GROUP INC®
INDEPENDENT WEALTH MANAGEMENT SOLUTIONS™

Is Your Retirement Confidence Grounded in Reality?

Retirement is a confidence game. You need to be confident that you:

- Will have enough income from a mix of your savings and other sources, such as Social Security or part-time work.
- Can spend more in your earlier retirement years while you and your spouse still have your health and the energy to do things.
- Have enough resources should your health change or should you need long-term care.
- Can weather financial storms or boomerang children.

Apparently, not a whole lot of people feel that confident about their retirement. According to the Employee Benefit Research Institute's *2012 Retirement Confidence Survey*, only 52% of the respondents felt very or somewhat confident that they will have enough money to live comfortably throughout their retirement years. Those with high debts, health issues, and wage compression felt even less confident.



But among those who felt confident, is this confidence warranted? A study by the Schwartz Center for Economic Policy Analysis looked at retirement savings from the 2010 census, particularly "near retirees," defined as those individuals age 50-64. The results were not pretty. Those households in the top quartile (greater than an income of $100,764) had a median retirement plan balance of only $133,404. The other quartiles had far lower balances.

Assuming a generous 5% distribution rate, this $133,404 translates into $6,670 per year. By our "back of the napkin" calculations, it takes over $2 million of capital to replace that $100,764 of household income. If Social Security were included in the mix, perhaps $1.4 million is needed.

And if your household income exceeds $200,000, you will need about $4 million at retirement time, or maybe $3.6 million if Social Security is considered. Of course, these simple estimates are no substitute for a complete analysis, which factors in many other variables.

Don't have that much? You have four basic options to help with the problem: 1) working longer, 2) dying earlier, 3) spending less in retirement, 4) saving more now. There may be other variables, such as selling your business or receiving an inheritance, but these are the four drivers.

1. Working longer?

Some might argue that work is another asset class and an important part of the retirement income portfolio. It is fulfilling for many people. As Mitch Anthony, author of *The New Retirement Mentality* defines it, ***"work is adding value to others while adding meaning to your life."*** We have a lot of clients who retire briefly, then return to work—not for financial reasons—but because of boredom, lack of social interactions, and the need for a sense of purpose. To the extent that brings in additional income, that's great.

If you can, working longer greatly improves your long-term retirement security. **But don't bet your retirement security on working into your late 60s or 70s. For some people that may not be possible.** Some people have the type of job where they can dial it back a little by working part time. But for others, it may be "all or nothing" affair. And some jobs are physically demanding. And even if working longer or phasing out gradually is possible, you

Continued on back page

Making Sense of the New Retirement Plan Disclosure Rules

On July 1, new regulations (inches thick) issued by the Department of Labor (DOL) became effective regarding the disclosure of fees that are charged to certain retirement plans. The rules are confusing, but the intent is to give employees, plan sponsors and/or trustees more information about what they are paying for what they are getting.

We sent detailed information to our business owner clients who provide a retirement plan for their employees. If your employer offers you the ability to make your own investment decisions regarding your share, you will receive regular information about the fund performance of your account and the underlying fees paid indirectly by you or your employer.

On an annual basis you should receive a disclosure with the plan's investment options (which includes investment performance), administrative and individual expenses. These disclosures should include the plan's investment options, investment performance and fees in an easy to read chart.

On a quarterly basis, you should receive a disclosure that details the fees that were deducted from your account.

So, what do you do with this information? The intent is to keep you more in the loop about what you are paying, or what your employer is paying on your behalf. It may help you make more informed choices if you have a large menu of investment options. **But remember the cheapest isn't always the best, nor always the most appropriate.** International and small cap stock funds and high yield bond funds, for example, have higher costs than large company funds, but they add diversification and higher potential returns.

Please remember that your employer and the retirement plan provider cannot afford to offer a plan that provides all things to all people with unlimited investment choices. It simply becomes unmanageable and cost prohibitive. As it is now, these plans have a lot of costly reporting and administrative costs, and many compliance issues to navigate. Also, employers/plan sponsors offering their employees a self-directed option are required under Section 404 to provide appropriate employee education about the investment choices and investing. Somebody somehow has to pay for it.

That said, if you need help making sense of the information you have received we'd be happy to review your statement in the context of your overall planning.

Repaying Student Loans...*Continued from page 1*

lower, and it might be more advantageous in the long run to take a higher paying job and use those extra earnings to retire your debt.

6. Ask your employer

Some hospitals and organizations (even here in the Willamette Valley) may offer help with student loans as part of an overall compensation package. From an employer's standpoint, loan payments don't include payroll taxes and retirement plan contributions as salaries do, making them cheaper than a higher salary. However, beware that any repayment of a student loan on the borrower's behalf by a third party is considered taxable income.

7. Put loan repayments into the context of your overall situation

This is perhaps the most important loan repayment strategy of all. We have seen young people try to repay their loans too quickly because they are obsessed with the amount they owe. But few people obsess about a mortgage that is equal to or greater than their annual incomes. If you are a recent graduate, you need to put this into perspective about your total income and competing priorities, such as:

- **Percentage of your total debt to your annual income.** What counts is your capacity to service your debts.
- **Percentage of your student debt payments to your monthly income.** Over the years, a good rule of thumb is 8-9%. If you have extra money at the end of each month, then you can focus upon some of the items below:
- **Purchasing or saving for a home.** Prices are low now; they may not be 5-10 years from now.
- **Professional practice buy-in for in a group practice.** This could be a very good investment opportunity resulting in substantially higher net income once your buy-in is complete.
- **Retirement.** There is an old man or woman in your future. Starting now, even with a small amount, can make a huge difference compared to starting later with larger monthly retirement plan contributions.
- **Emergency fund.** Stuff happens. Opportunities arise. An emergency fund will give you peace of mind and the ability to continue making your student loan payments if something comes up.
- **Disability income insurance.** You are only one home improvement mishap, car accident, or head injury away from not being able to work. DI insurance protects your most valuable financial asset—the ability to earn an income.

The above is just a very brief overview. More information is available at studentaid.ed.gov and elsewhere on the web or from lenders. It makes sense to study the details carefully, seek professional advice, and put things into perspective.

Play Me, I'm Yours!

We were proud to be one of 10 firms in Salem to sponsor a piano for the "Play Me, I'm Yours!" festival in Salem. Ours got a lot of play from all kinds of people, right in the heart of downtown. More links about the project can be found on our blog.

The Team Advantage™

Ron Kelemen, Mary Way, and Larry Hanslits are independent Certified Financial Planner™ certificants. They jointly serve their clients as a team with over 72 years of combined experience. They are members of The National Association of Personal Financial Advisors (NAPFA), and as such work on a fee-only basis and do not accept any third party compensation or finders fees. Their practice focuses on wealth planning and management for professionals, business owners, and retirees. They are advisory associates of The H Group, Inc., one of the largest independent fee-only registered investment advisory firms in the Northwest with 18 professionals and over $550 million under active management.

About Ron Kelemen, CFP®

In practice since 1981, Ron is a contributing author of three financial planning reference books and is frequently quoted in the national press and professional journals. *Medical Economics* lists him as one of the 150 best financial advisors for doctors. He is active in Rotary and several non-profit organizations.

About Mary Way, CPA, CFP®

Mary joined the practice in 1995. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She is a board member of the Salem Rotary Foundation, and like Ron, a past president of the Willamette Valley Estate Planning Council.

About Larry Hanslits, CFP®

In practice since 1985, Larry merged his practice with Ron's and Mary's in 2011. He sits on the investment policy committee of The H Group, Inc., provides advanced estate planning case writing services to attorneys nationwide, and is a teacher and a judge for the financial planning scholarship competition at Oregon State University.

TEAM UPDATE

It's been a nice summer, with a good balance between work and play. We now have the right mix of team members to cover vacation absences without too much of a workload on those "manning the fort." We spent a lot of time navigating the complicated new retirement plan disclosure rules for our business owner clients. And in early September, we addressed the results of an SEC audit regarding disclosure issues.

Lani had a fun and exhausting week of "grandma duty" in June and enjoyed her sister's visit in July. Her summer highlight was a family reunion at Waldport with 23 of 29 family members present, with 12 of them under the age of 9.

Debbie hosted a bridal shower for her daughter's friend. She and husband Bob took short trips to Sisters, Gig Harbor, and a week-long trip to Orcas Island.

Larry actually took a vacation away from home! He and wife Laurie spent a relaxing week in Bend on the river. They are thrilled because the bank of Laurie and Larry will soon be closing for son Eric, who has one more term at OSU. Daughter Jenna was accepted to the School of Finance and the School of Accounting at OSU where she plans to complete a double major.

Mary attended a Trusts and Estates conference in June and the NAPFA West Conference in Portland in early September with **Ron**. She and **Larry** hosted an on-line chat session for the *Statesman Journal* newspaper on the topic of putting one's home into the context of long-term planning. (You can find the transcript in our blog.) She and husband Steve doted on their grandson in Bend and enjoyed nice times on their boat at Detroit, the Coast, and on the Willamette River.

Ron attended a two-day virtual conference in July, but we wondered why he didn't get any logo pens, mugs, or tote bags. (He scored better at the NAPFA West Conference in Portland.) He and wife Kathy bicycled part of the Columbia Gorge historic road on their road bikes, and mountain biked in Central and Southern Oregon. They have thoroughly enjoyed extended weekend trips with their Airstream trailer, plus a three-week road trip to Idaho, Montana, and Wyoming that included a lot of hiking and biking, plus a family reunion campout at Yellowstone.

THE H GROUP INC®
INDEPENDENT WEALTH MANAGEMENT SOLUTIONS™

Ron Kelemen, CFP®
Mary Way, CFP®, CPA
Larry Hanslits, CFP®

The Kelemen, Way & Hanslits Financial Perspective
500 Liberty Street SE, Suite #310 • Salem, OR 97301

ADDRESS SERVICE REQUESTED

SMALL BUSINESS OF THE YEAR
SALEM AREA CHAMBER OF COMMERCE
2011

Would you like to receive an email version of this newsletter?

Please send an email to **Salem@theHGroup.com** with the email address you would like us to use. And don't forget to check out our regular blog at the "Our Blog" tab of **www.PlanningVisionProcess.com**

Retirement Confidence...*Continued from page 2*

cannot be certain that you or your spouse will have the health to make it happen.

2. Dying early?

We mention this more as a joke to drive home the point that we are all living longer and we don't know when we are going to die. The medical profession has done wonders to extend our longevity, but this creates a widespread risk that didn't exist for new retirees 50 years ago. Many of today's boomers could be retired longer than they worked. Your money has to last longer.

3. What about spending less?

In our combined 75 years of practice, we have yet to see a client couple retire, then the very next month drop their spending to 60% or 70% of their pre-retirement lifestyle spending. Could you? Granted, some things like clothing and commuting costs are less, and hopefully the kids are launched and the mortgage is paid off. But these are more than offset by travel, time for hobbies, and other things. This is especially true in the early active phase of retirement. As retirees age, the spending gradually decreases until medical expenses start kicking in. And along the way, vehicles and roofs usually need replacing.

So, if spending less at retirement is going to be part of your retirement solution, try living on that reduced expenditure level now.

4. Saving more (and smarter)

Whether you invest in stocks, bonds, mutual funds, real estate, small businesses, or Social Security taxes, **all that will be there for you when you stop working is what you send on ahead.** These assets have to work for you when you can't. The quantity (amount) you save every month for the future can be less if you focus on the quality (return) of your retirement savings.

Putting your retirement savings under the mattress at today's low rates for what could conceivably be a 40-year portfolio just doesn't make sense. As you can see by the graph, you can save less if your money works harder for you.

The above are all shorthand calculations and very crude rules of thumb. As we said earlier, they are no substitute for a complete analysis that factors in many other variables. So, by all means, be confident about your own retirement, but ground this confidence with a reality check that is unique to your situation. We'd be happy to help you do that.