

FINANCIAL PERSPECTIVE



Ron Kelemen, CFP®



Mary Way, CPA, CFP®

May 2010 / Vol. 19, No. 2

CREATING CLARITY & CONFIDENCE IN A COMPLEX WORLD

Out-of-Pocket Medical Costs During Retirement—A True Wild Card

Five years ago we wrote about the cost of health care during retirement. Since then, new sophisticated studies are shedding more light on the topic and the need to plan for health care expenses, regardless of what does or does not happen with health care legislation. It's a good news, bad news situation.

The good news? Thanks to modern medicine, we are all living longer after retirement. According to an article in the February 23 Economist and 2006 figures from the CDC, Americans are living 18.7 years past age 65. This is an average of all races and genders. And just since the last 15 years, life expectancy at age 75 has increased by one full year to an additional 12 years of retirement. So, if you make it to age 75, you have a 50% chance of being retired for 22 years or more. And the probabilities are even higher if we calculate in a joint life expectancy with your spouse.

By contrast, The Economist reported that average retirement for males from 1965 to 1970 lasted just under 10 years. When you think about just the medications that control cholesterol and blood pressure, it is no wonder. Not to mention cancer breakthroughs, use of seat belts, and better diet and exercise.

The bad news? A longer retirement most often equates to higher medical costs, especially if the longer life span is plagued with chronic diseases. We're living longer, but not always better. Until now, we really didn't have an accurate way to quantify out-of-pocket medical expenses during retirement because we didn't have enough data. But a 2010 paper by Webb and Zhivan at the Center for Retirement Research at Boston College, gives us some new insights using new data and methodologies. And the numbers are much higher than we first reported in 2005.

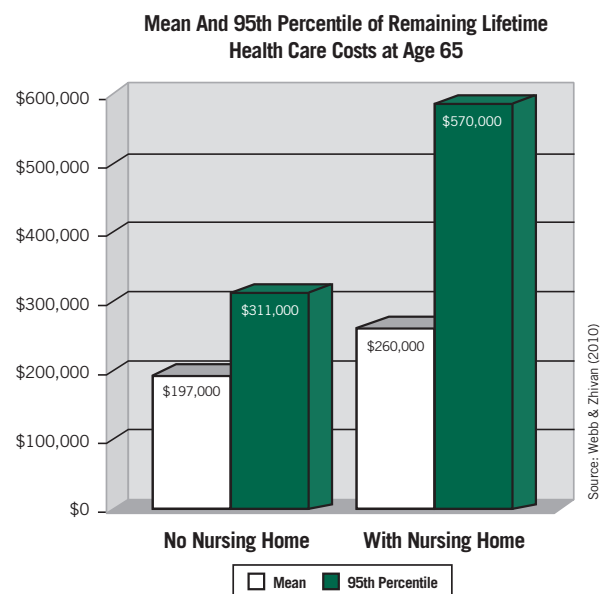
The study looks at household out-of-pocket expenses during retirement, such as co-pays, deductibles, home health care costs, and Medicare supplement premiums. Using data on many mortality and morbidity factors, they reported the mean and the 95th percentile in

today's dollars. The study contains many variables, assumptions, and footnotes, so if you want to examine all 45 pages in more detail go to: http://crr.bc.edu/images/stories/Working_Papers/wp_2010-1.pdf.

Their findings? A couple retiring at age 65 in good health with no chronic conditions can expect to pay on average \$197,000 during retirement for out-of-pocket medical expenses, and \$311,000 if they fall into the 95th percentile. This doesn't include nursing home care. When that is included, the mean and 95th percentile costs increase to \$260,000 and \$570,000 respectively.

The corresponding amounts for couples reaching ages 70 and 75 are very similar. The mean cost at age 70 is \$192,000 and the 95th percentile is \$317,000. This is because the couple no longer needs to worry about the costs from ages 65 to 70, but faces inflation and higher probabilities of needing care during the remainder of their lifetime.

Continued on page 4



Saving for College—New 529 Plan Options for Oregonians

Pretty soon, many of our readers will be sitting on bleachers proudly watching high school graduates ascend the stage as the band plays Sir Edward Elgar’s Pomp and Circumstance March over and over. Fortunately your mind will stop replaying that tune in about two weeks. But if you’re like most parents, the melody will be replaced by less pleasant thoughts of paying for college.

Second only to retirement, providing a college education for your children can be one of the most expensive purchases you will ever make. Quite often, college expenses hit close to retirement time, so for those of you who won’t be in the bleachers in the next few years, now is the time to start planning. The 2010 costs aren’t available yet, but according to the College Board, here are the average expenses for 2009.

- Private four-year \$26,273
- Public four-year \$7,020
- Public two-year \$2,544
- Public four-year surcharge for out-of-state students \$11,528.

These are just the averages. Books, lab fees, student activity fees, room, board, and transportation can easily add another \$12,000 to \$15,000 to these costs—not to mention beer money.

Paying for college often involves a combination of needs-based scholarships (not too likely for a number of our readers), merit based scholarships, employment, loans, funding with current cash flow, or savings. The best approach is probably a combination of strategies that fit your unique situation. We would be happy to discuss them with you.

Socking the money away early is your lowest-cost alternative, provided you have adequate life and disability insurance, and are maximizing your retirement plan. There are several ways to save for college. They all have pluses and minuses. Keep in mind these criteria:

Oregon TIAA-CREF 529 Choices

Portfolio	Description	Suitability / Comments
1. Aged-Based	As the child ages, the 6 different portfolios migrate from aggressive to more conservative.	Good for “auto pilot,” especially in the early years. May need more careful tuning shortly before and during college.
2. Multi Fund Portfolios	Portfolios of different mutual funds. The mixture of asset classes determines the aggressiveness or conservativeness of the portfolio.	Better control because you can choose the risk level based on your total circumstances, and leave the portfolio construction to them.
3. Single Fund Portfolios	A small choice of funds from which to build your own custom portfolio. An inflation-protection bond portfolio and a social choice fund are also available.	These are more for do-it-yourself types. They require periodic attention and rebalancing.
4. Principal Protection Portfolio	Resembles a guaranteed insurance contract with a low fixed rate of interest in exchange for a principal value that doesn’t fluctuate like a bond fund.	This is not absolutely guaranteed, but as close as one can get. Because of the very low interest rates, this and the money market should not be used for younger beneficiaries.

Whatever you decide to do, get started! You will be sitting on the bleachers for your child or grandchild before you know it. For every \$1,000 of college cost today at 6% inflation, it will be \$1,338 in five years; \$1,790 in 10; \$2,396 in 15; and \$3,207 in 20 years.

1. Your long-term rate of return should be higher than the college cost inflation rate. The College Board reported that costs at public institutions increased 6-7% in 2008, and by 4-5% at private colleges. CDs, money markets, and savings bonds fall way short in this criterion.

2. Match your investment strategy with the timing of when the funds will be needed. In other words, don’t make short-term investments for a 10-year old, or speculative investments for a 17-year old. Remember, too, that not all the money is needed the day your child enters college.

3. Control and flexibility. Sadly, not all kids stay out of trouble or go to college. If the account is in their names, you may have no say in the matter. Strategies that do “double duty” for more than one purpose or goal are worth considering.

4. Keep an eye on taxes, but don’t let taxes drive the entire strategy. Either shelter the college account from taxes or shift the tax burden to your child when appropriate (see Control above). This is best done by transferring assets to the student as needed.

The 529 Solution

Section 529 College Savings Plans, in my opinion, do the best job of meeting all four criteria because:

- You have a choice of a wide variety of investment options;
- The accounts grow tax deferred;
- Currently the earnings can be withdrawn tax free if used for post-secondary education;
- The account can be shifted to a relative;
- You get a \$2,085 Oregon income tax deduction; \$4,170 for joint filers;
- You retain control;
- The assets gifted to one are not part of your taxable estate,

- The account is protected from creditors.
- Anyone—parents, grandparents, aunts, and uncles—can establish an account or contribute to an existing one.

The Oregon 529 Situation

Many Oregonians soured on the Oregon 529 plan after Oppenheimer Funds, the manager of the Core Bond Fund lost over 35% in 2008 in the plan's most conservative portfolio. The state recently settled for \$20 million, which was distributed among the 45,000 accounts that owned the Core Bond Fund.

Since then, TIAA-CREF replaced Oppenheimer. This is a well-respected, lower cost alternative without any sales charges, loads, or 12b-1 fees. Owners of all the Oppenheimer funds have been seamlessly transferred into similar TIAA-CREF funds. You can sign up and select your portfolio(s) directly by going to www.OregonCollegeSavings.com.

The venerable MFS Funds are also available, but only through a broker. They have commissions and higher fees, but they come with assistance of a financial professional. And of course, you can use any other 529 plans offered by other states, some of which are excellent. You just won't get the annual Oregon tax deduction for your contributions.

With the new Oregon arrangement, you now have many more choices from which to choose, but if you are working with us, you actually have the opportunity to integrate and compliment your education planning with your overall financial plan. Basically, your TIAA-CREF choices fall into four categories as you can see in the table.

Are You Affected by 3.8% Surtax on Investment Income?

The recently-passed health care law affects many people in many different ways. One provision in the bill includes a 3.8% surtax on net investment income if your Modified Adjusted Income (MAGI) is above a threshold amount. The threshold is \$200,000 for single filers; \$250,000 for married filers, and \$11,200 for trusts and estates. This starts in 2013, but now is the time to start planning for it.

The definition of investment income is what provides the planning opportunities. Investment income for the purposes of this bill is basically passive income from dividends, interest, royalties, rents, and the gain on investment assets not normally held in an active trade or business.

However, other sources of investment income are excluded from the definition. These include income from a trade or business, IRA and other qualified plan distributions, tax-free bond interest, Roth IRA distributions, and the gain on the sale of an active interest in a partnership or S Corporation.

So here's the deal: As long as your income from salaries and investment income (as defined above) are below the threshold amount, you owe no surtax on your investment income. For example, if you are married and had no investment income, you could make \$500,000 or even \$1 million in salaried income and still not be subject to the 3.8% surtax. However, if you make only \$100,000, but have \$170,000 of investment income (for a total of \$270,000) then \$20,000 of your investment income would be subject to the 3.8% surtax.

Sounds complicated? It is, but there are strategies to deal with it. So if you think you may be in this situation—or inadvertently thrown into it by some asset sales or IRA minimum distributions in the next 30 months—let's get together with your tax professional to discuss ways to minimize the impact.

The Team Advantage™

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certificants. They jointly serve their clients as a team with over 42 years of combined experience. They are members of The National Association of 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 \$500 million under active management.

About Ron Kelemen, CFP®

In practice since 1981, **Ron Kelemen, CFP®** is a contributing author of three financial planning reference books. *Medical Economics* continues to list him as one of the 150 best financial advisors for doctors. He is Immediate-President of the Rotary Club of Salem, chair of the Willamette Academy Advisory Board, and a founder and the past president of the Medical Foundation of Marion and Polk Counties. Ron is frequently quoted in the national press and professional journals.

About Mary Way, CPA, CFP®

Mary Way, CPA, CFP® joined the practice in 1995. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She sits on the Investment Policy Committee of The H Group, Inc., is President of the Willamette Valley Estate Planning Council, and a board member of the Salem Rotary Foundation. She is also active in the Financial Planning Section of the Oregon Society of CPAs.

The opinions expressed in this newsletter are those of Ron Kelemen, CFP® and Mary Way, CPA, CFP®. They do not necessarily reflect those of The H Group, Inc. They are general comments that may not be appropriate for every individual. They should not be construed as legal or tax advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. All economic information is historical and not indicative of future results.

TEAM UPDATE

Well, here we are in the new Waterplace building with new stuff and updated technology. So far, it has exceeded our expectations in terms of productivity, comfort, client parking, and convenience. Of course, getting moved in was something else. Thanks for your patience. If you didn't get a chance to stop by at our open house in March or for the building's grand opening on April 30, please feel free to stop by for a personal tour, no appointment necessary.

Debbie stayed busy providing supplemental information to tax professionals, processing retirement plan contributions, and withdrawals for quarterly tax payments. She and husband Bob traveled to the Grand Canyon, where their son is a helicopter pilot.

Lani kept busy with getting us settled in. Any unanticipated moving-related items fell into her lap. Fortunately there weren't too many of them. She and husband Jim drove to Utah to visit her 91-year old mother, dodging ice storms coming and going.

Mary has been absorbed with new planning cases and updated retirement projections for existing clients. She is taking helping to update the Salem Rotary Foundation's investment policies, procedures, and reporting. She is also wrapping up her year as President of the Willamette Valley Estate Planning Council. She and husband Steve took a quick trip to Las Vegas to catch The Lion King

Ron attended his quarterly Strategic Coach seminar in Chicago and started wrapping his duties as Past President of the Rotary Club of Salem. He buried himself in work-related and civic projects for two weeks while Kathy took her 85-year old mother to Paris, Vienna, and Venice for two weeks. It seemed to him longer than the nearly 32 years they have been married!



Ron Kelemen, CFP®
Mary Way, CFP®, CPA

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

ADDRESS SERVICE REQUESTED

PRSRT STD
U.S. POSTAGE
PAID
SALEM, OR
PERMIT NO. 106

Out-of-Pocket Medical Costs... *Continued from page 1*

Unlike many Americans entering retirement, accumulating the extra \$197,000 for retirement is manageable for most of our readers if they plan for it. **But what about that 5% probability of ending up in the 95th percentile and needing \$311,000?** We're sure you all know people, who for one reason or another, fall into this category. Could it be you? And will you have enough retirement assets to handle it?

And long-term care expenses are an even greater wild card. A 2004 Congressional Budget Office study reported that one-third of individuals turning 65 in 2010 will need at least three months of nursing home care, 24% more than a year, and 9% more than five years. What does that cost? According to a 2008 survey by Prudential, average nursing home costs were \$79,000 for a private room. Alternatively, a home health aid for four hours a day, five days a week costs about \$22,000 per year. What if you need 24/7 care or more skilled care? Now we're talking about real numbers. Granted, your travel budget may have decreased completely, but we have seen clients where just the fear of these kinds of expenses keeps them from fully enjoying retirement when they have their health and energy.

You can either self insure or purchase long-term care insurance to handle the nursing home risk. But at this time at least, your only options for the out-of-pocket costs are to stay healthy and to self insure through disciplined investing today. The table gives you an idea of what it takes. In an age of long-term financial insecurity at the personal and national level, all that you can really depend upon in the future is what you send on ahead.

Annual Investments Required to Accumulate \$300,000 Adjusted for 4% Inflation*

Years to Age 65	\$300,000 @ 4% inflation	Accumulation Method	Amount at 5%	Amount at 8%	Amount at 10%
5	\$364,996	Annual	\$66,055	\$62,216	\$59,785
		Lump Sum	\$285,984	\$248,410	\$226,634
10	\$440,073	Annual	82,889	75,013	27,612
		Lump Sum	270,166	203,839	169,667
15	\$540,283	Annual	25,038	19,898	17,005
		Lump Sum	259,885	170,319	129,339
20	\$657,337	Annual	19,879	14,364	11,476
		Lump Sum	247,947	141,147	97,790

*2008 Congressional Budget Office projection of out-of-pocket inflation-adjusted health care cost increases over next decade, based on past three decades.