MARYLAND COOPERATIVE EXTENSION
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Fact Sheet

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For most people, retirement means the end of regular employment. With adequate planning, your retirement years should be financially secure. You may need to change your financial plan by increasing your income or conserving your assets during these years. Some useful strategies for keeping your finances under control include reducing everyday living expenses, adding income through part-time employment, and using equity in your home. Also you could manage savings and investments and use income tax strategies. You may also decide to extend withdrawals from Individual Retirement Accounts (IRA's) or other tax-deferred accounts. Before thinking about these topics in detail, consider the following reasons for financial planning during retirement.

The Importance of Financial Planning During Retirement

Financial planning during retirement is essential. Because your retirement income probably will come from more than one source, you must know what they are and understand their limitations. Common sources include Social Security benefits, company pensions, income from postretirement employment, and personal savings. If inflation rises to unexpected levels, your income may become inadequate. Now, the Federal government adjusts your Social Security income for inflation each year in January. However, Congress could change these rules. Also, your company pension may not keep pace with inflation. When this happens, you must make up the rest of your retirement income needs with postretirement employment and personal savings. Managing your income carefully will help you maintain your lifestyle during your retirement years.

Ways To Manage Your Finances During Retirement

Reducing Everyday Expenses

Plan your spending carefully during retirement, especially if your assets are few and your income does not increase with inflation. Analyze each item in your budget. Pay special attention to major expenses, such as food, utilities, transportation, clothing, and health care.

Remember that inflation will take its toll on your purchasing power.[1] When prices rise, you will either have to reduce your spending or increase your retirement income. For suggestions on reducing spending, request Fact Sheet 337 "*Retirement Planning—Managing Expenditures*" from your county Extension Service office.

Working During Retirement

Many people who retire start a second worklife either to supplement retirement income or to remain active during their retirement years. Should you decide to work again, consider a business operated from your home. When selecting a business, look for one that requires a small capital investment. You do not want to jeopardize your retirement assets.

A service business may be more appropriate than one involving merchandise. With a service business, you do not need to invest in inventory. You also might consider what you like to do and are good at. There may be a need in your community that you could fill. Use your lifetime experience, profession, talents, and abilities as guidelines. Do you know a trade or have a hobby that you could teach others? If you have always maintained your own home, you might become the neighborhood repairperson. A telephone service to wake up sound sleepers or check on elderly people is another idea. If you live in a historic area, you may be able to be a tour guide. If you like to travel, you could make a business of transporting other people's cars to Florida. Individuals with sewing skills could start a clothing alteration business.

One advantage of these businesses is that you can work as much or as little as you want and on you own schedule. Often the only money you will invest is the cost of a few newspaper advertisements. For information on starting a small business, contact the Small Business Administration. The telephone directory lists the local offices under United States Government. Also be aware there may be local regulations related to home repair businesses and driving cars for others.

If you would rather work for others, consider part-time service jobs in retail stores and offices. Do not overlook the chance of working weekends. If there are no jobs, trade your skills with your neighbors for services you would normally have to pay for. Some communities have nonprofit barter groups to help with the trading of skills. You can get more information on nonprofit barter groups from the National Center For Citizen Involvement, P.O Box 4179, Boulder, CO 80306.

Using Your Home To Increase Income

Your home, if you own it, is a major asset that you can use to increase your income. Some strategies you may want to consider include shared living arrangements, creative financing, or selling your home.

Shared living arrangements. If your home is larger than your needs, and zoning laws allow, consider renting out part of your house. Whether you own or rent your home, you may be able to rent rooms. Also, you could share your home with another person and split expenses. Do you like people? Would you not mind preparing a simple breakfast? If yes, your house might be suitable as a bed and breakfast inn for travelers.

Creative financing. You can use creative financing if you own your home and have considerable equity in it. The first option is a reverse mortgage.

A reverse mortgage is the opposite of a regular mortgage. Instead of making monthly payments, you receive a monthly cash advance or a line-of-credit to draw upon as needed. The size of the payment depends on your age, the value of your home, the prevailing interest rate, and the cost of the loan.

[1] You can calculate the amount of time it will take prices to double by using the Rule of 72. To determine this amount, divide 72 by the inflation rate. If the inflation rate is 4 percent, prices will double in 18 years. Should the inflation rate increase to 8 percent, prices will double in 9 years.

You keep the title to your home. You defer repayment of the loan until you sell your home, die, or leave your home permanently. To get a reverse mortgage, you must be age 62 or older. The cost of starting the mortgage process is $100.

In Maryland, you may choose from two types of reverse mortgages: FHA-insured or private lender. To find the name of a local FHA lender, write the American Association of Retired Persons, Home Equity Information Center, 601 E Street, NW, Washington, DC 20049 or call (202) 434-6466. The private lender is the Household Senior Services, a division of Household Bank, a Federal savings bank in Illinois. The loan is called "Ever Yours." Ever Yours loans in Maryland are processed through Unity Mortgage. Unity Mortgage can be reached at (800) 368-3254.

FHA limits the maximum home value used to determine the equity that you can borrow depending upon the county where you live. The national maximum is currently $151,725. Ever Yours has a limit of $500,000 or higher with lender approval. FHA loans can be received as a lump sum, monthly payments, or a check based on your line-of-credit. When drawing on your line-of-credit, the lender will either mail you a check or deposit the funds directly into your bank account. Ever Yours offers only a line-of-credit, which you access by check or direct deposit to your bank account. Both loans have adjustable rates. The FHA interest rate is based on the 1-year Treasury Bill rate plus 1.6 percent. It has a cap of 2 percent annually or 5 percent over the life of the loan, and the rate is adjusted yearly. The Ever Yours rate is based on the prime rate plus 3 percent. Rates are adjusted monthly. The minimum rate is 8 percent, and the maximum rate is 21 percent.

Ever Yours requires neither insurance nor loan service fees. FHA requires a fee of 2 percent of the maximum home value. This fee is added to the initial loan balance. Additionally, FHA adds one-half of a percent per year that is charged monthly on the outstanding loan balance and a $25 monthly loan service fee. It takes 60 days for FHA lenders to process a loan and 30 days for Ever Yours.

When you set-up a credit line with the FHA plan, your credit line grows in value every month. The Ever Yours credit line does not grow. Both reverse mortgages never require payment of more than the amount loaned plus interest or the value of the house, whichever is greater.

The FHA plan requires extensive counseling from an independent FHA-certified housing specialist. Ever Yours requires counseling by a "counselor" who works for the lender. Since this counselor works for the lender, consider taking a relative or friend who can help you think through all the questions you might have about the loan.

A second creative financing option is a sale leaseback. It, too, allows you to live in your home. You sell your home to an investor at a price that is 15 to 30 percent under its current market value. In return you receive a cash payment of 10 percent of the purchase price and monthly payments for 10 to 15 years. You then negotiate the rental price you will pay to live in the house. The buyer takes care of taxes, insurance, and maintenance costs. The buyer also will buy an annuity for you that will continue payments after the buyer's payments have ceased.

A final option, if you want to stay in your home, is to give your home to your adult children. They will take over the expenses. Since you continue to live in your home, your children may be able to take a tax deduction for your support. However, should your children die before you do, you may lose your home. The law does not require your children to will your home back to you.

Selling your home. This becomes a workable strategy when you decide your home is too large and requires more care than you can provide. When you sell, you may receive a tax break on the profits. You must be over 55 years old and have lived in the house 3 of the past 5 years. You will be able to exclude for income tax purposes up to $125,000 of capital gains or profits. This is a once-in-a-lifetime exclusion. Married couples can only use this exclusion once. Widows and widowers who plan to marry and who both own houses should sell both houses before they marry. This allows both to get this exclusion for each house. Upon remarriage, the exclusion is only available if neither of you have used it before.

Your home is one asset that you can use to increase your income in retirement. However, it is probably not the only asset you control. Your savings and investments also are available for use as income. Savings and investments require careful management to maintain their purchasing power throughout your retirement.

Managing Savings and Investments

Those approaching, entering, or living in retirement often think they must shift completely from growth-oriented investments to income-oriented investments. However, the balance between the two depends on the size of your nestegg, your ability to manage money, and your interest in managing money. Also consider your personal preferences and your risk tolerance. Finally, think about your investment and estate goals, and your estimate of how much inflation will rise during your retirement years. You must realize that the purpose of keeping a portion of your investments in growth-oriented investments is to keep pace with inflation. Keep in mind that is better to suffer a loss of return than a loss of principal.

Experts make a wide variety of recommendations on how to structure investments in retirement to protect purchasing power. For safety, most recommend that you keep a major portion of assets in the following assets. These include certificates of deposit, money market funds, intermediate-term bonds, and bond mutual funds. However, experts also recommend a maximum growth-oriented limit of 40 percent of assets for retirees age 55 to 74. The maximum decreases to 30 percent of assets for retirees age 75 and older. Your limits may be lower or even zero.

Savings. Your Federal income tax bracket affects the amount of earnings from savings and investments that you will keep. If you are in the lowest tax bracket, earnings do not have to exceed inflation by much for you to break even. With a 4 percent inflation rate and a 28 percent tax bracket rate, you need a 5.5 percent earnings rate to stay even. Next add the effect of Maryland State and local taxes, which in 1995 range from 7.5 percent to 8 percent in most Maryland counties. The interest rate needed is 6.2 percent at the 7.5 percent tax rate.[2]

If you are comfortable earning interest only, you might consider certificates of deposit, money market funds, savings bonds, Treasury bills, and Treasury notes. Other choices include municipal bonds[3], Ginnie Mae certificates, and bond mutual funds. How much you earn on these forms of savings will depend on interest rates. When interest rates are rising or look like they are as low as they will go, be sure to keep the length of your investment short. When inter-

[2] To calculate the minimum return needed to stay even with taxes and inflation, use the following formula:

$$\frac{\text{Inflation Rate}}{100 - \text{Tax Bracket Rate}} = \text{Rate of return}$$

Use just your Federal Tax Bracket Rate if no State and local taxes are payable, such as for Series EE Bonds. Use the combined Federal, State, and local rate for other investments where Maryland taxes the total return.

[3] A tax-free municipal bond provides a higher net return when the equivalent tax-free rate is greater than the equivalent taxable bond rate. For example, a tax-free bond rate of 5 percent is equivalent to taxable bond rate of 7.75 percent when the combined Federal (28 percent), State (5 percent), and local (2.5 percent) rates are 35.5 percent. To find the equivalent rates use the following formula:

$$\frac{\text{Tax-exempt yield}}{100 - (\text{Federal} + \text{State} + \text{local tax rate})} = \text{Equivalent taxable yield}$$

Following the above example:

$$\frac{5}{100 - (28 + 5 + 2.5)} = 7.75$$

est rates start to fall, reverse your strategy to lock in the higher rates.

Investments. The first step in selecting investments during your retirement years is to determine the percentage of your funds that you will keep in growth investments. Once you establish these limits, you can select specific mutual funds and stocks. Your choices should both appreciate in value and earn income. Mutual funds are useful if you have no experience in investing in the stock market or if you do not want to manage a portfolio of individual stocks.

The most appropriate types of mutual funds for retirees emphasize income with growth as a secondary consideration. Growth-oriented funds that are appropriate for retirees include growth and income funds, income funds, and balanced funds. Growth and income funds have in their portfolios stocks of mature companies. The companies have a history of paying high dividends and have the potential to increase in value. Income funds have high-yielding stocks, bonds, and money markets to get the highest possible income. Balanced funds keep 20 to 50 percent of their assets in bonds and the remainder in stocks. Be sure to check the prospectus for the goals of these funds, which can vary from high income to growth and income to growth. For more information on mutual funds, request Fact Sheet 656 "*Mutual Funds*" from your county Extension Service office.

If you already own a portfolio of stocks, you may want to reduce your exposure to risk by changing your holdings. Reduce the number of stocks in primarily growth-oriented industries. Increase the number of stocks in industries that do not vary much from one business cycle to another. These industries include food, pharmaceuticals, utilities, and health care products. Search for income-oriented stocks that have a history of increasing dividends. For more information on savings and investment, request Fact Sheet 422 "*Understanding Savings and Investments*" from your county Extension Service office.

Managing Income Taxes

Depending on your age, there may be some adjustments you can make to reduce your Federal, State, and local income taxes. There is a tax credit for the elderly. To use this credit, you must have limited income (including Social Security benefits). Also, you must be 65 years old by the end of the tax year.

Taxpayers who are over age 65 or blind may receive an additional standard deduction. The deduction is available to taxpayers who do not itemize. Married taxpayers receive an additional deduction of $650 each and single taxpayers receive a deduction of $850. If the taxpayer is both over 65 and blind, the deduction doubles. You add the additional deduction to the standard deduction. Check your income tax instruction book for the current regular standard deduction limits. These limits change each year.

Starting in 1984, the percentage of Social Security benefits subject to income taxes becomes a two-tier system with up to 85 percent of benefits taxable for higher income retirees. Those in Tier 1 who are single with a base income of more than $25,000 annually and married couples with a base income of more than $32,000 will pay taxes on up to 50 percent of their Social Security income. Base income includes your adjusted gross income, your income from tax-free investments, such as municipal bonds and other items identified in the current Internal Revenue Service (IRS) instruction book, and one-half of your Social Security benefits. Tax payers in Tier II will pay taxes on up to 85 percent of their “adjusted base amount” when the amount is greater than $34,000 for single taxpayers and $44,000 for taxpayers who file jointly. The computations are lengthy. Consult your IRS Form 1040 instruction book for details on how to compute these taxes.

Making Required Withdrawals From Tax-Deferred Retirement Plans

Your nest egg invested in tax-sheltered plans continues to grow tax-deferred until you withdraw the funds. Tax-sheltered plans include IRA's, Keogh Plans, 401(k) plans, 403(b) plans, and 457 plans. It is a good idea to maintain these accounts for as long as possible to take advantage of tax-deferred compounding. Also, you avoid paying the taxes on withdrawls. Once you turn 59 1/2, you are able to withdraw these funds without penalty. However, on April 1 the year after you reach 70 1/2, you must start withdrawing a portion of your tax-sheltered funds. For example, if your 70th birthday is February 15, 1993, you will not have to make your first required withdrawal until April 1, 1994. You must complete the second and each remaining withdrawal by December 31 of each year. This means that if you wait until April 1 of the first year, you must make the second withdrawal within the same calendar year. At age 70 1/2, you must withdraw an amount equal to your life expectancy or to the joint life expectancy of you and your spouse. By using a joint life expectancy you reduce the amount you must withdraw.

Individual life expectancies from ages 70 to 90 are shown in Table 1.

Table 1 shows what happens on April 1 after the year a person turns 70 1/2. The law requires that he or she withdraw 1/15.3 or 6.5 percent of assets from an IRA or other tax-deferred fund.

Table 2 is a partial table of joint life expectancies. It is based on the comparative ages of the spouses. You can find a complete table in IRS Publication 939 *Individual Retirement Arrangements.* A joint life expectancy is longer than a single life expectancy. Two individuals born in different years usually do not die in the same year.

If you are single, a widow, or a widower, you can name a younger person as a beneficiary. However, the law requires that you withdraw at least one-half of the amount required as a single individual. You must do this even when you use the joint life expectancy rule. Failure to withdraw the correct amount in either case requires a penalty payment to the IRS. The penalty is 50 percent of the required withdrawal left in the account. To further extend the number of years of withdrawal, you may recalculate your life expectancy each year. Recalculating extends the number of years you can make withdrawals. The longer you live, the longer you can expect to live. If you look closely at Table 1, you will notice that you do not lose a year of life expectancy for each additional year you live.

Table 1. IRS life expectancies for single individuals

Age	Life expectancy (years)
70	16.0
71	15.3
72	14.6
73	13.9
74	13.2
75	12.5
76	11.9
77	11.2
78	10.6
79	10.0
80	9.5
81	8.9
82	8.4
83	7.9
84	7.4
85	6.9
86	6.5
87	6.1
88	5.7
89	5.3
90	5.0

Distributions after your death. If distributions from your IRA have begun before you die, they must continue going to your beneficiary as rapidly as under the method you were using before your death. If your death occurs before distributions have begun, your spouse may roll over your account into his or her account. Your spouse can begin withdrawals as early as age 59 1/2 or as late as April 1 of the year he or she reaches 70 1/2. Alternately, your spouse may leave the account in your name. Your survivor can avoid

Table 2. IRS joint life expectancies

Your age	Your beneficiary's age									
	65	66	67	68	69	70	71	72	73	74
70	23.1	22.5	22.0	21.5	21.1	20.6	20.2	19.8	19.4	19.1
71	22.8	22.2	21.7	21.2	20.7	20.2	19.8	19.4	19.0	18.6
72	22.5	21.9	21.3	20.8	20.3	19.8	19.4	18.9	18.5	18.2
73	22.2	21.6	21.0	20.5	20.0	19.4	19.0	18.5	18.1	17.7
74	22.0	21.4	20.8	20.2	19.6	19.1	18.6	18.2	17.7	17.3
75	21.8	21.1	20.5	19.9	19.3	18.8	18.3	17.8	17.3	16.9
76	21.6	20.9	20.3	19.7	19.1	18.5	18.0	17.5	17.0	16.5
77	21.4	20.7	20.1	19.4	18.8	18.3	17.7	17.2	16.7	16.2
78	21.2	20.5	19.9	19.2	18.6	18.0	17.5	16.9	16.4	15.9
79	21.1	20.4	19.7	19.0	18.4	17.8	17.2	16.7	16.1	15.6
80	21.0	20.2	19.5	18.9	18.2	17.6	17.0	16.4	15.9	15.4

withdrawal penalties by making withdrawals matched to your age (59 1/2 or 70 1/2). If your beneficiary is not your spouse, your beneficiary must remove the remaining assets from the account within 5 years. If withdrawals start within 1 year, your beneficiary must distribute the account over the beneficiary's life expectancy.

Concluding Thoughts

Chances are the economy will not stay the same throughout your retirement years. As economic conditions change, you will need to reevaluate the yield earned on your assets. So during retirement, you must manage your financial affairs. Eventually, you may need to spend some of your remaining principal to maintain your lifestyle. You can determine the number of years your savings will last. To do so, you must assume a specific interest rate and withdraw a specific percentage of your total savings each year. Consult Table 3. For example, if your savings and investments earn an annual return of 8 percent and you withdraw 10 percent per year, then your savings will last 21 years. If you only withdraw 8 percent of your savings each year, you will never deplete your fund because you will be living on the interest only. If you plan to withdraw interest to cover living expenses, remember you pay taxes on your earnings.

In addition to thinking about the management of your finances, take a look at the rest of your lifestyle. Keeping mentally and physically active will help you get more enjoyment from your retirement years.

Tips for Remaining Financially Secure During Retirement

1. Carefully investigate climate, shopping, and health care facilities, recreational opportunities and other community services if you are considering a change of location.
2. Be cautious when investing in a business that reduces your savings. The failure rate of small businesses is high.
3. Diversify your savings and investments so they will earn income and increase in value.
4. Spend some of your principal as you age. If the members of your family live exceptionally long, add 5 years to your life expectancy to determine the rate for spending your assets.
5. Ignore money-making schemes that appear too good to be true; they usually are.
6. Manage your family finances jointly with your spouse.

Table 3. Number of years to deplete principal and interest

Annual rate of return	Percentage of savings withdrawn													
	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%
1%	69	40	28	22	18	15	13	11	10	9	8	7	6	5
2%		55	35	25	20	16	14	12	11	10	8	8	7	6
3%			46	30	23	18	15	13	12	10	10	9	9	8
4%				41	28	21	17	14	13	11	10	9	9	8
5%					36	25	20	16	14	12	11	10	10	9
6%						34	24	18	15	13	12	10	9	9
7%							31	22	17	15	13	11	10	9
8%								29	21	16	14	12	11	10
9%									27	20	16	13	12	10
10%										26	19	15	13	11
11%	Forever										24	18	14	12
12%												23	17	14
13%													22	16
14%														21

7. Realize that you may no longer need life insurance.
8. Extend the life of your assets by spending prudently.
   a. Be wary of unsolicited telephone calls offering vitamins, travel services, water purifiers, magazine subscriptions, promises to fix your credit history, and free vacation trips. Unethical salespeople often victimize older consumers.
   b. Ask about senior citizen discounts when you shop.
   c. Take advantage of special sales for the products you use.
   d. Buy only one Medigap policy. Keep the old policy if benefits are good. Shop for the best price and a well-known company when buying a new policy.
9. Shop and travel during the day when most people are working.
10. Update your estate plan, will and letter of last instructions.

Note: Tax laws discussed in this fact sheet are current as of December 1994.

References and Further Reading

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P93/V95