Baby brings new financial responsibilities: Education, retirement are tops

Money Manager/by Karin Price Mueller/ www.businesstoday.com

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Problem

Having a baby throws dozens of new, strong emotions your way. Among them are joy, wonder and more than a little bit of worry.

That's what's facing Frank and Anna, a couple who have been financially confident in the past. Now that 8-month-old Jordan is in the picture, the couple has asked the Herald to help make sure their money priorities are still on track.

``We just want to double-check,'' says Frank, 30, an engineer. ``We started putting money away for him every month.''

College funding is one of their long-term goals. By the time Jordan is ready for higher education in 17 or 18 years, Frank and Anna hope they will have saved enough to foot most of, or all of, the bill. To get there, they've opened a 529 Plan through Fidelity Investments. They contribute $50 per month to the plan, which has a balance of $300.

In the next couple of years, the couple plans to have at least one more child. Even though baby No. 2 isn't here yet, they fret about funding his or her future education, too.

The other big goal is retirement.

``We just want to be able to maintain the lifestyle we have now,'' Frank says. ``We hope everything will be paid off and that we'll have enough money.''

The couple is saving steadily for their golden years. Anna, 31, a government employee, earns $53,500 a year and saves $300 a month to her 457 Plan. The plan, which has a balance of $3,000, is split evenly between Fidelity Aggressive Growth and Aetna S&P.

Anna has another $6,000 in a 457 Plan from her former employer. The account is invested entirely in Janus S&P.

She also has an individual retirement account worth $3,500. It's also invested in the Janus S&P Fund.

Frank, too, contributes to his employer-sponsored retirement plan. He saves 15 percent of his $44,000 salary to the plan, and he gets an employer match of 25 percent. The account is worth $18,000 and is also invested in Janus S&P.

In non-retirement accounts, the couple holds $700 worth of T. Rowe Price Science and Technology, and has the rest of their holdings in cash investments.

They have $200 in a jointly held money market fund. Anna has $3,000 in her savings account, and $6,000 in a Morgan Stanley money market. Frank has $2,500 in his savings account and $9,700 in his Morgan Stanley money market.

As they try to accumulate assets, Frank and Anna have managed to keep their debt in check. They owe $106,316 on their Boston-area home.

They also own an investment property in Pennsylvania, on which they owe $28,000. The property basically breaks even each year.

They earn $475 a month from rent, but expenses are rising, and the couple is considering selling the property to look for a more profitable real estate opportunity.

Frank and Anna have no credit card debt or car loans. Frank does have a 401(k) loan with a balance of $11,000, which he took out to pay off a car loan.

``The market wasn't doing well so I figured I'd do better to pay myself back, and at the same time, clearing out a debt,'' Frank says.

Solution

Family on its way to fulfilling goals

Frank and Anna are on their way to reaching their financial goals, thanks to their disciplined savings strategies and their concern about the future. They just need a little tweaking to make sure they maximize their savings efforts.

``One of the things that impressed me the most is they keep their fixed expenses very low,'' said Jennifer Harney, a certified financial planner and financial representative of Baystate Financial Services in Marlboro and a registered representative of New England Securities. ``For a young couple, I'm very proud of what they're doing.''

If the couple continues to save as they are today, Harney, a member of the Financial Planning Association, said Frank and Anna will be able to save for college for their son and fund a healthy retirement. Their reasonable fixed expenses today gives them a surplus of about $10,000 a year, which they can put toward their long-term savings goals.

Harney said the couple hopes to retire at age 65 - more than 30 years from now. Assuming that they will live to age 90, Harney said the couple needs about $3.6 million to pay for today's lifestyle through their golden years, assuming an inflation rate of 4 percent.

Helping to foot the bill will be Social Security and Anna's pension, which together will fund about $1.1 million of their needs. That leaves $2.5 million they need to accumulate. If they continue to make their current retirement contributions, they will have $4.4 million of assets available to them at age 65, creating a surplus of $1.9 million, Harney said.

In addition to contributing to their retirement plans at work, because they have a surplus of cash after they pay the bills, they should each consider an individual retirement account, Harney said. The limit for 2001 is $2,000 per individual, and that amount has increased this year to $3,000.

Harney said the couple's asset allocation needs some work. Almost all of their retirement assets are invested in large-cap, U.S. index funds.

``They need to diversify more,'' Harney said.

An aggressive growth portfolio that would maximize capital appreciation potential would best suit their investment objective, Harney said. She recommended they reduce their U.S. large-cap exposure so their investments look more like this: 28 percent U.S. value stocks, 18 percent U.S. growth stocks, 18 percent small-cap stocks, 26 percent international investments, 5 percent U.S. government bonds and 5 percent in a money market fund.

As for college planning, Harney said it's great that the couple has already started regular contributions to a 529 Plan for their child. The 529 allows assets to grow tax-deferred, and under new law, distributions from

529s are tax-free as well. With their extra discretionary cash each month, they can afford to up their savings to $200 per month, earmarking the money for college.

``They could easily afford to fully achieve their college savings plan, which is to pay for their son to go to a four-year public university,'' Harney said.

The couple's near-term goals are also on track. The couple has saved about five months' worth of expenses as an emergency fund. This money is readily available in money market savings accounts. Normally, people should keep between three and six months of expenses on the sidelines in case of emergencies. Harney believed Frank and Anna need a full six months because of their investment property, which creates additional risk. In order to protect themselves against their tenant's potential cash flow problems or unexpected home improvements, they should boost their emergency fund by another $5,000.

On the insurance side, Frank and Anna both have disability insurance plans paid for by their employers, which would replace 60 percent of their income upon disability. They should boost that number to 80 percent of income if possible, because the 60 percent will leave them with a $2,000 monthly shortfall in paying for their expenses, Harney said. And she recommends one important change:

``They should look into paying for the policies themselves,'' she said. ``If the employer pays the premiums the benefit is taxable, but if they pay for it the money will come to them tax-free.''

The couple should also buy some additional term life insurance. If one of them dies, the surviving family members will be able to continue their standard of living. They each have coverage of $250,000 today. Based on their income levels, Harney said Anna needs another $350,000 and Frank needs $137,000 more.

``I think they'll do very well,'' Harney said. ``They're successful people who really care about their family. They've already started the planning process by identifying what's important to them. A lot of people their age don't want to think about long-term goals yet.''