

Credit-card debt may take comfort out of retirement

Money Manager/by Karin Price Mueller- www.businessstoday.com

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Problem

Al and Darlene dream of a retirement filled with visits with their grandchildren - who live in other states - and games of golf.

The Cape Cod couple, whose names have been changed for publication, came to the Herald to figure out if they could maintain their current standard of living during their retirement years together - which will begin in about a year, when Darlene, 64, leaves her job as an executive assistant.

"Retirement is so close by," she says. "I want to have something for retirement and to pay down our debt before then."

Al and Darlene have been married for 10 years - this is the second marriage for both. The couple got together shortly after Al retired from his job in the printing industry - timing that will affect their financial plans.

Al, 75, receives annual income of \$40,000 from Social Security and a company pension. When he chose his pension distribution options, he and Darlene weren't married, so he didn't choose a payment option that would give Darlene any income in the event Al passes away.

So Darlene also has to consider her financial situation should she live longer than her husband.

She contributes 15 percent of her \$46,200 annual salary to her employer-sponsored 401(k) plan. Her employer matches another 6 percent.

Worth \$110,000, Darlene's 401(k) is invested in mutual funds managed by her company, and they're not available to the general public. Seventy percent of the account is in fixed income and 30 percent is in employer stock.

Darlene isn't sure what she should do with the account when she retires.

"I want the 401(k) in something that's going to generate income, but we can't afford to lose what we have," she says, wondering if the current allocation is the best to help the couple reach their future goals.

The couple also owns \$3,350 worth of Darlene's company stock in a separate brokerage account. They have \$9,880 in a non-retirement mutual fund account, invested in Fidelity Advisor High Yield Growth.

In liquid accounts, Al and Darlene have \$2,500 in a money market fund, \$1,000 in a certificate of deposit and \$1,600 in a checking account.

"I don't feel like we've saved enough," Darlene says. "Prices for goods continue to go up astronomically and once you're retired, your income doesn't go up much."

So while Darlene and Al are worried about having enough income in retirement, they know their high-interest credit-card debt is adding to their financial challenge.

The couple has some \$18,000 in debt spread among four credit cards. Much of the debt was accumulated when they made large purchases, such as appliances and a Bose radio Al purchased for more than \$1,000.

They've been actively trying to pay down the debt, using about \$500 of their cash flow each month towards the cards. They'd like to be free of credit-card debt by the time Darlene retires, but they don't have that kind of cash in the bank.

In addition to the credit-card debt, they pay mortgage, taxes and insurance of \$822 each month, and another \$379 per month toward a car payment.

SOLUTION

Eliminate credit-card debt by using home-equity loan

Al and Darlene are on track to have a comfortable retirement without making too many changes to their lifestyle, as long as they rid themselves of their high-interest credit-card debt.

“They'll have enough income from Social Security and Al's pension to meet their retirement cash flow needs, without dipping into retirement accounts,” says **Chris Dalto**, a certified financial planner with Delessert Financial Services in Newton. “And that assumes their expenses stay the same.”

Dalto says the couple's after-tax income from Al's pension and both spouses' Social Security will be approximately \$3,900 a month. Today, the couple's expenses are just under that amount, so Darlene and Al should be able to live within their means.

Dalto says their cash-flow situation should be even better in retirement because their post-retirement expenses should go down. For example, Darlene will no longer have to spend \$190 a month to commute, and their taxes should decline substantially.

Their other expenses won't change much, Dalto says. The couple pays \$378 a month for utilities and telephone service, \$612 a month for groceries and dining out, \$265 a month for personal care items, \$115 a month for entertainment and \$130 a month for lawn service and snow plowing.

The couple's rosy future doesn't mean there isn't action to take, he says. The first step is to eliminate the \$18,000 of credit-card debt that's hanging over their heads.

Instead of continuing to pay \$500 a month toward that debt, Dalto suggests another strategy. He says the couple could take out a home-equity loan to immediately pay down the debt, and at the same time, they'd increase their cash flow.

At an interest rate of 7 percent, Dalto calculates a five-year home-equity loan would cost Al and Darlene \$357 a month - a monthly savings of \$143, or \$8,580 in interest payments over the life of the loan. Plus, the couple could save about \$1,000 in taxes over the life of the loan by deducting the interest.

As much as Darlene and Al would like to be debt-free at the start of Darlene's retirement, Dalto says it doesn't make financial sense for the couple to withdraw funds from their retirement accounts to pay off the debt. There could be negative tax implications, and they'd have to sacrifice the potential growth of their investments.

Once the couple gets on a debt-reduction plan, Dalto says they should turn their attention to Darlene's 401(k) plan. When she retires, Dalto suggests Darlene roll over the funds in her 401(k) to an individual retirement account at a discount brokerage, such as Charles Schwab, Fidelity or Vanguard.

First, Darlene needs to reallocate the 30 percent of the account that's in her company's stock.

“Thirty percent is too much in one stock,” he says. “Anything can happen to one company from problems with the CEO to a product being pulled off the market.”

Instead, he'd like to see the couple change their exposure so that the stock doesn't exceed 10 percent of their assets.

To make sure the account is well-diversified, Dalto says Darlene should reallocate the funds so that 50 percent is invested in fixed income and cash and 50 percent is in equities to give the portfolio growth.

“I'd like to see her have 80 percent of the equity portion of the portfolio in a large index fund, such as one that tracks the Standard & Poor's 500 or the Wilshire 5000,” Dalto says. “It keeps expenses lower and there's not a lot of thinking to do.”

The remaining 20 percent of the equity investment should be invested in a large-cap value fund, such as Selected American, which has a 10-year return averaging 14.41 percent, and expenses of .92 percent a year, according to Morningstar.com.

Even though the couple is a little hesitant to put a lot of money in the stock market, Dalto says the couple needs to make sure their money grows to keep up with inflation.

The fixed-income portion of the portfolio should be invested in an intermediate term corporate bond fund, such as Harbor Bond Fund, he suggests. The fund has a 10-year average return of 8.49 percent, with annual expenses of .60 percent, according to Morningstar.com.

“They should be able to let those funds grow without having to dip in at all for retirement because the pension and Social Security will cover expenses,” he says. “It's an outstanding position to be in.”