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FOCUS ON FINANCIAL FREEDOM® **FALL 2009**

How Will You Deal with Long-Term-Care Costs?

Life expectancies have increased significantly and are expected to continue to increase in the future. As people age, however, they are more likely to develop conditions that limit their ability to live independently. Thus, as life expectancies increase, so does the need to make provisions for long-term-care costs. If you are wondering how likely it is that you will need to deal with long-term-care costs, consider the following:

- Almost 70% of those who are currently age 65 will require long-term care before they die. Care will be needed for an average of three years, with 20% requiring care for five years or more (Source: Center for Retirement Research, April 2007).
- Currently, the average annual cost for home care service is $34,000 and for a private room in a nursing home is $75,000 (Source: Center for Retirement Research, April 2007).
- Approximately half of private-pay nursing home patients run out of funds during their stay and must then use Medicaid funding (Source: Center for Retirement Research, April 2007).
- Almost 72% of nursing home patients are women (Source: *Financial Planning*, April 2007).
- In 2006, approximately 20% of applications for long-term-care insurance from individuals age 60 to 69 were declined, while 42% of those age 70 to 79 were declined (Source: *Financial Planning*, April 2007).

What Are Your Options?

Health insurance policies typically don't pay for nursing home care, while Medicare only pays for 100 days of skilled nursing home care, if admission follows a hospital stay. Medicaid pays a significant portion of all nursing home costs, but the government has enacted tougher rules to qualify for assistance. Typically, you need to deplete most of your assets before you qualify for assistance.

Many elderly individuals rely on family members for help, but the personal toll can be huge. Currently, long-term-care insurance pays a small percentage of all long-term-care costs. That percentage may increase in the future as more people become aware of the risks of long-term-care costs and look to insurance as a way to fund those costs.

In 2005, Medicaid paid 49% of all long-term-care costs, Medicare paid 20%, individuals paid 18%, and private insurance paid 7% (Source: Center for Retirement Research, April 2007).

Do you need long-term-care insurance? If your assets, not including your home, equal at least $2 million, you can probably fund long-term-care costs with those assets, although you may not want to deplete your assets for this care. Those with very few assets will probably be covered by Medicaid. It is the people between these two extremes who should consider long-term-care insurance. This coverage may be especially important for women, who tend to outlive their husbands.

What Should You Consider?

If you're thinking about purchasing long-term-care insurance, consider these points:

- **Purchase at a relatively young age.** You should probably purchase the insurance by the time you are in your late 50s or early 60s. After that, the premiums get

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Building Your Financial Home

A home purchase is one of many difficult financial decisions you may have faced over the years. For most, the home search begins with a vision of your ideal home. As homes are considered, the distinction between "needs" and "wants" inevitably becomes clearer. In some cases, expectations may need to be adjusted, as the gap between the price of the ideal home and budget becomes more apparent. The process is daunting but still exciting.

Financial planning also begins with a vision. Hopes and dreams for your future provide a framework for establishing goals — much like the home-buying decision. Goals become the foundation for a financial strategy that takes into account personal values, lifestyle, family relationships, health, and financial condition. The potential impact of the stock market and tax and estate laws are taken into account. Your "needs" and "wants" are defined, and priorities are established. A financial plan provides both clarity and direction.

The world is growing ever more complicated. Working with a financial planner may provide a valuable perspective to assist you with your financial decision making. A CFP® professional has the training required to consider the range of factors that may impact your circumstances — investments, taxation, estate planning, and risk management.

Someone once said, "I look to the future, because that is where I am going to spend the rest of my life." A financial planner may be your best ally in building your financial "home" for the years ahead.

Charlene K. Dolan

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Long-Term-Care Costs

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much more expensive. You also run the risk that you could develop a serious health condition that would prevent you from purchasing the insurance. On the other hand, don't purchase the insurance too soon, or you could end up paying premiums for decades.

- **Check for inflation provisions.** Since you may not receive benefits for many years, and long-term-care costs have increased significantly in recent years, make sure your policy has inflation "protection. You can obtain simple or compound inflation protection. Simple protection increases the benefit amount by a specific percentage of the original benefit each year. Compound inflation increases the benefit on a compounded basis, so it provides substantially more protection.
- **Select an appropriate benefit period.** Many people choose a benefit period of three years, to cover the average nursing home stay. However, due to the substantial costs associated with long-term care, you may want to select a longer period. Lifetime coverage, however, probably isn't necessary. Only 1.5% of policyholders with five years of coverage exhausted their benefits (Source: *Financial Planning*, April 2007). Look for a provision where the insurer continues to pay benefits if you haven't reached the policy limit during the maximum benefit period. For instance, if your policy pays a maximum of $200 daily for three years, but you only use $150, the company would continue to pay benefits until you reached the policy limit.
- **Make sure the policy terms are reasonable.** Benefits should be paid in as many situations as possible, including skilled care, intermediate care, custodial care, home health care, and adult day care. Many people prefer to remain at home as long as possible, so make sure the policy covers a wide range of home services. Review the waiting period carefully to ensure a good balance between premium costs and out-of-pocket costs.
- **Understand the level of assistance needed to qualify for benefits.** Typically, benefits are paid when you are unable to perform two of five activities of daily living, including bathing, eating, using the bathroom, moving back and forth from a chair to a bed, and remaining continent. Typically, benefits are also triggered when a cognitive impairment, such as Alzheimer's disease, requires substantial supervision.
- **Determine how benefits are paid.** Some policies pay a set daily amount, regardless of your actual costs. This may be a good alternative if you are staying at home and want to compensate a friend or family member for helping you. Other policies will only pay your actual out-of-pocket expenses up to a daily limit or may only pay reasonable and customary costs. Find out how you prove that you're entitled to benefits. Some plans require an in-house doctor to review your health, while other plans allow your own doctor's review.
- **Review new policy provisions.** Long-term-care policies are relatively new, so policy riders are evolving. Make sure to check out new provisions, such as the ability to combine a life insurance and long-term-care policy, an accelerated premium provision that allows you to stop making premiums after a certain number of years, or a provision that returns premiums if you die without using benefits. Also look into partnership policies, which allow you to qualify for Medicaid after exhausting the policy's benefit, while keeping more assets than normally allowed by Medicaid.
- **Consider sharing a policy with your spouse.** Some companies now offer policies that allow spouses to share policy benefits, which can operate in several ways. Spouses may take out separate policies, with a rider allowing them to use each other's unused benefits. Another alternative is to purchase one policy that both spouses can use. A third alternative gives each spouse a specified amount of benefits plus a third amount that can be drawn on by each spouse. However, be sure that one spouse doesn't use all the benefits, leaving the other spouse with no benefits.
- **Check the policy's tax status.** A qualified policy allows you to deduct a certain percentage of the premium, depending on your age, as a medical expense on your tax return. Medical expenses are deductible to the extent they exceed 7.5% of your adjusted gross income.

Please call if you'd like to discuss your options for dealing with long-term-care costs. ❍❍❍

Will You Be Able to Work Longer?

Retiring at age 65 without working for the rest of your life is starting to look like a difficult proposition. It was already challenging due to longer life expectancies, uncertain Social Security benefits, declining pension benefits, unknown inflation rates, and low retirement savings. Then, most people's retirement savings decreased significantly over the past couple of years due to declining investment values and lower home prices. The prospect of funding a retirement that could span 30 years is looking very tough. The most common solution to the problem is to work longer than the current average retirement age of 63.

Today's workers are typically healthier and working at less physically demanding jobs than workers in prior generations, which makes working longer seem like an easy solution. But there are a number of factors that might not make that possible. First, approximately 15% to 20% of workers will not be healthy enough to remain in the work force longer (Source: Center for Retirement Research, September 2008). Second, since reduced Social Security benefits are available at age 62, a majority of workers claim benefits as soon as they are available. Finally, a significant portion of older workers no longer work for the same employer from middle age to retirement age.

A recent study looked at the percentage of men between the ages of 58 and 62 who were working for the same employer they had at age 50. In 1983, 75% of full-time male workers worked at the same employer, compared to only 50% in 2006 (Source: Center for Retirement Research, September 2008). These results were consistent across all educational levels. If workers are leaving voluntarily, they are probably moving to better jobs with better pay, which should mean they will stay employed longer. If workers are laid off or forced out of their jobs in their 50s or 60s, they are likely to take inferior jobs at lower pay, which may mean they are less likely to stay employed into their late 60s.

While it is difficult to determine why workers changed jobs, the wages of workers who switched jobs were approximately 75% of the wages of those with the same employer (Source: Center for Retirement Research, September 2008). Another study found that workers who left their jobs between the ages of 51 and 65 with at least 10 years of tenure did so due to retirement, layoffs, and voluntary and involuntary quits, with each factor accounting for one-third of the total (Source: Center for Retirement Research, September 2008). ❍❍❍

Thus, while it is frequently suggested that workers should work longer before retiring, there are complicating factors that might make that difficult for all workers. Please call if you'd like to discuss this topic in more detail. ❍❍❍

Develop a Tax-Planning Mentality

Many people confuse tax planning with tax preparation and only think about the subject when preparing their annual tax return. However, there is little you can do to actually lower your bill when preparing your return. If your goal is to reduce income taxes, you need to be aware of tax-planning opportunities throughout the year.

Take time early in the year, perhaps as part of the tax preparation process, to assess your tax situation, looking for ways to reduce your tax bill. During the year, consider the tax consequences before making important financial decisions. This will prevent you from finding out later that there was a better way to handle the transaction for tax purposes. Look at your tax situation again in the fall, which gives you plenty of time before year-end to implement any additional tax-planning strategies.

There are basically three strategies that can help reduce your income tax bill:

❍ **Reduce or eliminate taxes.** The objective is to receive income in a nontaxable form or to find additional tax deductions, exemptions, or credits. For instance, you might want to consider municipal bonds, whose interest income is generally not subject to federal, and sometimes state and local, income taxes. Or investigate investments that generate capital gains, such as growth stocks. Gains are not taxed until you actually sell the investment, and if held for over one year, capital gains are subject to the 15% capital gains tax (0% for individuals in the 10% or 15% tax bracket). If you have realized capital gains, you might want to offset those gains by selling investments with losses.

❍ **Postpone the payment of income taxes until sometime in the future.** By postponing tax payment, your earnings compound on the entire balance, including the portion that will eventually be paid in taxes. You may also be in a lower tax bracket when taxes are paid. As an example, contribute as much as possible to retirement accounts, including employer plans and individual retirement accounts (IRAs).

❍ **Shift the tax burden to another individual.** The objective of this technique is to transfer assets to other individuals so that any income on those assets becomes taxable to those individuals. Typically, however, you have to give up control of the asset. For instance, annually you can give tax-free gifts, up to $13,000 in 2009 ($26,000 if the gift is split with your spouse), to any number of individuals. Any future income generated on those gifts then becomes taxable to those individuals. You may also want to use your lifetime gift tax exclusion of up to $1,000,000 to make larger gifts. ❍❍❍

Segregating Your Goals

Your willingness to assume risk with your investments is not necessarily a static concept. You may be less willing to take risk with investments designated for an essential financial goal, while you may be more willing to take risk for nonessential goals. However, those varying risk levels may be difficult to assess if all your investments are commingled into one account.

For instance, assume you have three goals — to ensure you have enough funds to support yourself through retirement, to send your child to an Ivy-league college, and to purchase a vacation home. The most crucial goal is to ensure you don't run out of money during retirement. Thus, you want a high level of assurance that you'll reach that goal, devoting a substantial portion of your resources to the pursuit of it. Your investments for that goal are likely to be somewhat conservative, especially as you approach retirement age. The next important goal is sending your child to an Ivy-league college. You have more limited resources to devote to that goal, plus your children can still attend a less-expensive college or pay part of the costs themselves. For that goal, you may be willing to assume more risk with your investments to increase the likelihood of reaching that goal. Your goal for a vacation home is clearly last, so you may have few resources to devote to it. For that goal, you may be willing to use very aggressive investments, since that may be the only way you can achieve that goal.

The point is that your willingness to assume risk is not static. It will vary depending on how important each goal is to you and how much you can designate to that goal. Commingling all your investments for all goals in one account may make it difficult to analyze your investments in this manner. Thus, you might want to set up separate accounts for each goal, so you can more closely match the investments to your willingness to assume risk for that goal. Please call if you'd like to discuss this concept in more detail. ❍❍❍

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Claiming Social Security Benefits

Social Security benefits are a significant component of most people's retirement income. There are three basic retirement benefit types for workers and/or their spouses:

- A worker benefit, payable to the worker based on length of employment and earnings.
- A spousal benefit, payable to the worker's spouse based on the worker's record.
- A survivor's benefit, payable to the worker's spouse once the worker dies.

While full retirement age for Social Security benefits is gradually increasing from the current age of 66 to 67, you can still start benefits at age 62. However, by doing so, your benefits will be permanently reduced by 20.8% to 30%, depending on when you were born. Waiting until you are older than full retirement age to claim benefits will increase your benefits by 3.5% to 8% annually, again depending on when you were born.

The maximum benefits are reached at age 70.

While most individuals simply apply for Social Security benefits when they want to retire and draw those benefits for life, there are three strategies for claiming benefits that can increase lifetime benefits in certain circumstances:

Withdraw your application. You can undo your decision to claim Social Security benefits by filing form 521, "Request for Withdrawal of Application," with the Social Security Administration. You must pay back benefits received, but you do not have to pay interest or inflation adjustments. When does it make sense to do this? Suppose you retire at age 62 and decide by age 63 that you really don't enjoy retired life. You can pay back your benefits for that one year, work for seven more years, and then reapply at age 70, receiving substantially higher benefits.

Or suppose you retire at age 62 with reduced benefits. You didn't realize that when you die, your spouse will receive 100% of your benefits provided he/she is over full retirement age. You wish you had waited until your benefits were higher, so your spouse would receive more income after your death. You can file form 521, repay all benefits received, and immediately reapply for Social Security benefits, receiving the higher benefits amount.

Claim benefits and immediately suspend them. Once you reach full retirement age, you can claim Social Security benefits and immediately suspend them, which allows your spouse to claim spousal benefits. Your spouse's benefits equal half of your benefits. Spousal benefits are reduced when taken between the ages of 62 and full retirement age, but do not continue to grow after full retirement age. By delaying your benefits, you increase those benefits as well as any survivor's benefits.

Claim spousal benefits now and worker benefits later. A married individual can claim spousal benefits at full retirement age and then claim worker benefits at a later date. This allows you to collect benefits while still increasing the value of your worker benefits. For instance, assume a husband is already claiming benefits, and his wife reaches full retirement age of 66 this year. She can claim spousal benefits and continue working. Once she reaches age 70, she can stop the spousal benefits and claim her own benefits, which will have reached maximum value. To use this strategy, the spouse must have reached full retirement age when applying for the spousal benefits. ❍❍❍

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Did You Know?

Approximately 32% of Americans have spent less money over the past few months and plan to continue to do so in the future (Source: Gallup Inc., May 2009).

Almost 66% of consumers feel that advertising agencies are partially responsible for the current economic crisis because they persuaded consumers to make purchases beyond their means (Source: Harris Interactive Inc., April 2009).

In a recent survey, the average 401(k) plan investor lost 28% of his/her balance in 2008. Approximately 63% said their confidence in their ability to retire had declined in the past year, and 15% said they were worried that they would never be able to retire. Participants believe the best way to recover losses is to save more or work longer (Source: Barclays Global Advisors, April 2009).

Approximately 14% of loans between family and friends end up in default, compared with less than 3% of consumer bank loans (Source: *Journal of Financial Planning*, April 2009).

A recent study reveals that today's preretirees will need to postpone retirement by 4.2 years on average to make up for losses caused by the housing and stock markets. That is the first time in history that the retirement age has significantly increased in America (Source: Age Wave, 2009). ❍❍❍