LaRoche Wealth Management

Quarterly Newsletter

LaRoche Wealth Management
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Wishing everyone a happy and memorable summer filled with vacations, touring college campuses, or grilling on the patio with family and friends. We have a new family photo display board in the office and would love to add your family memories, email or send us your favorite photo! -Brian

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LaRoche Wealth Management
DESIGNING YOUR WEALTH

Projecting a Happy Retirement

A 2015 study found that 41% of households headed by someone aged 55 to 64 had no retirement savings, and only about a third of them had a traditional pension. Among households in this age group with savings, the median amount was just $104,000.[1]

Your own savings may be more substantial, but in general Americans struggle to meet their savings goals. Even a healthy savings account may not provide as much income as you would like over a long retirement.

Despite the challenges, about 56% of current retirees say they are very satisfied with retirement, and 34% say they are moderately satisfied. Only 9% are dissatisfied.[2]

Develop a realistic picture

How can you transition into a happy retirement even if your savings fall short of your goals? The answer may lie in developing a realistic picture of what your retirement will look like, based on your expected resources and expenses. As a starting point, create a simple retirement planning worksheet. You might add details once you get the basics down on paper.

Estimate income and expenses

You can estimate your monthly Social Security benefit at ssa.gov. The longer you wait to claim your benefits, from age 62 up to age 70, the higher your monthly benefit will be. If you expect a pension, estimate that monthly amount as well. Add other sources of income, such as a part-time job, if that is in your plans. Be realistic. Part-time work often pays low wages.

It's more difficult to estimate the amount of income you can expect from your savings; this may depend on unpredictable market returns and the length of time you need your savings to last. One simple rule of thumb is to withdraw 4% of your savings each year. At that rate, the $104,000 median savings described earlier would generate $4,160 per year or $347 per month (assuming no market gains or losses). Keep in mind that some experts believe a 4% withdrawal rate may be too high to maintain funds over a long retirement. You might use 3% or 3.5% in your calculations.

Now estimate your monthly expenses. If you've paid off your mortgage and other debt, you may be in a stronger position. Don't forget to factor in a reserve for medical expenses. One study suggests that a 65-year-old couple who retired in 2015 would need $259,000 over their lifetimes to cover Medicare premiums and out-of-pocket health-care expenses, assuming they had only median drug expenses.[3]

Take strategic steps

Your projected income and expenses should provide a rough picture of your financial situation in retirement. If retirement is approaching soon, try living for six months or more on your anticipated income to determine whether it is realistic. If it's not, or your anticipated expenses exceed your income even without a trial run, you may have to reduce expenses or work longer, or both.

Even if the numbers look good, it would be wise to keep building your savings. You might take advantage of catch-up contributions to IRAs and 401(k) plans, which are available to those who reach age 50 or older by the end of the calendar year. In 2016, the IRA catch-up amount is $1,000, for a total contribution limit of $6,500. The 401(k) catch-up amount is $6,000, for a total employee contribution limit of $24,000.

Preparing for retirement is not easy, but if you enter your new life phase with eyes wide open, you're more likely to enjoy a long and happy retirement.

[1] U.S. Government Accountability Office, "Retirement Security," May 2015

[2] *The Wall Street Journal,* "Why Retirees Are Happier Than You May Think," December 1, 2015

[3] Employee Benefit Research Institute, Notes, October 2015

What You Need to Know About Private Student Loans

Students and parents borrowed $106.1 billion in education loans in 2014-2015. (Source: Trends in Student Aid, College Board, 2015)

It's an unfortunate trend in college pricing--the average cost of tuition and fees at four-year public and private institutions are significantly higher than they were just a decade ago. For example, the average published tuition and fee price of a full-time year at a public four-year institution is 40% higher, after adjusting for inflation, in 2015-16 than it was in 2005-06. (Source: Trends in College Pricing, College Board, 2015) As a result of these rising costs, many individuals have to rely on student loans to help fund their college education.

Will I have to take out private loans to finance my college education?

What can be surprising to many first-time student borrowers is how little federal student loan debt they may be allowed to take on. Currently, the maximum amount students can borrow for college in federal Direct Stafford Loans is $5,500 during their first year, $6,500 during their second year, and $7,500 during their third and fourth years. (Source: Federal Student Aid, U.S. Department of Education, 2015)

In most cases this amount is not nearly enough to cover the cost of attending a four-year college, and many student borrowers must look to private student loans to help close this gap. And while taking out private loans to pay for college is a fact of life for many individuals, there are some important questions you'll want answered before taking out these types of loans.

What is the interest rate on the loan?

Private student loans tend to have higher fixed interest rates than federal Direct Stafford Loans. However, depending on the lender, you may be able to choose a loan that offers a lower variable interest rate.

Keep in mind that with a fixed rate, the interest rate remains the same from the day you take out the loan until the day you pay it off. With a variable rate, your interest rate may initially be lower than a fixed rate but then will be adjusted periodically to keep up with changes in market conditions. If your interest rate rises, your monthly payment and/or the number of payments required will increase.

What repayment options are available?

Unlike federal student loans, which offer repayment programs such as pay as you earn, income-based repayment plans and student loan forgiveness, private lenders are not required to offer specific repayment assistance to borrowers struggling to make payments. However, most private student loan companies do offer limited forms of repayment options, such as loan forbearance or extended repayment schedules. The types of repayment programs offered will vary from lender to lender.

Is a co-signer required?

Some private lenders may require borrowers to have a co-signer guarantee a loan, especially if a borrower has little or no credit history. Having a co-signer may also help you obtain a lower interest rate for your loan and improve your chances for loan approval.

The good news is that the co-signer doesn't necessarily have to be tied to the loan forever. Most lenders will allow borrowers to apply for a co-signer release after a certain number of on-time payments have been made and other loan conditions have been met.

Are the terms of the loan favorable?

As a result of recent increased regulatory scrutiny surrounding private loans, many of the larger lenders have improved the lending process by offering more attractive loan terms.

For example, certain lenders have eliminated "auto defaults," which is when a co-signer dies or declares bankruptcy and the lender demands that the loan be paid back immediately by the borrower. Others have made the process for obtaining a co-signer release easier and more transparent. Loan costs, discounts, terms, and conditions can differ greatly, depending on the lender. It's important to thoroughly research each potential lender and carefully compare all offers before signing a loan agreement.

Are other financing options available?

When it comes to using private loans to pay for college, student borrowers should try to graduate with the least amount of private student loan debt possible. It's generally a good idea to exhaust all federal student loan options and avoid taking out loans for the maximum amount that is offered by private lenders unless absolutely necessary.

Additional financing options should also be considered, such as:

- Parent PLUS loans
- Grants or scholarships
- Parent/family loans
- State-sponsored student loan programs
- Part-time employment

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Earn Too Much for a Roth IRA? Try the Back Door!

If you have taxable compensation, you can contribute up to $5,500 to an IRA in 2016, or $6,500 if you'll be 50 or older by the end of the year. You can't contribute to a traditional IRA for the year you turn 70½, or thereafter.

To be eligible for tax-free qualified distributions from a Roth IRA, you must satisfy a five-year holding period and, in addition, one of the following must apply: you have reached age 59½ by the time of the withdrawal, the withdrawal is made because of disability, or the withdrawal is made to pay first-time homebuyer expenses ($10,000 lifetime limit from all IRAs).

It's not clear how long the back door is going to remain open. There have been suggestions that this is a loophole that should be legislatively closed.

Background

Roth IRAs, created in 1997 as part of the Taxpayer Relief Act, represented an entirely new savings opportunity--the ability to make after-tax contributions that could, if certain conditions were met, grow entirely free of federal income taxes. These new savings vehicles were essentially the inverse of traditional IRAs, where you could make deductible contributions but distributions would be fully taxable. The law also allowed taxpayers to "convert" traditional IRAs to Roth IRAs by paying income taxes on the amount converted in the year of conversion.

Unfortunately, the law contained two provisions that limited the ability of high-income taxpayers to participate in the Roth revolution. First, the annual contributions an individual could make to a Roth IRA were reduced or eliminated if his or her income exceeded certain levels. Second, individuals with incomes of $100,000 or more, or whose tax filing status was married filing separately, were prohibited from converting a traditional IRA to a Roth IRA.

In 2005, however, Congress passed the Tax Increase Prevention and Reconciliation Act (TIPRA), which repealed the second barrier, allowing anyone to convert a traditional IRA to a Roth IRA--starting in 2010--regardless of income level or marital status. But TIPRA did not repeal the provision that limited the ability to make annual Roth contributions based on income. The current limits are set forth in the chart below:

Phaseout ranges for determining ability to fund a Roth IRA in 2016*	
Single/head of household	$117,000-$132,000
Married filing jointly	$184,000-$194,000
Married filing separately	$0-$10,000
***Applies to modified adjusted gross income (MAGI)**	

Through the back door...

Repeal of the provisions limiting conversions created an obvious opportunity for high-income taxpayers who wanted to make annual Roth contributions but couldn't because of the income limits. Those taxpayers (who would also run afoul of similar income limits that prohibited them from making deductible contributions to traditional IRAs) could simply make nondeductible contributions to a traditional IRA and then immediately convert that traditional IRA to a Roth IRA--a "back door" Roth IRA.

The IRS is always at the front door...

For taxpayers who have no other traditional IRAs, establishment of the back-door Roth IRA is essentially tax free. Income tax is payable on the earnings, if any, that the traditional IRA generates until the Roth conversion is complete. However, assuming the contribution and conversion are done in tandem, the tax impact should be nominal. (The 10% penalty tax for distributions prior to age 59½ generally doesn't apply to taxable conversions.)

But if a taxpayer owns other traditional IRAs at the time of conversion, the tax calculation is a bit more complicated because of the so-called "IRA aggregation rule." When calculating the tax impact of a distribution (including a conversion) from any traditional IRA, all traditional and SEP/SIMPLE IRAs a taxpayer owns (other than inherited IRAs) must be aggregated and treated as a single IRA.

For example, assume Jillian creates a back-door Roth IRA in 2016 by making a $5,500 contribution to a traditional IRA and then converting that IRA to a Roth IRA. She also has another traditional IRA that contains deductible contributions and earnings worth $20,000. Her total traditional IRA balance prior to the conversion is therefore $25,500 ($20,000 taxable and $5,500 nontaxable).

She has a distribution (conversion) of $5,500: 78.4% of that distribution ($20,000/$25,500) is considered taxable ($4,313.73), and 21.6% of that distribution ($5,500/$25,500) is considered nontaxable ($1,186.27).

Note: These tax calculations can be complicated. Fortunately, the IRS has provided a worksheet (Form 8606) for calculating the taxable portion of a conversion.

There's also a side door...

Let's assume Jillian in the example above isn't thrilled about having to pay any income tax on the Roth conversion. Is there anything she can do about it?

One strategy to reduce or eliminate the conversion tax is to transfer the taxable amount in the traditional IRAs ($20,000 in our example) to an employer qualified plan like a 401(k) prior to establishing the back-door Roth IRA, leaving the traditional IRAs holding only after-tax dollars. Many 401(k) plans accept incoming rollovers. Check with your plan administrator.

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What are some tips for organizing financial records?

Organizing your financial records is a cyclical process rather than a one-time event. You'll need to set up a system that helps you organize incoming documents and maintain existing files so that you can easily find what you need. Here are a few tips.

Create your system: Where you should keep your records and documents depends on how quickly you want to be able to access them, how long you plan to keep them, and the number and type of records you have. A simple set of labeled folders in a file cabinet may be fine, but electronic storage is another option for certain records if space is tight or if you generally choose to receive and view records online. No matter which storage option(s) you choose, try to keep your records in a central location.

File away: If you receive financial statements through the mail, set up a collection point such as a folder or a basket. Open and read what you receive, and decide whether you can file it or discard it. If you receive statements electronically, pay attention to any notifications you receive. Once you get in a routine, you may find that keeping your records organized takes only a few minutes each week.

Purge routinely: Keeping your financial records in order can be even more challenging than organizing them in the first place. Let the phrase "out with the old, in with the new" be your guide. For example, when you get this year's auto policy, discard last year's. When you receive an annual investment statement, discard the monthly or quarterly statements you've been keeping. It's a good idea to do a sweep of your files at least once a year to keep your filing system on track (doing this at the same time each year may be helpful).

Think safety: Don't just throw hard copies of financial paperwork in the trash. To protect sensitive information, invest in a good quality shredder and destroy any document that contains account numbers, Social Security numbers, or other personal information. If you're storing your records online, make sure your data is encrypted. Use strong passwords, and back up any records that you store on your computer.

How long should I keep financial records?

There's a fine line between keeping financial records for a reasonable period of time and becoming a pack rat. A general rule of thumb is to keep financial records only as long as necessary. For example, you may want to keep ATM receipts only temporarily, until you've reconciled them with your bank statement. But if a document provides legal support and/or is hard to replace, you'll want to keep it for a longer period or even indefinitely. It's ultimately up to you to determine which records you should keep on hand and for how long, but here's a suggested timetable for some common documents.

One year or less	More than one year	Indefinitely
Bank or credit union statements	Tax returns and documentation*	Birth, death, and marriage certificates
Credit card statements	Mortgage contracts and documentation	Adoption papers
Utility bills	Property appraisals	Citizenship papers
Annual insurance policies	Annual retirement and investment statements	Military discharge papers
Paycheck stubs	Receipts for major purchases and home improvements	Social Security card

*The IRS requires taxpayers to keep records that support income, deductions, and credits shown on their income tax returns until the period of limitations for that return runs out--generally three to seven years, depending on the circumstances. Visit irs.gov or consult your tax professional for information related to your specific situation.

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