Financial planning for the ages

PETER AND MARIA HOEY FOR THE BOSTON GLOBE

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Comments

The beginning of a new year is a great time to set financial goals, take stock, and make adjustments. Financial planning issues, however, can vary according to age.

Millennials are typically figuring out the basics. Gen Xers have to factor in the demands of a family, home, and developing career. And baby boomers — approaching or in retirement — need to make decisions about lifestyle, investments, and cash flow.

So here’s a generation-by-generation financial planning guide geared to different stages of life and the transitions faced along the way.

Millennials: Figuring out the basics

When it comes to financial planning, millennials — now approximately 20 to 35 years old — have one big advantage: “Time is on their side,” said Eric Roberge, a fee-only financial planner at Beyond Your Hammock in Boston.

While the rent may be due next week, retirement is still 30 or 40 years away. That means establishing good financial habits can pay big dividends in the future.

Goals here typically start with paying the bills, establishing an emergency fund, staying current on student loans, and saving for retirement. But don’t forget to think about a vacation, a new car, a home purchase or perhaps paying for a wedding.

“You’ll likely have more goals than you can fund,” Roberge said, “so you’ll have to prioritize,”

To do that, you need to take a close look at cash flow. Those workplace paychecks have to cover rent, food, utilities, transportation, student loan debt, and other essentials. So do the math and make sure you have enough for the basics before you spend so much as a dime on a mocha latte.

Automatic banking can help. You can create financial discipline by having money automatically taken out of your paycheck or checking account to put towards your emergency fund, retirement plan, student loans, rent, or even a vacation. “Before it even hits your checking account, most of that paycheck should be allocated somewhere else,” said Michael Solari, a fee-only financial planner based in Bedford, N.H.

Once essential expenses are covered, you can spend what's left on the extras, he said. There are many online budgeting tools such as Mint.com or youneedabudget.com that can help in allocating resources, tracking spending, and crunching the numbers.

For many millennials, debt is the subtext that underlies all other financial conversations. Some have undergraduate school loans, while others have taken on debt to pay for graduate or professional school. The amounts, which can reach $300,000 or more for medical school, can be daunting. These days, however, there are lots of repayment options, many pegged to income, said Paul Garrard, president of PGPresents, a student-loan consulting company based in West Virginia.

One rule of thumb: If you owe more than you will make in a year, "you may not be able to afford the standard 10-year repayment plan unless you have additional resources," Garrard said. In such cases, he recommends that people consider income-driven repayment plans that offer lower payments over a longer period of time. These options typically include provisions for loan forgiveness after a designated period of time if the borrower still has a balance or works in the public sector. StudentLoans.gov has information about federal repayment options.

Remember, financial goals are an objective. It takes time to achieve them. Still, having a clear target will make the job easier. Fee-only financial adviser Cheryl Costa of Woodside Wealth Management in Framingham recommends that millennials build an emergency fund to cover three months of living expenses in case of an unplanned car repair or unexpected job loss.

The goal for retirement savings? Employers often match contributions to workplace 401(k)s, with amounts typically ranging from 3 to 6 percent of pay. That’s free money. Be sure to contribute enough to get that employer match. Then start increasing your contributions at a half a percentage point each year. Solari said.

When it comes to investing, millennials are largely limited to money tucked into their retirement accounts. Advisers typically recommend using low-cost investments that track a market index or a basket of assets. Both index funds and exchange-traded funds can work here.

Another alternative is the target-date mutual fund, which automatically resets the mix of stocks, bonds, and cash equivalents in its portfolio based on a selected time frame. A fund for someone 45 years from retirement, for example, might be 90 percent invested in stocks with just 10 percent in bonds. By retirement, that fund might have shifted to a 50-50 allocation.

“If you don’t know what to do, find the target-date fund pegged to the date closest to your retirement,” said Roberge.

Insurance barely registers on the financial radar of millennials just graduating from college. Health insurance is a must, but those under 26 can stay on their parents’ plan. Once they find a job, employers typically offer both health insurance and basic disability plans.

Employers may also provide T passes, health club subsidies, and other perks. “Good management of benefits is a good way to save some money,” said Roberge.

One increasingly important benefit is the health savings account. Offered by companies with high deductible health plans, it allows employees to contribute pre-tax dollars which can be used at any time in the future to pay medical bills.

"It is a great way to not pay taxes on money used for medical bills you'll be paying anyway," Roberge said.

Gen Xers: Making the pieces fit

Today, Gen Xers are navigating a financial world filled with competing demands. Granted, Gen Xers, now ages 36 to 51, have typically worked for a decade or more, so there has been time to establish an emergency fund, save for retirement, and build a career.

But for many, this middle stage of life also includes a spouse, children, and a home. That means juggling expenses ranging from mortgage payments and home insurance to child care and college savings. Then, too, there are often important decisions to be made about career, geographic location, and even the need to be available to aging parents.

Long-term goals feel more pressing. Insurance and estate planning have taken on greater importance, and retirement is no longer a far distant event. As such, any list of New Year's goals will likely emphasize such safety-net issues. But this is also a prime time for career changes that may provide interesting new challenges or perhaps leave more room for family, fun, and adventure.

Cash flow here is important, so take a close look at where you're spending your money. If you haven't automated your banking, this is a good time to make sure funds are automatically taken out of your paycheck or bank account to cover housing costs, retirement savings, college savings, and other financial objectives.

Many Gen Xers have become homeowners, but the youngest of this generation may be just entering the market. They should think hard about why they want to own a home, said Eric Roberge, a fee-only financial planner at Beyond Your Hammock in Boston. "You can't simply say that a home is a good investment, because that's not always the case."

Buying typically doesn't make sense for anyone thinking about relocating in the next five years. "There are closing costs, moving costs, and liquidity to consider," said Roberge. "Can you sell your house when you want to or need to?"

At this stage of life, the emergency fund should cover six months of living expenses or more, said fee-only financial adviser Cheryl Costa of Woodside Wealth Management in Framingham. "The impact of a job loss is severe when you have a mortgage, day-care expenses, and car payments," she said.

Emergency funds, she added, should be all cash: “You need that money to be there if you get laid off.”

Insurance is critically important. You need enough life insurance to cover the mortgage, day-to-day living expenses, and future schooling costs should one spouse die.

Michael Solari, a fee-only financial planner in Bedford, N.H., suggested that Gen Xers own multiple term policies because they are at the stage when they need life insurance the most. Some policies, he says, should stretch for 20 or 30 years, supplemented by shorter 10- or 15-year policies to boost coverage during this period of greatest need.

Don’t skimp on homeowners insurance, and make sure that you carry a personal excess liability policy, also known as umbrella insurance. Coverage of $1 million to $2 million is relatively inexpensive, typically $350 or less, and protects you from big court damages resulting from legal action due to a car accident or home injury.

Estate planning also takes on new importance. That means not only having a basic will, but also making sure that health care proxies, powers of attorney, and guardianship of children are in order. Remember: Update the beneficiaries on your retirement accounts and life insurance policies. Otherwise you may end up leaving your IRA assets to your mother instead of your spouse or children.

Student loans may still be a challenge. “Early Generation X borrowers may have started out aggressively paying down their student loans, only to shift gears to lower payments as they had families and other financial obligations,” said Paul Garrard, president of PGPresents, a student-loan consulting company in West Virginia.

Some Gen X borrowers may qualify for public-service loan forgiveness after 10 years working in the nonprofit sector. Another option for some is refinancing with a private lender that may offer less repayment flexibility than the federal government, but lower rates, he said.

With retirement beginning to loom, many Gen Xers have to choose between funding 401(k)s and IRAs or putting money aside for the kids’ college education, often in 529 college savings plans. According to Costa, retirement savings needs to come first. She recommends that at least 15 percent of income go to retirement. “Twenty-five percent would be better,” she said.

Baby-boomers: Tapping hard-earned resources

The oldest baby boomers are now turning 70, while the youngest are 51. As such, this generation is straddling the great retirement divide.

That’s why Barbara Nevils, a fee-only financial planner in Wakefield, said it’s helpful to divide this generation into two distinct groups. Young boomers with children at home or in college might not have actively thought about retirement. Many older boomers, however, have already made key retirement decisions about work and Social Security, and they are now planning around the effects those choices are having on their lifestyle.

Both groups will most certainly be living a retirement very different from the one their parents experienced. “They are going to live longer, probably be healthier, and want very active lifestyles,” she said. “You have to plan for that.”

Setting goals here starts with a look at life expectancy, balancing it against expected cash flow, and choosing a lifestyle that fits. Sometimes decisions are driven by the calendar. There’s the ability to tap retirement accounts without penalty that begins at 59 ½, the need to sign up for Medicare at 65, and the decision about when to start taking Social Security, which can be claimed any time between 62 and 70.

Once again, planning starts with cash flow. Here the number crunching might begin with current salary, but it quickly moves to include projected monthly Social Security checks, pension payouts, and required annual distributions from retirement accounts. Next comes some best-guess calculations about annual expenses based on current lifestyle. Then consider changes that might reduce expenses, such as moving to a smaller home or less expensive community.

When making projections, advisers these days typically like to plan for a 100-year life span. While average life expectancy for a 65-year-old today is about 20 years, one out of every 10 now aged 65 will live to 95. Some will live longer. So planning to 100 is one way to hedge against the possibility of outliving your money.

Increased longevity is one reason that advisers recommend that people wait until 70 to take Social Security. While you can claim benefits at 62, you will get only 75 percent of the benefits that would be available at full retirement age. That’s 66 for boomers born before 1955, gradually increasing to 67 for those born in 1964 or later. Wait until age 70 to take benefits, and you’ll get payments that are up to 32 percent more than what you would get at full retirement age.

Expenses will probably change in retirement, but they can be hard to predict. You might not need to cover commuting expenses or buy professional clothes for the workplace, but you might choose to travel more. Then, too, your projections should include tax calculations, changes in insurance needs, and the likelihood of higher health care costs. Simply navigating the complexities of Medicare coverage can be challenging, requiring significant homework just to find the best plan.

Taxes are a critical planning factor. Money taken out of traditional IRAs, for example, is taxed as regular income. That could translate into a significant tax bill once required annual minimum distributions from these accounts kick in at age 70 ½. These distributions will also affect taxes owed on Social Security payments, since couples with a combined taxable income of more than $44,000 will owe taxes on up to 85 percent of their benefits.

Once the children are grown and the mortgage is paid, the need for life insurance is limited. But there’s still a need for homeowner’s insurance and an umbrella policy to cover personal liability claims, said fee-only financial adviser Cheryl Costa of Woodside Wealth Management in Framingham. She also recommends that people consider long-term care insurance to offset the cost of future health issues that might require a nursing home or special home care.

Estate planning takes on new importance. Such planning provides for distribution of your assets upon your death, and might include charitable contributions or your wishes about how personal possessions are divided. Key documents include health care directives detailing your wishes in case of incapacity as well as powers of attorney so family members or others can access your financial accounts to pay bills and conduct your business.

Finally, your investment portfolio will need some tweaking. With minimum annual distributions required at age 70½, it makes sense to keep some of your retirement plan money in cash so that you don't have to fund those distributions by selling into a down market.

At the same time, boomers also need some stock investments, although the amount may depend on age and health. "Most people need some growth," Nevils said. Assuming expenses are covered for three to five years, Nevils said, most advisers would recommend stock holdings of 25 to 30 percent for even the most conservative portfolios.

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