Flash!
News from the Pomona Plan
A Financial Guide for Friends and Alumni of Pomona College (800) 761-9899
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Ensuring Our Longevity

We have all seen it: a recreational vehicle with a gray-haired couple in the cabin and a bumper sticker on the rear that says, "We are spending our children's inheritance." A retired couple may be willing to spend some of the children's inheritance, but they don't want to overspend and risk becoming financially dependent on those children. It is one thing to die broke; it is quite another to go broke ten years before you die.

"Do you have a minute to talk about your retirement years?"

The issue then becomes how much you can withdraw from your retirement funds and investments on a sustainable basis without fear of running out of money. What you need to withdraw depends on your lifestyle and the inflation rate. What you can safely withdraw depends on your life expectancies and the investment returns on your assets.

How Long Can You Expect to Live?

If you retire in your early sixties, you can expect to live another 25 to 30 years. If you are already 70 and are in reasonably good health, your life expectancy is 15 to 20 years. As medical technology advances, those life expectancies are likely to increase. With all of these years stretching ahead of you, it is critically important to make sure your money lasts as long as you do.

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Inside:

How Much Can You Safely Withdraw from Your Nest Egg?

You probably have three major assets: your retirement funds; your personal investments consisting of cash, securities and perhaps real estate; and your residence.

How much can you withdraw each year from a combination of your retirement funds and personal investments without the risk of running out of money? The answer depends, in large part, on the prevailing economic conditions during your retirement years. A period of high inflation, for instance, will erode the purchasing power of your retirement funds. Likewise, financial markets are cyclical, as more recent changes in stock values and interest rates have reminded us, and it is possible to see retirement savings decline significantly in value as a result. During economic storms the risk of running out of money is much greater, especially for those who retire early and withdraw high percentages of assets each year.

Payments for as Long as You Live

One way to ensure that you never run out of money is to establish a gift annuity. In exchange for a transfer of cash or securities, Pomona agrees to pay a fixed sum of money to you (or to you and another person) for life. Those payments, which are backed by all of the assets of Pomona College, will continue for as long as you live, even if you are one of the fortunate few who reach or live past 100 years of age. Also, your payments will not decrease during times when interest rates fall and the stock market declines.

While you can outlive the income from every other kind of investment, you cannot outlive the money you receive from an annuity. Because of distribution requirements, you may eventually exhaust your IRA or other retirement fund, but an annuity keeps on paying. What is more, if it is a gift annuity it continues to work even after you are gone by advancing the mission of Pomona College.

Example: Robert, now 68, retired two years ago and plans to start taking distributions from his IRA this year. He and his wife, also 68, decide that a gift annuity would be a good way to cover their basic household expenses, so they contribute $200,000 of stock. They purchased the stock for $120,000, and it is paying a dividend of only 1%.

They will receive payments in the amount of $9,800 annually, jointly and then to the survivor. They like the fact that when the first of them dies, payments continue undiminished and without delays of probate to the survivor. For the duration of their joint life expectancy, payments will be taxed as follows: $3,254 as ordinary income, $2,618 as capital gain and $3,928 tax-free. Thereafter, payments will be fully taxable.

They receive a charitable deduction of $54,694 that in their 28% marginal tax bracket results in tax savings of $15,314. Although a portion of their payments is taxed as capital gain, there is no tax on any gain when they transfer the stock. Had they sold the stock to generate cash, the entire gain would have been taxable in the year of the sale.

What happens to a $500,000 retirement nest egg over a 30-year retirement? It depends …

The Purchasing Power of a Dollar			
Annual Rates of Inflation			
Years	**3%**	**4%**	**5%**
0	$1.00	$1.00	$1.00
5	.86	.82	.78
15	.64	.55	.48
25	.48	.38	.30

Retirement		
Year	**7% Growth, 3% Inflation**	**6% Growth, 4% Inflation**
1	$500,000.00	$500,000.00
5	$577,635.05	$515,465.48
10	$626,673.15	$512,030.55
15	$666,665.44	$468,917.59
20	$688,946.62	$364,361.88
25	$681,001.98	$167,429.23
30	$624,421.30	-0-
Key Assumptions:		
Initial value of nest egg: $500,000		
Initial spending: $25,000, increasing by the annual inflation rate per year thereafter		

The Long-Term Care Annuity

With today's longer life spans, charitable vehicles that generate additional income can greatly enhance the "golden years" of your parents and could be beneficial to you as well.

If you are contributing to the care of a parent with after-tax dollars, it may be advantageous to transfer some cash or property to a gift annuity and have the annuity payments made directly to your parent(s). The payments would be taxed in your parent's lower tax bracket, but you, as the donor, would receive a current deduction, reducing your income tax liability.

In this case, the age of the recipient of the annuity payments, not the age of the donor, determines the annuity rate, charitable deduction and tax-free portion of the annuity payments.

Example: Bob Smith, 52, is a successful executive with a good income. His mother Dorene is 82 and still lives in the family home. To help meet his mother's expenses, Bob provides $6,000 per year. Bob must earn $8,955 in his 33% tax bracket to net the $6,000 he gives Dorene.

By creating a gift annuity, Bob can make a gift to Pomona College, provide for his mother and receive a welcome charitable tax deduction of $15,386 at the same time. After consulting his advisors and a member of our staff, Bob makes a gift of $56,605 to establish a charitable gift annuity for his mother at a favorable payment rate of 10.6%.

Note: The value of Bob's mother's income interest of $41,219 ($56,605 less $15,386) is a reportable gift for federal gift-tax purposes. However, his gift-tax annual exclusion and available exemption amount will offset any potential gift-tax liability. In her 15% tax bracket Dorene nets $5,945.

"I can see by the sudden appearance of little dishes of hard candy in every room, Veronica, that we have finally entered our golden years."

Not Yet Retired?

If you are not yet retired, you still have time to build a nest egg large enough to sustain yourself during your retirement years, perhaps even large enough to allow you to retire early. Yet you may be hampered because you are already contributing the maximum allowable to a qualified plan such as a 401(k) or 403(b).

In that case, consider a **deferred-payment gift annuity**: There is no contribution limit, you can contribute appreciated securities and not be currently taxed on the gain and you can start receiving income as early or as late as you wish. You can even build in flexibility for the starting date of your annuity if you are not sure when you would like your income payments to begin.

Advantages & Disadvantages of Annuities

After satisfying the payment obligation to the beneficiary(ies) of your gift annuity, we use the remaining portion of your contribution for charitable purposes. As with other gifts to Pomona College, you can designate the purpose for which your contribution is used. Annuity gifts help secure our future and make long-range planning possible.

Disadvantages?

A gift annuity does not protect you against inflation. While payments never decrease, which is good when interest rates fall and stocks drop in value, if prices rise your payments will have less purchasing power.

Whatever the sources of your retirement income, you need to be concerned about inflation. Your income in the early years of retirement may be quite adequate but may fall short later on if it does not keep pace with inflation. That is why many people, even after retirement, keep a portion of their investments and IRA assets in stocks.

Advantages?

Although a gift annuity does not offer inflation protection, there are compensating factors: Annuity rates are higher than the percentages you would likely withdraw from a retirement plan or investment portfolio, and your payments are favorably taxed.

FROM THE DIRECTOR:

Income Insurance for Later Years—Problem Solved!

Mary, who recently became a widow, is organizing her financial life as she prepares for retirement years that she will unexpectedly be spending alone. Her retirement plan seems intact despite her husband's death; her financial advisor has produced charts showing that she should have sufficient income until at least age 90, with a 95% degree of certainty. Mary, however, wonders about that 5% of uncertainty and the impact of inflation over the next several decades. Believing she might need to replace $100,000 per year, inflation of 3%-4% per year means she will need at least $165,000 in income by age 80 and over $200,000 by age 85. The proceeds of a $1 million life insurance policy seems as if it might hold the key to a future that is secure in case she turns out to be as long-lived as other family members.

Over the years Mary has learned about life-income programs at Pomona, so she contacts the Office of Trusts and Estates to find out if there are any creative options she should consider. We suggest a flexible deferred gift annuity, which defers payments with progressively higher rates and allows the beneficiary to choose which year to begin payments. A gift illustration demonstrates that payments range from $196,000/year for payments to begin when she turns 80 to as much as $299,000/year when she turns 85, when funded now with $1 million. These rates would allow her not only to replace lost income—with payments that would never end as long as she lived—but even to increase her future standard of living while still making a significant gift to Pomona. *Problem solved!*

If you have concerns about financial security in the later years of life, you may want to consider a deferred gift annuity such as Mary's. Yes, you really can do well while doing good.

Sincerely,

Robin Trozpek
Director

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