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7 RETIREMENT TIPS FOR FEDERAL EMPLOYEES

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Federal employees, whether under the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), have many decisions to make as they complete their retirement paperwork.

While the list below is not meant to be all-encompassing, we've highlighted what we feel are the seven most important choices to make.

1. CHOOSE THE SURVIVORSHIP OPTION

– in most cases, particularly for couples with one CSRS retiree, choosing the maximum survivorship option of 55% is the best choice. Federal annuitants that select the survivorship option forgo up to 10% of their maximum pension amount. We are occasionally asked, "why not decline the survivorship, take my full pension amount, and buy life insurance"? The reason: regardless of the annuity amount, the 10% reduction to your pension is far less than what a life insurance premium would cost you to mimic the lifetime, cost-of-living-adjusted income stream that your surviving spouse receives. In other words, the survivorship option is the lowest cost life insurance available.

2.CONSIDER A PARTIAL ROLLOVER OF YOUR THRIFT SAVINGS PLAN (TSP)

– there has been a lot of press about the low-cost of the TSP funds and that it is a mistake to rollover your TSP at retirement. Financial Advisors that act more like money managers than fee-only fiduciaries typically suggest rolling over all of your TSP. Our unbiased view is that it does not have to be an all-or-nothing decision. You can choose a partial rollover – a strategy we have executed for many clients.

The TSP provides five asset class funds (C Fund, S Fund, I Fund, F Fund, and G Fund).

a. The C Fund is a passive index fund that tracks the S&P 500, the 500 largest US companies.

b. The S Fund in an index fund created to track the remaining US companies not listed in the S&P 500

c. The I Fund invests in international-based companies. The fund limits investments to companies in developed countries. These include countries like the United Kingdom, Australia, Japan, etc. It does not include emerging markets countries.

d. The F Fund, one of two bond funds available, tracks the common Barclays Aggregate Bond Index.

e. The G Fund invests exclusively in nonmarketable short-term US Treasury security that is specially issued to the TSP.

Why do we believe in partial rollovers? Because there are several investments missing from the TSP funds that research shows provides increased returns with better overall diversification. The I Fund does not include companies from emerging market countries. This asset class has been the top performing asset class in 4 of the past 15 years; three of those years it beat the second-best performing asset class by more than 30%. Emerging Market companies are an integral part of a well-diversified portfolio, making up 11% of the world's stock market. Even the most conservative of retirees should have at least something in emerging market companies.

Another important asset class missing from the TSP funds is Real Estate Investment Trusts (REITs). US Real Estate funds were the best performing asset class in 2006, 2010, and 2011. More importantly, it was also the best

performing asset class in 2000. Why is that of more importance than the other years? Because in that year, Large Cap US stocks represented by the S&P 500 (and thereby the C Fund) were down 9%. If you owned REITs and Emerging Markets during the tech bubble crisis in the early 2000s, your portfolio did far better than one invested only in the 5 funds available within the TSP.

The examples above are only some of the examples. Other meaningful asset classes missing from the TSP: Micro Cap stocks, International bonds, and Commodities.

Doing a partial rollover of your TSP would allow you to gain access to other asset classes while still using the best of the TSP, particularly the G Fund. As we emphasized above, the G Fund invests in US short-term treasuries exclusively available to the TSP. The G Fund has not been replicated in public mutual funds. This results in a guaranteed return of principal and a higher interest rate credited than can be achieved in the open market. Therefore, a wise strategy for partial rollovers would keep at least the amount in the TSP that should be invested in short-term government securities, utilizing the G Fund to gain access to the asset class.

Partial rollovers work best when you are managing your portfolio as one, comprehensive unit, and not trying to maximize returns and diversification within each account. We have the capability to manage the TSP assets, along, and in coordination, with your other assets, to ensure your overall portfolio is diversified and efficient. Here is a sample portfolio using TSP funds and other ultra-low cost mutual funds to achieve expanded diversification and expected higher returns with a partial rollover approach. This is not to be construed as investment advice, but just an example of what could be done to achieve great diversification using both the TSP and a rollover IRA:

C Fund – 15%
S Fund – 9%
MicroCap Fund – 3%
US Real Estate – 3%
I Fund – 13%
International Real Estate – 2%
Emerging Markets Fund – 5%
Commodities Fund – 5%
F Fund – 25%
G Fund – 10%
International Bonds – 5%
Inflation-Protected Bonds – 5%

As you'll note, there are seven asset class funds in addition to the five TSP funds used to diversify the portfolio. As long as you are using low-cost funds to invest in the seven asset classes, you can achieve better diversification and higher expected returns.

3.INVEST IN THE VOLUNTARY CONTRIBUTION PLAN

– eligible only to CSRS annuitants, the Voluntary Contribution Plan allows a federal employee to add up to 10% of their lifetime income into the plan. For 30-year federal employees, this could amount to hundreds of thousands of dollars. This asset could then be annuitized, adding to your lifetime income stream. However, the better alternative in most situations, is to rollover the Voluntary Contribution balance into a Roth IRA prior to retirement. The Roth IRA can then grow tax-free with no required minimum distribution during your lifetime. This strategy is ideal for those CSRS annuitants that have substantial cash balances in bank or brokerage accounts. Once turned into a Roth IRA, the money should be earmarked for later in life or as wonderful (and tax-efficient) bequest to your heirs. A federal employee with $2,000,000 in lifetime earnings (over a 30-year career) could put up to $200,000 into the Voluntary Contribution Plan. You do not need to do this all at one time either. You could start contributions 5-10 years before retirement to begin to build this account balance. Before retirement, you rollover the 200,000 into a Roth IRA, and allow it to grow for 20 years. After 20 years, assuming roughly a 7% growth rate, this account would be $800,000! This is a great way to self-insure Long Term Care needs or begin to build wealth for heirs.

4. AT AGE 65, DECLINE MEDICARE B

- Medicare B was created for non-government retirees to mimic the Federal Employees Health Benefits (FEHB) federal retirees receive in retirement. In most cases, Medicare B is duplicative and if you happen to be a two-pension family, or your spouse continues to work during your retirement, your Medicare B premiums will be higher than the standard rate. Incomes above $170k are subject to higher premiums than the $104 monthly standard rate. Unless you have major medical concerns and/or visit doctors very often, your Medicare B premiums will far exceed what you would pay out-of-pocket through the FEHB plans.

As you near retirement, you will hear from your insurance provider that Medicare B is a wise choice for you. Consider their incentives though. If you select Medicare B, it becomes your primary insurer while your FEHB coverage becomes secondary. It saves the FEHB provider a tremendous amount of money when they are collecting premiums from you, but Medicare is paying the bulk of your health care expenses. You are paying two premiums, but only one provider (Medicare) is paying that doctor's bill.

While in general it makes sense to decline Medicare B, everyone's situation is unique. These are the types of decisions you should seek non-conflicted third party advice that fee-only financial planners like us provide.

5.CHOOSE THE 75% REDUCTION, PAID UP FEDERAL EMPLOYEE GROUP LIFE INSURANCE (FEGLI) OPTION FOR LIFE INSURANCe

- You will pay premiums until age 65 and your death benefits will drop to 25% of your basic coverage at 65. Then, your premiums go away and you retain the 25% death benefit. If you selected the survivorship option for your pension and have otherwise adequately prepared for retirement, you don't need more life insurance than that.

6. IF YOU ARE A CSRS ANNUITANT, RETIRE IN THE FIRST 3 DAYS OF A MONTH

- this will ensure you receive your first pension check at the end of the month. Retire after day 3 and you will likely not receive your first pension check until the end of the month after your retirement month. For example, retire on January 3rd and receive a check in January. Retire on the 4th, and you may not receive a check until February 28th.

7. BANK YOUR SICK LEAVE PAYOUT

- If you have vacation or sick leave remaining and plan to receive a lump sum, put that check in the bank to help fund expenses in the first few months of retirement. Your initial pension checks will likely be about 80% of your full, expected pension. OPM will then "true up" the payments once they have finalized your paperwork. Having some extra money in the bank account will add peace of mind while you are receiving the reduced pension amount.

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