Retire On Time & Parker Financial Services, LLC
"Helping Business Owners and Professionals Retire on Time"

July 2008

Retire On Time
Parker Financial Services, LLC
David E. Parker, CPA, CFP®
3830 Packard Road
Suite 260
Ann Arbor, MI 48108-2051
734-975-8711
fax: 734-418-2106
dave@retireontime.net
www.retireontime.net

Yeah, Summer is here !

Thank you for your business and referrals.

My business continues to be successful because of great Clients like you. If you know anyone else who would value my services, please let me know. With their permission, I would be happy to call and introduce myself. Anyone you refer will receive special attention and the finest service.

For more info and articles please visit:
www.retireontime.net

The information contained in this newsletter is derived from sources believed to be accurate. You should discuss any legal, tax, or financial matters with the appropriate professional.

In this issue:

Making Sense of Municipal Bonds

The Pros and Cons of Self-Insuring Long-Term Care

The Three C's of Credit

Ask the Experts

Making Sense of Municipal Bonds

Recent action in the credit markets has created situations that are unusual in the relatively placid world of bonds. Whether you're hoping for a buying opportunity or are concerned about existing holdings, it can pay to understand some basics of municipal bonds.

All munis are not alike

Exemption from federal income tax isn't a muni bond's only tax advantage. If you live in the state where the muni is issued, the interest also may be free from state and local income taxes. Municipal bonds have special tax status because they are issued by state and local governments to pay for a variety of projects. Revenue bonds finance specific public works projects; their interest payments are secured by revenue from those projects. General obligation (GO) bonds are secured by the full faith and credit of the issuing body. Because of that taxing authority, GO bonds are generally perceived as less risky than revenue bonds, and usually pay a lower interest rate.

Still other muni bonds may be taxable, depending on what they're used to finance. For example, so-called private activity bonds fund projects that provide a significant benefit to private interests, such as a sports stadium. Because they lack the tax advantages of tax-exempt munis, their rates typically are more comparable to corporate bonds. They also are included when calculating any alternative minimum tax (AMT) liability, so you may want to consult a tax professional about them.

A so-called flight to quality last spring sent many investors into the relative safety of Treasury bonds, and prices rose as a result. Because bond yields move in the opposite direction from their prices, Treasury yields dropped. Simultaneously, concern about the companies that insure bonds also cut demand for many other types of bonds, including some municipal ("muni") bonds that historically have had relatively low default rates and haven't required insurance protection. With reduced demand and lower prices came increased yields. In some cases, yields on munis have even exceeded those of Treasury bonds; traditionally, Treasuries have offered higher interest rates, largely because they don't offer munis' exemption from federal income tax.

Interest paid by a muni bond fund may or may not be tax free, depending on how the fund is invested; obtain and read a fund's prospectus before investing, and weigh your objectives, risk tolerance, and time horizon.

Are munis appropriate for you?

Although the stated interest rate on a muni bond is generally lower than the rate offered by a taxable bond of similar credit and duration, a tax-free muni bond actually may provide a greater after-tax yield. The higher your tax bracket, the more attractive a tax-exempt investment becomes. For example, if your marginal tax rate is 35%, a taxable investment would need to yield 9.23% to equal a tax-exempt yield of 6%. You'll need to compare a bond investment's tax-equivalent yield to know if it's a tax-efficient choice for you.

Other factors to consider

Munis involve a variety of risks. Like other bonds, muni prices typically tend to rise when interest rates fall, and drop when rates go up. Liquidity risk--the possibility that you might not be able to sell a bond--has been a factor recently. So has credit risk--the risk (real or perceived) that a bond's issuer may not make interest or principal payments. Inflation risk also can decrease demand for bonds and in turn lower their prices, because rising consumer costs cut the purchasing power of a bond's fixed interest payments.

The Pros and Cons of Self-Insuring Long-Term Care

The cost of long-term care can be expensive. In 2007, the national average for the cost of care in a nursing home exceeded $66,000 per year. In addition, about 70% of people over age 65 require some long-term care services, with the likelihood of needing such care increasing with age.

Source: National Clearinghouse for Long-Term Care Information, 2007

Thinking about the potential impact of long-term care often involves considering whether to buy long-term care (LTC) insurance or to self-insure. Sometimes your options are limited. For example, poor health or old age may make the cost of LTC insurance too expensive for you, or you may be denied coverage altogether. Medicaid may not be an alternative either if your income and assets exceed minimum qualification limits. In this case, self-insuring may be your only option. But if you are able to choose between LTC insurance and self-insuring, here are some issues to consider.

Why might you self-insure?

There are many reasons why people choose to self-insure rather than buy LTC insurance, presuming these options are available. Often, people will choose to self-insure because they think they have enough income and assets to pay for whatever long-term care they'll need, or they decide not to plan for long-term care because they think they'll never need it during their lives. However, there are both advantages and disadvantages to self-insuring.

Advantages of self-insuring

You have greater flexibility in how you use your financial resources. Even if you choose to allocate income or savings to potential long-term care costs by self-insuring, those assets will still be available to use for other purposes such as retirement, business ventures, or education funding.

Long-term care insurance premiums may become too expensive. Often, people buy LTC insurance during their working years, but find that their income decreases in retirement or policy premiums increase, making LTC insurance hard to pay for. If you own LTC insurance, or you're thinking about buying it, try to estimate what your income will be in retirement and whether you'll be able to afford the premiums, especially if they increase. If you think the premiums might be too costly, as an alternative, consider setting up an LTC savings account into which you can contribute as much as you can afford. This account may not provide the funds that an LTC policy could, but it can help pay for LTC expenses if they occur, and you won't be financially strapped with premium payments you can't afford.

You have more control over your care. Many policies provide only limited benefits--often with additional restrictions and conditions--that may end up covering only a small percentage, or even none, of your long-term care costs. For example, a policy may provide limited benefits for in-home care, even though most people would prefer to receive care at home. If you do need long-term care, using your own assets may give you more control over the type of care you get, where you receive the care, and who provides the care to you, without the restrictions or limits of some LTC insurance policies.

Disadvantages of self-insuring

If you never need long-term care, then, in hindsight, self-insuring is almost always the right choice. But what if you do need long-term care? How long will you need that care and how much will it cost? These uncertainties lead to some of the disadvantages of self-insuring.

Long-term care expenses can deplete your assets and income, leaving little or nothing for your spouse or dependents. Paying for some of your care with LTC insurance may allow you to conserve more of your savings and income for your spouse or dependents.

You may need to depend on family members to provide your care. Some people gamble that they'll never incur long-term care expenses. If they're wrong, their options may be very limited. If they can't qualify for Medicaid, their assets and income may be enough to pay for some of the care, but not all of it. Consequently, they often rely on family to provide some if not most of their long-term care. Long-term care insurance may cover some of the costs of skilled or custodial services and nursing home care, relieving your family of some of these caregiving responsibilities.

Self-insuring could increase your taxes. Depending on the type of assets you have, paying for long-term care from your savings could increase your income taxes. Withdrawals from certain retirement plans such as IRAs or 401(k)s are usually subject to ordinary income taxes, so taking sizable withdrawals from them to pay for long-term care expenses might increase your income taxes significantly. On the other hand, if your LTC insurance is tax qualified (as most policies are), then benefits paid from the policy for care are generally not subject to income taxes.

The Three C's of Credit

When you're looking for credit, it's worth understanding what potential creditors are looking for when they're looking at you. Traditionally, they're looking for the three C's: capacity, character, and collateral.

Capacity

Potential creditors want to know if you have the wherewithal to repay a debt. To this end, they'll inquire (usually on an application form) about your income information: How much is it? Does it come from wages, commissions, or some other source? Does it come on a regular or seasonal basis?

On the flip side, they'll also want to know about your expenses, especially any debt obligations. In addition, they'll want to know how many dependents you have and whether you're required to pay any child support and/or alimony.

Of particular interest to potential creditors is your debt-to-income ratio. This ratio compares your monthly recurring debt obligations to your monthly gross income. Your recurring obligations include your mortgage or rent, credit card payments, loan payments--including the one you're applying for--and alimony/child support you pay. Your income includes bonuses, commissions, and any other income you receive, such as Social Security, pensions, and alimony/child support.

Note: *The debt-to-income ratio is also known as the back-end ratio. A second ratio, called the front-end ratio, compares your rent or total mortgage payment to your gross income, and is used primarily to determine whether you qualify for certain mortgage loans.*

Your debt-to-income ratio goes a long way toward determining whether you are granted credit, how much, and at what interest rates. While many other factors affect your capacity to repay a loan, lenders generally consider debt-to-income ratios of 35% or less to be ideal, 36% to 42% to be manageable, 44% to 49% to be risky, and 50% or above to be unacceptable.

Character

Okay, your sweetheart thinks you're the best thing since sliced bread, and your bosom buddy knows you're one in a million. But that's not the sort of character endorsement creditors are looking for. What creditors want to know is, given that you *can* repay a debt (capacity), *will* you?

When it comes to your credit character, lenders often look for another C: consistency. Have you bounced around from address to address, or job to job? Doing so makes creditors nervous. Longevity in employment and residency indicate stability, and that's what creditors like to see.

Lenders also firmly believe that your past actions are a good predictor of your future behavior. So, they're looking to see if you've used credit before, and what your repayment track record has been like. To do this, they rely primarily on your credit report and your credit score.

Collateral

Maybe you've proven your capacity to repay a loan and your excellent character, but the lender may want something of value to secure the debt, particularly if the loan is for a large amount and/or a long term. If you default on the loan, the lender would be legally entitled to take possession of that item as a form of compensation. Tangible property used in this fashion is called collateral.

Typical examples of consumer loans that involve collateral arrangements are mortgages and home equity loans (failure to repay the loan can result in foreclosure) and vehicle loans (failure to repay the loan can result in repossession). While seizing property in the event of a loan default may not repay the entire balance due, it would at least mitigate the creditor's loss.

The "can'ts" of credit

There are some things a potential creditor can't do when considering you for credit. A creditor can't use your age, gender, marital status, race, color, religion, or national origin to:

- Discourage you from applying for credit
- Refuse to grant you credit if you otherwise qualify for it
- Make you a loan on terms different from those granted another person with similar income, expenses, credit history, and collateral
- Close an existing account

Furthermore, a creditor can't refuse to consider any public income you may receive, such as Social Security, veterans benefits, or welfare benefits.

Other C's that matter

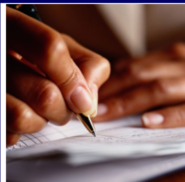
Capital: *Assets that could cover a debt (such as investments, bank savings accounts, personal property, or real estate) if your income became unavailable. In some cases, lenders will want you to use your capital as collateral.*

Conditions: *These are often factors beyond your control, such as the general health of the economy, a growth spurt or a downturn in the industry that employs you, and even (for mortgages) changes in the neighborhood around your property.*

Retire On Time
David E. Parker, CPA, CFP®
3830 Packard Road
Suite 260
Ann Arbor, MI 48108-2051

Securities and Advisory Services offered through NEXT Financial Group, Inc. Member FINRA/SIPC. Retire On Time and Parker Financial Services, LLC are not affiliates of NEXT Financial Group, Inc.

Ask the Experts



Can I roll over funds from my 401(k) to a Roth IRA?

Yes, beginning in 2008, you can make a rollover from a 401(k) plan (or other qualified employer plan, 403(b) plan, or governmental 457(b) plan) to a Roth IRA, as long as you meet certain requirements.

First, you must be entitled to a distribution from your plan. Generally, you can access your account when you terminate your employment. But, in some cases, you may also be able to make in-service withdrawals of your or your employer's contributions (for example, at age 59½). The terms of your plan control, so talk with your plan administrator or review your plan's summary plan description (SPD).

Second, your distribution must be an "eligible rollover distribution." In general, this is any distribution you receive from the plan that isn't a hardship withdrawal, certain periodic payments, or a required minimum distribution.

Third, you must meet income guidelines. You can roll over funds from a 401(k) plan to a Roth IRA only if your modified adjusted gross income is $100,000 or less (this dollar limit applies whether your tax filing status is single or married filing jointly). If you're married filing separately, you can't make a rollover at all. (These limitations will be repealed in 2010.)

You must include in gross income any amount that would have been taxed if the distribution had been paid to you, and not rolled over. But that's the price you have to pay to be able to receive tax-free qualified distributions from your Roth IRA in the future.

In most cases you should elect a direct rollover, where your 401(k) plan transfers the funds directly to your IRA. If instead the plan pays you, you'll have 60 days to complete the rollover, but your 401(k) plan will be required to withhold 20% of the taxable portion of your distribution.

Note: *If you have funds in a Roth 401(k) or Roth 403(b) account, different rules apply. If you receive an eligible rollover distribution, you can generally make a tax-free rollover (direct or 60-day) of those funds to a Roth IRA without restriction.*

Copyright 2008 Forefield Inc. All Rights Reserved.