

Focus on the kids

HAVING children spurred the savings habits of Judy and Tom Maslanka of Lisle, Ill. When Nicholas, now 18, was born, the Maslankas invested in an Illinois tax-free bond for education that matured this year, paying \$10,000. Two years later when daughter Danielle came along, they bought another bond that will be worth \$5,000 in 2008, when she will be halfway through college.

In those early days, before tax-free 529 college-savings plans were around, investing for a child through a custodial account was the norm. The Maslankas have rethought their investing strategies since then, investing in mutual funds in their own names, with the idea that they could use the money either for their kids' education or their own retirement. They describe themselves as prudent and conservative and have given up on individual stocks in favor of more-diversified and less-risky mutual funds.

"I'm in sales, so my income fluctuates," says Tom, 49, an advertising account manager who earns more than \$100,000 a year. "In a good year, we sock money away, and in a bad year we don't." The Maslankas' mutual fund investments are in addition to Tom's 401(k) plan and his cash-balance pension plan. Judy, 48, works part-time in an antiques store and contributed to a Roth IRA for the first time this year. She is also vested in a pension from a job she held for ten years before the children were born.

As Tom and Judy found out the hard way, saving in a child's name can be counterproductive when it comes to qualifying for financial aid for college. "The old philosophy was to use Uniform Gifts to Minors Act accounts, but now they come back to bite you," says Judy. After meeting with college-aid planning consultant Joseph Orsolini (www.notpayingforcollege.com) during Nicholas's senior year in high school, the Maslankas realized that assets held in a student's name are weighted more heavily than those of a parent. While a

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student is expected to contribute 35% of his assets to education costs each year, parents are expected to contribute only 5.65% of their assets, not including retirement accounts.

"If you think you are going to qualify for financial aid, you don't want to have anything in the kid's name to prevent you from qualifying," says Orsolini, who advises parents to get their college finances in order during the first semester of the student's junior year in high school because federal aid applications, which are due in the student's senior year, are based on the previous year's tax return.

With a six-figure family income, the Maslankas didn't qualify for financial aid this year, when Nicholas is a freshman at Bradley University, in Peoria, Ill. So they'll use his \$10,000 Illinois tax-exempt state bond to pay part of his annual \$23,000 college costs, reducing his assets and increasing his chances of aid in the future, when he and Danielle will be in college at the same time.

"It's good to have more than one child in college at the same time because it reduces the family contribution amount per student," explains Orsolini. While a family earning \$120,000 with one child in college is expected to contribute \$24,000 a year, for example, if they have two children in college, the expected family contribution drops to \$13,000 per student. "My goal is to keep clients' family contribution as low as possible," Orsolini says.

Because the Maslankas already had money saved for college, Orsolini suggested they take advantage of Illinois's

529 plan, which allows a state income-tax deduction for the full amount of a contribution. So they took \$25,000 and opened two state college-savings accounts for Nicholas and Danielle. (If opened in the parents' names, the 529 funds count toward the parent's assets, not the child's.) That move will reduce their state taxes for 2003 by \$750, and withdrawals used for education are free from both state and federal taxes.

The Maslankas don't expect to be able to take advantage of the Hope or Lifetime Learning credits on their federal tax return this year, because their income exceeds the \$103,000 maximum, or the \$3,000 tuition tax deduction for families with adjusted gross income below \$130,000. But they may have better luck next year and in 2005, when a new provision will allow those with incomes between \$130,000 and \$160,000 to claim a \$2,000 tuition deduction, and the tax break for those with incomes below \$130,000 will increase to \$4,000. However, the tuition tax break will disappear in 2006 unless Congress acts to extend it.

Nicholas, who has worked every summer since he was 14, planned to use some of his earnings to pay for college. Orsolini recommended that he deposit up to the maximum \$3,000 a year in a Roth IRA, because retirement assets are not counted in financial-aid assessments and he can withdraw his contributions—but not earnings—at any time without tax or penalty. In a Roth IRA, you contribute after-tax dollars, but upon retirement both your contribution and its earnings are yours tax-free. If Nicholas dips into his Roth IRA earnings to pay college expenses, those earnings will escape the penalty for early withdrawal, but they will still be subject to income taxes. Since Nicholas is in the lowest tax bracket, the 10% tax bite wouldn't be onerous.

Retiring early

THE ULTIMATE savings goal for many people is an early and comfortable retirement. Richard Rychtarik set his goal early, stuck to his



■ **Judy and Tom Maslanka socked away money to pay for the college education of their children, Danielle and Nicholas.**

plan, and managed to retire two years ago at 57. He did this despite working for 24 years for a computer company that went bust and left him with a lump-sum pension of only \$45,000. By the time he retired, Rychtarik and his wife, Geri, owned a conservatively run portfolio worth more than \$1.5 million.

What's his secret? "Live below your means," he replies, "and for two-income

families, than means saving at least half of one spouse's income. Have some fun, but don't be stupid. Always max out your 401(k) and IRAs. Pay credit card bills each month and budget at least once a year."

Richard and Geri sold their home of 20 years in St. Louis, pocketing a \$125,000 profit, and paid \$250,000 for their new house in Las Vegas, taking

advantage of the builder's 2% discount for buyers who paid in cash. Now they are looking for a second home, possibly in one of the Utah ski-resort areas about three hours away. They can escape the summer heat of Las Vegas there and rent the house to vacationing skiers during the winter.

Most of their money is locked up in laddered CDs. Richard searches the

Internet to find the best rates, but with interest rates so low, they haven't bought any CDs this year. Instead, they moved 20% of their portfolio into closed-end funds that invest in preferred stocks yielding between 7% and 8% a year, and into tax-free municipal bonds that earn 6% and 7%. He likes buying inflation-protected Treasury bonds, but he has already purchased the maximum \$30,000 allotment for the year and used his credit card—paying off his balance the next day—to earn frequent-flier miles.

Although Richard turns 60 in December and is eligible to tap his tax-deferred retirement funds penalty-free, he plans to leave that money alone for as long as possible. In the meantime, the couple lives comfortably and debt-free on about \$58,000 a year from their savings. Geri, 52, recently started working full-time, mainly to qualify for employer-sponsored medical benefits.

Enjoy the good life

ACROSS THE country in Wayne, N.J., Sal Puglisi, 62, also managed to retire early after a 33-year career with Warner-Lambert and generous stock options from the company that was later bought by Pfizer. Sal and his wife, Sandy, 60, enjoy an active retirement, traveling several months a year and spending time with their six young grandchildren who live nearby.

Like the Rychtariks, the Puglisis lived conservatively and paid off their credit cards each month before retirement, and they own their home outright. "I didn't spend a lot other than to send three children to college," says the former director of packaging design for the pharmaceutical company.

They have lived in the same lakeside home for 35 years, with a few remodeling projects and additions along the way. Since they already have access to a beach and to sailing, they feel no need to buy a vacation home. "All I wanted to do was maintain our lifestyle and travel as much as we wanted," says Sal.

When he retired in 1999, the market

A financial adviser calls income-guarantee programs 'the closest thing to a time machine you can get.'

was still going like gangbusters. But being risk-averse, Sal's biggest concern was to preserve what he had, to generate enough income to maintain his standard of living throughout retirement and to pass on what was left to his heirs. Unlike the Rychtariks, who took shelter largely in fixed-rate investments, the Puglisis found a way to take advantage of market run-ups while protecting themselves from downturns.

With the help of his financial adviser, Mark Cortazzo of Macro Consulting Group in Parsippany, N.J., Sal decided to sell a chunk of company stock and diversify into other investments. But he was not comfortable putting all of his money into the stock market. So Cortazzo suggested a compromise: a variable annuity that would invest in several investment funds (similar to mutual funds) with a guarantee that no matter how the market performed, Sal would earn at least 5% on his initial investment each year. If the underlying investments performed well, his account balance would reflect that, and he would lock in the highest value on the anniversary of the contract each year, even if the balance in the account subsequently declined.

The interest rate and high-watermark guarantees kick in only if Sal decides to take regular annuity payments. If he decides to take a lump sum instead, the payout would be based on the market value at the time. In addition, he can withdraw 5% of his initial investment each year and still guarantee a death benefit or an annuity payout equal to his initial investment.

"It was the 5% income guarantee that was important to me," says Sal, particularly because he made the decision to go ahead with the investment on Sept. 11, 2001, when the world seemed to be falling apart. He invested \$600,000, divided evenly among six subaccounts. Since then, his overall balance is up more than \$150,000, or 26%, thanks largely to two of his investment funds—one that invests in small companies and another that invests in stocks in developing nations. Both increased by 60% during one of the worst bear markets in history. "I'm absolutely comfortable being in the market rather than just sitting on the sidelines earning 5% all the time," Sal says. "It's fun watching some of the funds go up and knowing I'm protected if they don't."

Cortazzo acknowledges that many variable annuities have a well-deserved reputation for high costs and low return. But if your primary goal is to create an income stream for the rest of your life and to make sure your heirs are protected, there are a few such income-guarantee programs that can be a valuable part of the planning process. He calls them "the closest thing to a time machine you can get," by locking in early gains that can be paid out over a set number of years or over a lifetime, even if you start withdrawing funds in a bear market.

Although the Scudder "Destinations" program Puglisi chose is now closed to new investors, other income-guarantee programs are available. Unfortunately, the devil is in the details, and finding the right annuity contract is a challenge. For a \$50 fee, Cortazzo (800-776-2276) provides a second opinion to investors. He can evaluate one or two annuity contracts you may be considering or an existing annuity you are thinking of dropping. He says a lot of older contracts have tremendous value in terms of interest-rate guarantees that people simply don't understand, and the person who may be advising you to drop an annuity only makes money if you buy a new policy. ■

THE VISION THING

■ It wasn't easy, but Katherine and Chris Garland saved \$60,000 in one year, to finance a dream house.

Saving for a goal requires **COMMITMENT**

toward the finish line. *By Mary Beth Franklin*

SAVING FOR a financial goal takes discipline and hard work. Buying a first home, saving for college, planning for a comfortable retirement—you name it—successful investors have one thing in common: a vision. Focusing on their ultimate goal motivates them to ignore short-term temptations that can drain their resources and to concentrate on the best way to grow their nest eggs.

Katherine Garland, a drug-company sales rep and a triathlon enthusiast from Nashville, is a prime example. No stranger to discipline, Katherine decided to apply the same rigorous principles to her finances that she employs in her daily physical training. She and husband Chris set a goal—to trade their suburban location for a house in downtown Nashville in order to cut their commuting time.

Katherine, 30, decided that they needed to save enough to put at least 20% down on a house, to avoid having to pay private mortgage insurance. Most lenders tack on PMI for mortgages that exceed 80% of the cost of a home, to protect the lender if the borrower defaults on the loan. Katherine's goal was to keep their monthly mortgage payments below \$1,600, and an added \$100 a month in PMI might have put her dream house out of reach.

"We lived like misers for a year," Katherine jokes. "I didn't buy clothes. We would rent videos rather than go to

the movies, and we would only go out to dinner occasionally." The Garlands, who were married three years ago, are both so busy they hardly had time to spend money on entertainment or shopping anyway. In addition to her high-pressure sales job, Katherine trains every day for the upcoming Iron Man Florida triathlon, which entails a 2.4-mile swim, a 112-mile bike ride and a 26-mile run. Equally self-disciplined, Chris, 29, is a former Army Ranger who runs his own martial arts school, where he often works seven days a week. He also has a contract with the federal government to train special military units, which sometimes takes him away from home for weeks or months at a time.

Eye on the prize

IT WASN'T EASY, but together Katherine and Chris saved \$60,000 in one year, enough for a PMI-free deposit on a 1930s-style, four-bedroom home near Vanderbilt University. They bought the house for

\$295,000 in December 2002. Normally, the Garlands keep their finances separate, but they opened a joint checking account in January because Chris was scheduled to spend three months in Kuwait training military Special Forces. His government paycheck was deposited directly into the joint account so they could pay the mortgage and household bills while he was away. Chris turned the day-to-day operation of his martial arts studio over to a trusted student and left the finances in the hands of a fellow businessman.

In addition to designating a portion of each paycheck for the house down payment, Katherine scoured the Internet to find the online bank that paid the highest interest rate on their savings. Now that Katherine and Chris are settled in their new home, she is working on her next goal: updating the kitchen. So every two weeks, after putting money aside to pay her share of the mortgage and household bills, and having 5% of her paycheck withheld for 401(k) contributions, which her company matches, she designates \$500 for her next savings goal. She also earmarked her quarterly bonus for the kitchen-remodeling project.

What's the secret to this young couple's financial discipline? In this consumer-driven culture, buying a big-ticket item usually means running up credit card bills or tapping a home-equity loan. "My parents were teachers so we didn't have a lot of money growing up," Katherine explains. "I don't feel I need a lot of things, and neither does Chris." She adds that they both work hard and enjoy their jobs, and they want to save for their goals while they can—in case having children alters their financial picture in the future.