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# 5 MINUTE FINANCIAL PLAN

QUICK AND SIMPLE

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## I. BUDGET/FINANCIAL STATEMENT PHILOSOPHY

Most clients always want to know how they can “save money”. It doesn’t matter if they make \$1,000,000 a year or \$50,000 a year, at the end of each year there is no savings.

I tell my clients that they must put together a budget and then allocate a portion of the budget to savings. The amount paid into savings is first, the old “pay yourself first” rule and the remaining budget must be followed closely by both husband and wife.

The best computer program I recommend is Quicken. By using Quicken the client can now categorize their expenditures into tax deductible categories which we currently use on their tax return. I also give them an alphabetical list of tax deductible categories.

If the client consistently inputs their checking account information, they are then able to reconcile their bank statements, call up financial information and print a personal financial statement to be used when applying for a bank loan.

I often charge the client by the hour to “set up” Quicken and give them a quick update on how to use the program. If the client is ever audited by the IRS, specific reports can be printed showing categories, date, check numbers, vendor and amount, assuring the client of a good audit result.

## II. LIFE INSURANCE PHILOSOPHY

Life insurance is a necessary evil. It's a cost which must be paid if a financial obligation exists which can not be covered by current, available assets.

A young single individual with no financial obligations to anyone, including family, does not need life insurance. On the other hand, a doctor making \$150,000/year with two young children, married to a housewife with few assets built up must buy life insurance to cover this "financial obligation" to support the family in case he prematurely dies.

The first question is how much and for how long. My opinion is that the insured needs to "replace" his income if he dies so that his wife can take the insurance proceeds (tax-free) and place the funds in a bank account (sinking fund) and draw out enough money to live on and not change the current life style she is accustomed to.

Because the wife would not pay tax on the proceeds of the life insurance, only on the interest earned, her withdrawal would approximate one half of the \$150,000 salary, or \$75,000. Therefore, 10 times the gross income or \$1,500,000 would allow the wife to live, without working, for about 20 years.

My general rule is that the life insurance proceeds should last 20 years because by that time the children are adults and can get a job to support the wife and themselves. Also, the wife could go back out in the work force and earn a living or sell the house and live off the proceeds.

Because I have used 20 years, obviously I am also telling you to buy term life. Term life is much cheaper and is sold most of the time as a level premium which means you pay the same amount each year for 20 years. After 20 years, and hopefully you didn't die, your financial assets should be enough to cover your entire financial obligation if you have done proper financial planning. I use the analogy that the term insurance is a safety net for the first 20 years in case you fall off the tightrope of life. Once you have reached financial security, or land in my example, why would you want to keep paying for a safety net?

Remember, the insurance companies and salesmen aren't rich because life insurance is a good bet. In fact, it is a lousy bet, just like a lottery ticket. If it's necessary, buy it, but buy it at the cheapest rate possible from a good company.

Lastly, I only believe in term and nothing else to insure your life. Insurance salesmen will want to sell you whole life or universal life due to the extra savings provisions in the policy.

What they are really saying is they want you to pay higher premiums so they can make larger commissions. Also in the whole life or universal life product, you will need to keep paying premiums for your entire life, which means they receive commissions for their entire life. It should be noted that when you are in your 70's and 80's, you will be paying for life insurance at those exorbitant rates. If you have borrowed any monies greater than the premiums you paid

into the policy and you don't die with the policy in force, you will be taxed on the difference which could be in the millions of dollars.

Be smart and buy term and invest the difference. If you have a whole life or universal life policy, cash it out before it's too late and buy term. Never get rid of any necessary life insurance until you have the replacement policy in force.

### III. DISABILITY INSURANCE PHILOSOPHY

Just like life insurance, disability insurance is a necessary evil. If you are earning a good living, whether you are married or not, if you can't work and have financial obligations, you most likely need disability insurance.

The cost can be expensive but it's the only substantial payment you will receive if you become disabled. State disability will pay \$500 a month for 24 months. What do you do after this?

Just like other insurances, you need to contact an insurance salesperson who is independent and can sell all types of policies, finding the right one for your needs.

The standard rule of thumb is to obtain 60% of your gross income as a benefit because individual disability payments when received are tax-free. Therefore, you are currently living on 60% of your gross income due to income taxes. Normal disability policies pay an individual until he/she is 65 years old at which time social security begins to pay.

Therefore, for a normal 35 year old male making \$100,000 gross income per year, he would request a \$60,000 policy ( $\$100,000 \times 60\%$ ) paying \$5,000 per month ( $\$60,000 \div 12$  months) until his is 65 years old. Such a policy would cost approximately \$350 per month.

#### IV. CHILD'S EDUCATION PHILOSOPHY

Savings for a child's education is a difficult and onerous task but can be made possible using a tax deferred plan. The two tax deferred plans I recommend are:

- 1) An educational savings account.
- 2) A section 529 plan.

Both plans allow monies to be contributed (not tax deductible) and grow tax free with the earnings tax free on withdrawal, if such funds are used for educational purposes.

Currently tuition at a public four year school is averaging \$7,020 per year and at a private school the amount is \$26,273. Housing will cost an additional \$5,000 to \$8,000, books and supplies \$1,100 and transportation and other spending averaging between \$1,500 to \$3,000 per year.

To figure how much you need to save per year for your child's education, a simple formula exists.

You first figure how much you will need to fund the entire four years of your child's education in today's dollars. Let's assume in our example \$40,000 (\$10,000/year x 4 years).

To estimate the future dollars when your child will actually use the monies to pay for their education, you must multiply the current dollars, \$40,000 in our example, by a future cost factor based upon your child's current age. Using the table (which assumes a 6% annual increase in college costs) and assuming your child is 6 years old, a 2.012 future cost factor is used. Therefore in future dollars, you must have saved \$80,480 (\$40,000 x 2.012).

#### Education Cost Calculator

Age of Child	Estimated Future Cost Factor	Age of Child	Estimated Future Cost Factor
1	2.693	10	1.594
2	2.540	11	1.504
3	2.397	12	1.419
4	2.261	13	1.338
5	2.133	14	1.262
6	2.012	15	1.191
7	1.898	16	1.124
8	1.791	17	1.060
9	1.689	18	1.000

Next you must take the \$80,480 of future cost and multiply it by the annual required savings factor to calculate the annual savings you must make to meet your child's education expenses. It is assumed that your savings is earning an after tax yield of 6%.

Therefore, using the savings factor of 0.050 (your child is six years old), the annual savings you must make is \$4,024 ( $\$80,480 \times .05$ ) or \$335.33 a month.

**College Expense Savings Calculator**

Age of Child	Annual Required Savings Factor	Age of Child	Annual Required Savings Factor
1	0.031	10	0.083
2	0.033	11	0.095
3	0.037	12	0.112
4	0.041	13	0.136
5	0.045	14	0.167
6	0.050	15	0.216
7	0.056	16	0.300
8	0.063	17	0.458
9	0.072	18	0.944

The sooner you start saving for your child's education, the less it will cost you per year. Start now!

## V. LONG TERM CARE INSURANCE PHILOSOPHY

Because my Dad and my Grandmother died of Alzheimer's disease, I know the financial burden which someone can experience when they do not have long term care insurance.

As the baby boomers get older, long term care will become, or is becoming, an issue which must be dealt with. Ignoring this issue is ignoring proper financial planning. Long term care insurance will pay for either home care costs or nursing care costs if the insured qualifies.

I believe you must work with an independent long term insurance salesperson who exclusively sells long term care for over 120 major insurance companies, each company with different benefits, riders and premiums.

You must receive advice regarding your special needs and why one insurance company is better than another. If you are looking at a company group plan, be aware that such plans are very limited in coverage. You can only get this from someone who exclusively deals in the sale of long term care with all insurance companies.

I believe the best time to purchase long term care is at the age of 40. I have looked at the increase in premium from 40 on and have noted that purchasing the policy earlier will keep the premiums at a lower price and will be cost effective based upon the higher premiums in the future. You also risk your health changing as you age and that may exclude you from obtaining coverage.

Currently the average cost per day at a long term care facility is \$150/day or \$4,500/month but with inflation at 3% for 30 years the \$4,500/month becomes \$11,000/month. Could you afford to pay \$11,000/month in long term care in 30 years? A study projected that there is a 40% chance that one spouse of a married couple will need long term care.

That's why I highly recommend that you purchase a \$4,500/month policy with an inflation rider so that the \$11,000/month is taken care of.

The typical married couple (age 45) can expect to pay approximately \$2,800/year for a \$4,500/month policy with an inflation rider.

Your other option is to do nothing and hope you don't need long term care (medi-cal and Medicare does not cover this). If you need long term care then you must use up all of your financial assets and apply to medi-cal (i.e. no assets) so that you can live the rest of your life in a run down, urine smelling facility. I don't believe that's good financial planning.

## VI. RETIREMENT PLANNING PHILOSOPHY

Don't be the person who wants to start his retirement planning when he/she is 55 years old. It's too late and you will either have to inherit a large sum of money or work for the rest of your life. Start now! Your retirement will come sooner than you think and social security will not be enough to cover your retirement expenses.

The easiest and most efficient way to save for retirement is in a qualified pension plan. Many plans exist depending upon the company you work for, but all usually have the following benefits:

- 1) Your contribution is tax deductible;
- 2) Your pension plan monies grow tax-deferred.

Because of the tax deductibility and the tax deferred benefit, your funds will grow much faster than an ordinary savings account. In addition, many employers will "match" your contribution. This equates to a 100% return on your money for the year you make your contribution.

Most financial planners believe that the average person will need to retire on 70% of their pre-tax income. Social security will make up 40% of the income leaving a 30% shortfall.

This shortfall must be made up with other retirement accounts and personal savings.

A rule of thumb is to multiply the amount of money you want to be able to spend the first year in retirement by 20 to 25. Make sure you subtract from the amount you want to spend any social security income you will be receiving.

Go to [www.asec.org/ballpark/blpkcomp.htm](http://www.asec.org/ballpark/blpkcomp.htm) to figure out your "ballpark" shortfall and begin saving now! The sooner the better!

## VII. LEGAL FEES PHILOSOPHY

The old saying goes "if you are your own attorney, you have a fool for a client". In other words, pay the extra cost of an attorney to do any legal work for you so it's done right.

The two areas where I have found the major need for an attorney are living trusts and the incorporation of a business.

In regard to a living trust, if you own assets and die and the assets are not titled with a beneficiary, the courts will determine who gets the assets through probate court. The court allows an attorney to charge a percentage of the asset value, usually 5 to 8%, as his fee to determine title.

In other words, if you are single, die and own a house worth \$500,000 (mortgage debt is ignored), the attorney may charge between \$25,000 to \$30,000 to say the house goes to your parents.

With a living trust and the title of the house in the living trust, you save all the legal fees in probate court. A living trust costs approximately \$1,000 to set up. Do you want to pay \$25,000 - \$30,000 or a one time fee of \$1,000?

Also in the living trust you can name a guardian for your children if you and your spouse were both to die together and you can include advanced health care directions.

In regard to incorporating a business, what is the best time? My general answer is when you hire your first employee. At that time you have potential liability of tort claims from your employee regarding sexual harassment, firing for undue cause and discrimination just to name a few. The incorporation, if properly done, will protect your personal assets.

You may also want to incorporate if you have other situations which may lend themselves to you being sued such as dealing with the walk-in public or demonstrations of products.

A normal incorporation will cost approximately \$1,000 which should include a Federal I.D. number and S-Corporate election if applicable.

**VIII. ESTATE PLANNING PHILOSOPHY**

Everyone believes that you must hire an attorney to pay little or no estate (death) taxes. In fact, using a proper living trust where a deceased spouse “bypasses” the living spouse’s trust, most taxpayers will never pay death taxes.

The following exclusion, per taxpayer, is allowed.

<u>YEAR</u>	<u>EXCLUSION</u>
2004	1.5 Million
2005	1.5 Million
2006	2.0 Million
2007	2.0 Million
2008	2.0 Million
2009	3.5 Million
2010	Unlimited (pending Congressional decision)
2011	1.0 Million

Therefore, if your 2009 net estate after subtracting debt is less than **7 Million Dollars** (3.5 million x 2 people), you owe zero in estate taxes. If you exceed this amount you can gift away large portions using children, grandchildren, charities and educational trusts.

Save your money on paying attorneys for schemes which you don’t need.

## IX. INVESTMENT PHILOSOPHY

If there was such a thing as a “crystal ball” we could all become millionaires in the investment field. In other words, there is no such thing as an investment messiah.

Investment advisors try to “read” economic trends and invest accordingly. It is common and accepted knowledge that to protect your investments from any large fluctuations your portfolio must be properly allocated and diversified based on your risk tolerance.

Such allocations and diversification should be left to an investment advisor who spends his time reviewing his client’s portfolio with the knowledge of what is happening in the market and is proactive in managing your account. Don’t do it yourself and don’t act on MONEY magazine recommendations. Stick to what you know best and delegate the rest to professional, competent advisors.

In today’s world an investment advisor typically charges 1% of your investment portfolio. Your advisor should always be available to answer your questions and allocate your assets in a prudent, logical manner at the best available cost based on your risk preference.

## X. REAL ESTATE LOAN PHILOSOPHY

In today's market of constantly changing interest rates, the simplest financial planning advice that can be given is "are you borrowing at the lowest interest rate you can qualify for?"

Just like all professions, all mortgage lenders are not the same! In fact, a loan broker must shop your loan to a bank or savings and loan while a direct lender can make the loan "directly" thereby saving you additional middleman costs in processing and points.

That's why I believe a direct lender with many loan options is best. In addition, a respectable direct lender will not try to "gouge" the prospective borrower with large loan fees and points, which can fluctuate into the tens of thousands of dollars. Experience also counts when choosing a mortgage lender to get the best program tailored to your situation.

I recommend that my clients adjust their loans whenever they can drop their rate by 1/4 of a percent or more. I request that the refinance loan is a no points, no cost, no prepayment loan, if possible. In this case, the client can't lose if a refinance is done in the near future.

If the borrower is 40 years or older, I recommend that the loan is a fully amortized, 15 year loan, so that by the time the borrower is 65 years old and retired, the loan is paid off. This is good financial planning as far as cash flow during retirement and the actual loan is about 1/2% lower verses a 30-year loan.

Generally speaking, I believe a variable rate and a loan with a balloon payment should not be requested due to the potential problems each type of loan can cause down the road.

With a variable loan, if interest rates rise, payments will rise causing cash flow to decrease and potential negative amortization of the loan. If the borrower tries to sell the house to get out, most likely other borrowers are doing the same and you are selling in a down market. The same would be true for a balloon payment.

Only buy as much home as you can afford. A rule of thumb is 4 to 5 time your gross income in today's interest rate environment.

## XI. HEALTH INSURANCE PHILOSOPHY

Today one of the biggest issues for the nation is health care. If you don't have it you are risking your financial assets and future on the health of yourself and your family.

That's why you must have adequate health insurance because, just like other types of insurance, many companies exist who sell health insurance with many different types of bells and whistles. Each different bell and whistle must be examined to see which ones fit your individual needs.

I recommend a health insurance salesman who can sell all types of health insurance policies (*an independent agent*) including individual, group, PPO, HMO and catastrophic policies so that you, as the consumer, receive the best product at the best price.

Also it is important that if the policy is a company sponsored plan, the salesperson will assume responsibility for the following:

- Track day-to-day services provided by a client member documentation system
- Administration of COBRA continuation coverage
- Section 125 premium only arrangements
- Full flex (cafeteria) plans
- An 800 toll free number for easy access
- Assist in identification of employee benefit goals
- Analyze existing plan in light of goals
- Develop benefit strategy to meet goals
- Market plan to obtain competitive quotes
- Analyze carrier proposals and make recommendations
- Develop multi-media and printed employee communication materials
- Conduct employee orientations
- Provide on-site administrative training
- Review contracts
- Conduct continuing review of benefit and cost performance
- Negotiate competitive renewal actions
- Develop effective approaches to ongoing benefit cost management
- Provide legislative updates
- Advise of changes in concepts and new benefit developments

## XII. HOME AND AUTO INSURANCE

When was the last time you “shopped” your home and auto insurance with another carrier? Most of my clients keep paying on their same old policies with little idea that they are paying hundreds of dollars more a year in premiums.

All insurance companies are not the same and you shouldn't be penalized if you have had no claims but you are with a carrier who suffered losses with other policy holders.

In fact, for the auto insurance, if you are a good driver, there is a 75% chance you are paying too much.

Shop your policy with an independent broker (not a captured broker working only for Farmers or Allstate) and begin savings now. This includes having a broker who is knowledgeable about all of the discounts a policy holder can receive such as:

- Renewal Discounts
- Good Driver
- Group
- Good Student
- Multiple Autos
- Multiple Policies
- Mature Driver
- LoJack/Tele-Trac

Home insurance discounts include:

- Newer Home
- Increased Deductible Credit
- Renewal
- Dog Exclusion
- Alarm
- Sprinklers