

Identifying and prioritizing your financial planning goals

By Mary D. Kirtland, CFP

As a Certified Financial Planner and mother of a pharmacist, I have had many opportunities to offer advice on financial planning to my daughter, which is why I felt called to write this article. For those of you about to enter the profession after 6 years of college and pharmacy school, stepping out into the world with an entry-level salary closer to six figures than five brings both financial opportunities and financial temptations. The opportunities come from your ability to start saving or paying off debt at an early age, and the temptations come from the

ability to spend or have easy access to credit at an

early age. The theme I emphasize for young pharmacists is that there's no time like your twenties to start putting your money to work, giving you greater potential to achieve your financial goals throughout your life. Ask yourself what you can do now to ensure that you get on a road to financial freedom rather than a detour to financial frustration.

As financial planners love to say, financial planning is a process and that process has steps: establishing goals, gathering information needed to develop your plan, analyzing and evaluating your financial resources, devising specific tactics to pursue your goals, implementing the plan and monitoring the plan, and making necessary adjustments as you move through life. Each of these steps warrants discussion, but I want to focus on the first step of setting and prioritizing goals. Why? Because if you shoot at the wrong targets, or goals, you won't have any arrows, or income, left once you determine what you want to hit!

Choices, choices, choices

Goals are simply financial targets. Since we all have a limited number of financial arrows, it is important to choose targets carefully, so I will break your goals into different time frames.

Short-term goals are the ones you want to achieve in the next 5 years. Some examples might be a wedding, honeymoon, new car, or new furniture. Medium-term goals are 5 to 10 years down the road and might

include purchasing a home, paying off student loans, or saving for college education. Finally, long-term goals are things you want to achieve by the time you retire, such as funding your retirement, passing on an estate, or traveling.

The first time you do this, you should make a list of things you want to accomplish in general terms. But over time, you should refine this list and get more specific in terms of dollar costs or in relation to your income.

Having a budget is necessary if you expect to reach your financial goals. There are many tools available online to help you draw up a budget. Why don't more people use a budget to guide their spending? Because a budget requires self-control!

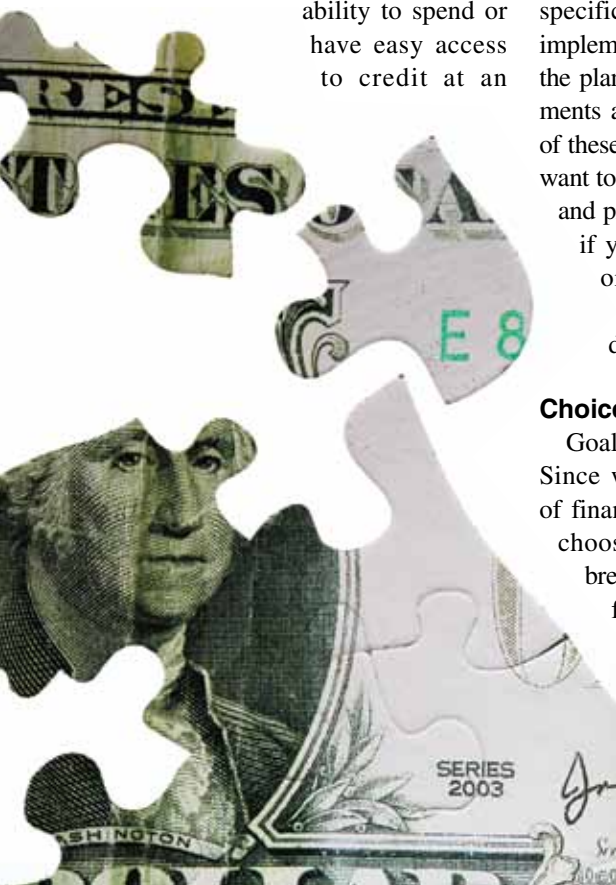
Developing and adhering to a budget means you are willing to spend your income based on goal-directed decisions rather than impulsive purchases. In those terms, living without a budget is like driving without roads or maps. While the budgeting warrants its own article, I will focus my discussion on prioritizing your goals.

The old adage, "It's not what you earn that counts, it's how much you spend," is more true now than ever. I have seen people who earn very generous salaries have huge amounts of debt because they spend more than they earn. In your early years after college, don't let your standard of living escalate beyond what you can actually afford. Keep your expenses low during the first 3 to 4 years after college.

When setting goals, avoid the temptation to buy a house, car, or boat instead of reducing debt or saving for a down payment or retirement. Getting an early start on your saving means you will have more money in the future (see sidebar on page 10).

Pay off debt or save

With so many graduates leaving



school today with student loans, the question of how to prioritize the goals of paying off debt and saving is certain to arise. You have three options: pay off your student loans now and save for retirement later, save for retirement now and make the minimum student loan payments required, or a combination of the two. The decision between the three options comes down to interest rates and tax deductibility of the interest payments. When it comes to paying off balances, your first goal should be to pay off your nondeductible debt, such as credit card or car loan, with the highest interest rate before you consider paying off a deductible student loan or business loan.

Paying off student loans before starting to save for retirement is a common mistake. That is usually because graduates want to get out of debt before saving for retirement. While this may sound rational, it is not practical. If you waited until you had no more debt to begin saving for retirement, you'd never be able to retire.

However, there are times when it makes sense to pay off student loans immediately and save for retirement later. This is a smart decision if your student loans have interest rates greater than 8%. The historical long-term investment return on the stock market has been roughly 8%, so while past performance cannot guarantee future results, if you are paying more in interest than you are earning on your investments, your money is best used paying off your high interest loans first and investing in retirement later. If the interest rate on your student loan is less than 8% and the stock market returns 8% or more over the long run, then the money would be better used to invest for retirement. If you are saving using a 401(k) or IRA, the benefits of tax-deferred growth make an even stronger case for

investing for retirement and making the minimum student loan payment.

Since financial planners love to preach diversification, a third option is to do some of each. If your student loans have an interest rate between 6% and 8%, you may want to diversify your approach by dividing your savings between paying off your student loans and saving for retirement. For example, when developing your budget, if you determine that you have \$500 per month that can go to savings, you might put an additional \$250 towards your loan payment and \$250 in your 401(k).

A suitable place for many investors to save for retirement is a 401(k), particularly if your employer matches your contributions, but you can also save for retirement by contributing to an IRA or Roth IRA. This can be a very effective way to save money. Many employers, especially larger companies, will match half of your 401(k) contributions up to 6% of your salary. If you make \$80,000 but don't contribute 6%, you're missing out on \$2,400 of free money from your employer! You're also missing out on the tax-deferred growth of that money over the next 35 years. If your 401(k) earned an average 8% annual return, that single year of contributions (\$4,800 deferral and \$2,400 match) could have grown to more than \$106,000. If you opt to pay off student loan debt rather than save for retirement, you can try to make up for lost opportunities once your debt is paid off by making extra contributions to your retirement plans, but you cannot get back the money you passed up by declining your employer's match.

Since many pharmacy jobs pay well, it is important to understand that in some cases, the interest you pay on student loans may not be deductible. According to IRS guidelines, the loan payment deduction is claimed as an

adjustment to income, so you do not need to itemize your deductions to benefit. However, you can only claim the deduction if you paid interest on a qualified student loan during the tax year, your status is not married filing separately, your modified adjusted gross income is less than \$70,000 (\$145,000 if filing jointly), and you (and your spouse, if filing jointly) cannot be claimed as dependents on someone else's return. If you cannot deduct student loan interest, you will want to treat the debt like all other nondeductible debts that you currently have.

To buy or not to buy

Prior to the recent collapse in the housing market, the unwritten rule was that buying was a better financial decision than renting. However, with home prices expected to flatline for the next few years, the decision to buy in anticipation of building equity in your home requires that you stay in the home longer than you would have before 2007.

Since the case for buying versus renting has always relied on building equity, it is important to keep in mind there are some expenses of home ownership that do not build equity. I remind my young clients that the after-tax costs of interest, real estate taxes, and homeowner's insurance do not build equity—that money is essentially down the drain.

For example, assume the interest on a \$300,000 mortgage is \$15,000 and the real estate taxes are \$3,000 per year. If you are in the 25% income tax bracket, your after-tax cost for these two items is \$13,500 per year or \$1,125 per month. Adding in nondeductible homeowner's insurance of approximately \$100 per month, you have a \$1,225 monthly cost of homeownership that you should compare to the cost of renting, as these expenses will not be recouped unless the price of your

home appreciates. It is also important to remember that if you live in states that are prone to natural disasters like Florida or Louisiana, you will need to consider the cost of additional insurance on your house, which can add thousands of dollars per year.

Buying a home requires a one-time down payment, meaning you'll need some savings first. If you put down less than 20%, you will probably have to pay for private mortgage insurance, an added monthly cost. Your current cash flow should be high enough that you can afford to set aside 1% to 2% of your home's purchase price each year to cover regular maintenance. For example, for a \$300,000 home, you should have \$3,000 to \$6,000 on hand each year for general upkeep.

To figure out whether renting is a better value than buying, the best metric to look at is your area's price-to-rent ratio. To figure it out, divide the price of a home you'd like to buy by the annual rent you would pay on a comparable home. If the ratio for your market is far above the historical average of 15, renting may be a better deal.

More than anything, the decision to buy a home or rent depends largely on your own situation. Most planners advise that it only makes sense to buy if you plan to stay in the same home for at least 7 years. Many of you may be planning to move in the next few years or to get married and start a family, in which case it may be important to maintain the flexibility that renting provides.

Tools you can use

As a member of the Financial Planning Association (FPA), I highly recommend you visit the FPA website at www.fpaforfinancialplanning.org and take advantage of the excellent tools and calculators available. The site includes a free financial roadmap that

is easy to use to help you set and prioritize goals, and then see how much you will need to save to fund them. FPA also provides additional resources through its partnership with the APhA New Practitioner Network, which you can enjoy by continuing your membership with APhA after you graduate.



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The power of compounded earnings

Suppose you invest \$8,000 every year from age 25 to age 30. You could then stop saving entirely and, assuming an average annual return of 5%, your savings would grow to more than \$244,000 (ignoring taxes) by the time you're 65. However, if you save nothing the first 30 years but then, starting at age 55, save \$20,000 per year—if inflation is 3% per year, it will take \$20,000 30 years from now to buy what \$8,000 buys today—for 10 years, you would only have approximately \$250,000 at age 65. In other words, if you wait until you are 55 to start saving, you would need to save \$200,000 to have the same amount of money at age 65 as you would have if you had saved \$40,000 during the early years of your career.

Compounding of earnings is very powerful for those who start saving for retirement in their twenties. The ability to build large nest eggs with relatively little pain is amazing, as long as you invest regularly. The current market performance should not affect your savings and investing plans. Remember, you are not going to use this money for 30 to 40 years. Over the long run, the prices you are paying now for stocks may look like bargains.

Five pharmacy websites you should have bookmarked

1. **www.pharmacist.com**. Your Access to the World of Pharmacy. APhA's website is an absolute must-visit if you're trying to become informed about the issues affecting pharmacists and student pharmacists, stay updated on the latest drug and industry news, and if you have any questions about the organization that represents pharmacists in all aspects of practice. But you knew that already, didn't you?
2. **www.globalrph.com**. A free website with many references, including medical calculators, IV compatibility, infectious disease therapy, medical terminology, and drug tables. It probably won't replace Micromedex or Lexi-Comp, but the price is right.
3. **www.guidelines.gov**. Want to know the latest clinical guidelines for the disease of the week? This website, run by the Agency for Healthcare Research and Quality, probably has it in an easy to search layout.
4. **www.nabp.net (Your state's board of pharmacy)**. Laws, regulations, and fees can change frequently, so keep up-to-date and be prepared for the MPJE by checking this website often. Check it out for a complete list of all 50 state boards of pharmacy.
5. **<http://www.medscape.com/pharmacists>**. A repository of drug and disease information. Pharmacists also keep you up-to-date on the latest medical news and opinions and offers traditional and multimedia CE.

—Compiled by Jessica Sipe