Financial Planning Rules of Thumb: Junk or Treasure?

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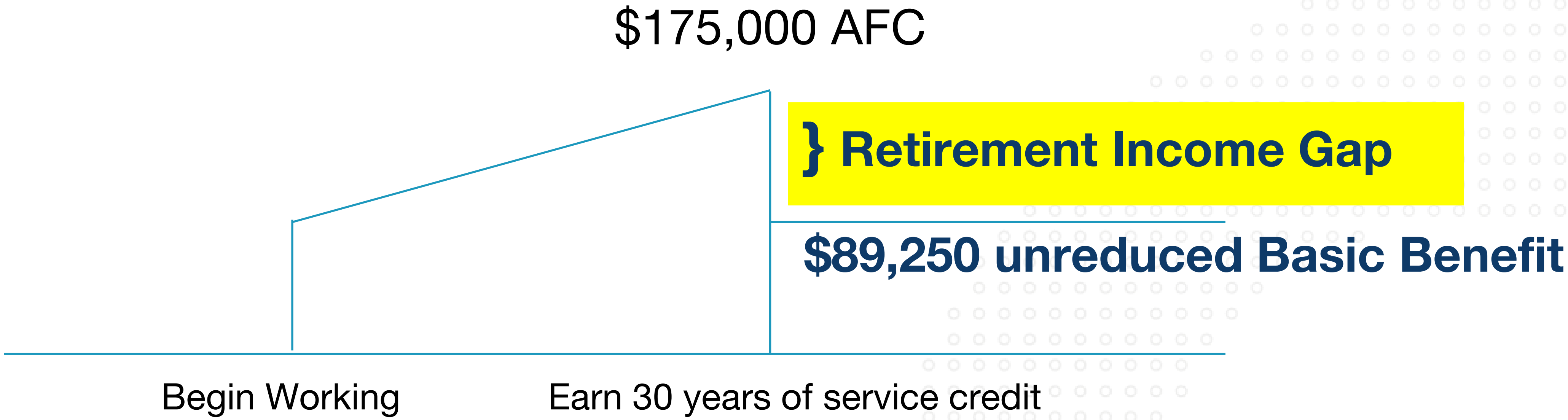
100 minus your age should determine your allocation between stocks and bonds (fixed income)

You need 25x your planned annual spending in your portfolio when you retire

You should plan on projected annual retirement expenses of 75% of current expenditures.

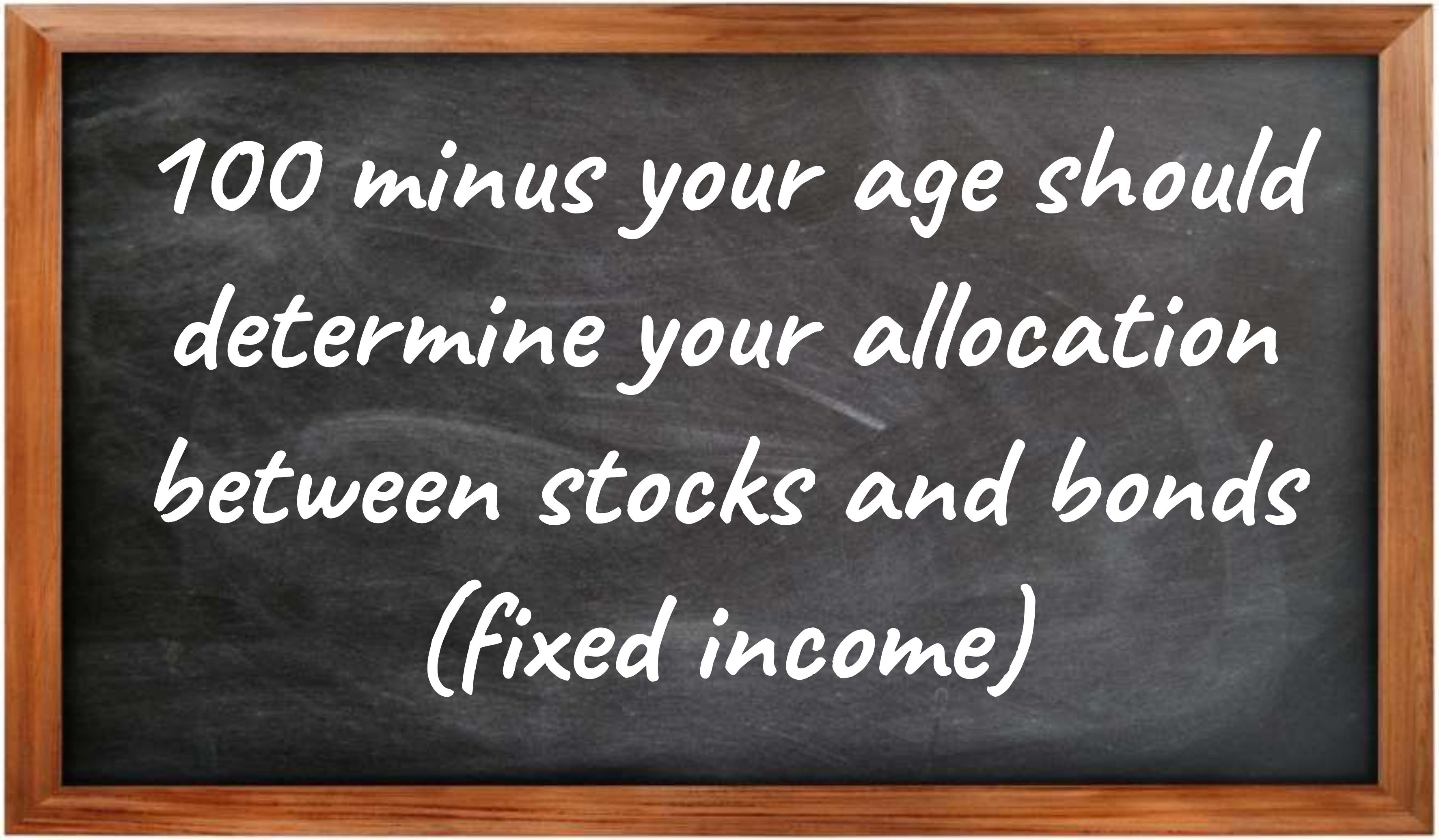
Are these rules of thumb junk or treasure?

Retirement Income Gap



A retiree under VRS Plan 1, with 30 years of service credit and an Average Final Compensation of $175,000 would receive an unreduced Basic Benefit of $89,250. This would be a **51% net loss of gross income!** Social Security does not make up this gap.

How should I allocate the funds in my portfolio?



Is this Rule of Thumb Junk or Treasure?

What is the proper balance among stocks & bonds (fixed income)?

The 100 - Your Age Rule of Thumb

- For years, a common guideline was that individuals should hold a percentage of stocks equal to 100 minus their age
- The idea is to gradually reduce your risk as you get older.
- With people living longer and many fixed income investments providing lower yields, an **adjusted rule of thumb** suggests that you hold a percentage of stocks equal to 120 or 110 minus your age.

Asset Allocation with the Adjusted 110 - Your Age Rule of Thumb		
Age	**Allocation to Stocks**	**Allocation to Bonds**
40	70	30
50	60	40
60	50	50

Comparing Returns & Volatility

Income-Focused

Age 90: Adjusted Rule of Thumb

Historical Risk/Return (1926-2020)

- Average annual return: **7.2%**
- Best year (1982): **40.7%**
- Worst year (1931): **-10.1%**
- Years with a loss: **16 of 95**

Balanced

Age 60 - Adjusted Rule of Thumb

Historical Risk/Return (1926-2020)

- Average annual return: **8.7%**
- Best year (1982): **33.5%**
- Worst year (1931): **-22.5%**
- Years with a loss: **20 of 95**

Growth-Focused

Age 30 - Adjusted Rule of Thumb

Historical Risk/Return (1926-2020)

- Average annual return: **9.8%**
- Best year (1982): **45.4%**
- Worst year (1931): **-34.9%**
- Years with a loss: **24 of 95**

Historically, stocks have higher average returns & more volatility.

A VRS retirement benefit acts a lot like an investment in bonds.

Assets	Approximate Value	Percentage
Bond that provides income stream of $89,000 annually for 30 years with 5% annual return earned by the investment (almost equal to Basic Benefit for Plan 1 member with 30 years service and AFC of $175K)	$1,387,000	78%
Portfolio - 403(b), 457(b), etc.	$400,000	22%
Total	$1,787,000	100%

- The adjusted rule of thumb suggests a 50/50 stock/bond split for someone at age 60.
- Superintendents should consider a growth-focused portfolio allocation to stocks within their portfolio because a VRS benefit is similar to a fixed income investment and serves some of the purposes of bond holdings.
- Ultimately the assets, goals, risk tolerance and other aspects of the superintendent's financial picture should drive the allocation.

"If it looks like a duck . . ."

risk tolerance vs. risk capacity

After deciding on my allocation among stocks and bonds, how do I choose specific funds within my 403(b) and 457(b)?

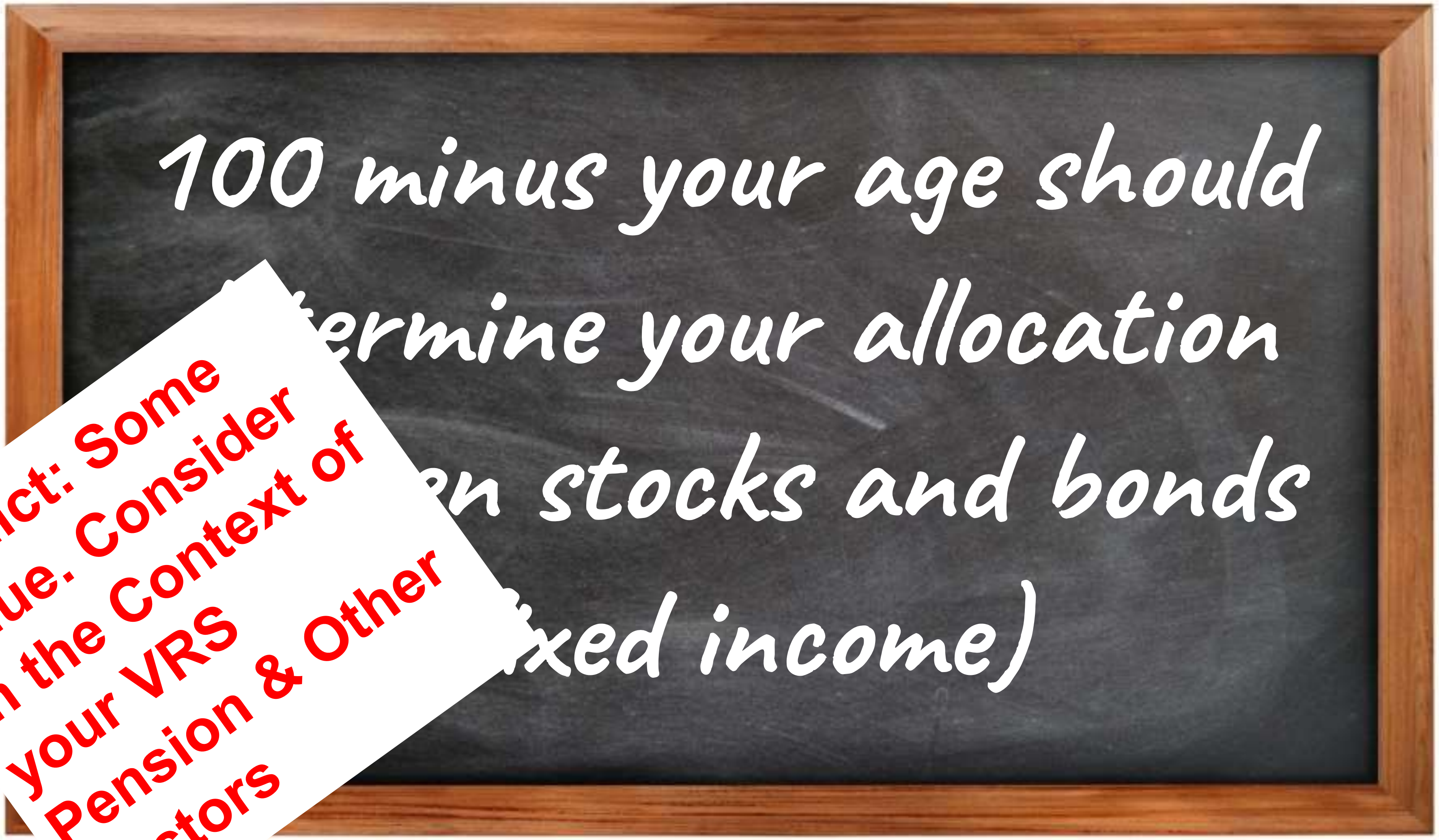
Vanguard Retirement Date Fund	Allocation to Stocks	Allocation to Bonds
2025	53	47
2030	62	38
2040	77	23
2050	90	10

- If you choose a Target Date fund, consider a target date farther out than your planned retirement date, recognizing that VRS benefits are similar to fixed income investments.
    - Target date funds reflect the principles underlying the adjusted 110 - age Rule of Thumb, with fixed income assets becoming a greater portion of the portfolio closer to the retirement date.
- Consider passive index funds with lower expense ratios i.e. total U.S. stock market index, total international stock market index, total U.S. bond market index, total international bond market index
- Consider asset allocation funds that match your desired allocation i.e. income, balanced, growth
- Choose a provider with lower expense ratios - expense ratios for the same mutual fund can vary significantly with different providers

Beware Annuities Masquerading as Mutual Funds

- Annuities can provide a reliable income stream in retirement, but if you die too soon, they may not be a good deal
- VRS pension already provides a reliable income stream
- Annuities often have higher fees/lower returns than mutual funds
- Consider reallocating any current investments in annuities and converting annuities to a rollover IRA upon separation from service

How should I allocate the funds in my portfolio?



Verdict: Some value. Consider in the Context of your VRS Pension & Other Factors

Is this Rule of Thumb Junk or Treasure?

How should I project expenses in retirement?

Is this Rule of Thumb Junk or Treasure?

Project YOUR actual expenditures, varying over time

- The expenses of retirees vary significantly due to factors relating to individualized travel plans, debt, health, etc.
- Ideally, create a current budget that categorizes expenditures and project changes in retirement.
- Using 100% of current expenditures in the absence of a budget is more conservative than the 75% rule of thumb.
- A smile is an image that captures the expenditure pattern of many retirees during early retirement, mid-retirement, and late-retirement

The Smile of Retirement Expenses Funded from Portfolio

Early Retirement: the Go-Go Years

- increased travel and entertainment
- not yet eligible for Medicare
- not yet drawing Social Security
- buying a second home

Mid-Retirement: the Slow-Go Years

- fewer travel expenses, major purchases, and renovations
- mortgage paid off
- eligible for Medicare and drawing Social Security

Late Retirement: the No-Go Years

- minimal travel and entertainment expenses
- increased healthcare expenses

The Bucket Approach to Investing

- You can mentally group your investments based on your investment time horizon.
- The risky bucket of investments includes funds that you will not need to tap for more than ten years
- The safe bucket of investments provides annual income for the first part of the expenditure smile. It closes the gap between your pension & Social Security income, on one hand, and your expenses, on the other hand.
- Funds in the cash flow bucket should be invested more conservatively, such as fixed income investments

How should I project expenses in retirement?

Verdict: More Junk than Treasure

How much do I need in my retirement portfolio so that I can afford to retire?

Is this Rule of Thumb Junk or Treasure?

The 25x Rule for Non-Superintendents

- The 4% rule emerged from research by Bill Bengen in the 1990s.
- 2023 Morningstar Study estimates that a new retiree planning for a 30-year time horizon can safely withdraw as much as 4.0% of the portfolio's value as a starting safe withdrawal rate for a portfolio with a 40% equity weighting, assuming a 90% probability of still having funds after 30 years.

Planned Annual Spending	$125,000
Projected After-tax Social Security Benefit - hypothetical retiree	$23,000
Amount to be withdrawn from portfolio using 4% Rule	$102,000
Required portfolio balance entering retirement	$2,550,000

Is this Rule of Thumb Junk or Treasure?

The 25x Rule for Superintendents

Planned Annual Spending	$125,000
Projected After-tax Social Security Benefit - hypothetical superintendent	$23,000
Projected VRS Benefit - hypothetical superintendent	$70,000
Amount to be withdrawn from portfolio using 4% Rule	$32,000
Required portfolio balance entering retirement - hypothetical superintendent	$800,000

Is this Rule of Thumb Junk or Treasure?

Assess Progress towards Retirement Readiness Monte Carlo Analysis

- considerations include expenses, savings rates, retirement date, asset allocation, asset class returns and volatility, tax rates, projected longevity, bequest goals, and a variety of sequences of returns

- run 1,000 trials using 1,000 different return possibilities to calculate the probability your plan will be successful in funding all your goals without running out of money
- may run different scenarios with different assumptions i.e. retirement date; savings rate; spending rate
- the purple “Below Confidence Zone” (<70%) involves too much uncertainty
- the green “In Confidence Zone” (70% - 90%) reflects a balance between current and future lifestyle
- the blue “Above Confidence Zone (>90%) may reflect giving up more than necessary now

How much do I need in my retirement portfolio so that I can afford to retire?

Verdict: Valuable starting point, w/ consideration of your VRS Pension

Is this Rule of Thumb Junk or Treasure?

Sample Contract Revisions

- Annual leave payout with calculation of per diem rate specified
- Deferred compensation as employer contributions, leaving employee contribution capacity
- Leave payout at separation via 403(b), 457, and 401(a) accounts
- Trade non-creditable compensation for creditable compensation
- Rewording to make deferred compensation creditable
- Additional salary equal to amount of 5% VRS employee contribution

VASS Compensation & Benefits Survey
2023-2024

Statewide	
Average Superintendent Salary	$184,240
Average Deferred Compensation among All Superintendents	$11,429
Average Deferred Comp among Superintendents with Deferred Compensation	$16,508
% of Superintendents Receiving Travel Allotment	40%
Average Monthly Travel Allotment among Superintendents with Allotment	$763
Response Rate	80%

Salary by District Size

JLARC Size Range	District Size using JLARC Categories	Response Rate	Minimum 2023-2024 Salary	Maximum 2023-2024 Salary	Average of 2023-2024 Salary
<1,000	Very Small	67%	$107,100	$205,000	$143,864
1,000 to 1,999	Small	75%	$130,000	$188,000	$151,083
2,000 to 4,999	Small Midsize	91%	$106,000	$234,000	$172,598
5,000 to 9,999	Midsize	85%	$131,000	$252,000	$188,465
10,000 to 29,999	Large	78%	$181,560	$304,603	$237,267
>=30,000	Very Large	63%	$289,592	$375,000	$326,144
Statewide		80%	**$106,000**	**$375,000**	**$184,240**

VASS Compensation & Benefits Survey 2023-2024

Deferred Comp by District Size

JLARC Size Range	District Size using JLARC Categories	Min Deferred Amount for those w/ Deferred Comp	Max Deferred Amount for those w/ Deferred Comp	Average Deferred Comp among All Supts	Average Deferred Comp among Supts w/ Deferred Comp
<1,000	Very Small	$4,000	$10,000	$4,050	**$6,943**
1,000 to 1,999	Small	$4,000	$34,000	$7,019	**$11,486**
2,000 to 4,999	Small Midsize	$3,400	$39,000	$9,865	**$14,418**
5,000 to 9,999	Midsize	$2,500	$30,000	$11,374	**$13,811**
10,000 to 29,999	Large	$10,000	$61,225	$18,269	**$25,576**
>=30,000	Very Large	$20,000	$99,500	$37,930	**$47,412**
Statewide		**$2,500**	**$99,500**	**$11,429**	**$16,508**

VASS Compensation & Benefits Survey 2023-2024

Salary by Region

Region	Response Rate	Minimum	Maximum	Average
1	53%	$161,000	$250,000	$204,585
2	80%	$147,000	$303,000	$219,702
3	88%	$134,846	$307,876	$178,560
4	68%	$154,646	$375,000	$235,666
5	100%	$115,000	$233,642	$181,052
6	64%	$107,100	$252,000	$175,560
7	95%	$106,000	$175,000	$141,475
8	83%	$130,000	$175,000	$153,963
Statewide	**80%**	**$106,000**	**$375,000**	**$184,240**

Deferred Comp by Region

Region	Min Deferred Amount for those w/ Deferred Comp	Max Deferred Amount for those w/ Deferred Comp	Average Deferred Comp among All Supts	Average Deferred Comp among Supts w/ Deferred Comp
1	$10,000	$28,595	$9,924	$15,879
2	$7,250	$61,225	$14,653	$25,119
3	$5,000	$26,711	$11,319	$15,435
4	$7,000	$99,500	$22,296	$26,350
5	$4,000	$30,000	$11,819	$14,774
6	$2,500	$15,000	$5,611	$10,100
7	$3,400	$20,000	$6,047	$10,280
8	$4,000	$34,000	$8,405	$12,007
Statewide	**$2,500**	**$99,500**	**$11,429**	**$16,508**

Deferred Comp by Region

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