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A plan for the future in baby steps

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Special to The Seattle Times

Along with their first baby, Dave Wilton and Molly Harmon are expecting big financial changes in the next few months.

Like many parents-to-be, the couple are weighing the cost of day care against the income Harmon will lose if she stops working or works reduced hours.

Either way, Harmon, who is self-employed full-time as a private chef, expects to earn less this year.

"We really don't know how it's going to be," Harmon, 33, said about her work schedule after the baby is born. "We're going to play it by ear."

ALAN BERNER / THE SEATTLE TIMES
Molly Harmon and her husband, Dave Wilton, are expecting their first child in April.

Wilton, 38, works for a Seattle nonprofit that develops K-12 educational programs and together, they typically earn between $60,000 and $65,000 a year.

They estimate their income will drop by at least $10,000 this year, possibly more depending on how much Harmon works.

Both are disciplined savers who have been contributing as much as they can to retirement — they have about $95,000 spread among 401(k) accounts from previous employers, plus IRAs and Roth IRAs — but they recognize that long-term focus may have to change with their new addition.

"[We're] trying to do the juggling act of saving for our futures without mortgaging our child's health and education," Wilton wrote in a survey to participate in a free financial makeover arranged by The Seattle Times.

Though Wilton says they feel fortunate to have health insurance, adding a baby to either of their plans will be an extra expense.

Currently, Harmon pays out-of-pocket for a single-payer plan, which was more cost-effective than being added to Wilton's plan at his work.

Their biggest monthly expense is the mortgage on their Seattle condo. With a loan balance of about $150,000, their total payment with taxes, insurance and homeowner fees is roughly $1,200, but Harmon says they've been trying to pay off their fixed-rate mortgage faster with extra principal payments.

And although they do not carry a balance on their credit cards, they do have a zero-interest car loan and student loans to boost their total debt to about $190,000.

Besides their retirement accounts, they have approximately $60,000 in other investments and savings.

With their current work, neither has access to a 401(k), matching contributions or group life or disability insurance. Harmon says they're kind of on their own.

"We do the best we can, but there's just a lot of questions right now," Harmon said. "Do we pay off the student loans or do we start the kid's college fund or do we contribute the maximum amount we can to a retirement fund?"

Professional help

To help them prioritize, the couple met with Gary Brooks, a certified financial planner and registered investment adviser at Brooks, Hughes & Jones in Tacoma.

Gary Brooks, Financial planner with Brooks, Hughes & Jones

Brooks praised the couple for doing the right things to build savings and avoid too much debt, which he says is a big problem for a lot of people their age.

"They've gotten off to the right start, but certainly their considerations change significantly once they start thinking about having to fund another member of the family," said Brooks, who is also a member of the Financial Planning Association – Puget Sound Chapter.

Brooks talked to Wilton and Harmon about their goals and helped them segment those goals into needs, wants and wishes.

Then, rather than focus on how much income they'll bring in, Brooks' approach is to take what's left over after the "needs" are met to put toward the "wants" and "wishes."

"It was the first time I've advised someone to reduce their annual contribution to retirement accounts," Brooks said.

With a child on the way, minimal employer benefits and the prospect of reduced income, Wilton and Harmon should focus their savings on such shorter-term needs as health and life insurance, he said.

Brooks recommended the couple fund their Roth IRAs with $2,500 each and that Harmon contribute $3,000 to her SEP-IRA, which for now should be a sufficient contribution given that they both want to work well into their 60s and envision a modest retirement.

For planning purposes, Brooks used $75,000 as the amount in today's dollars the couple would need annually throughout retirement.

Wilton said that since he and Harmon both grew up in families of savers, it was strange to hear that they should put away less for now.

"It was a little nerve-racking, but we're realizing that we aren't shortchanging ourselves, but putting it to another goal," Wilton said.

Switching strategy

In the plan that Brooks developed, some of the couple's retirement-account assets were earmarked to pay for college expenses for their child, since there isn't room in their budget for setting up and regularly contributing to a 529 college-savings plan at this time.

"You're not going to get penalized if you're taking dollars out of your retirement account early to pay for college," Brooks said.

The couple had been looking into purchasing life insurance before they met with Brooks, who provided them with quote sheets from eight different types of policies.

He suggested the couple opt for term life coverage of $400,000 on Harmon and $600,000 on Wilton and built the projected cost, about $750 annually, into their financial plan.

Brooks wrote in his recommendations that disability insurance is more expensive than life insurance because claims are more frequent. For now, the couple's budget doesn't allow for disability coverage, he wrote, but it's another element of risk protection he recommends once they can afford it.

As for health insurance, it's an expense the planner calls the couple's "most significant challenge between now and retirement."

Their plan calls for annual insurance premiums for Harmon and their child of $6,000, increasing 7 percent per year, though that may vary depending on legislation. Wilton is covered through his job.

"While you can afford the payments based on your current income, the inflating cost will become harder to keep up with over time," Brooks wrote in their plan.

"We've realized just how smack dab in the middle of the health-insurance debate we fall," Wilton said. "This will have consequences for us either way, however it goes."

Brooks also analyzed the couple's investments and recommended a few tweaks. Harmon has a bank stock Brooks advised selling at a loss to realize a tax benefit.

Some of their mutual funds are in Class C shares, which Brooks said come with an elevated internal expense ratio. These management fees, he wrote, pay their brokers about 1 percent of the assets each year on top of the regular expense ratios for other share classes.

"If you feel like you receive advice worth the 1 percent, somewhat hidden advisory fee, then it's not a problem to pay the elevated fee," Brooks told them.

Among a few other investment suggestions, Brooks said Wilton should consolidate the retirement accounts he has with three former employers into a single IRA to have better control over his investment choices and management costs.

A direct rollover would not incur a tax or early-distribution penalty and would reduce the number of accounts Wilton has to keep track of, Brooks said.

Another marching order Brooks gave the couple was to make sure they finish an estate plan, including wills, medical directive and their plans for their child should something happen to both of them.

"You can use Quicken Family Lawyer software or a Nolo product to inexpensively document your wishes in an official format," Brooks wrote in his recommendations. "Or see an attorney for the basic set of documents, expecting to pay approximately $500."

And finally, the couple also had questions about whether they should try to pay off their student loans faster. Brooks said no (they pay $300 each month and have 87 payments left, which is a little more than seven years) because the interest rate is favorable (2.25 percent) and it is better for them to save the money for insurance costs and Molly's lower income.

Overall, though Wilton said he and Harmon approached the financial-planning process with some trepidation and worried they'd made some horrible financial decisions in the past they couldn't recover from, they came away reassured and appreciative of where they are in life.

Wilton said the process has made them more aware of what the impact will be on their finances if Harmon is working less and for how long. Brooks told them they can afford to spend down their cash reserves to some extent, but they should try to keep six months of expenses (roughly $15,000) in their emergency fund.

"There's the quality of life that money affords you, but also the quality of life that money can't buy you," Wilton said. "What's more important? Is it putting away more money for something or spending more time together now?" I don't know, I haven't gotten there yet."

What has been made clear for them, Wilton said, is that having the plan is one thing, but they really need to do something with it.

"So now it's incumbent upon us to actually do it," Wilton said.

About this series

THIS IS THE LATEST in a series of monthly "financial makeovers" by The Seattle Times for readers who want to get real about their money.

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