Mark Donovan

SESSION 4: Practical Application

Follow up sessions: e-mail bpayne@sgclouisville.org for a 1-hour appointment on a Saturday morning in March. The dates are March 10, 17, or 24, subject to availability. Please plan on bringing your personal balance sheet, and a list of your income and expenses or your budget.

I. Baby Step 4 – Invest 15% of your income in retirement

A. Time Value of Money – *"The time value of money (TVM) is the idea that money available at the present time is worth more than the same amount in the future due to its potential earning capacity."* Investopedia.com

B. Example: if a person at age 30 makes a $1,000 deposit each year for 35 years and earns an average of 8% each year, they will have saved:

Interest Rate	After 5 years	After 10 years	After 15 years	After 20 years	After 25 years	After 30 years	After 35 years	After 40 years
4%	5,416	12,006	20,024	29,778	41,646	56,085	73,652	65,026
6%	5,637	13,181	23,276	36,786	54,865	79,058	111,435	154,762
8%	5,867	14,487	27,152	45,762	73,106	113,283	**172,317→**	**259,027**
10%	6,105	15,937	31,772	57,275	98,347	164,494	271,024	442,593
12%	6,353	17,549	37,280	72,052	133,334	241,333	431,663	767,091

C. By starting 5 years earlier at age 25, the amount jumps to $259,027, an extra $87,000 in growth for only a $5,000 extra investment.

D. Another way to maximize your return on investment is to use the tax laws to your advantage. Retirement contributions can be made on the traditional basis or the Roth tax basis, to either an IRA or an employer plan like a 401k or 403b.

Traditional Tax Basis	Roth Tax Basis
$35,000 in contributions is NOT taxable. But, the total of $172,317 at retirement IS taxable.	$35,000 in contributions IS taxable. But, the total of $172,317 at retirement is NOT taxable.
Estimated Federal tax rate = 15%	Estimated Federal tax rate = 15%
Tax Savings = $5,250	Tax Savings = $25,848

V. Baby Step 5 – Start saving for college

A. Section 529 Plans – savingforcollege.com. Each state has a plan, but you are not restricted to your state's plan.

B. There is a state income tax deduction for contributions in some states, but not Kentucky.

C. The growth and gains over the years are Federal and State income tax free if used for education.

D. No penalties if a scholarship is received, though perhaps some tax consequences

E. Other family members, friends, strangers can contribute.

F. Any excess is transferrable to another child or certain other family members.

VI. Baby Step 6 - Pay off your home early

A. Buying a House – 15-year versus 30-year mortgage

B. The assumption is a $175,000 house (average in Louisville) with a 5% down payment of $8,750 resulting in a mortgage of $166,250.

Loan Amount	Term	Rate	Monthly Payment	Interest	Total Payments
$166,250	30 years	4.375%	$830	$132,572	$298,822
$166,250	15 years	4.375%	$1,261	$60,767	$227,017
Savings:				*$71,805*	

C. Dave Ramsey suggests you pay no more than 25% of your net income for a 15-year mortgage. In this example, that is roughly $5,000 per month of net income, or take-home pay. A 30-year mortgage would require $3,300 per month of net income.

D. Every early mortgage payment made results in a guaranteed 4.375% return on that investment.

VII. Baby Step 7 - Build wealth and give generously

A. Remember the 1Tim 6:9 warnings against the desire to be rich.

"But those who desire to be rich fall into temptation, into a snare, into many senseless and harmful desires that plunge people into ruin and destruction." ESV

B. Give generously and outrageously at this phase of life, but if you were not faithful with a little earlier, you may not be faithful with much later.

Luke 16:10 - "*One who is faithful in a very little is also faithful in much, and one who is dishonest in a very little is also dishonest in much*." ESV

C. Avoid hoarding, which is excessive savings with no purpose or goal.

D. Max out retirement contributions up to the allowable limits. Retirement planning calculators can be helpful.

E. Estate planning – do a last will and testament. Do it yourself software makes it easier than ever.

VIII. Insurance

A. Life insurance, or perhaps think of it as <u>dependent</u> insurance:

   a. Term life insurance, not whole life or universal life, is suggested.

   b. Five to ten times your annual income is recommended for a death benefit amount. An employee benefit might supplement.