The State of Your Retirement

The Essential Guide for all State of Florida Employees

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Introduction

If you are a member of the Florida Retirement System (FRS), you have seen a lot of changes to your retirement options over the past few years. The state of your retirement has changed dramatically and what made sense in the past often does not make sense today. We regularly meet with state employees to help them figure out these ever changing options. These meetings generally focus on reviewing the pros and cons of your retirement choices to help you make an informed decision and are done as a free service to you. To learn more about us, please review the section "What Makes Nelson Financial Planning Different?" on page 22 of this booklet.

While you are working, we keep you informed on a continuous basis by mailing FRS Update letters every few months or so. We do not charge for this ongoing service. Simply put, keeping you informed about the latest legislative changes and market performance while you are still working is somewhat straightforward. It also gives you an opportunity to try us out before you'll really need us in retirement.

As a current employee, your options have changed a lot since 2008. These changes fundamentally shift your retirement options. Be sure to read the section on page 11 entitled "Shifting Sands for Current Employees – The Litany of Changes since 2008".

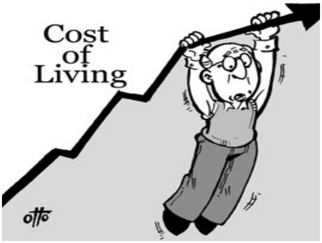
Once you retire, things get a lot more complicated. Our focus shifts to providing personalized retirement income strategies to meet your unique retirement expenses and tax liabilities. These income needs are ever changing and the tax implications in retirement are very important. There are a variety of accounts available as a state employee and each has different tax implications depending on your age and job. Your investment focus also shifts to a more growth and income oriented mix which is very different from the approach used while working.   Simply put things get a lot more complicated in retirement and that's when our customized advice applies. Be sure to read the section on page 18 entitled "Retirement Income – Your Age and the Account Matters."

The FRS Pension Plan – The Guaranteed Check a Month Club

FRS
Florida Retirement System

The oldest retirement option within the FRS is the Pension Plan. The Pension Plan is a defined benefit plan where your benefit of a monthly retirement check is defined by law. The amount of this check is determined by your years of service, your creditable service percentage and your average final compensation. In addition, you select from among four different options for your retirement income. The two most popular options are Options 1 and 3. Option 1 generates the most amount of income but ends when you die and Option 3 generates income for you and then your spouse when you die but with a reduction in income over Option 1 of typically 15-20% depending upon the age of your spouse.

This retirement income amount is annually supplemented in retirement by the application of a cost of living adjustment (COLA). However, the COLA has been suspended effective July 1, 2011 which results in a reduction of the prior COLA benefit of 3% per year. Despite better finances in Tallahassee, there has been no suggestion about reinstating this COLA in the future. Consequently, the COLA continues at 0% for all years of services after 2011.



Effective for new employees after July 1, 2011, retirement eligibility has increased to age 65 or 33 years for regular class and age 60 or 30 years for special risk class. Previously, normal retirement was age 62 or 30 years for regular class and age 55 or 25 years of service for special risk class. The vesting period for the Pension Plan has also increased from six to eight years for new employees hired after July 1, 2011. In addition, a 3% employee contribution is required that goes into the general Florida Retirement System.

For a more complete description of the FRS Pension Plan, please refer to the Frequently Asked Questions about the Pension Plan and the Pension Plan Summary prepared by the State of Florida Division of Retirement. Both of these documents can be found within www.myfrs.com.

In summary, the FRS Pension Plan is a traditional check a month retirement plan. This check is guaranteed by the state to last for your lifetime or, with a reduction in income, for a set period of time or the life of another like your spouse. There is never any ability to utilize lump sum amounts from the Pension Plan nor leave a legacy to your beneficiaries. For some, this is the appeal of the Deferred Retirement Option Program (DROP).

DROP – The Holding Bin for Your Pension Check

DROP is a program that allows you to retire without terminating your employment while your retirement benefits accumulate in a separate account earning 1.3% as of July 1, 2011. Previously, the earnings rate was 6.5%. In essence, you retire under the FRS Pension Plan and then have the ability to aggregate a lump sum cash benefit. At the end of your DROP period of 5 years, you must terminate employment. For a more complete description of DROP, please refer to the Frequently Asked Questions about DROP prepared by the State of Florida Division of Retirement available within www.myfrs.com.

DROP is not extra money or some kind of bonus. It is simply holding your pension check while you are continuing to work for the State. DROP participation means you retired under the FRS Pension Plan based upon your years of service at the time you elected DROP participation. By retiring at that time, your subsequent retirement benefit that would accrue over the next five years is set aside in a lump sum payment. However, your monthly check that you receive from the FRS Pension is less than it would be since the five years you spend in DROP do not count for the FRS Pension Plan calculation. In addition, the earnings rate on these DROP monies has been reduced from 6.5% to 1.3%.

The DROP balance should be rolled over to either the FRS Investment Plan or an Individual Retirement Account (IRA) upon leaving the state's employment in order to properly manage taxes and retirement income. This rollover should be done properly in order to avoid full taxation of the lump sum amount. As you use this DROP amount to provide retirement income, regular income taxes will apply. By using an IRA you set the proper tax withholding rather than being subject to the 20% mandatory withholding that applies for direct DROP or FRS Investment Plan withdrawals.

However, if you are under the age of 59½ at retirement than you want to roll your DROP over to the FRS Investment Plan. Assuming you meet certain parameters (over 50 and special risk or over 55 and regular class), you are able to avoid the 10% penalty for early withdrawal by drawing directly from DROP or using the FRS Investment Plan (if over age 55) for these DROP monies. This is where your age, your job and where your money winds up starts to really matter if you want to reduce your taxes in retirement.

FRS Investment Plan – Leaving It To The Kids

The FRS Investment Plan option started in 2002. The Investment Plan is a defined contribution plan in which employer contributions are a set amount as defined by law. The period of time in which the Investment Plan monies actually become yours or vest is only one year. The 3% employee contribution is still required but those monies go directly to your own personal Investment Plan account rather than to the general FRS fund. The amount of your retirement income depends directly on the performance of your Investment Plan account balance. Unlike the FRS Pension Plan, there is no fixed benefit level at retirement with the Investment Plan.

The Investment Plan is funded through defined employer contribution rates based upon your salary and your FRS membership class. The contribution rates are currently at 6.3% for regular class and 11% for special risk class. These contributions are made every pay period to your own personal Investment Plan account. Prior to July 1, 2012, these contributions were 30% higher but this reduction occurred to level the Investment Plan benefits with prior cuts that were made in 2011 to the FRS Pension Plan benefits. Regardless, it is disappointing to have any cuts to contribution rates especially in this time of stagnant salaries.

The Investment Plan contributions are sent to your personal account within the FRS Investment Plan. Within this account, there are only 21 different investment choices (10 of which are target date funds) to invest your contributions. While these choices are somewhat limited in number, there are some worthwhile investment options. We monitor daily the performance of the investment options we recommend within the FRS Investment Plan and let you know if any changes are warranted through our regular correspondence. Remember the overall balance in one's FRS Investment Plan account is solely dependent on how your underlying investments perform.

In summary, the Investment Plan provides you an option to personally control your retirement monies. Your years of FRS service are represented entirely in a cash value lump sum. The beneficiaries of this lump sum can be your spouse or children when you pass. However, this lump sum must be used to generate your retirement income. It does not come with any guaranteed benefit like the Pension Plan. For a more complete description of the FRS Investment Plan, please refer to the Summary Plan Description of the FRS Investment Plan prepared by the State of Florida Division of Retirement located within www.myfrs.com.

For a complete comparison of the advantages and disadvantages of these FRS options, please refer to FRS Plans Advantages and Disadvantages prepared by the State of Florida Division of Retirement at www.myfrs.com. In addition, we are here to meet with state employees at any time at no charge to discuss these options.

Shifting Sands for Current Employees – The Litany of Changes since 2008

In 2011 with the inauguration of Rick Scott and a Republican Legislature, the Florida Retirement System started to change. These changes were predicated on the aftermath of 2008 on the state's finances. The market decline during 2008 and 2009 dramatically reduced the value of the FRS Pension Plan assets from about $135 billion to under $100 billion. As a result, politicians embarked on a cost cutting spree that effectively reduced your retirement benefits. The effect of these changes on employees depended on whether they were in the Pension Plan, DROP or the Investment Plan. These changes still remain in place despite the improvement in state finances and the value of Pension Plan assets returning to over $140 billion.

The single biggest change was the requirement for all state employees to contribute 3% of their salary to the Florida Retirement System. For those in the Investment Plan, these monies go into their own account. For those in the Pension Plan, those monies go into the general fund of the Pension Plan. This required contribution did not apply to those employees who were currently on DROP. This required contribution continues to effectively act as a 3% reduction in one’s salary. For most employees that was particularly tough to take over the past few years given the absence of any salary increases.

Meanwhile, the biggest change for those under the Pension Plan was the effective elimination of the Cost of Living (COLA) of 3% per year that is part of the calculation of one’s Pension Plan benefit.

While the original legislation stipulated that this was a five year suspension ending in 2016, by requiring legislative action to bring the COLA back, it effectively served as an elimination of this benefit. The effect of this change is to prorate an employee’s COLA benefit across their total number of service years.

For example, if you have 25 years of service as of July 1, 2011 and worked another 5 years, your COLA benefit under the FRS Pension Plan would decrease to about 2.5% per year from the current 3%. Given that the value of the Pension Plan assets have returned to a value greater than what they were before the 2008-2009 financial crisis, the COLA benefit should arguably return. Unfortunately, there is no discussion in Tallahassee to do so.

Employees who choose to go on DROP are also affected by these legislative changes as well. Prior to 2011, DROP monies earned a guaranteed rate of return of 6.5%. After 2011, this rate dropped dramatically to just 1.3%. Over the five year DROP period, this 5.2% annual differential has a dramatic effect on reducing DROP values.

Investment Plan members were able to escape the effect of the 2011 legislative changes but in 2012 politicians caught up with them. In 2012, House Bill 5005 reduced the contribution paid by employers into the Investment Plan by a whopping 30%! Prior to July 1, 2012, the total contributions (including the mandatory 3% employee contribution) to one's Investment Plan account was 20% for special risk employees and 9% for regular class employees. After July 1, 2012 those contribution rates declined to 14% and 6.3% respectively. These levels include the mandatory 3% employee contribution.

While billed as a necessary change to level the benefits between the Pension Plan and the Investment Plan, it served to disproportionately undermine the benefits of the Investment Plan. In addition, these changes in contribution rates were buried in legislation that was passed at the 11th hour and largely occurred without much discussion with the affected employees.

Of course, the deal is also different for new State employees as well. For those entering FRS employment on or after July 1, 2011, the vesting under the FRS Pension Plan increased to 8 years from 6 years. Vesting under the FRS Investment Plan remains at one year. In addition, average final compensation under the FRS Pension Plan increased to the 8 highest years of service from the 5 highest years. The age eligibility for retirement increased from age 62 to age 65 for regular class and from age 55 to age 60 for special risk. The retirement eligibility based on years of creditable service increased from 30 years to 33 years for regular class and from 25 years to 30 years for special risk. New FRS employees will need to work longer in order to receive comparable benefits available to current FRS employees.

The bottom line on all these changes is that it affects your decision and timing on making any changes to your retirement. In the past, when employer contribution rates to the Investment Plan were 30% higher, the timing of any switch to the Investment Plan was somewhat immaterial. Now, the timing of the switch really matters. Over the years we have reviewed countless individual comparisons and while each situation is unique, based on these reviews, it seems that any move to the Investment Plan needs to be either at the inception of your career or at the end. This also preserves your second election to switch among the FRS options for future use as well.

At the beginning of your FRS career you have time to generate a sufficient balance in your Investment Plan and can take advantage of its shorter vesting requirements. In fact, we have seen some scenarios of late where employees who had initially started with the Investment Plan had the opportunity after 10-15 years to buy back into the Pension Plan and retain a significant portion of their Investment Plan balance.

In contrast, those that wait to switch at their 25th year of service (30 years if not special risk) experience the largest run up in their projected lump sum balance in the last five years of service. After hitting these full retirement service years, the projected balance rises at a rate similar to inflation. In those cases, it may make sense to make a move in that 25th (or 30th) year of service if an employee wants to go into the Investment Plan. The hardest scenarios are those with 15 years or so of service. For them, it probably makes sense to just wait things out before considering any move among the FRS options.

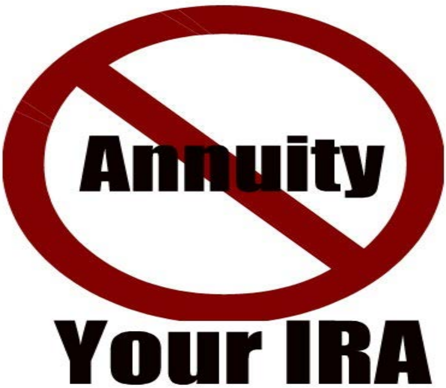
Retirement Income – Your Age and the Account Matters

Planning your retirement income as a member of FRS is a very intricate process. Depending on your age, your years of service, your job, your FRS choices, and your deferred compensation account, the composition of your retirement income and your taxes will be different. We typically spend several hours with FRS retirees properly planning their retirement income. We encourage you to contact us to schedule your complementary, no obligation conversation about planning your retirement income.

We want to warn you about three examples of FRS retirees receiving bad advice that limited their retirement options.

FLORIDA
DEFERRED COMPENSATION PLAN
PLAN. SAVE. RETIRE.

<u>First, do not rollover your deferred compensation account to an IRA if you are under age 59½.</u> Once this money is placed in an IRA, you have to pay an extra 10% tax penalty to use the money if you are under age 59½. If the funds are left alone in the deferred compensation plan, you have completely flexible access to the funds with no tax penalty. ***Bottom line, if you are under age 59½, leave your deferred compensation alone.***



<u>Second, the guarantees and promises that come with these "new" income approaches that use annuities are simply not as they are described.</u> These guaranteed income streams and returns are filled with caveats, fine print and high costs. These promises don't actually guarantee any real return on your money as they only apply to internal insurance company values. If FDIC guaranteed CDs are paying around 1%, insurance companies aren't really paying you 5% or more. ***Bottom line, if it sounds too good to be true, it is.***

In addition, the State of Florida is now promoting the use of annuities in its Investment Plan correspondence to state employees. The state's suggested annuity approach offers an irrevocable option that leaves nothing to your beneficiaries. If state employees prefer a guarantee, they should consider staying with the Pension Plan.

Third, if you are over age 55 and under age 59½ when you retire, you need to leave the amount of money you will need to spend before age 59½ in the FRS Investment Plan. The FRS Investment Plan provides you an exception to draw money out in any amount or frequency without having to incur a 10% tax penalty for early withdrawal if you retire in the year you turn age 55. This is a very valuable option for those that qualify. If all the money is rolled out of the FRS Investment Plan and into an IRA, you lose the flexibility of this option. ***Bottom line, if you are retiring in the year you turn age 55, you have more flexibility by actually leaving some money behind in the FRS Investment Plan.***

Properly planning your retirement income is of the utmost importance. These are just some of the examples we have seen where if the retiree had followed the advice given, they would have effectively eliminated their flexibility in retirement or even worse been subject to an extra 10% tax penalty. Simply rolling over your FRS Investment Plan, DROP or Deferred Compensation account to an IRA may not be the best course of action and could generate an extra 10% tax cost in retirement.

What Makes Nelson Financial Planning Different?

1. **Expert Tax Advice You Can Actually Rely On.** You hear a lot of conversations about saving for retirement but not much about planning your retirement income. The biggest reason for this is that most financial firms don’t or won’t give tax advice. Check out their websites. If the fine print says the firm you are using does not provide tax advice and you should consult your own tax advisor, how good is the tax advice you are getting? Our firm employs a full time IRS Enrolled Agent as a member of our financial planning team. We also have a tax preparation service for our retirees that includes a CPA and we stand behind our tax advice.

2. **Expertise and Unbiased Advice of a Certified Financial Planner™.** In the financial services industry, credentials matter. Being a Certified Financial Planner™, means that the advisor has completed extensive training and experience requirements and is held to a rigorous ethical standard. According to the Certified Financial Planning Board, certificants "understand all the financial complexities of the changing financial climate and will make recommendations in your best interest". If the firm you are using does not employ Certified Financial Planners™, how "expert" and "unbiased" is their financial advice?

3. **Only Recommend Investments that We Own Personally.** Our most important policy is that

we only recommend to our clients investments that we personally own. In the financial industry, few firms can make that claim of their financial planners. Jack Nelson started that commitment when he began the firm in 1984. While Jack has since passed, this bedrock principle continues today. Don't you want to be dealing with somebody that truly has a vested personal interest in how your investments perform?

4. **Central Florida's longest running Radio Show – 31 Years and Counting!** Many firms do radio shows for certain periods of time but ours is the longest running in Central Florida. We view the radio show more as an opportunity to speak to our followers every week with fresh ideas and perspectives on the most current events of the day. Our radio show "Dollars and Sense" is heard live every Sunday at 9AM on Newsradio 102.5 WFLA and is simulcast on 540AM as well. If you miss the show on Sunday, it is always available on any of our social media sites – Facebook, Twitter,

Soundcloud, Google or Linked IN – or at www.NelsonFinancialPlanning.com. Unlike other shows that constantly tell you to call the office now, ours does not because its purpose is to educate, inform and hopefully entertain the listening audience.

About the Author Joel Garris

The entire contents of this booklet were personally written solely by Joel J. Garris, J.D., CERTIFIED FINANCIAL PLANNER™ and President and CEO of Nelson Financial Planning.

Started in 1984 by Jack Nelson as Nelson Investment Planning Services, today we remain a fully independent and family owned and operated firm. We only recommend actively managed investments that we own personally. Our retirement income and investment approach is based on our over 30 years of experience with what really works overtime.

Joel specializes in bringing all the various parts of an individual's finances into focus. His areas of expertise include retirement income planning, cash flow planning, retirement planning, tax planning and estate planning. He recommends effective solutions for efficiently managing cash to meet all needs and develops plans to properly provide retirement income. In addition, Joel also provides successful strategies to reduce both income and estate taxes.

Prior to joining Nelson Financial Planning, Joel was a securities law attorney at the law firm of Dickstein Shapiro LLP, a large multi-practiced firm with more than 400 attorneys in Washington, DC. He specialized in initial public offerings, mergers and acquisitions and debt financing for a wide array of corporate clients, including Fortune 500 companies. Prior to becoming an attorney, he worked as an engineer at Central Maine Power Company.

Joel is a Certified Financial Planner™ and a member of the Massachusetts and Washington, DC bar. He holds various securities licenses including, Series 7 – General Securities Representative, Series 24 – General Securities Principal, Series 27/28 – Financial and Operations Principal and Series 51 – Municipal Fund Securities Principal.

Joel is the Treasurer of the Delaney Park Neighborhood Association and serves as an Assistant Scoutmaster for Troop 24 chartered by First Presbyterian Church of Orlando. He has served as a youth sports coach on numerous occasions for Delaney Park Little League, Association of Christian Youth Sports, YMCA and Upward. He is also a member of various organizations, including Mensa, and has been a volunteer for Literacy Volunteers of America and the Veterans' Administration.

Joel is the current host of Central Florida's longest running radio show, which was started in 1984 by Jack Nelson. "Dollars and Sense" is heard live from 9:00 AM to 10:00 AM every Sunday on Newsradio 102.5 WFLA and 540 AM. Previously, Joel was the host of "Moneywise", a financial call-in talk show on WORL 660 AM, for five years. Joel also taught a personal enrichment class entitled "Analyzing and Solving Life's Financial Matters" through Orange County Public Schools.

Joel married Stephanie Nelson on February 13, 1999. Stephanie is the Executive Director of Grace Medical Home and previously served as the Executive Director of the Orlando Metro Area for the American Cancer Society. She is also a past President of the Junior League of Greater Orlando. They have three sons Nelson, Ethan and Connor Garris who attend Boone High School and The Christ School in downtown Orlando.

Where indicated, market data and performance represents past performance which is no guarantee of future results. Individual results may vary and values do fluctuate in any investment. This booklet contains our most current understanding of the Florida Retirement System and U.S. tax laws as of January, 2017. This booklet is intended to detail complicated retirement topics but is not a complete discussion as each individual's situation is different and various exceptions exist. Nelson Financial Planning offers securities through Nelson Ivest Brokerage Services, Inc., a member of FINRA/SIPC. Please note that the information provided in this document has not been approved or endorsed by the State of Florida or the Florida Retirement System.

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