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Rosalyn and Joe Vega of White Lake begin one of their "funscapes," family camping trips with children Adrianna, 3, Shane, 4, and Donovan, 6. The couple are deciding how much money to spend on their new home.

Money Makeover

White Lake family must limit house cost

Payment may affect timing of retirement

By Melissa Preddy / The Detroit News

Not yet in their 40s, Rosalyn and Joe Vega have done a pretty good job of balancing their current wants and future needs.

In their 14 years of marriage, the White Lake couple — she's an airline flight attendant, he's an Oakland County sheriff's deputy — has accumulated solid home equity and a six-figure retirement nest egg while managing, for the most part, to stay away from high-interest consumer debt. All that while maintaining a lifestyle filled with what Rosalyn calls "funscapes," such as the beloved family camping trips with children Donovan, 6, Shane, 4 and Adrianna, 3.

Now the Vegas face a turning point. They just accepted an offer on their White Lake house with an eye toward moving to the southern Oakland County suburbs. But can they trade up to a grander home without jeopardizing their early retirement dream?

Keith Southwick, a certified financial planner in Novi, advises the Vegas against spending to the hilt of their $114,000 combined income.

Keep in mind, he reminds them, that the larger the home, the greater the start-up costs for landscaping, redecorating, furnishing and otherwise making it their own.

The Subjects

Rosalyn Vega, 38
Occupation: Flight attendant
Joe Vega, 39
Occupation: Sheriff's deputy
Their objective: To get advice about a new home purchase and to make sure they are saving enough for long-term goals.

The Expert

Keith Southwick
Keith Southwick, a certified financial planner, is president of StraitGate Financial LLC in Novi. He specializes in comprehensive financial planning and wealth management services for professionals, corporate executives and retirees.
His advice: The Vegas should try to keep their mortgage loan around $130,000 and increase college savings by about $200 a month.

With the $174,000 equity from their current house, added to a $132,000 mortgage at 5.49 percent, the Vegas can shoot for a home with a $306,000 purchase price and keep their principal and interest payment below $750 — just about where it is now.

Rosalyn Vega had thought they could afford a principal and interest payment closer to $1,050, since they will soon pay down a home equity loan that was used to purchase their 2000 Chevy van and has a $300 a month payment.

“As a percentage of your outflow you would be fine as far as being able to service the debt,” Southwick replied. “But that’s not the issue. There are going to be a lot of other things you want to do.

“A higher payment just ripples through your whole strategy, and the idea of retirement at 55 might need to be adjusted.”

Southwick is concerned because no matter how he scrutinized the Vegas’ budget, he still couldn’t account for what should be a $17,000 surplus. If the couple can review their expenses and locate that missing money, the home-purchase budget will ease. “But I still think closer to $300,000 would be a more comfortable fit,”

That’s especially so because the Vegas are on track to retire in 2021, when Joe will be 56 and Rosalyn will be 55. To achieve the purchasing power of $100,000 in today’s dollars, they’ll need income of nearly $108,000 in the first year of retirement, Southwick figures. With inflation, that soars to $363,000 in 2050, when Joe turns 85.

The numbers sound astronomical, but Joe’s $52,000 pension — he’s eligible in 11 years — will kickstart the plan. And if the Vegas continue saving at their present rate in employer-sponsored plans — Rosalyn contributes 19 percent of her pay to a 401(k), while Joe diverts 13 percent of his gross to a 457 plan — their $109,000 nest egg should grow enough to cover the balance. And later, when they are eligible for Social Security benefits, the Vegas likely will collect a combined $35,000 a year beginning at age 62.

Southwick has developed a Prosperity Index that grades how well people are saving. In a nutshell, the formula divides net worth by family income to come up with the index score. Older people should have higher scores, meaning their nest egg should be a higher multiple of their annual wages.

For example, for the purposes of the index, the Vegas have a net worth of $680,000. This does not include home equity, on the assumption that a dwelling won’t be providing retirement income because you’ll be using it to live in. But the index does consider what Southwick calls “phantom assets,” such as the theoretical value of Joe’s pension, which he feels currently is $554,000 based on Joe’s present vesting in the plan.

Dividing assets by household income, the Vegas earn a Prosperity Index score of 5.98 — well above the score of 2 that Southwick recommends for people around age 40. That’s commendable, the planner said, but pointed out the index is designed for people targetting a normal retirement age of 65 or so.

“But if you want to retire 10 years sooner at 55, you should now be meeting the score for age 50,” Southwick said. According to the Prosperity Index scale, at age 50 the nest egg should be seven times the household’s income, and at age 55 it should be 10 times that income.

In the Vegas’ case, Joe’s full pension, which he can collect after 25 years on the job, will close the gap. That means the Vegas will also be able to set aside money for the kids’ education. Their goal is to fund two years apiece of tuition, books, room and board for Adrianna, Shane and Donovan, starting in 2016. Currently, they have about $5,300 set aside and are growing that by $67 a month per child.

Assuming the money earns an annual return of 8 percent, Southwick would like the Vegas to add $75 a month for Donovan, $67 a month for Shane and $55 a month for Adrianna. That will give them nearly $100,000 by 2016 for educational expenses, which Southwick figures will grow to $20,000 a year with inflation.

“We have felt lost for a long time about investing for the kids,” Joe Vega said. “This is awesome.”

The existing account, a Coverdell Education Savings Account (formerly known as an education IRA) is adequate, Southwick said. But because the Coverdell allows only a $2,000 annual contribution per child, the Vegas should probably switch to a 529 college saving plan if they decide to boost contributions and fund a full four-year ride for each child.

Speaking of the children, “you don’t have a will and you don’t have a power of attorney,” Southwick said. “And I’ve got to tell you, that frightens me.”

The planner said it’s urgent that the Vegas create a will that appoints guardians for the kids in the event of any tragedy. “Maybe you have verbally asked someone to watch over them, but without a will the courts might make a different decision,” he said.

As part of their estate planning, the Vegas will also want to appoint someone to manage life insurance proceeds and other financial assets for the children. On that note, he feels that the Vegas are not carrying enough life insurance for their needs. And he is concerned about the variable life policy they just purchased for Joe, which carries a premium of more than $1,900 a year for only $50,000 of coverage. Similar policies for the children charge $400 apiece annually for a $30,000 death benefit.

Unlike term insurance, which only provides a death benefit, variable policies are touted as a long-term investment.

“But I’m a firm believer that life insurance should never be used as an investment vehicle,” Southwick said. Indeed, he noted, the appropriate amount of term insurance would cost eight times less than a comparable variable life policy.

He also pointed out that even if the investments within the variable policies achieve a 6 percent annual rate of return, in five years the cash value of Joe’s policy, for example, will be only $7,145 — a lot less than the $9,535 he would have paid in, not counting the lost opportunity for earnings in a different investment.

Therefore, even though the Vegas have sunk considerable money into the policies, Southwick urges them to consider eliminating them in favor of lower-cost term insurance. By biting the bullet and taking a short-term loss, they can save considerably on premiums and increase their coverage dramatically.

Taking into account salary replacement, final expenses, mortgage payoff, college funding and child-care costs, the planner figures that Joe should be insured for $1 million and Rosalyn for $752,000. Because some costs, such as child-care, will phase out over the next decade or so, the couple could even consider splitting their coverage between a 10-year and 20-year term policy to further lower premiums.

The Vegas already have some term coverage, and Southwick figures that Joe could boost his by $750,000 for about $1,100 a year. Rosalyn could add $475,000 for about $717 a year. (The rates are for nonsmokers in good health.)

Overall, the planner said, “I have to commend you. You’ve done a good job of accumulating assets.”

The Vegas said they are relieved to have an action plan.

“I feel like I’m acting with confidence now,” Joe Vega said.