# Why Save for Retirement If I Have a Pension?

CalSTRS and CalPERS members will receive a pension once they retire. However, few realize that this pension will not equate to their pre-retirement income. There have also been issues with pension funding. CalSTRS, for example, is extremely underfunded and is projected to only be able to fund pensions through the mid 2020s. It is estimated that underfunded liabilities grow by $22 million per day. Click Here For More Pension Reform Information Supplemental savings plans offer employees a chance to compensate for what the pension fails to cover. Surprisingly, 45 percent of American households with working members have not saved for retirement at all. 70 percent of those aged 50-74 years have less than $28,000 in retirement savings. These issues have resulted in a "Retirement Crisis."

Click Here For More Retirement Crisis Information

## California Pension Plans

Teachers and public employees in California can qualify for a state-funded pension plan upon retirement. It is important to thoroughly understand each plan and estimate the monthly benefits each supply. You may be surprised to find that you need a supplemental savings plan in addition to your pension to maintain your standard of living once you retire. Ed4Ed.org is here to offer you this information and help you understand your options in retirement. The two pension plan options are:

**The California State Teachers Retirement System (CalSTRS)**

The California State Teachers Retirement System (CalSTRS) is responsible for administering pensions for all California Public School certificated employees. Each employee who meets the required time served will receive a pension income for life. The Teachers' Retirement Fund is one of the largest in the United States. If you are a public school teacher, you are required to use the CalSTRS retirement plan. A portion of your gross salary is paid to CalSTRS each month. CalSTRS invests in stocks, bonds, short-term investments and real estate. CalSTRS uses these investment options to earn a profit each year. Your contribution is invested along with your employer contributions.

CalSTRS uses a formula to calculate each retirees' benefits. The Benefit Formula is:

***Service Credit x Age Factor Percent x Final Compensation = Member-Only Payout Option***

This formula can be broken down as:

- Service Credit – This is the total number of years that a teacher has worked and paid into CalSTRS. In some cases, a teacher can apply unused sick leave towards additional service credit.
- Age Factor Percent – This is the percent of income to which a member is entitled for each year of service. For example, if a retiree is age 63, the age factor maximum is 2.4 percent. Pension Reform has changed the age factor to 2.4 percent at age 65 if hired after 2013.
- Final Compensation – The three-year average of the retiree's earnings before retirement (for those with less than 25 years of service). This average is calculated on gross salary before CalSTRS contribution is subtracted. Teachers with at least 25 years of service can use their highest one-year of earnings. Pension Reform has changed the final compensation to the three-year average for those hired after 2013 (regardless of years of service).

Once you are nearing or are retired, this formula will be used to calculate your pension. In many cases, a pension alone will not supplement pre-retirement income. In cases like this, you will want to consider a supplemental retirement plan.

## ***Here is an example of the formula at work:***

***Retirement Age: 62***

***Years of Service at Retirement: 30***

***Beneficiary Age: 62***

***30 (Years of Service Credit) x 2.4% (Age Factor with Career Factor) =***

**Estimated Payout Options:**

**Member-Only Option (No Beneficiary):** ***72% of Final Compensation***. This is the maximum lifetime benefit that is payable. A designated beneficiary will receive any remaining accumulated contributions after the retiree's death. Note that the beneficiary will not receive a monthly income after the teacher's death.

**100% Beneficiary Option: 63% *of Final Compensation*.** This modified benefit offers a beneficiary the same modified allowance that the teacher received before death.

**75% Beneficiary Option: 66% *of Final Compensation*.** This modified benefit offers a beneficiary 75 percent of the modified benefit after the teacher's death.

**50% Beneficiary Option: *68% of Final Compensation*.** This modified benefit offers a beneficiary half of the modified benefit after the teacher's death.

Click Here For Your Estimated STRS Benefit

**Income Gap**

As you can see from the example above, the pension will cover 63-72% of the members final compensation. Most CalSTRS members standard of living is based upon 90% of compensation during their working years. The income gap is the difference between 90% of the members final compensation and the payout CalSTRS provides based upon the benefit formula (63-72%). In the example above there would be an income gap of 18-27%. It is important to note the payout percentage can change based upon the beneficiary's age. For example, if the beneficiary is younger the CalSTRS member will receive less per month and the income gap would increase.

Members who are age 55 or older, but who have not retired, have the option of designating an option before retirement. This will ensure that a beneficiary will receive a monthly income if the member dies before retirement. All benefits received are 100 percent taxable for teachers who started working after 1986.

**The California Public Employee Retirement System (CalPERS)**

The California Public Employee Retirement System (CalPERS) is the largest public pension plan in both California and the U.S.A. The plan is funded in three ways:

Contributions made by the employee

Earnings from the investment of CalPERS assets in stocks, real estate, bonds and more

Employer contributions

CalPERS uses a special formula to calculate the pension amount each retiree receives. The Benefit Formula is:

***Service Credit x Benefit Factor x Final Compensation = Unmodified Allowance***

This formula can be broken down as follows:

- Service Credit – Service credit is earned each year or partial year while working for a CalPERS covered employer. You can find your accumulated Service Credit on your CalPERS Annual Member Statement.
- Benefit Factor – This is the percentage of pay you are entitled to for each year of service. This is determined by your age at retirement and the retirement formula for school employees.
- Final Compensation – This is the average full-time pay rate and special compensation you received for the last consecutive 12 months of employment.

## ***Here's an example of the formula at work:***

***Retirement Age: 60***

***Years of Service at Retirement: 31***

***Beneficiary Age: 60***

***31 (Years of Service Credit) x 2.314% (Benefit Factor)*** =

**Estimated Payout Options**

**Unmodified Allowance - *74% of Final Compensation*.** This is the maximum lifetime benefit that is payable. A designated beneficiary will receive any remaining accumulated contributions after the retiree's death. Note that the beneficiary will not receive a monthly income after the CalPERS member's death.

**Option 2 - *64% of Final Compensation*.** This modified benefit provides a lump sum payment of retiring member contributions to a beneficiary after the retiree's death. The monthly benefit is reduced depending on life expectancy at retirement.

**Option 2W - *65% of Final Compensation*.** With this option, the member can elect to receive a higher allowance with the caveat that the allowance is not eligible to increase to the amount of the Unmodified Allowance.

**Option 3 - *69% of Final Compensation*.** This modified option pays half of the member's monthly allowance to a beneficiary for life upon the member's death.

**Option 3W - *70% of Final Compensation*.** With this option, the member can elect to receive a higher allowance as long as it does not increase to the Unmodified Allowance amount.

Click Here For Your Estimated PERS Benefit

To be eligible to receive a pension through CalPERS, a participant must be hired before January 1, 2013 and be at least 50 years of age with at least five years of CalPERS-credited service. Participants hired after January 1, 2013 must be at least 52 years of age to retire.

**CalPERS Retirement Options**

As a CalPERS member, you will receive a monthly benefit for life once you retire. When you retire, you can choose from several different retirement options. An unmodified options will give you the full amount each month. However, a modified option could be chosen to ensure a beneficiary has a monthly income after the retiree's death. Here are the options available to CalPERS members:

**The Income Gap**

It is important to understand your income gap once you have determined your pension amount. The "Income Gap" is the difference between your pre-retirement income and your after-retirement income.

Click Here For Help Calculating Your Retirement Income Gap

It is likely you will have an income gap of some kind. In fact, it is estimated that only 60-70 percent of your pre-retirement income will be covered by your pension. It is up to you to bridge this gap. You can do this through a defined contribution plan.

## Retirement Saving Plans

Teachers and public employees in California deserve to enjoy a retirement free of financial worries. While the state offers a pension to qualifying members, few realize that this amount will likely only cover 60 – 70 percent of pre-retirement income. It is important to consider a retirement savings plan to supplement the pension you will receive. There are three retirement savings plans available to CalSTRS and CalPERS members:

### 403(b) / Tax Sheltered Annuities

A 403(b) is a voluntary Defined Contribution Plan which allows you to contribute pre-taxed income through payroll deduction. This contribution grows over time. Once you retire, you can withdraw what you need. These withdrawals will be taxed as income. Note that 403(b) contributions are aggregated with other retirement plans, such as a 401(k).

**2015 403(b) Contribution Limits:**

- $18,000 or 100% of Compensation (whichever is lower)
- Over Age 50 catch up - $6,000
- Total Allowed - $24,000

Click Here For More 403(b) Information

### 457(b) / Deferred Compensation

A 457(b) is a voluntary Defined Contribution Plan that also allows employees to make contributions from income before tax is taken. These contributions will grow, tax-deferred, until retirement. If coupled with a 403(b) plan, you can enjoy the benefit of double-deferral.

**2015 Contribution Limits:**

- Normal Annual Limit – $18,000
- Over Age 50 - $6,000
- Total Allowed - $24,000

*Note that an employee can contribute to both plans, though each has its own limit.*

Click Here For More 457 Information

**Roth 403(b)**

A Roth 403(b) is different from a traditional 403(b). With a Roth, contributions are made after-tax. This means that no taxes will be due at distribution. It is important to note that the more time you have to save for retirement, such as in your 20s and 30s, the greater benefit you will receive from a Roth.

Click Here For More Roth 403(b) Information

**Additional Retirement Income**

CalPERS and CalSTRS will provide members with monthly income post-retirement. However, this amount may not be enough. It is important to know that there are other sources of income during retirement that may be available to you:

- Social Security – This is a government defined benefit program for workers in the US that can provide monthly income during retirement. The amount of income you will receive depends on the number of years your worked and contributed to Social Security. Note that teachers participating in CalSTRS do not accumulate Social Security credits from public school employment. Teachers will also receive a reduced Social Security benefit due to Windfall Elimination Provision and Government Pension Offset.
- Medicare – This is a program under the US Social Security Administration which reimburses hospitals and physicians for medical care provided to qualifying individuals over the age of 65. While most CalSTRS members do not contribute to Social Security, most contribute to Medicare.

- Pension Maximization – When members chose a modified benefit option, they lose out on income. However, members can purchase a life insurance policy instead of taking a modified benefit option and still provide for their spouse. Choosing to purchase a life insurance policy instead of a modified benefit can help save thousands of dollars each year in retirement.

Click Here For More Pension Maximization Information

It is also important to note that the law provides that cost-of-living adjustments be made to ensure retirees who live long after retirement have a fair income. The current cost-of-living adjustment is 2 percent.

**How Much Should I Save?**

As you age, the percentage of your income you should save increases. Here is a general guide for saving for retirement, depending on your age:

- During Your 20s – Save 5% of your income
- During Your 30s – Save 8% of your income
- During Your 40s – save 12% of your income
- During Your 50s – Save 15% of your income

You can adjust this percentage to reflect your existing retirement savings balance.

Saving 5 to 15 percent of your income may seem like a daunting task; however, there are some simple things you can do to accomplish this. By simply cutting back on a few common monthly expenses, you will find that you can easily afford a small contribution that will continue to steadily grow over time as you near retirement.

For example, everyone enjoys dinning out. By give this treat up once a week you can likely save $100 per month. This equates to a savings of over $94,000 in 25 years if invested!

**The Take Away**

When planning for retirement, it is important that you:

- Understand your state pension payout percentages, including its limitations.
- It is important to know what your income gap will be in retirement and plan for the future starting now.
- Save as much as you can by taking advantage of a supplemental savings plans.
- Know that there is no “best” plan. Every family situation is different and has different needs. Each plan can offer benefits and drawbacks, depending on the situation.
- Procrastinating on retirement planning will be costly.

For more information you can visit our website to find out how to best prepare for retirement.