NELSON FINANCIAL PLANNING

THE STATE OF YOUR RETIREMENT

THE ESSENTIAL GUIDE FOR ALL STATE OF FLORIDA EMPLOYEES

Fifth Edition

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Where indicated, market data and performance represent 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 October 2023. 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/ MSRB/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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Introduction

The purpose of this booklet is to provide a single resource to state employees who are nearing retirement. 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 several 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 focus on reviewing the pros and cons of your retirement choices to help you make an informed decision. These conversations are done as a free service to you as a state employee. To learn more about us, please review the section

"What Makes Nelson Financial Planning Different?" on page 44 of this booklet.

While you are working, we keep you informed on a continuous basis by mailing FRS Update letters twice a year along with weekly updates of a variety of financial topics, including FRS matters, on our weekly podcast "Dollars & Sense." Our program was recently named one of the Top 25 Financial Planning podcasts so be sure to subscribe to us on your favorite podcast platform. If you have trouble finding our channel, visit our website at www.NelsonFinancialPlanning.com or just scan the QR code below.

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Unlike other firms that charge annual consulting fees to FRS members seeking guidance, we do not. Since 1984, our primary purpose has been to help educate individuals about their financial options. Simply put, keeping you informed about the latest legislative changes and market performance while you are still working is part of our usual operations. It also gives you an opportunity to try us out before you'll really need us in retirement.

In addition, we believe helping individuals understand the tools and strategies to know and apply to ultimately achieve financial success is a priority. Consequently, we recently wrote a book to help you develop a solid plan for achieving your financial goals whether you are just starting your financial journey or ready to retire. *Next Gen Dollars and Sense* is available on Amazon and Barnes & Noble, or you can request a complimentary copy by visiting www.NextGenDollarsandSense.com or scanning the QR code below.

NextGenDollarsandSense.com

Your FRS options have changed a lot since 2008 and caused a fundamental shift in your retirement options. Be sure to read the section on page 20 entitled "Shifting Sands for Current Employees – The Litany of Changes since 2008".

Once you retire, things get a lot more complicated. We provide personalized retirement income strategies to meet your unique retirement expenses and tax liabilities. These income needs are ever-changing and the tax implications of retirement are easily misunderstood. There are a variety of options available as a state employee and each has different tax implications depending on your age and job. Your investment focus should also be shifting 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 becomes invaluable. Be sure to read the section on page 32 entitled "Retirement Income – Your Age and the Account Matters."

This booklet is now in its fifth edition and includes the latest legislative updates about your retirement options within the Florida Retirement System.

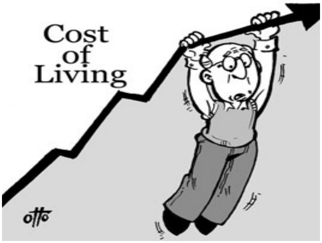
The FRS Pension Plan – The Guaranteed Check a Month Club

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.

Option 2 provides a guaranteed payout time period of at least 10 years and Option 4 allows one to include dependent or disabled children as contingent recipients of your pension. Just like Option 3, Options 2 and 4 reduce the amount of your pension calculated using Option 1.

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 service after 2011. For retirees under the Pension Plan, your COLA in retirement is calculated by adding the number of years at 3% to the number of years at 0% and then dividing by your total number of years as a state employee. This average then becomes your COLA that will be permanently applied to your pension check in retirement.

For example, if you plan to retire in 2024 with 25 years of service, your COLA would only be 1.44% rather than 3% - a 52% reduction in future benefit increases. For many years after 2011, inflation held at about 1% so retirees didn't feel the full impact of losing this COLA benefit. Now, with inflation hitting record highs, the value of this COLA cannot be understated for retirees who are seeing their purchasing power shrink.



Effective for new employees after July 1, 2011, retirement eligibility has increased to age 65 or 33 years for regular class employees. Previously, normal retirement was age 62 or 30 years for regular class employees. In the 2023 legislative session, the normal retirement age for special risk class employees was restored to age 55 or 25 years of service. From 2011 to 2023, these parameters had been increased for new special risk class employees to age 60 or 30 years. 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. This effectively serves as a 3% reduction in employee compensation.

For a more complete description of the FRS Pension Plan, please refer to the Pension Plan Summary Plan Description prepared by the State of Florida Division of Retirement. This document can be found under the Publications section of 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 or leave a lump sum 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 now earning 4% as of July 1, 2023. From 2011 to 2023, this interest rate was set at 1.3%. The recent increase to 4% is incredibly valuable but still ranks below the 6.5% earned on DROP monies prior to 2011. 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, you must terminate employment.

The 2023 legislative session extended the DROP period in an effort to help retain FRS employees. The maximum amount of time one can spend on DROP increased from 60 calendar months to 96 for all employee membership classes. In addition, instructional personnel such as public school teachers have the opportunity to extend their DROP participation for up to 24 calendar months in addition to the 96 months. Beyond that, the DROP entry window was expanded to allow participation in DROP at any time after an FRS employee reaches their normal retirement date and their vesting requirement is met.

For a more complete description of DROP, please refer to the DROP Guide prepared by the State of Florida Division of Retirement, available in the Publications section of www.myfrs.com.

DROP is not extra money or some kind of bonus. It is simply holding your pension check while you continue 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. Your retirement benefit that is payable to you then accrues in DROP as a lump sum payment that is only available when you leave the employment of the State of Florida. However, your monthly check that you receive from the FRS Pension does not reflect the years you spend in DROP as those don't count in your FRS Pension Plan calculation. In addition, the earnings rate on these DROP monies has been improved to 4% but that is still significantly less than the 6.5% rate that was used prior to 2011. In today's interest rate environment, this undermines the value of DROP particularly considering that your years in DROP don't increase your benefits under the Pension Plan.

The DROP balance is typically 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.

Since the DROP monies are considered retirement monies, a tax penalty of 10% could apply if you are under age fifty-nine and a half at retirement. You must exercise special care in order to avoid this penalty as you use your DROP monies. If you meet certain parameters (over age 50 and a public safety officer (i.e., special risk class) or over age 55 and regular class), you are able to avoid the 10% penalty for early withdrawal by drawing directly from DROP. If you plan to take money over time, you can roll your DROP monies over to the FRS Investment Plan, which is considered a qualified plan. Such qualified plans allow you to withdraw money penalty free if you retire in the year in which you turn age 55 or older. A major distinction between DROP and the FRS Investment Plan is that the DROP rules specifically recognize the age 50 public safety employee exemption as an exception to the normal 10% early distribution penalty. Meanwhile, the FRS Investment Plan does not specifically recognize this age 50 exception and only provides for the usual age 55 exemption. 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.

The 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. These contributions are made every pay period to your own personal Investment Plan account. As of July 1, 2023, the contribution rates are currently 11.3% for regular class and 19% for special risk class which include the mandatory 3% employee contribution. This is a 2% increase in employer contribution rates over 2022 and a total increase of 5% since 2021. This is a significant increase in employer contribution rates which directly benefits FRS Investment Plan participants. Unfortunately, prior to July 1, 2012, these contribution rates were even higher but were reduced in 2011 to level the Investment Plan benefits with prior cuts that had been previously made to the FRS Pension Plan benefits.

In addition, these changes in contribution rates often mean that the timing of any decision to switch from the Pension Plan to the Investment Plan should be carefully considered. The second choice service on www.myfrs.com allows you to calculate different scenarios for when your lump sum balance is maximized. Often this occurs after you have completed your required years of service for full retirement (*i.e.*, 25 years as special risk and 30 years as regular class for those hired prior to July 1, 2011). After that, if you are still working, increases in the lump sum benefit amount start to slow. The other alternative is to choose the

Investment Plan at the inception of your career with the state. In order to access the comparison service at myfrs.com, you need to establish log in credentials that are unique to that website.

The Investment Plan contributions are sent to your personal account within the FRS Investment Plan. Within this account, there are only 20 different investment choices (11 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 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 addition, when you retire, this account needs to follow a growth and income approach to provide you with a monthly retirement benefit like what you would have gotten under the Pension Plan. This means that you cannot treat the Investment Plan like a cookie jar in retirement by taking chunks out of the balance. The objective with the

Investment Plan balance is to generate a regular monthly income by using a diversified and properly allocated investment approach. This is where our firm provides its greatest assistance to state employees by working together at retirement to establish a financial and retirement income plan for the rest of their lives.

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. Your retirement income will be solely based on the investment performance of the funds in the FRS Investment 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 the Publications section of www.myfrs.com.

For a complete comparison of the advantages and disadvantages of these FRS options, please refer to the Plan Comparison Chart 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.

One important note about generating income from an Investment Plan account. This is best done using a systematic withdrawal plan that also gives you the option of having a certain amount of tax withheld each month to cover your tax liabilities.

Unfortunately, in every quarterly Investment Plan newsletter, FRS keeps pushing annuities from MetLife as a solution to your income needs in retirement. We don’t know how much MetLife is paying FRS for the advertisement of their products but here are a few things to keep in mind when it comes to annuities. First, annuities are perhaps the most misunderstood, highest expense and most restricted investment option available.

Second, an immediate annuity takes a lump sum of money and converts it to an income stream. Consider the following example in the January 2022 FRS Investment Plan newsletter. If you invest $100,000 in a MetLife annuity, you will receive $474 per month for the rest of your life starting at age 65. A typical 65-year-old has a life expectancy of about 20 years today. That's 240 payments of $474 or a total of $113,760. Does a $13,760 profit over 20 years on a $100,000 investment sound like a good idea? If you really want a guaranteed lifetime income option for your retirement, you should remain in the Pension Plan rather than use monies in an Investment Plan account to purchase an annuity.

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 $185 billion as of June 30, 2023.

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 is not applicable to those employees 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 and now the impact of heightened inflation.

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 was 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. To date, there has been no real discussion in the Florida Legislature to reinstate the COLA for state employees. Given that the value of the Pension Plan assets has returned to a value greater than what it was before the 2008-2009 financial crisis, the COLA benefit should arguably return, especially in the current environment of higher inflation.

The effect of this change is to prorate an employee's COLA benefit across their total number of service years. For example, if you had 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%. Similarly, if you retired in 2022 with 25 years of service, you would have 11 years at a COLA of 0% (the years since 2011) and 14 years at a COLA of 3%. This would average out to produce a COLA of 1.68% on your pension in retirement.

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% but increased to 4% effective July 1, 2023. Over an extended DROP period, the applicable interest rate can have a dramatic impact on DROP values. In fact, employees should compare the impact of the additional years of service time on their pension with their DROP benefits. In some cases, the additional years increase one's pension benefit more significantly than the potential income from the lump sum DROP amount. Remember, years spent on DROP don't count towards calculating your pension benefit.

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 huge margin. Prior to July 1, 2012, the total contributions to one's Investment Plan account were 22% for special risk employees and 9% for regular class employees. After July 1, 2012, those contribution rates declined to 13% and 6.3% respectively. Recently, these contribution rates have increased back to 19% for special risk employees and 11.3% for regular class employees. Unfortunately, these rates include the mandatory 3% employee contribution, so employer contribution rates are still lower than they were prior to 2012.

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 still 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 class. 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. During the 2023 legislative session, these parameters for special risk employees were returned to their original levels of age 55 or 25 years of service. Unfortunately, all other new FRS employees will need to work longer in order to receive comparable benefits available to current FRS employees.

In addition, new employees must make an election between the Pension Plan and the Investment Plan within eight months after their hire – otherwise, the state will choose for them! Effective January 1, 2018, if new employees do not make an election by the end of the election period of eight months, there will be a default membership. Employees in classes other than the Special Risk Class will default to the Investment Plan and members in the Special Risk Class will default to the Pension Plan. All members will continue to have a second election, but employees should make their first election immediately after their hire. Otherwise, you may wind up using your second election to reverse a default decision that you didn't intend to make.

The bottom line of all these changes is that they affect your decision and timing to make any changes to your retirement. In the past, when employer contribution rates to the Investment Plan were 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 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 (30/33 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 much slower rate. In those cases, it may make sense to make a move in that 25th (or 30th/33rd)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 these days to just wait things out before considering any move among the FRS options.

In addition, those retiring under the FRS Investment Plan need to be aware of the timing restraints that exist to access your money. Retirees must wait one full calendar month after the month in which they retire before they have an early access opportunity to draw funds from the FRS Investment Plan. In order to shorten this window, one should retire at the end of the month rather than the beginning of the month. For example, if you work a few days at the beginning of a month, you would have to wait the rest of the month plus all of the next month before getting any access to your FRS Investment Plan. This early access is also limited to just 10% of the balance and is available only to retirees who meet the normal age and years of service retirement parameters. In order to gain full access to their Investment Plan balance, retirees then have to wait another full two months after the early access period. Consequently, it often takes over three months before retirees can set up normal retirement income from their accounts. This is a significant issue with retiring under the FRS Investment Plan, and retirees need to consider these timing restraints and plan their finances accordingly in order to have enough resources to bridge those first three months of retirement.