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Consider financial future before accepting buyout

By Andrew Leckey
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An employee buyout can lead to the best of times or the worst of times.

The worst: A client of certified financial planner David Berman who accepted a buyout from a pharmaceutical company at 56 is struggling. He expected to land another job in six months, but a year and a half later still hasn't found one. He burned through his severance and the only money left is his retirement account.

The best: "I've often seen a buyout provide a real kick in the pants for someone to make a career change they'd been contemplating anyway, or to relocate to another city they'd been considering before," said Berman, a principal of Berman McAleer Inc., Timonium, Md. "They receive money and time off to get their feet on the ground, so it is a great thing."

David Kudla, chief executive of Mainstay Capital Management in Grand Blanc, Mich., has counseled several hundred autoworkers facing buyouts. Kudla said personal circumstances such as age and amount received vary but need for strategy is universal.

"The biggest mistake is to accept a buyout without first developing a comprehensive income and investment plan that realistically accounts for retirement risk," said Kudla, a fee-based adviser. "Basic assumptions are often wrong, or the individual hasn't really gone through the math."

The worker must make an informed decision on whether assets will be invested immediately or are needed for a cash reserve, he said. With poor planning, individuals who thought they were done with work forever often find themselves taking jobs they don't like.

Key financial factors faced by workers accepting buyouts, according to Kudla, are:

Longevity

People overall are living longer, so accepting buyouts in one's 50s or early 60s might mean they'll spend as much time retired as they did in the workforce.

Rising inflation

The cost of living, which has been kicking up lately, can greatly reduce long-term purchasing power.

Pension concerns

Not only are fewer companies offering traditional pension plans, but many existing plans have been experiencing serious financial trouble.

Portfolio management

Individuals often invest too conservatively and don't amass enough money to maintain their withdrawal rate, or are too aggressive and lose significant money when the market takes a hit.

Unrealistic withdrawals

Kudla considers an annual withdrawal rate of 4 percent to 5 percent realistic, yet some people take out much more. That means the money isn't going to last.

"Accepting a buyout most certainly involves redoing everything you've already done," Berman said, "Your overall investment plan and the income you draw off your portfolio are going to change."

Re-evaluate expenses such as travel habits and the gifts you give, he said. If you have children in college, figure where that money will now come from.

"Because a buyout can flood you with a wide range of emotions, we help people to focus on what is important for them and we do it in a structured way," said Malcolm Greenhill, a certified financial planner and president of Sterling Futures, San Francisco. "Building a financial foundation is very important before you move on to numbers-crunching that will include cash-flow projections."

Because what's at issue is making sure your money doesn't run out, the important computations can't simply be made on the back of an envelope, he said.

"While a buyout may seem like a lot of money, when a financial planner considers the lack of additional income or the tax implications, it may not seem like so much anymore," Greenhill said. "The client may not want to work again, but if the financial planner says there isn't enough money in the buyout to do that, then part-time work will have to be considered."