Kiplinger's

RETIREMENT REPORT

Your Guide to a Richer Retirement

VOLUME 10 NUMBER 3 MARCH 2003

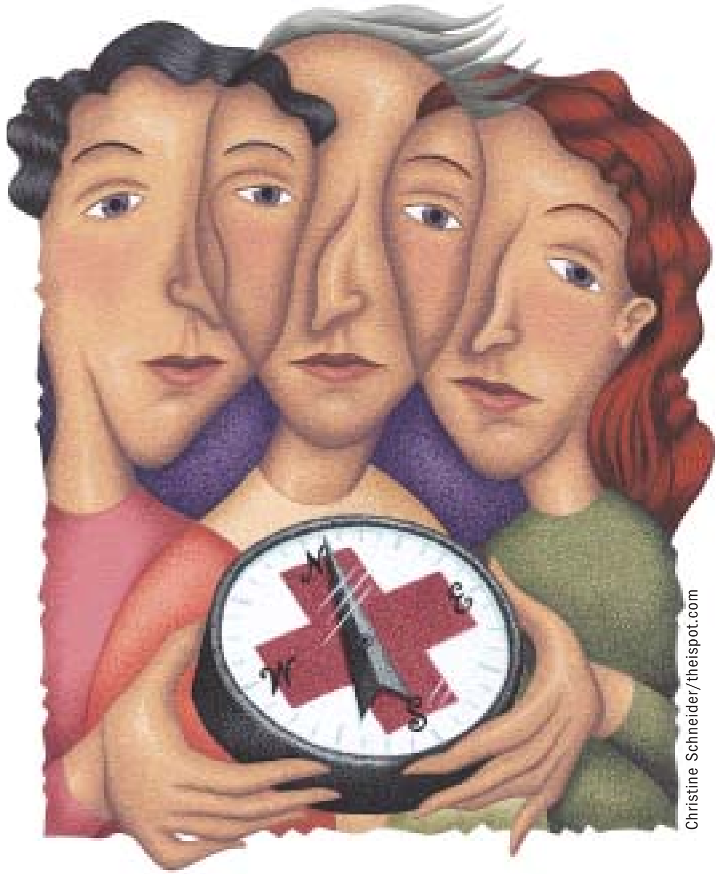
IN THIS ISSUE

Christine Schneider/theispot.com

Kiplinger's
RETIREMENT REPORT
Your Guide to a Richer Retirement MARCH 2003 VOLUME 10 NUMBER 3 $5.00

Retiree Health Care: Costs Surge Higher

Prepare to pay more out of pocket for your health insurance, medical services and prescription drugs.



Christine Schneider/theispot.com

THE DRAMATIC RISE in health care costs continues. That, coupled with a sluggish economy, is causing many employers to look for additional ways to cut benefits or shift those expenses to workers and retirees. Last year, employers saw their costs for health care coverage rise an average of 15%, according to a survey by Mercer Human Resource Consulting. The increase was 18% for small- and midsize firms with fewer than 500 workers and 12% for big firms. This year's run-up is expected to be in the same league, and many employers are reaching the end of their rope. A sure sign: The words "universal health care coverage" are once again being whispered in Washington, D.C., and in corporate offices across the country.

Cost Hikes for Retirees: Somewhat Tempered

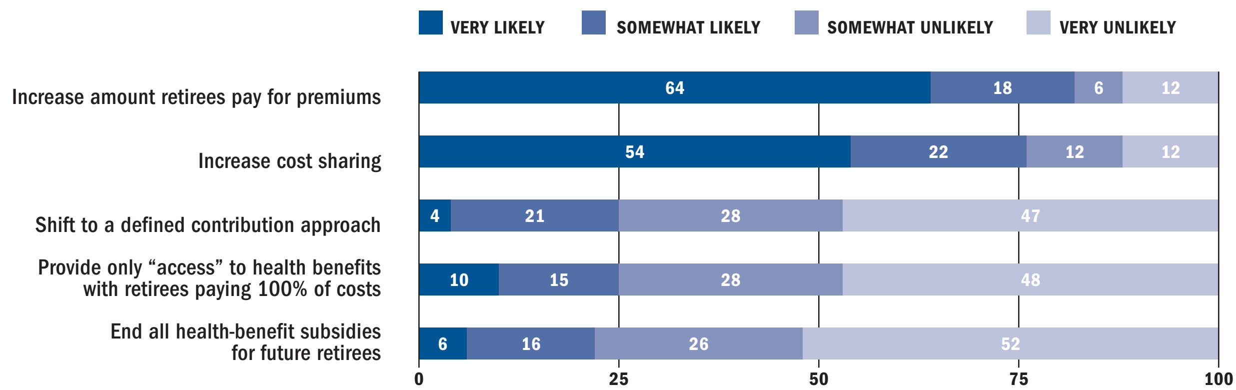
Since most retirees are covered by Medicare (a federal program which is also facing surging costs and multiple proposals for reform), they won't bear the brunt of employers' changes to health care benefits. But their coverage won't go unscathed, and out-of-pocket costs will rise. Employers may keep changes to a minimum for fear of angering retirees whose benefits were negotiated by their union—or who might prove in court that the company never clearly established the right to cut their health benefits at a future date. But "if it's just raising a co-pay from $10 to $20, that's something that employers may put through to everybody," says Harvey Sobel, a senior actuary with Buck Consultants.

On the positive side, if you currently are covered through a former employer who has 1,000 or more employees, you will probably retain coverage. According to a recent survey by the Kaiser Family Foundation and Hewitt Associates, 95% of the large companies polled said they would continue offering coverage to retirees—those 65 and older, and those who left work at a younger age—for the next three years. But 82% said they expected to raise retiree premiums, and 85% plan to raise prescription-drug co-payments or co-insurance. And about 66% of the firms said they are likely to increase premiums for dependents, including spouses, over the next three years.

Employers are also concerned about the costs of drug coverage for retirees: Recently, drugs accounted for

Brace Yourself for More Changes in Health Benefits

A recent Kaiser/Hewitt study asked businesses with 1,000 or more employees that provide health benefits to retirees the likelihood of their making the following changes to their health coverage within the next three years. The companies' responses are shown in the table below.



SOURCE: Kaiser/Hewitt 2002 Retiree Health Survey, December 2002. Because of rounding, numbers may not add up to 100.

40% to 60% of employers' overall spending on retirees' health care. It's no surprise, then, that nearly two out of three employers surveyed for the Kaiser report said that they would be more inclined to retain drug benefits for seniors if Medicare were to become the primary payer and their company's coverage became secondary.

The Shape of Things to Come

Many employers will consider adopting one or more of the following options in the next year or two:

■ A return to co-insurance, with workers and retirees paying a share of the cost, rather than a flat co-payment.

■ More "tiering" of health services, not only for pharmaceuticals, for which the practice is now common, but also for hospital and physician services. This means that your out-of-pocket expenses will be higher if you opt for providers in the upper tiers, just as you now pay more for brand-name drugs than for less costly generics. For example, if you chose a high-quality teaching school for a routine surgery, you would pay more than you would for the same procedure at a lower-tier facility, such as a community hospital.

Those who aren't yet retired face more uncertainty and bigger adjustments. The types of impending changes you can expect are reflected in what some of the country's biggest employers are already doing, according to a recent Watson Wyatt survey:

■ In order to qualify for retiree health benefits, workers will have to work longer for their employer. In 1984, nine out of ten big companies that offered medical benefits to retirees over age 65 required five years of service or less. Last year, only 25% were so generous,

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REPRINT SERVICE
PARS International Corp.
102 W. 38th St., Sixth Floor,
New York, NY 10018
TELEPHONE: 212-221-9595, ext. 322
E-MAIL: reprints@parsintl.com

Published monthly (ISSN# 1075-6671); $59.95 for one year; $89.95 for two years; $114.95 for three years.

Periodicals postage paid in Washington, DC.

POSTMASTER: Send address changes to Kiplinger's RETIREMENT REPORT, P.O. Box 3295, Harlan, IA 51593.

and the number is expected to gradually drop to 14%.

■ Employers will kick in less for retiree health benefits. Currently, employers typically pick up 80% of the tab, but that will gradually fall to 60%. Some large employers have already cut their contribution level. In the Kaiser/Hewitt survey, for example, the average premium for new retirees was $194 a month, with employers contributing $115, or 60%.

■ More employers will set up retiree medical-health accounts and contribute a fixed amount based on years of service. The contributions may be made as a lump sum at retirement or annually, with the employer typically contributing from $750 to $2,500 a year to the account. In addition, the funds in the account grow by a fixed rate, usually 5% to 8%, during both the accumulation and the spend-down phase. Upon retirement, a worker usually uses the account to buy insurance coverage, such as a Medigap policy. Once the account is depleted, the retiree becomes responsible for the entire cost of his medical care, and there's no limit on his out-of-pocket costs not covered by Medicare.

■ Employers also may offer retirees "access" to the company's health coverage, meaning retirees could purchase coverage through the company's employee health plan but would have to pay the full, unsubsidized cost.

High Health Costs for the Youngest Retirees

Those who retire without employer coverage or subsidies and before age 65, when Medicare coverage usually kicks in, could face expenses that are much higher than they anticipated. For example, they would have to find health insurance in the individual market, where annual premiums can easily exceed $10,000 for a married couple.

A new report from Fidelity Investments estimates that a couple retiring today at age 60 would need at least $200,000 in savings to cover their medical expenses during retirement. The study assumes that the couple moves on to Medicare at age 65 but doesn't have employer-sponsored supplemental health coverage. The costs they face include the Medicare premium, a Medigap policy, cost-sharing expenses, and the out-of-pocket cost of services not covered by either Medicare or Medigap. The $200,000 estimate includes the out-of-pocket cost of prescription drugs but not the cost of long-term care, such as help with bathing or dressing.

To put the couple's situation another way, on average Medicare covers roughly 55% of beneficiaries' medical costs during retirement, leaving a financial gap of about $7,000 per couple each year.

As We See It

PRESIDENT BUSH'S proposed budget has plenty of tax breaks for just about everyone. The administration is asking for $1.46 billion in tax cuts over the next ten years, about $100 million more than the tax cuts that were enacted in 2001.

Every person, regardless of age and income, would be able to open a tax-free **lifetime savings account** (LSA) and contribute $7,500 a year. Earnings in the LSA grow tax-free and payouts, also tax-free, could be taken at any time, for any reason.

In any year that you have earned income, you could contribute to a **retirement savings account** (RSA) and put in up to $7,500 a year on an after-tax basis. A husband or wife could also contribute up to $7,500 for a nonworking spouse. If you withdraw from the RSA before age 58, you would be subject to taxes and penalties.

Existing Roth IRAs would simply be renamed RSAs. You could keep your regular IRA, but you wouldn't be able to make additional contributions. Distributions would be fully taxable as ordinary income, as they are now. You would also have the chance to convert your regular IRA by paying tax on all the earnings that have built up tax-deferred so far (including any tax-deductible contributions). If you convert promptly, you could spread the tax bill out over four years.

Existing 401(k), 403(b) and 457 plans would be replaced with **employer retirement savings accounts** (ERSAs), with a $12,000 limit on contributions (and a $2,000 catch-up contribution for employees age 50 or older).

Also in the proposed budget is a change that would permit you to make tax-free donations to charity from your IRA. And a measure that would give more taxpayers a break on long-term-care insurance premiums. It calls for an above-the-line tax deduction that nonitemizers could use.

Congress is already working on bills to stimulate charitable donations. Proposals on savings plans are more controversial: Expect a big fight.

Priscilla Brandon

Editor

MANAGING YOUR FINANCES

Social Security Benefits: Ready, Set, Review

AS YOU APPROACH retirement, familiarize yourself with Social Security and how your benefits will be determined. Start by visiting www.socialsecurity.gov to use the site's "Benefit Eligibility Screening Tool." Then scroll down the menu on the left and click on "Publications" for guides and booklets on the program. You can also obtain information and publications by calling 800-772-1213. Once you have the benefit basics down, get acquainted with a few of Social Security's lesser known features that could have an impact on your benefits.

The Dreaded Pension Offset

If you earned a pension working for a federal, state or local government and consequently didn't pay Social Security taxes, your right to a spousal or widow's Social Security benefit is reduced, or "offset," by the extent of that pension. The Social Security benefit you receive will be limited to the amount that exceeds two-thirds of your government pension.

Retiring school teachers often run into this pension offset, notes Avram Sacks, a Social Security expert with CCH. They typically assume—incorrectly—that they will receive their government pension plus half their spouse's Social Security benefit. For example, say that at age 65 you retire with a teacher's pension of $900 a month. Two-thirds of that would be $600. Your spouse, who is a few months older, is entitled to a full Social Security benefit of $1,500. The maximum Social Security benefit you could receive would ordinarily be $750 (one-half of $1,500). But when your pension offset is figured in, that amount is reduced to $150 ($750 minus $600). The offset will also affect the Social Security benefit you would receive if your spouse dies before you. In this example, if your spouse dies first, you would be entitled to a widow's benefit of $900 ($1,500 minus the $600 offset).

Disability Versus Early Retirement

If you're under 65, have paid into Social Security and develop health problems serious enough that you can't work, consider applying for disability rather than early-retirement benefits, says Joseph Matthews, a lawyer in San Francisco and co-author of *Social Security, Medicare and Government Pensions*. You will likely have a greater benefit than if you take a reduced early-retirement benefit, and you will be eligible for full benefits once you're old enough.

For instance, if you turn 62 this year, you must work until 65 and eight months to receive a full benefit. If, instead, you apply for early retirement this year, you'll be entitled to an amount equal to about 76.6% of your full benefit.

The reason many applicants choose the reduced-benefit option is that applying for disability benefits takes time and effort—typically, two to three months from the time you file to when you begin receiving benefits, but potentially a year or longer if it's a complex situation. Also, you may need to hire a lawyer to help you file the paperwork and answer questions.

Options After a Divorce

If you were married for at least ten years, you may qualify for higher benefits based on your ex-spouse's work record than on your own record. And you may be eligible even if your ex-spouse has remarried (provided you haven't remarried), as long as you and your former spouse are both 62 or older and you've been divorced at least two years. (The two-year waiting period is waived if your former spouse was already collecting retirement benefits before the divorce.) The right to benefits based on an ex-spouse's record is absolute and can't be relinquished in a divorce or separation agreement.

Once you remarry, you lose your right to collect benefits based on your former spouse's work record.

What if you've been married and divorced more than once? If you're eligible to collect a benefit, the amount will be based on whichever ex-spouse's work record would provide you with the highest payment.

For More Information

- ***Social Security, Medicare and Government Pensions*** **(Nolo, $30), by Joseph Matthews and Dorothy Berman, is an up-to-date reference. It's sold in bookstores and by the publisher (800-728-3555; www.nolo.com).**
- ***2003 Guide to Social Security and Medicare,*** **a 56-page booklet prepared by Mercer Human Resource Consulting. To order, make your check for $5.50 payable to *Kiplinger's Retirement Report,* and mail it to *KRR*, 1729 H St. NW, Washington, DC 20006-3938.**

MANAGING YOUR FINANCES

Outlook for REITs

REAL ESTATE HAS BEEN one of the few harbors sheltering investors from stock-market losses over the past three years. But the question now is: How long can commercial real estate escape the economic downturn? In Dallas, for example, nearly 30% of downtown office space is vacant, according to research from Cushman & Wakefield, a commercial real estate brokerage firm.

Rising vacancy rates and falling rents will eventually hurt stock prices of real estate investment trusts (REITs), experts say, but the dividends of most REITs are secure unless the economy stumbles again.

Income-oriented investors often buy REIT stocks for their generous dividends. REITs are publicly traded companies that own and manage offices, distribution centers, malls, apartments and hotels. They are required to pay out most of their profits to shareholders. REIT stocks have been yielding more than 7% lately, compared with the 1.9% dividend yield of Standard & Poor's 500-stock index. In addition to their dividend yields, REITs have lately enjoyed better total returns than the S&P 500, which posted annualized 15% losses over the past three years through December 31. In contrast, the Wilshire REIT index posted 15% annualized gains over the same three-year period.

How Secure Is That Dividend?

Today, dividends paid out by REITs consume about 72% of "funds from operations"—a common measure of cash flow for REITs. That payout ratio is well below the 90% threshold that could threaten future dividends; with 72%, "We're talking about a pretty good cushion," says Keith Pomroy, senior real estate editor with SNL Financial, a service for institutional investors.

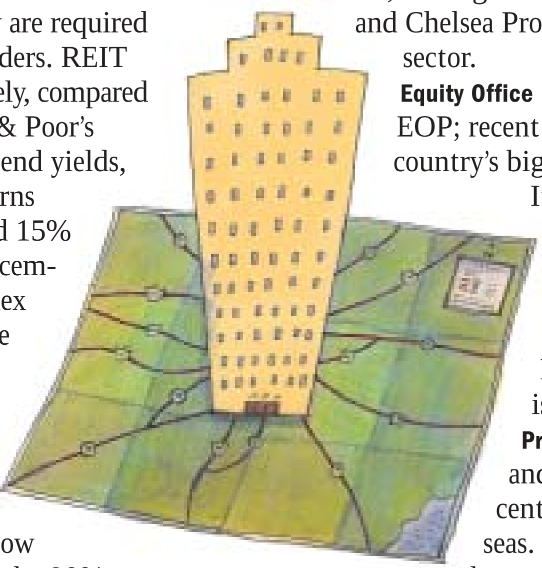
To see how your REIT stock measures up, pull out the company's latest quarterly report (Form 10-Q) or annual report (Form 10-K), or print out the copy from the Securities and Exchange Commission's Web site (go to the home page at **www.sec.gov**, and then click on "Search for Company Filings"). Look up the number of common shares outstanding and multiply that number by the distributed dividend per share for the period. Then divide that amount by the funds from operations to obtain the stock's payout ratio.

Once a stock begins paying dividends that exceed 90% of its funds from operations, consider selling. The higher the payout ratio, the greater the risk that the company may not be able to sustain its dividend.

Good Prospects for Investors

Hotel and apartment REITs have been hit hard by the economic downturn, and some have already cut their dividends. Hotels were crushed by the post–September 11 drop in travel, and low interest rates have lured thousands of renters into homeownership. Conservative investors should stay away from REITs in these businesses until an economic recovery is well under way.

Instead, consider the stocks of well-managed office, industrial and retail REITs, says Ralph Block, author of *Investing in REITs* and REIT portfolio manager for Bay Isle Financial, a San Francisco investment advisory firm. He suggests that income-oriented investors take a look at Equity Office Properties Trust in the office sector, ProLogis for industrial buildings, and Chelsea Property Group in the retail sector.



Equity Office Properties Trust (symbol EOP; recent price, $24), is the country's biggest REIT. It owns 731 office buildings in 20 states and the District of Columbia, and its stock was recently yielding 8.5%. Its dividend payout ratio is 55%.

ProLogis (PLD; $24) owns and manages distribution centers in the U.S. and overseas. Block says the company has successfully penetrated Europe and Japan to diversify its operations. The stock recently yielded 5.6%, and its payout ratio is 59%.

Chelsea Property Group (CPG; $34) owns 54 shopping centers in 28 states and recently opened two successful centers in Japan. Half of the shopping centers are upscale fashion outlets that command high rents and are 98% full. Recent yield, 5.7%; payout ratio, 68%.

If you prefer to invest in REITs through mutual funds, consider Fidelity Real Estate. Manager Steven Buller looks for reasonably priced stocks of REITS he believes will grow. The fund's three-year annualized total return through December 31 was 15%. Another strong candidate is Vanguard REIT Index fund, which tracks the Morgan Stanley REIT index. Its three-year annualized return through December 31 was 14%.

Investing for Income

Recommended Dividend Stocks

Using the stock-finder tool at Kiplinger.com, we screened for stocks with ten years of dividend increases and good projected earnings and turned up these drugmakers.

DIVIDEND STOCKS	YIELD	SHARE PRICE
Schering Plough (SGP)	**3.8%**	$18
Merck (MRK)	**2.7**	53
Abbott Labs (ABT)	**2.7**	35
Pfizer (PFE)	**2.1**	28

U.S. Treasury Yields

MATURITIES	YEAR AGO	3 MONTHS AGO	THIS MONTH	NEXT AUCTION*
Three-month bills	1.76%	1.25%	**1.19%**	weekly
Six-month bills	1.86	1.30	**1.20**	weekly
Two-year notes	3.02	1.92	**1.66**	Mar. 26
Five-year notes	4.30	3.05	**2.92**	May 7

Treasury yields are for February 20, 2002; November 20, 2002; and February 20, 2003. *Dates are tentative.
SOURCES: Technical Data, R.H. Wrightson & Associates.

Selected Fixed-Income Mutual Funds

These Ginnie Mae funds have good managers and low expenses. Yield shown is for the past 30 days. For more details on funds, go to www.kiplinger.com/investing/funds.

GINNIE MAE FUNDS	YIELD	PHONE NUMBER
Vanguard GNMA (VFIIX)	**5.0%**	800-635-1511
USAA GNMA (USGNX)	**4.3**	800-382-8722
Fidelity Ginnie Mae (FGMNX)	**3.7**	800-343-3548
Category Average	**3.7%**	

Money-Market Funds

Top-performing funds with minimum initial investments of $10,000 or less. These 30-day compounded money-market yields are to February 20, 2003.

TAXABLE	YIELD	PHONE NUMBER
RBB MMP/Sansom*	**1.19%**	800-430-9618
USAA	**1.14**	800-531-8448
Vanguard Federal	**1.14**	800-635-1511
Category Average	**0.80%**	
TAX-FREE	**YIELD**	**PHONE NUMBER**
Alpine Municipal*	**1.11%**	800-221-4524
Strong*	**1.08**	800-368-3863
Vanguard	**1.03**	800-635-1511
Category Average	**0.60%**	

*Fund is waiving all or a portion of its expenses.
SOURCE: *Money Fund Report* (for up-to-date rates, go to www.imoneynet.com and click on "Money Fund Data").

Benchmarks

	YEAR AGO	3 MONTHS AGO	THIS MONTH
Inflation rate*	1.14%	2.03%	**2.59%**
Yield on S&P 500	1.44	1.90	**1.95**
One-year Treasury (CMT)**	2.23	1.49	**1.31**
10-year Treasury	4.91	4.05	**3.94**

*Year-to-year change in CPI as of October 2002 and January 2003.
**Constant Maturity Treasury yield.

MANAGING YOUR FINANCES

Your Questions Answered

Medicare Terminology

I'm enrolled in traditional Medicare. If my doctor doesn't accept assignment does that mean I can't use her services?
No, it means that your doctor hasn't agreed to accept what Medicare pays as full payment for her services. When a doctor accepts assignment, you owe only your share of the cost of the visit (normally 20%). Otherwise, you are liable for up to 15% over Medicare's approved amount plus your co-insurance payment. Unfortunately, the cap doesn't apply to all services.

Reporting Sale of Principal Residence

I sold my home of 30 years in October 2002 and made a profit of $230,000. Must I report this on my tax return?
No, most homes sales don't need to be reported on Schedule D. If the home was your primary residence and you owned and used it for periods totaling at least two years (730 days) during the five years before the sale, up to $250,000 of the profit is tax-free. When you closed the sale, you signed a paper certifying that your profit on the home was below the threshold. As a result, the escrow agent or lawyer who handled the closing wasn't required to report the sale to the IRS—and neither are you.

Tax-Efficient Funds Are Overrated

Should I invest in tax-efficient mutual funds?
Not unless you plan to keep the funds for decades and you don't hold them in a tax-deferred account. The government requires funds to distribute their realized capital gains to shareholders each year. That means that if you own the fund in a taxable account, you'll pay income taxes on the distributions regardless of whether you have a gain or a loss. But today's distributions lower your future taxes. If you reinvest distributions, the cost basis in the fund increases, and you'll have a lower gain when you eventually sell your shares. In other words, paying taxes on reinvested distributions each year lowers your future tax on the shares. The only real penalty is forgoing earnings on the tax payment.

Learning About Medicaid

My elderly mother is in a nursing home, where my husband and I are currently helping her pay for a private room. At some point, she may spend her savings and qualify for Medicaid. I'd like to learn about how this welfare program works.
Take a look at the fourth edition of *Choose the Right Long-Term Care* (Nolo, $22; www.nolo.com), by Joseph Matthews (another of his books is mentioned on page 4) or *The Complete Idiot's Guide to Long-Term Care Planning* (Alpha, $20; www.amazon.com), by Marilee Driscoll. Both books include strong sections on Medicaid and also offer other helpful advice on long-term care.

Leaving IRA to Multiple Beneficiaries

I want to leave half my IRA to my spouse and the other half to our two grandchildren. I understand that the government's new "separate account" rules for IRAs mean that I don't have to split my account to accomplish this. Is this a good idea?

Not if you want to be absolutely sure that your spouse and grandchildren get the best possible outcome. It's true that the new rules give multiple beneficiaries more flexibility, but only if they know what to do and when (see *KRR*, June 2002, page 1).

Presumably you want to allow each beneficiary to stretch out an IRA's tax-deferral benefits as long as possible by using his or her own age to compute required minimum distributions. In addition, you probably would like your spouse to have as many options as possible after your death (see *KRR*, July 2002, page 10).

The best way to guarantee those results is to split your IRA into separate IRAs and name one designated beneficiary (plus backup beneficiaries) for each account. The drawback: It's easier to own one IRA than three.

The February 2003 issue of *Ed Slott's IRA Advisor* (800-663-1340; www.irahelp.com) includes a thorough discussion of the separate-account rules and the arguments for dividing an IRA. We have 50 complimentary copies of the newsletter, available to readers on a first-come, first-served basis. Send your request to *KRR*'s Helen Fritzel (hfritzel@kiplinger.com).

IRAs and the Federal Estate-Tax Exemption

Your January article on federal estate taxes made me wonder whether the unified credit can be used to offset an IRA?
Yes, it can. Any retirement plan you own at death is part of your estate when figuring estate taxes, and the unified credit is used to offset all or part of the federal estate-tax bill. This year, the credit is $345,800, which exempts up to $1 million from estate-and-gift-tax liability. In addition, you can leave an unlimited amount to a spouse free of federal estate taxes.

Investing for Income

Certificates of Deposit

SIX MONTHS	YIELD	PHONE NUMBER
IndyMac Bank (Cal.)	**2.15%**	800-734-6063
Legacy Bank (Okla.)	**2.15**	800-687-9688
Imperial Capital (Cal.)	**2.05**	800-455-4485
nBank (Ga.)	**2.00**	800-332-8231
Bank Direct (Ga.)	**2.11**	877-839-2737
National Average	**1.18%**	
ONE YEAR	**YIELD**	**PHONE NUMBER**
NetBank (Ga.)	**2.43%**	888-256-6932
ING Direct (Del.)	**2.30**	877-469-0232
American General (Cal.)	**2.30**	800-325-7283
National American (Tex.)	**2.27**	888-252-7489
Community Commerce (Cal.)	**2.27**	323-268-6100
National Average	**1.40%**	
TWO AND A HALF YEARS	**YIELD**	**PHONE NUMBER**
Countrywide Bank (Va.)	**3.15%**	800-844-1091
Capital One (Va.)	**3.14**	888-810-4013
Bank Direct (Ga.)	**3.00**	877-839-2737
Intervest National (N.Y.)	**3.00**	877-226-5462
American Bank (Pa.)	**2.85**	610-366-1800
National Average	**1.93%**	
FIVE YEARS	**YIELD**	**PHONE NUMBER**
Intervest National (N.Y.)	**4.15%**	877-226-5462
Capital One (Va.)	**4.06**	888-810-4013
ING Direct (Del.)	**4.05**	877-469-0232
Domestic Bank (R.I.)	**4.00**	800-556-6600
Eastern Savings (Md.)	**4.00**	800-787-2265
National Average	**3.15%**	

CD yields include compounding and are to Feb. 20, 2003. For information on deposit insurance, go to the Web site of the Federal Deposit Insurance Corp. (www.fdic.gov).

SOURCE: © 2003 Informa Research Services. All deposits are federally insured up to the maximum allowed. For updated rates, visit www.kiplinger.com and click on the "Managing" tab.

Fixed Annuities

SINGLE-PREMIUM IMMEDIATE-ANNUITY AVERAGE PAYOUT FACTORS	3 MONTHS AGO	THIS MONTH
Monthly payout for 70-year-old male	7.31	**7.22**
Monthly payout for 70-year-old female	6.84	**6.74**
Monthly payout for 75-year-old male	8.06	**7.96**
Monthly payout for 75-year-old female	7.62	**7.52**

Payout factors, like interest rates, fluctuate with Treasury and bond yields. Annuity payouts are guaranteed to the annuitant for life and to his or her beneficiary for ten years. These averages are derived from the top 50 single-premium immediate-annuity programs; the payout factors are per each $1,000 and are applicable to the life-and-ten-years-certain option.

DEFERRED-ANNUITY INTEREST RATES	3 MONTHS AGO	THIS MONTH
Flexible-premium average rate*	3.93%	**3.60%**
Flexible-premium highest rate**	5.65	**5.50**
Single-premium average rate*	4.38	**4.03**
Single-premium highest rate**	5.65	**5.00**
Certificate annuity, 3-year highest rate	3.50	**4.00**
Certificate annuity, 5-year highest rate	4.75	**4.80**

*Average base interest rate of top 100 annuity programs.
**Highest base interest rate among nonbonus annuity programs.

SOURCE: *Comparative Annuity Reports* (916-487-7863; www.annuitycomparativedata.com). Annuity data are to Nov. 1, 2002, and Feb. 1, 2003.

Information to Act On

ECONOMY

n Too much federal debt? That depends on whom you ask, of course, but consider this: The ratio of debt to gross domestic product (GDP) today is roughly 60%, down from 67% in 1996 and well below its 1946 wartime high of 122%. But debt limits federal spending on more desirable programs, because about 9% of the nationÕs $2.2 trillion budget goes to pay interest.

n Feeble 1% GDP growth in final quarter of 2002 is not as bad as the numbers imply. The economy is growing at about 2%, after adjusting for the pullback in auto manufacturing and the effects of the West Coast port strike. December auto sales soared, rather than sank as had been anticipated, and manufacturers ramped up production, but too late for the boost to be reflected in fourth-quarter GDP.

INVESTING

n New rules for savings bonds. If you buy savings bonds, you must keep them for at least one year. Beginning February 1, the Treasury extended the minimum holding period from six months to one year to keep people from churning them. The government acted because some consumers were using savings bonds, which are designed for long-term savings, as a place to park their money short term until they could find better rates elsewhere.

n Track the stock purchases made by corporate insiders. ItÕs generally a good sign when directors and managers snap up their companyÕs stock. You can keep tabs on insider moves by visiting http://finance.yahoo.com and http://insider.thomsonfn.com.

n Mutual fund advice galore. The Morningstar Guide to Mutual Funds (John Wiley & Sons, $25) is a new book from MorningstarÕs analysts that explains how to select mutual funds and manage an investment portfolio of funds. ItÕs available in bookstores. KiplingerÕs Mutual Funds 2003 is filled with practical advice and rankings to help you find suitable funds for your investment portfolio. The price is $5.95, plus $2 for shipping. For faster delivery, consider paying $4.50 for first-class mail. To order, go to www.kiplinger.com/annual/mutualfund, or call 888-547-5464.

TAXES

n Prepare and file your income taxes free online. If youÕre eligible, you can complete and file your return through one of the firms under contract with the IRS. For information, go to www.irs.gov and click on ÒFree Online Filing.Ó Most companies limit access to filers with adjusted gross incomes (AGIs) of less than $30,000, but when we clicked on ÒGuide Me to a Service,Ó three providers accepted a hypothetical 65-year-old Florida couple with an AGI of $100,000.

n A home office no longer triggers tax. The IRS has reversed its rule that required taxpayers who sold a primary residence to pay tax on the portion of the profit that was attributed to a home office. The reversal is retroactive, so if you paid tax on home-office profit within the past three years, you can request a refund by filing an amended return.

n Rules change for figuring estimated taxes. To avoid a penalty, if you reported an AGI of more than $150,000 in 2002, you must pay estimated taxes equal to at least 110% of your 2002 income-tax bill or 90% of your 2003 tax bill. If your AGI in 2002 was $150,000 or less, you must prepay either 100% of your 2002 tax or 90% of your actual tax in 2003.

INSURANCE

n Estimate out-of-pocket costs of Medicare HMOs. Compare the costs of more than 100 HMOs, with your health factored in, at www.hmos4seniors.com. The data is based on a survey that covers about 50 U.S. cities and was conducted by HealthMetrix Research, a managed-care research firm in Columbus, Ohio. You can also see which plans offered the best value by clicking on Ò2003 Senior Choice Gold Awards.Ó

n Those who are self-employed can deduct 100% of their medical-insurance premiums this year. The deduction, which was capped at 70% in 2002, canÕt be used if you are eligible for coverage through an employer-based plan, such as your spouseÕs plan at work. Also, the deduction canÕt exceed your earned income from self-employment.

MEDICARE

n Congress wonÕt cut Medicare payments to doctors. Lawmakers hope eliminating the scheduled reduction will encourage doctors to take Medicare patients.

n Updated benefit guidebook now available. You can download a copy of Medicare & You 2003 to your computer from www.medicare.gov, or order a free copy of the booklet by calling 800-633-4227. Large print, audio and Spanish editions are available.

SOCIAL SECURITY

■ **Higher earnings limit for 2003.** If you're between 62 and 65, you can earn $11,520 this year (up from $11,280 in 2002) before losing benefits. For each $2 you earn over the cap, however, you forgo $1 in benefits. If you turn 65 this year, calculating the break point works like this: Between January 1 and the day you reach age 65 and two months, you can earn up to $30,720 with no penalty. Above that amount, you lose $1 in benefits for each $3 earned. No earnings limit applies to beneficiaries over age 65 and two months. Use the calculator at www.ssa.gov/OACT/ANYPIA to estimate how working would affect your benefits.

■ **Social Security's Web page for Asian Americans and Pacific Islanders.** Among other services, the agency has posted Social Security information in Chinese, Korean and Vietnamese at www.ssa.gov/aapi.

HEALTH

■ **Free caregiver booklet on medications.** The MetLife Mature Market Institute and the National Alliance for Caregiving are now offering consumers the first in their series of caregiver guides, *Medications and the Older Adult.* To order, call 203-221-6580, or send your request by e-mail to maturemarketinstitute@metlife.com or by mail to MetLife Mature Market Institute, 57 Greens Farms Road, Westport, CT 06880.

■ **Product catalog for people with hearing loss.** To request a free *Products to Make Life Easier* catalog, call 888-296-3056. It's produced by Harris Communications, which sells its products to consumers who are deaf or hard of hearing. The company also has a Web site (www.harriscomm.com).

TRAVEL

■ **A room with a (re)view.** Point your browser to www.tripadvisor.com to scan hotel and room reviews written by travelers. The site also offers links to reviews published by major travel magazines.

■ **Is that "no-smoking" hotel room really smoke-free?** Since hotels can't guarantee nonsmokers that a room hasn't been smoked in, they usually use special cleaning methods before renting rooms to nonsmokers. Now some Doubletree, Hyatt and Marriott hotels have installed small machines called "ozonators" in rooms to continuously clear the air of smoke and other odors.

■ **Cruise lines swab the decks and more.** They don't want a repeat of passenger illnesses that were widely reported this winter. The problems were traced to passengers who harbored easily spread viruses. The cruise lines have sanitized the affected ships with disinfectants and fogging machines, and many lines now employ "clean" teams to roam their vessels wiping down railings and other surfaces where germs can be deposited and spread from one passenger to another.

SHOPPING

■ **Winemakers can include the word "Napa" on wines even if the grapes don't come from the Napa Valley.** A winemaker based outside Napa, Cal., won a California state appeals court decision that allows it to keep the Napa name on its wines as long as the true source of the grapes is stated on the label.

■ **Lower prices mean it's a good time to make the switch from video to DVD players.** Panasonic's DVD-RV32S ($120) is a good basic model; and for $230, you can step up to Sony's DVP-NC655P/S, which loads up to five discs. Setup for both models is simple.

■ **Bargains on secondhand electronic devices.** A company called ReturnBuy (www.returnbuy.com) repairs and repackages returned goods and then sells them at deep discounts from their original prices.

TAX TIP

Don't Say 'Charge It'

Last year, more than 300,000 taxpayers paid their federal income taxes with plastic. It's a tempting option, particularly if you use your credit card to rack up frequent-flier miles. But it's probably not a good deal. You'll pay a "convenience fee" of about 2.5% to the middleman who takes your account information and pays the IRS. (You have to pay a middleman because the IRS can't accept charges directly. Congress won't allow the agency to pay the processing fees charged by credit card companies.) Assuming a 2.5% fee, if you owe $3,000, the fee is $75; if you owe $10,000, it's $250. The fee is in addition to any interest you accrue on your credit card balance. Pay with a check instead, avoid the fee and earn a little float.

MANAGING YOUR FINANCES

Profit From a Hobby

IT'S AN APPEALING THOUGHT: Turn a longtime hobby into a business, and invite Uncle Sam to share your costs. You can breed dogs or turn pots primarily for profit rather than pleasure and deduct many of the costs you would otherwise pay out of pocket. But as you might expect, there are hurdles. Naturally, the government doesn't want to subsidize your fun. And if it is to become a business partner, so to speak, you must become serious about running the business and making money. In order to qualify a hobby as a business, you must prove that you're determined to eventually turn a profit.

Show Us the Money

The government understands that your endeavor may not make a profit right away. You can claim deductions that are related to the business beginning in the first year, but you must eventually earn profits in three out of five years. (An exception: If you breed, train, race or show horses, you must show a profit in two out of every seven years.)

If you pass the three-out-of-five-year profit test, you can claim business deductions during the entire five-year period, even for years you had losses. Include those expenses on Schedule C of your federal tax return.

If you turn a hobby into a business, get serious about making a profit.

If you fail the test, your endeavor is considered a hobby and deductions are limited to the income the hobby generates and are entered as miscellaneous expenses on Schedule A of your federal tax return. Such expenses are deductible only to the extent that they exceed 2% of your adjusted gross income (AGI). For example, if your AGI is $100,000, the first $2,000 of miscellaneous expenses are not deductible. Miscellaneous expenses include automobile and home-office expenses. For more information, see IRS Publication 535, *Business Expenses*. Forms and instruction are also available online at www.irs.gov, or by calling 800-829-3676.

If you convert a hobby to a business and the IRS challenges your deductions in the first couple of years, you can ask it to hold off making a judgment until the end of the five-year period. If after five years you haven't passed the profit test, you'll probably owe back taxes plus interest. Ask for the postponement by filing IRS Form 5213, *Election to Postpone Determination*. It's a simple one-page form.

Back Up a Business With Good Records

Be prepared to support the claim that you're running an enterprise in a businesslike manner. In some cases, taxpayers have persuaded the IRS that they were pursuing a business even when they failed the three-out-of-five-year profit test. That allowed them to hold on to the business deductions they claimed in profitless years.

If the IRS challenges your deductions, show them the evidence. Keep a journal, accounting records and other documents to substantiate your activities and your plans. These are the types of questions the IRS will ask before it determines whether you really mean business or are indulging a hobby.

Is the business being conducted in a professional manner? For instance, do you keep good accounting records, try to hold down costs and make efforts to rustle up new business?

Are you devoting enough time and effort to it? Log your work hours. The time you spend is an indication of your desire to make a profit and create a viable enterprise.

Do you depend on income from it? The more you need the profits the business generates for your livelihood, the more valid the undertaking appears in the eyes of the IRS.

What caused your losses? Losses caused by circumstances beyond your control may be treated more leniently. The same applies to start-up costs typical of your business.

How did you handle them? For example, after a loss, can you show that you altered the way you ran the business with an eye to improving the bottom line?

Are you in over your head? Do you and your advisers have the expertise to run a successful business?

Have you successfully run a business before? Obviously, a yes is better than no.

How do you expect to make a profit? For instance, you may be able to show that you can expect to make a future profit from the appreciation of the assets you own.

ESTATE PLANNING

Funds That Ease Giving

IT'S NOT ALWAYS EASY to combine reducing taxes with making gifts to deserving charities. For example, you may be eager to donate appreciated stock so you can claim a tax deduction for its fair-market value. But perhaps you haven't yet decided which good cause should receive your gift. Or maybe your family wants to support a local charity, but you'd like to keep the donor anonymous.

To resolve such issues, you could turn to a charitable organization called a donor-advised fund, established by financial service companies such as Fidelity, T. Rowe Price, Charles Schwab and Vanguard. As their popularity has grown, donor-advised funds have become big fish in the charity pond. For example, the Fidelity Investments Charitable Gift Fund is the country's second-biggest charity after the Salvation Army, according to data compiled by the *Chronicle of Philanthropy*.

How Donor-Advised Funds Work

Simply put, you give assets to a donor-advised fund and then direct the fund, either now or later, to donate to charities of your choosing. You qualify for the tax deduction when your gift is transferred to the fund. The assets can be cash, stocks, bonds or mutual funds. Your gift is irrevocable, and all future earnings attributed to your gift belong to the fund.

Typically, your initial gift must be at least $10,000. The funds generally accept only liquid assets, such as those listed above, and rarely accept hard-to-sell gifts, such as real estate and art work. There are exceptions, however. For instance, Fidelity's fund will accept shares of certain privately held companies.

When the fund receives shares of stock or mutual funds, it usually sells them and converts the proceeds to cash. You then direct the proceeds to one or more of the fund's investment pools, which essentially operate like mutual funds. Most of the big charitable funds offer at least four investment pools, which typically range from aggressive portfolios investing primarily in stocks to conservative portfolios investing mostly in short-term bonds and money-market funds. You may be able to choose a pool of socially or environmentally focused investments.

Within broad parameters, you tell the fund how much to give to which charity, and how often. You may also be able to give your spouse or child the authority to contribute to the account and to recommend charitable donations. The fund manages the money, tracks your giving and provides you with a single statement. Together, the combined administrative and investment fees range from about 0.65% to 2%, depending on the size of the account and which investment pools you choose. Generally, the more you donate to the fund, the lower the administrative fee.

If you open an account with Vanguard's Charitable Endowment Program, for instance, the fees run from 0.65% to 0.79% a year, depending on which investments you select (an administrative fee of 0.45% of assets, plus an additional 0.2% to 0.34% for investment expenses). Accounts up to $5 million pay an administrative fee of 0.45%; for additional amounts between $5 million and $15 million, it's 0.15%.

Donor-advised funds must determine that the charities they give to are legitimate. A fund must also verify that neither the donors nor their relatives are paid by or receive services from the charities. Ben Pierce, executive director of the Vanguard program, recalls how one donor improperly tried to pay his child's college tuition with a gift from his donor-advised fund.

One Couple's Strategy

Oren Tomlinson and his wife, Dixie, live in Coral Gables, Fla., and use T. Rowe Price's Program for Charitable Giving to support drug-education programs. For them, the simplicity and flexibility of giving through the fund outweighs any administrative and investment fees. And whenever they accumulate enough to donate, the process is straightforward.

Tomlinson retired in 1999 as a human-resources executive with an airline. When the market was beginning its three-year decline in 2000, he donated appreciated stock to the T. Rowe Price donor-advised fund, took an income-tax deduction based on its market value, and asked that the proceeds be invested in short-term bond and money-market funds. Tomlinson was fortunate: He gave the stock away before the bear market depressed the stock price and then selected new investments that have held their value.

That move also shaped the couple's future charitable-giving strategy. Now, when the Tomlinsons decide that a stock of theirs is topping out, they donate all or part of it to their fund. And if there's money left in the Tomlinsons' donor-advised fund after they are gone, they've arranged for their children to take over the job of giving through the account their parents set up.

Four Low-Cost Funds

These donor-advised funds have low costs and are managed by well-known fund companies.

- Fidelity Investments Charitable Gift Fund (800-682-4438; www.charitablegift.org). The minimum initial contribution is $10,000; subsequent contributions must be at least $1,000. The smallest grant is $250. Administrative fees range from 0.25% to 1%; investment fees range from 0.42% to 0.84%.
- T. Rowe Price Program for Charitable Giving (800-564-1597; www.programforgiving.org). Minimum required is $10,000; subsequent contributions must be at least $500. Grants must be for $250 or more. Administrative fees range from 0.25% to 0.5%, and investment management fees are 0.59% to 0.82%.
- Schwab Fund for Charitable Giving (800-746-6216; www.schwabcharitable.org). Minimum required, $10,000; subsequent gifts, $500 or more. Grants must be $250 or more. Administrative fees range from 0.25% to 1%; investment expenses, from 0.48% to 1.05%.
- Vanguard Charitable Endowment Program (888-383-4483; www.vanguardcharitable.org). Minimum required is $25,000; subsequent contributions must be at least $5,000. Grants must be $500 or more. Administrative expenses range from 0.1% to 0.45%; investment expenses, 0.2% to 0.3%.

Tax Rundown for Givers

The following tax rules apply to charitable giving in general. You can usually claim a deduction for gifts of cash up to 50% of your adjusted gross income (AGI) in the year you make the gift. The amount you can write off for stocks, bonds or mutual funds depends on how long you've owned the investments. For investments owned one year or less, the deduction is limited to 50% of AGI; for assets held more than one year, the deduction is limited to 30% of AGI. Donations above those limits may be carried over and used in another year for up to five years.

ESTATE PLANNING

For Heaven's Sake, Get Organized

WHEN A FAMILY learns that they've lost a loved one, the last thing they want to do is search through the deceased's home for critical documents, such as wills and funeral instructions. Unfortunately, that's what happens all too often: Barry Izsak of Arranging It All, an organizer service in Austin, Tex., recalls that when his father died, his family found his life insurance policies scattered about in sock drawers, closets and even tucked between sheet music in a piano bench.

If you want to spare your family that kind of experience, now's the time to tackle the job by breaking it into small, manageable steps. One common-sense approach is to organize your papers so both you and your family will know what you have and where it is located, says Izsak. Organizing your legal, financial and health care documents will not only make life easier for your executor and heirs when you die, it will also provide you with an opportunity to review your estate plans and take care of any problems that you discover.

Five Easy Pieces

Find and review documents. Rummage through your files, home safe and safe-deposit box and make a list of everything your family will need—wills, trust documents, IRA paperwork, life insurance policies, property deeds and other items. Check the names of beneficiaries named on your IRA and life insurance policies. Destroy outdated copies of wills and powers of attorney. Track down every last bank and investment account: “Sometimes people lose track of accounts with small amounts of money, or discover that they need to change beneficiaries,” says Stephanie Denton, a professional organizer in Cincinnati.

List the documents and where they are located. Use your list to reorganize and refile the documents in the logical places your family would look for them. When you’re done, create a revised list.

Store originals in a fireproof safe or safe-deposit box, or with your lawyer. Your spouse or another trusted family member should have an extra key to the safe or deposit box in case of an emergency. Make sure at least one person has the password and authority to open your safe-deposit box when you aren’t present. And don’t file the originals of your general and medical power of attorney: In most cases, the person you designated as your agent should keep these documents.

Keep your up-to-date list and copies of documents in a binder at home. Putting critical information in one place will make locating the originals easier for your executor.

Tell your executor and backup where the binder is. Sometimes people organize and list everything and then forget this basic step.

Putting It All Together

Hefty IRAs and valuable personal property aren’t likely to be overlooked, but other important chores can slip through the cracks. They include the following:

Contact information. A list of the phone numbers of people you would want notified. These may include distant relatives, friends, doctors, advisers and associates, such as those who do volunteer charity work with you.

Employment information. Include the names, addresses and phone numbers of current and former employers.

Medical records. If your family needs your medical records, they must know who has them on file.

Family memorabilia. Let your family know who is to receive old letters, photos, military mementos and the like. These items may not have monetary value, but they may be precious to particular family members.

When It’s Just Too Much

If the task of pulling it all together feels overwhelming, consider hiring a professional to guide you through the process. Perhaps you have a valuable antique or art collection and need help cataloguing it. An organizer can help you do that. For example, Stephanie Carbaugh of SRC-Sensible Resolutions for Chaos, in Lancaster, Pa., can evaluate your collection, help document it in a format that’s easy to follow and recommend an appraiser to put a dollar value on the collection. The process can take 15 to 20 hours, based on the size of the collection and how well it’s currently organized.

Depending on where you live, you may pay $40 to $200 an hour for professional help. You can hire someone to do part or all of the job, or advise you on how to approach it. To find an organizer in your area, contact the National Association of Professional Organizers at 770-325-3440. You can also visit the NAPO Web site at www.napo.net and click on “Referral Request,” then type in your zip code.

As always when seeking professional help, don’t hire someone you’re not comfortable with, check professional designations and references, and ask about experience, training, background and areas of expertise.

Store It on Your Computer

Storing personal information on your computer makes it easy to keep the information current and to provide updated copies for the appropriate people. These software programs can do the job, either on a PC or Mac.

Kiplinger’s *Your Family Records Organizer* covers all the basics. (If you don’t have a computer, you can buy a 38-page printed booklet that contains the forms and useful tips.) The CD includes 18 forms to help you record key information and the locations of important documents, such as emergency instructions and legal, medical, personal-property, insurance and investment forms. The CD also runs video streaming (also accessible as text on-screeen) with advice from our editors. The CD is $14.95 plus shipping; the booklet sells for the same price. To order go to www.kiplinger.com/organizer, or call 877-280-7165, operator 98.

Nolo’s *Personal RecordKeeper 5* comes with a 132-page user’s manual and the book *Estate Planning Basics*. The program enables you to create records and sort information in 27 categories, ranging from emergency information to estate planning. You can import information from Nolo’s *WillMaker 7* and export home-inventory or net-worth data to personal-finance software using Quicken Interchange Format. You can also use it to handle an art collection or keep records on a rental or vacation property. The program allows you to keep the information private with password protection. The price is $30 plus shipping. To order, call 800-728-3555 or visit www.nolo.com.

RETIREMENT LIVING

Winsome Inns Offer Rest and Romance

BOOKING A FEW NIGHTS at an intimate inn is a pleasant alternative to staying in a big hotel. There are inns that offer all the luxury you could want, plus the warmth and personal touch few hotels can provide. Any of the inns described below would be a fine choice for an anniversary or other special occasion. With the exception of the Greyfield, which is located on a secluded coastal island, all the inns are located in or near towns or cities that offer a wide variety of activities, restaurants and amenities. Except as noted, breakfast and either afternoon tea or cocktails are included in the room rates, and special package rates are sometimes available.

Cliffside Inn

The Governor's Suite is one of the most popular at the Cliffside Inn.

Nestle in a Newport Inn

At the turn of the 20th century, the small waterfront city of Newport, R.I., was the summer spot for some of America's richest families. Their mansions and beautiful gardens still grace the landscape in and around the old part of town, and many are open to the public. The two inns mentioned below are located a short walk from the downtown area, the harbor front and Cliff Walk, a three-and-a-half mile trail that winds past the mansions along the rugged New England shoreline.

Built in 1876, the exquisite Victorian **Cliffside Inn** (800-845-1811; www.cliffsideinn.com) was once the summer home of Maryland Governor Thomas Swann. The 16 guest rooms are furnished with period antiques and tastefully integrated modern amenities, such as whirlpool tubs.

The inn is known for serving an elegant afternoon tea, which is held in its tea parlor. Along with tea, you can enjoy the sumptuous spread of finger sandwiches, tiny fruit tarts, delicate cookies, puff pastries and scones served with imported Devonshire cream.

A room for two costs $235 to $545 a night, depending on its size and appointments. The inn's busy season runs from June to mid October, and we suggest making reservations at least one month in advance.

Another delightful choice is the 124-year-old **Old Beach Inn** (888-303-5033; www.oldbeachinn.com). The inn has six bedrooms, each decorated in a different flower motif, and a lovely backyard garden.

Rates range from $85 to $300. The busiest months are June through September. The inn is closed from January through mid February.

Regardless of which accommodation you select, it's a pleasant stroll to the acclaimed Black Pearl restaurant on Bannister's Wharf, managed by Luke Murray, who also runs the Old Beach Inn.

Florida With a Spanish Ambiance

Settled by the Spanish in 1565, St. Augustine's homes and formal gardens reflect that heritage, as does its living history museum in the Colonial Quarter. The city offers modern pleasures, too. For instance, you can play a few rounds of golf and then spend an afternoon visiting the town's numerous art galleries. On the first Friday of each month, many of the galleries stay open in the evening, giving you the opportunity to meet some of the artists whose works are on display. During your stay, you can sail in the bay or book a round of golf at Ponte Vedra, sponsor of the Players Championship, which is about 20 minutes from downtown.

Consider staying at the **Casa de la Paz** (800-929-2915; www.casadelapaz.com), an ornate stucco Mediterranean-style house that overlooks the scenic Matanzas Bay and is just a few blocks from the old-town area.

Casa de la Paz

The Casa de la Paz provides a breathtaking view of Matanzas Bay.

The old Spanish fort Castillo de San Marcos is a short walk away. At sunset, enjoy a cocktail in the courtyard, which is lush with tropical plants. The inn has seven bedrooms, and rates run from $130 to $250 a night. Advance reservations are suggested.

Linger on a Secluded Island

Cumberland Island is a 45-minute ferry ride from Georgia's mainland. If you book a room at the island's Greyfield Inn (888-241-6408; www.greyfieldinn.com), you'll be among a limited number of overnight guests

Ed Jackson

A wild horse roams the white-sand beach on Cumberland Island.

on this secluded island getaway, surrounded by white-sand beaches and an enchanting assortment of bird life. Fifty-six square miles in size, Cumberland Island is the country's largest wilderness island and is home to wild horses, deer, bobcat and boar. Sea turtles and more than 300 bird species also visit the island.

The inn, which was built in 1900 for the Carnegie family, has 11 guest rooms and will provide bicycles to its visitors who want to explore the island. The rate is $395 to $575 a night per couple, including three meals and hors d'oeuvres during the nightly cocktail hour, and ferry transportation to and from the island. If you decide to visit, we suggest arranging for a guide to show you around. Phone usage is limited to a radio-phone for emergencies, and guests must dress for dinner (jackets for men; comparable attire for women).

Enjoy California's Wine Country

It's hard to think of a more enjoyable way to spend a short vacation than exploring California's Napa Valley, touring a few sun-drenched vineyards and sampling their wines. There are many fine inns in the region, but we selected the following two because they have an old-country feel reminiscent of Provence.

Beautifully landscaped gardens surround the **Maison Fleurie** (800-788-0369; www.foursisters.com/inns/maison-fleurie.html), in Yountville, and vines clamber up its brick walls. The feeling of being nestled within an intimate landscape is complemented by panoramic views of the distant mountains from many bedroom windows. It's an easy walk into town, and there's a vineyard across the street from the inn that's open to visitors. Once you've settled in, you can borrow a bike and explore the quaint town of Yountville and then pedal to one of the nearby wineries.

Rates range from $120 to $275 a day. The busy season is August through September, when the local vineyards harvest their grapes. It also gets booked early for the town's wine auction during the first week of June.

La Residence (800-253-9203; www.laresidence.com) in Napa has 25 spacious bedrooms spread among four French-style buildings on a wonderfully manicured two-and-a-half acre property. Daytime excursions can include shopping for antiques or taking a hot-air-balloon ride over the area's vineyards. When you return, you can relax in the pool or spa before joining other guests on the terrace to taste local wines and watch the sunset. Rates range from $225 to $350, and advance reservations are recommended.

Bed and Breakfast in Hawaii's Old Inns

If you're headed to Hawaii, consider spending a night or two at the Victorian **Manoa Valley Inn** (808-947-6019; www.manoavalleyinn.com), in Honolulu. You're just a five-minute drive from downtown, but from the inn's spacious veranda, you can see Waikiki Beach and Diamond Head. The house is furnished with European antiques, much as it was when it was built in 1915. Rates range from $99 to $190 for one of the inn's eight bedrooms. Book at least three months ahead.

You might also enjoy a stay at Maui's historic **Lahaina Inn** (800-669-3444; www.lahainainn.com), which was built in 1938, serving first as a general store and later as a popular gathering place for U.S. soldiers stationed on the island during World War II. There's plenty to do on the island: During the day, you can whale watch, fish, snorkel or dive. In the evening, stroll to the Maui Theatre to catch *Ulalena*, a theatrical performance celebrating the islands' legends, music and culture.

Per-person rates range from $109 to $169 a night, and high season runs from December through April.

For other suggestions on unusual places to stay, go to the Web site run by American Historic Inns (www.iloveinns.com), and search for accommodations by city, state or region.

Car-Rental Advice for Those Headed to Europe

IF A TRIP to Europe is in the works, get off the tour-bus track this time around and be your own chauffeur. Among the advantages: Renting a car can give you the flexibility and freedom to explore sites off the beaten track and travel at your own pace.

It's simple to rent a car, but don't make assumptions based on past experience in the U.S. if you want a smooth trip. For example, the standard rental car in Europe is smaller than its U.S. counterpart, and it usually comes equipped with a manual transmission.

Vive la Difference

The advice below can save you both time and money.

Reserve a car from home. Many rental-car companies offer discounts of up to 50% to Americans who book from home. Americans get generous discounts because they typically rent for longer periods than Europeans do. If you book a car after you arrive in Europe, you won't be eligible for these discounts.

The biggest American car-rental agency in Europe is Avis (800-331-1084; www.avis.com), followed by Hertz (800-654-3001; www.hertz.com).

Stick with what you know. If you're not already familiar with driving a stick-shift car, don't try to learn on your vacation. You can expect to pay about 25% more to rent a car with an automatic transmission, but you'll be more at ease. Be sure to request a car with an automatic when you make your reservation.

Be specific about your needs. Car-rental companies aren't allowed to ask you how much you weigh or how tall you are. But the more details you can give, the better the rental agency can help you with selecting a car that's right for you. If you're traveling with others or carrying a lot of luggage, make sure the agent takes those needs into account, too.

Reserve the car for at least four to five days. Depending on the country and the season, the daily rate generally drops if you keep a car longer than five days. For example, an economy car from Avis in Paris for two days in July will cost $63 a day. If you rent the same car for seven days, your daily rate will drop to $27. With a full-size car, the $116 a-day rate falls to $50 when you rent for seven days.

Watch out for extra fees. For instance, you'll probably owe steep drop-off charges if you rent a car in one country and return it in another. Because of costs and insurance liability, consider crossing borders by train or plane and renting a different car in each country.

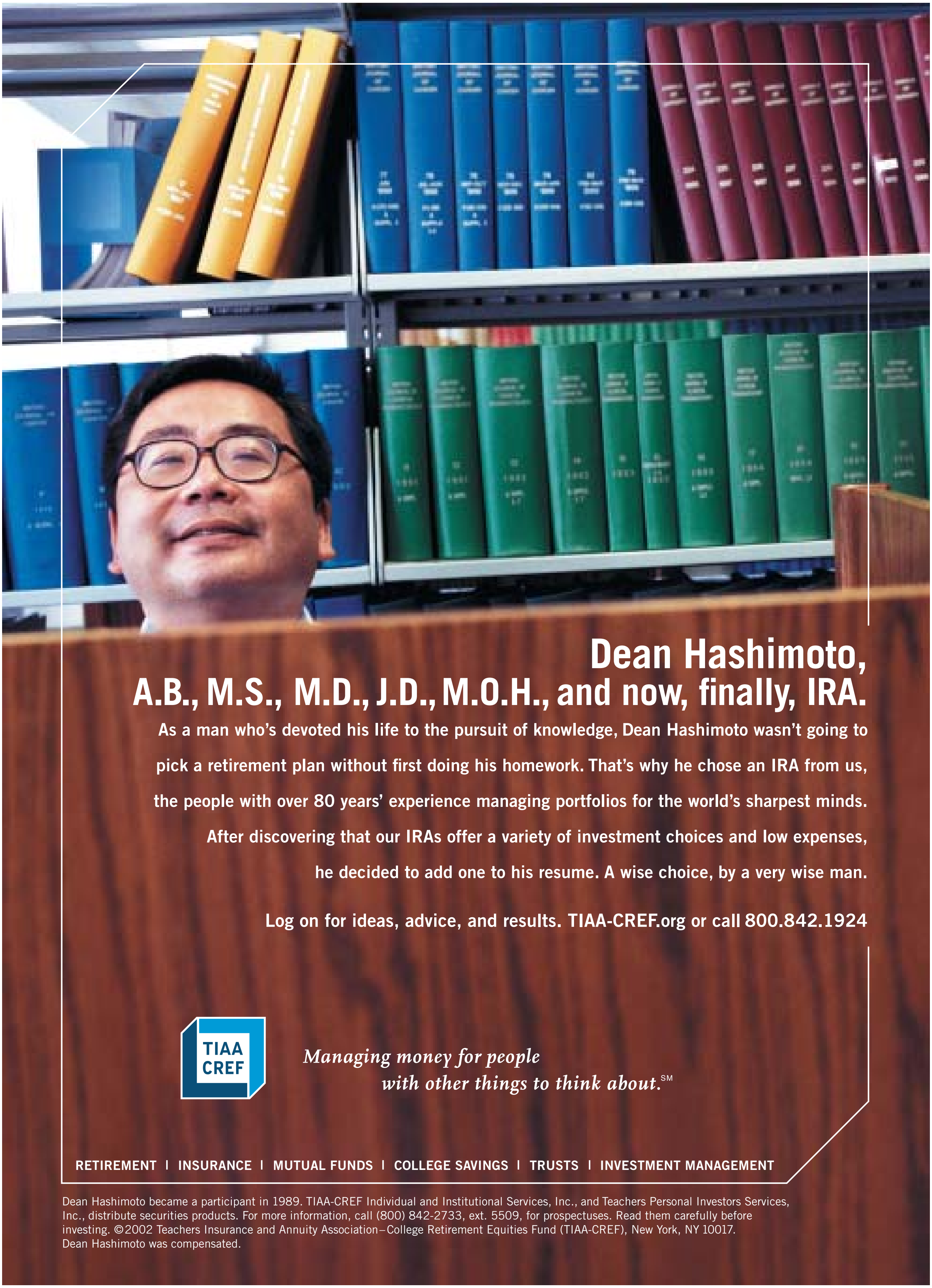
Review your rental-car insurance coverage. You may not need to purchase additional coverage from the rental company if the credit card you use offers sufficient coverage. But it's wise to verify exactly what the card's insurance covers and whether there are any exceptions. For example, the standard rental-car coverage you usually get when you charge a rental car to your American Express or Visa card specifically excludes Italy because of the high incidence of vehicle theft there.

And European unity notwithstanding, things can still get a bit sticky from a liability perspective when you cross borders in a rental car. For example, the collision and theft insurance you get when you rent a car in France may be void if you cross into Italy. And if you rent in Western Europe and venture into Eastern Europe, all liability coverage ceases.

Plan your route in advance. Purchase Michelin guides and maps, and plot your route before leaving home. If you rent from Avis, call 800-698-5674 and ask for their free travel itineraries called *Personally Yours*—13 driving tours through such popular locales as the Loire Valley and Tuscany. Each itinerary guides you through some ten to 20 towns and the scenery between them. Hotel recommendations and phone numbers are also provided.

Be Sure You're Properly Licensed

A U.S. driver's license is usually all you need to drive in Europe. However, if you plan to drive in Austria, Germany, Greece, Italy, Portugal or Spain, you'll also need an International Driving Permit. You can get the permit at your local AAA office for $10, and there's no test. To apply, bring two passport photos and a valid U.S. driver's license, and fill out an application.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