A Retirement Plan Requires Strong Legs to Stand On

If your retirement "stool" has only two legs (Social Security and personal savings), they'd better be extra sturdy. Be sure to shore them up with strong planning.

By RICK BARNETT, CERTIFIED ESTATE PLANNING PROFESSIONAL
Barnett Financial and Tax

Older Americans may fondly recall a time when retirements were financed with a three-legged stool of income sources: employee pensions, Social Security and personal savings and/or investments.

But now many, if not most, of those defined-benefit pensions are gone, leaving us with a wobbly, two-legged stool. And the Social Security leg may not be as sturdy as you'd hoped. Some people look at Social Security and say, "I can get a few bucks every month from there." But the problem is, with an average monthly benefit of $1,461 (2019), Social Security doesn't provide enough income to sustain their lifestyle.

So, if you want to balance on that stool, those two legs will need to be a lot wider. What does that mean, exactly?

SOCIAL SECURITY BENEFIT TIMING

For one thing, it's important to focus on optimizing your Social Security income benefit — and one of the most important aspects of that is deciding exactly when to start claiming benefits. Most people qualify for full Social Security benefits sometime between ages 66 and 67, but you can start drawing them as early as age 62, though at a reduced rate.

You can also put off drawing them beyond your full retirement age (FRA) up until you are 70 and be rewarded with a larger monthly check. Between the ages of 62 and your FRA, your benefit grows by 6.25% annually. Also, between your FRA and age 70, your benefit grows by 8% per year. For example, if your FRA benefit is $2,000, then your benefit at age 62 would be $1,500 and your benefit at age 70 would be $2,640. Just remember, your FRA is the 100% benefit amount. At age 62 you will get 75% and age 70 you will get 132% of the FRA.

If you think about it a moment, there are 96 months between the time you turn 62 and the time you turn 70, so a single person has 96 possibilities for when to start claiming the benefits. A married couple, since there are two of them, has even more than that. There is no perfect timing for everyone, since each person/couple's retirement plan is unique. The key is to compare the impact on your retirement savings to determine which strategy will allow you to take the most income that will last as long as you do.

OTHER SOCIAL SECURITY CONSIDERATIONS

When you consider how to optimize the dollar figure, it's really about going through a process to determine which way is the best to claim your Social Security benefits in order to provide the greatest amount of income. Don't ask the Social Security Administration for advice, though. They aren't allowed to give you that type of planning information.

There are some definite challenges to consider with Social Security. Here are a couple:

- One major factor to consider is taxes. A huge portion of many people's savings is in qualified (tax-deferred) retirement accounts, such as traditional IRAs. Every dollar you pull out of them in retirement is taxable. If you withdraw big chunks from those annually, plus receive a monthly Social Security check, you could end up taking a big tax hit if you're not careful and fail to plan studiously. Just one way to reduce those taxes would be, in the years before you retire, to begin moving money from your traditional IRA or 401(k) into a Roth account. You will have to pay taxes on the money when you make the transfer, but money in a Roth isn't taxable when you begin to withdraw it in retirement.
- Here's another factor to consider about Social Security: Let's say you decide to start taking your benefits at age 62 but you keep working. You will be limited on how much money you can make (currently, the limit is $17,640), and for every $2 of earnings you have over the limit, $1 of your Social Security benefits will be withheld. So, for example, if you earned $4,000 over the limit, Social Security would withhold $2,000 of your benefits. Eventually, though, you do get that money back. The Social Security Administration reports that if some of your retirement benefits are withheld for this reason, your monthly benefit will increase starting at your full retirement age to take into account those months the benefits were reduced.

THE SECOND LEG OF THE STOOL: YOUR INVESTMENTS AND SAVINGS

The other obvious retirement area to address is personal savings and investments — 401(k), 403(b), IRAs, etc. The key is trying to determine how much income will ultimately be needed in retirement based on current living expenses. But it's not wise to just guess that amount. It's crucial to have a financial plan that outlines your income, expenses, assets and liabilities. You can't just blindly say, "I've worked for this company for 30 years, and now I'm eligible to retire, so benefits or not, I'm just going to do it."

There are numerous other factors to analyze, such as how your portfolio is allocated. Many times, people go into retirement fully invested in the market. They're probably taking too much risk, and the wise thing to do is to use the rule of 100. That means subtracting your age from 100; the result is the percentage of your portfolio you should have at risk in terms of equities. For example, if you are 65, then 35% of your portfolio should be in stocks, and the rest should be in something relatively safer.

But many people at 50 or 60 still are invested 100% in the market. They're trying to set themselves up for growth, but they can also be setting themselves up for potential disaster.

Investments need to be properly allocated and diversified with the proper amount of risk. They should be positioned to produce the amount of income needed to last an entire lifetime, no matter how long that may be. The reality is, people are living a lot longer, so we have to take the time to understand what that market projection looks like. Example: If you expect to earn 5% or 6% annually on your money, even if you have a pension, it's crucial to understand how long that money is going to last based on those projections.

Dan Dunkin contributed to this article.

Rick Barnett is president and founder of Barnett Financial & Tax, a one-stop financial hub for clients in Michigan and beyond. He hosts the "Barnett Financial Hour" radio show and often serves as a source on local TV news stations. His professional designations include Certified Estate Planning Professional (CEPP), Masters of Estate Preservation (MEP) and Christian Financial Consultant and Advisor (CFCA).