

Motley Fool's *Rule Your Retirement* Newsletter

## How Much Can You Spend in Retirement? Uncle Sam Has a (Good!) Answer

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Let's begin today's article with a question: How much can you safely withdraw from your portfolio in retirement?

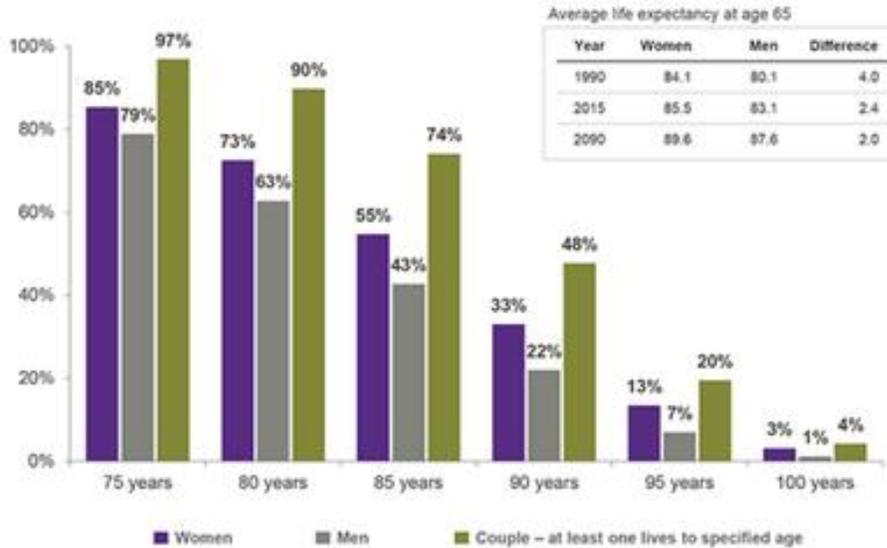
If you said, "4%," congratulations! Give yourself a golden (years) star.

That 4% rule of thumb can be traced back more than two decades to an article published by financial planner Bill Bengen. In later publications, Bengen dubbed this withdrawal rate the "SAFEMAX" for "the maximum 'safe' historical withdrawal rate." According to the methodology as originally conceived, retirees would apply that 4% to their portfolios just once: In the first year of retirement. Every year thereafter, they would take out that same amount, but adjusted for inflation. Thus, retirees maintained a level amount of purchasing power throughout the rest of their lives.

As [we wrote last year](#), subsequent research has found that 4% might be too low, while other analyses suggests it might be too high. But there's something most studies have in common: They assume a person is retiring in her mid-60s and will live until her mid-90s.

Statistically, this isn't likely, as you can see from this slide from J.P. Morgan Asset Management's [Guide to Retirement](#).

**If you're 65 today, the probability of living to a specific age or beyond**



**PLAN FOR LONGEVITY**

Average life expectancy continues to increase and is a mid-point not an end-point. You may need to plan on the probability of living much longer – perhaps 30+ years in retirement – and invest a portion of your portfolio for growth to maintain your purchasing power over time.

Chart: Social Security Administration, Period Life Table, 2013 (published in 2016), J.P. Morgan Asset Management.  
 Table: Social Security Administration 2016 OASDI Trustees Report.  
 Probability at least one member of a same-sex female couple lives to age 90 is 55% and a same-sex male couple is 39%.



Longevity is one of the great unknowns of retirement planning. Most studies of withdrawal rates handle this uncertainty by just assuming everyone lives until their 90s. If you don't live that long, you'll have spent less than you could have – and your heirs will inherit a tidy sum. But that's the price of mitigating the "risk" that you do live well into your 90s ... and run out of money.

## Withdrawal Rates for the Rest of Us

But what if you're not 65? Or you have very good reasons to believe you'll live more or less than 30 years? How much should you withdraw each year in retirement?

The answer might lie with an unexpected source: the IRS.

You are probably familiar with the concept of required minimum distributions (RMDs), which are the amounts you need to take from your 401(k)s and traditional IRAs after you turn age 70 ½. What you may not know is that you have to take RMDs from retirement accounts that you inherit from someone other than your spouse, regardless of your age – even if you're a 3-year-old who inherits an IRA from your grandfather. (By the way, if you're 3 years old, we're really impressed that you're able to read this article, and that you're already thinking about your retirement.)

Uncle Sam instituted RMDs because he intended IRAs and 401(k)s to be retirement-planning accounts, and not tax-advantaged estate-planning tools. So the IRS came up with a formula, based on actuarial life expectancy, that requires investors to take out the highest amount possible in a given year that doesn't cause them to run out of money before they pass away.

That sounds an awful lot like a safe withdrawal rate to me; it balances enjoying a reasonable amount of your savings this year but not so much that it jeopardizes the money you need in future years.

Some studies have looked at whether RMDs actually make for reasonable safe withdrawal rates. The answer: Uncle Sam is on to something.

## **The Wisdom of RMDs**

One [such study](#) was published by the Center for Retirement Research at Boston College, which concluded that "the IRS' Required Minimum Distribution rules may be a viable alternative" to other withdrawal-rate rules of thumb, such as the 4% rule and spending just interest and dividends (but not touching your principal). The study included a table of RMD withdrawal percentages based on age.

ANNUAL WITHDRAWAL PERCENTAGES FOLLOWING  
REQUIRED MINIMUM DISTRIBUTION STRATEGY

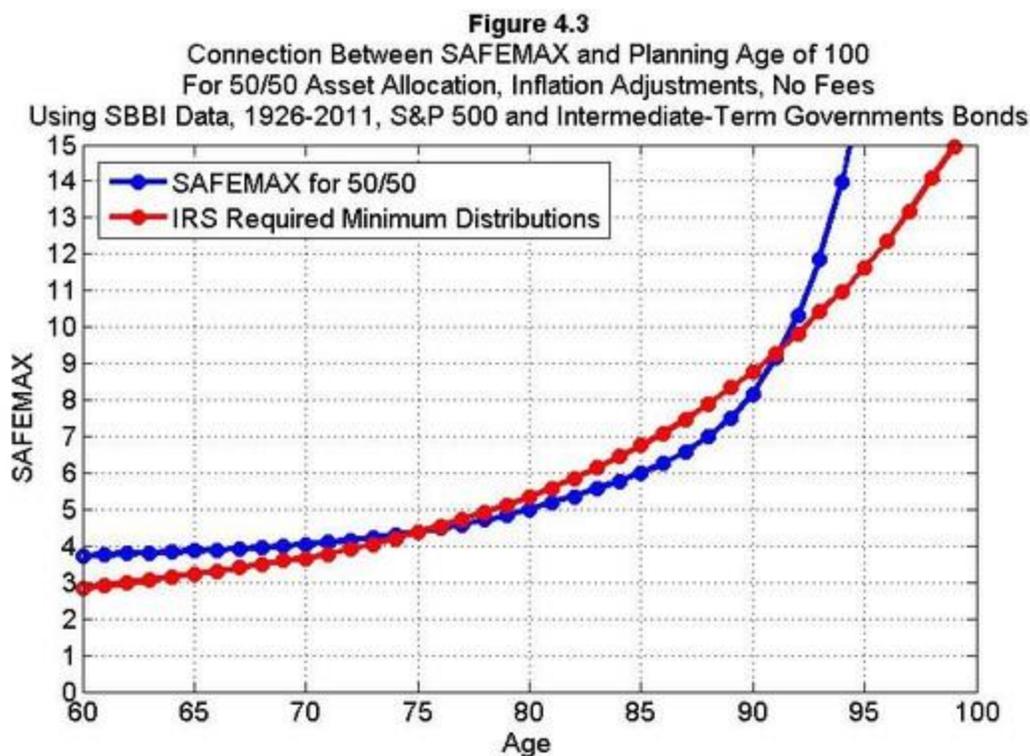
Age	%	Age	%
65	3.13	83	6.13
66	3.22	84	6.45
67	3.31	85	6.76
68	3.42	86	7.09
69	3.53	87	7.46
70	3.65	88	7.87
71	3.77	89	8.33
72	3.91	90	8.77
73	4.05	91	9.26
74	4.20	92	9.80
75	4.37	93	10.42
76	4.55	94	10.99
77	4.72	95	11.63
78	4.93	96	12.35
79	5.13	97	13.16
80	5.35	98	14.08
81	5.59	99	14.93
82	5.85	100	15.87

The authors of the study, Wei Sun and Anthony Webb, acknowledge that the rates might be too low for younger retirees, and they suggest a modification: spend interest and dividends on top of the percentage withdrawn. They illustrated with an example: "[A] 65-year-old couple with financial assets of \$102,000 who received \$2,000 of interest and dividends in the last year, would spend \$5,130: the \$2,000 in interest and dividends, plus 3.13% (the age 65 Annual Withdrawal Percentage under the RMD strategy) of \$100,000. In contrast, a household following the unmodified RMD rule would spend just \$3,130."

Why might a retired household stick with just the \$3,130? The authors suggest some retirees might want to play it safer early in their retirement if they're concerned about higher health-care costs later in retirement. I'll add that this also might be a prudent strategy for conservative retirees who rely on their portfolios for most of their income, especially in these times of high stock valuations, low dividend yields, and low interest rates.

## The IRS vs. the 4% rule

Wade Pfau, the brain behind the Retirement Researcher website, [compared the RMD methodology](#) to Bengen's methodology (a.k.a. SAFEMAX) at different ages (assuming a life expectancy of 100). As you can see in the following chart, using IRS guidelines is more conservative earlier in retirement, then slightly more aggressive from around ages 80 to 90, and then goes back to playing it safer.



His conclusion: "These curves are relatively close together, though do notice that the RMDs become more conservative as one approaches age 100. This makes sense, since as one approaches their planning age, it becomes increasingly likely that one will live beyond the age. Using the RMD rules to set withdrawal rates for each year of retirement does present a viable alternative to using constant inflation-adjusted withdrawal amounts."

## The Foolish Bottom Line

In our article [Safe Withdrawal Rates: A Sampling of Methods and Tools](#), we introduced you to the [Simple Calculator](#) spreadsheet created by Morningstar's David Blanchett. It suggests a withdrawal rate based on a handful of variables you enter, including asset allocation, investment fees, and life expectancy. But if you indicate that you expect your retirement to last less than 15 years, life expectancy is the only variable you can then fiddle with because it's the only one that really matters. And the withdrawal rate the calculator suggests is based on the IRS' RMD rules.

Given that we don't know the future returns of our portfolios, our future spending needs, or how long we'll live, it's impossible to determine the perfect retirement withdrawal rate. But the research from the past decade or so clearly indicates that a dynamic strategy – which involves adjusting your annual withdrawals according to portfolio value and life expectancy – is superior to the original 4% methodology. Using RMDs as a guideline is a perfectly fine place to start.

You can learn more about how to calculate your RMDs [from the IRS](#), although your broker's website probably has a calculator that is more user-friendly than an IRS publication. (No offense, people of the IRS -- please don't audit me!) If you have good reason to assume your life expectancy will be longer or shorter than most people your age, just subtract or add years to the age you enter into the calculator. For example, if you're in excellent health and your relatives tend to live well into their 90s, consider subtracting five years from your actual age for the purposes of calculating your withdrawal rate.