Social Security:
3 Income Strategies

One of the biggest decisions when developing your retirement income strategy is when and how to begin collecting Social Security benefits. Although you may begin drawing Social Security at age 62, there is no requirement to do so. In fact, your payment increases by approximately 7% to 8% for every year you delay, up to age 70. And if you're married, there are other good reasons to postpone as well.

Your decision about when to collect benefits should be based on several factors—including your age, marital status, income needs, and your plans regarding work during retirement. If you are married, the estimated payments you'll receive at Full Retirement Age (FRA)—the age at which you are entitled to full benefits—will be another factor. You can receive the maximum benefit based on your work history by waiting to start payments at age 70. Identifying an effective strategy based on your personal goals for receiving an income stream from Social Security

PHOTOGRAPH FROM GETTY IMAGES

can help you maintain your quality of life and may result in a significant increase in the value of the total benefit amount you collect over your lifetime.

DETERMINING HOW MUCH YOU'LL NEED

Your first step should be to figure out how much income you will need in retirement and where this money will come from. "You should plan to replace approximately 75% of your preretirement income during your first year in retirement and be able to increase that amount for inflation in each subsequent year," explains Christine Fahlund, CFP®, a senior financial planner with T. Rowe Price. "One of the most predictable sources of income will be from Social Security."

"The value in waiting to begin collecting benefits can be significant," Fahlund notes. "Because your initial benefit increases approximately 7% to 8% every year you delay taking payments, the monthly amount you receive at age 70 in today's dollars could be about 80% more than the amount you would start collecting at age 62." Your benefits generally are adjusted each year for inflation—and, if you're married and the higher earner, they are increased for the survivor's life as well. This means that, unlike many other income sources, the purchasing power of your benefits should remain relatively constant throughout retirement, as the actual dollar amount of your benefits increases.

CONTINUING TO WORK PART TIME

Your retirement plan includes making two important decisions: when to retire and whether to keep working in some capacity after you leave your career. If you leave your job before age 62, what will you do for income? And if you are under age 65, what will you do for medical insurance before you qualify for Medicare? Taking a part-time job can help fill any income gaps and cover health insurance premiums.

"If you want to remain in the work force part time after you turn age 62, it is generally a good idea to avoid collecting Social Security benefits at least until you reach your full retirement age, which is age 66 for most boomers," says Fahlund. Until then, the Social Security Administration will temporarily deduct $1 from the benefits you receive for every $2 you earn above the annual wage limit. (In 2012, the limit is $14,640.)[1] "Most importantly," Fahlund continues, "once you reach your full retirement age, there is no limit on how much you can earn without any temporary reduction in Social Security benefits."

In fact, like the majority of retirees today, you likely would come out ahead over the long term by continuing to work full-time for even a year or two beyond your original planned retirement date. An employer's payroll and benefits program would help cover your expenses during that time, your investments could continue to compound, and by shortening the years you'll need to draw on your nest egg—even if it's only a few years—you can increase the odds of a successful retirement. Staying in the workforce until age 66, for example, could increase your annual combined retirement income from Social Security by more than 30% over what you'd receive at age 62, even without any additional contributions to your retirement plan.

> **"...once you reach your full retirement age, there is no limit on how much you can earn without any temporary reduction in Social Security benefits."**

CONSIDER YOUR MARITAL STATUS

If you are single, the decision about when to take benefits will only directly affect you, not your heirs. Your choice will depend primarily on the value of the other financial resources available to you in retirement, the lifestyle you envision, and your expected life span. If you have health issues that could affect your longevity, you may choose to take your Social Security benefits once you reach age 62. On the other hand, if you are in excellent health and expect to live a long time, you may choose to hold off on taking your Social Security benefits until as late as age 70—especially if you expect to be entirely supporting yourself in retirement.

If you are married, the decisions you make now as a couple may result in significantly different financial outcomes for each of you later in retirement. Generally speaking, it makes sense for the higher-earning spouse to delay taking his or her Social Security benefits until age 70 because, after the death of a spouse, the surviving spouse receives the larger of the two spouses' benefits and is not eligible to continue receiving both.

3 GOALS AND STRATEGIES FOR BENEFITS

John makes $100,000, and Mary makes $50,000.* The couple—both age 60—are considering what to do about Social Security and are comparing three goals and strategies for their benefits, assuming John will live until age 83 and Mary will live until age 95. Note that the amounts presented in these cases are in today's dollars, which represent real purchasing power over the course of this couple's retirement. The actual inflated future dollar amounts would be much greater than shown.

GOAL: TAKE SMALLER ANNUAL BENEFITS AS SOON AS POSSIBLE

STRATEGY: Both claim their own benefit at age 62

RESULT: By claiming at the earliest eligible age, John and Mary would receive about 75% of their full retirement age (FRA) annual amount—and almost half the amount they would receive by waiting until they each reach age 70. And, when John dies first, at age 83, Mary, as the survivor, will receive approximately $22,000 each year thereafter. Essentially, she loses her own smaller annual benefit—about $15,500 per year—to receive John's higher amount.

The approximate total joint pretax Social Security benefit: **$1.05 million**. The portion paid to Mary while she is a widow: **$260,000**.

GOAL: TAKE BENEFITS AT SPECIFIC AGES

STRATEGY: John waits until his FRA—age 66—to take his benefits and Mary takes hers at age 62

RESULT: By waiting just a few years, and being the higher earner, John significantly increases Mary's benefit as a survivor. On an annual basis, she would receive about $28,500 per year as the surviving spouse. Over her widowhood, she would receive about $340,000—instead of the $260,000 she would receive if John had claimed his benefits at age 62. And the total payout would be $100,000 more in today's dollars.

The approximate total joint pretax Social Security benefit: **$1.15 million**. The portion paid to Mary while she is a widow: **$340,000**.

GOAL: MAXIMIZE THE BENEFITS OF A COUPLE OR SURVIVOR

STRATEGY: Both John and Mary delay initiation of their own benefits until age 70

RESULT: Both the couple's benefits and the survivor's benefits are maximized by both spouses delaying taking them until age 70. Mary, as the survivor, will be the recipient of John's benefit, since he had the larger of the two.

a) **By delaying until age 70**, Mary and John would both have much higher annual benefits: about $27,000 and $38,000, respectively. Since John waited, Mary would also have an annual benefit in widowhood of about $38,000, almost twice as much as she would have had if John had claimed benefits at age 62. As a survivor, she would receive about $455,000—about $200,000 more than if John had claimed his benefits at age 62.

b) **By waiting for their benefits until age 70**, one of them can claim an additional spousal benefit** at or after his or her FRA and switch to his or her own higher benefit at age 70. Before being able to claim a spousal benefit, however, the other spouse must either file for benefits, or "file and suspend" at or after that spouse's FRA, if possible. In general, it is best for the lower-earning spouse to claim the spousal benefit of the higher-earning spouse, if possible. John "files and suspends" at his FRA; then Mary "restricts her application" to spousal benefits from age 66 through 69, until she takes her own benefits at age 70. This tactic alone increases the couple's total joint income by $55,000.

c) **When they both delay benefits until age 70**, they maximize the annual benefits they can receive—and the amount the survivor will receive. This strategy gives this couple the maximum amount of cumulative benefits over both their lifetimes because it incorporates each spouse's highest possible benefit (age 70) and also the additional spousal benefit that Mary would be able to receive if they waited until age 70. This approach would generate total benefits of approximately $1.35 million—some $300,000 more than if they had both claimed at age 62.

The approximate total joint pretax Social Security benefit: **$1.35 million**. The portion paid to Mary while she is a widow: **$455,000**.

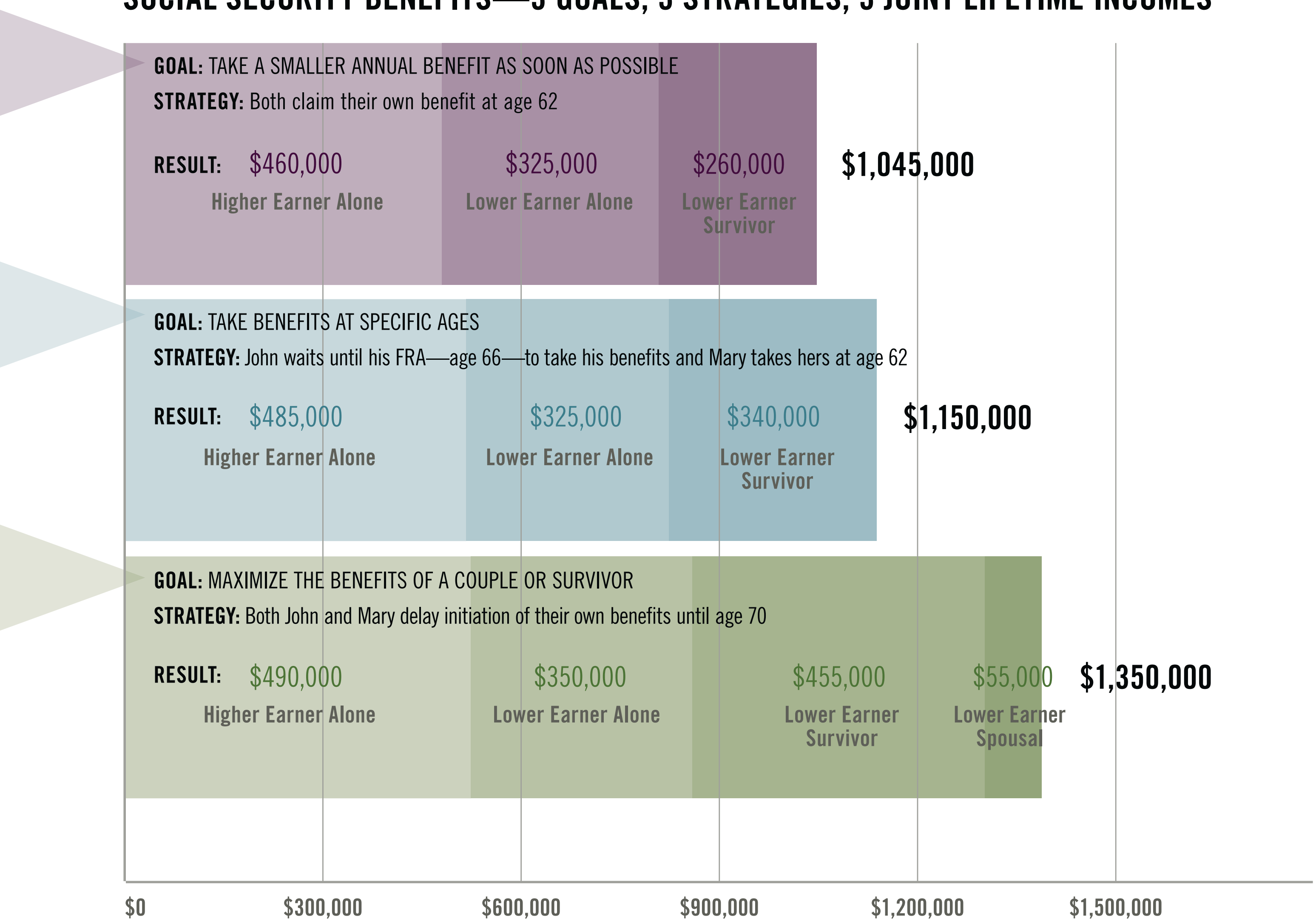
LOOKING AHEAD

As you approach retirement, consider all your options and talk with a financial advisor who has an in-depth knowledge of Social Security benefits. This is especially important if you are considering taking spousal benefits, because various combinations of age, income, and employment histories can affect if and when you may be able to apply this strategy. Think about what kind of life you want to lead when you retire and how much it will cost and, if married, consider the effect of your decisions on the survivor when one of you passes away. "It's best to assume a long and healthy life ahead for one or both of you—one that will require a lasting source of income," advises Fahlund. "And while it may be tempting to rely on Social Security to boost your cash flow immediately, few strategies can do more to enhance your retirement income over the long term than delaying the payout of your benefits."

To learn more about income in retirement, visit the Retirement Income Calculator at **troweprice.com/ric**.

[1] Go to the Social Security Administration's website for more on the retirement earnings test and exempt amount. Visit **www.socialsecurity.gov**.

SOCIAL SECURITY BENEFITS—3 GOALS, 3 STRATEGIES, 3 JOINT LIFETIME INCOMES



*For the purposes of the example, we assume that their future salaries only increase 3% each year for inflation.

**A spousal benefit is defined as an amount equal to one-half the Social Security benefit of one's spouse if that spouse were to hypothetically start taking benefits at his or her own FRA.