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Do You Plan to Spend, or Scrimp, in Retirement?

GAIL JOHNSON

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Wade Poziomka remembers how his grandfather used to keep warm: He'd turn on a spot heater in his living room rather than fire up his furnace. Having grown up during the 1930s, the man was accustomed to scrimping.

But he wasn't in a particularly dire financial situation; he could have easily handled the cost of heating his entire home. But deliberately cutting out unnecessary spending was part of a "just in case" philosophy.

"He went through the Depression," says Mr. Poziomka, policy director and general counsel at the Canadian Association of Retired People (CARP). "He came through a time where they had nothing, so he had a different mindset."

These days, restraint among retirees still isn't uncommon. Hikes in the cost of basics such as hydro (in Ontario) or rent (in Vancouver, for example) are just some of the reasons seniors are reluctant to part with their money.

"Canadians are not saving enough money for their retirements," Mr. Poziomka says. "Our members are worried, and we're worried for them."

However, it appears that what overwhelms retirees most is uncertainty – they lack confidence in their strategy to draw down their money and, at the same time, make it last.

According to a recent Texas Tech University study, most retired people of moderate means don't spend all of their income from social security, pensions and investment earnings, nor do they draw down the principal in their nest egg. Even affluent retirees are spending nowhere near an amount that would place them in danger of running out of money, say the study's authors Chris Browning, Tao Guo and Yuanshan Cheng.

A U.S. study by the Vanguard Center for Retirement Research study released in 2015, meanwhile, found that retirees who draw down their retirement savings (as they're required to do), don't necessarily spend what they take out; those with at least $100,000 in household wealth took the minimum distributions required and reinvested a third of their money. The study concluded that households with less-certain sources of income were more likely to continue to save rather than spend that income.

In short, retirees do not generally spend amounts that would put them in danger of running out of money.

Factors such as pension benefits and old age security benefits can easily be identified and incorporated into decumulation planning, but others – such as longevity, investment returns and medical costs – cannot.

"Longevity risk is a big worry," says Wanda Morris, CARP chief operating officer and vice-president of advocacy. "Can you ensure you don't outlive your money? It gets even trickier with low rates of return. It’s much harder to live off your earnings with low rates and living off your capital eats into your principal.

“Home care is very expensive and not much of it is government-funded,” she adds. “For people who want to be able to age in place they need to ensure they have the money saved to do so, and few people have long-term care insurance.”

Longevity, fear of loss, failure to plan, and a lack of confidence in drawdown strategies may be significant contributors to retirees’ conservative consumption, the Texas study found. Feeling poorly prepared for retirement may also shift people’s mindset from one of decumulation to that of preservation. And when retirees are loss-averse, they may frame decumulation as a risky proposition and spend less as a result, a defence mechanism to protect themselves against making a perceived financial mistake, the study says.

With so many unknowns, it’s no wonder that retirees are playing it safe.

“The phenomenon of people living considerably longer than they guessed … is making seniors more careful,” says Cathie Hurlburt, senior financial planner at Vancouver’s Integrated Planning Group. “Financial planning would be easy if you knew when you were ‘checking out.’

“A lot of people’s reticence to spend comes from uncertainty over how long their funds will last, or if they might outlive their money, and their personal perspective of how long they need the money to last.”

However, more retirees could benefit from assistance with basic money management, Ms. Hurlburt says.

“Most of my clients are conscious of the relationship of their level of spendable income to asset level,” Ms. Hurlburt says.

“The fine art of budgeting or ‘spend planning’ is alive and well with most of my wealthier clients, and it’s something I find missing from clients who don’t do so well accumulating wealth. If you’re not good at budgeting and something goes wrong, it’s a disaster. People who had lean years or immigrants or people who have had to be careful have better skills at managing their money. A lot of baby boomers don’t think thoughtfully about their spending.”

Having an annuity is an effective retirement strategy, Ms. Hurlburt says, though it’s one that’s often overlooked.

“Fundamentally what you’re doing is buying a lifetime stream of income that will last as long as you or you and your spouse will,” Ms. Hurlburt says. “Studies have shown that people with annuities are less anxious about making it through retirement.”

Seeking qualified financial guidance is another step people can take to help make sense of their circumstances. It should include information on estate wishes and budgeting as well as spending – and not simply portfolio management.

Conversations with financial planners may need to move away from sustainable withdrawal rates toward strategies that plan spending patterns for a given level of financial assets that place them at little risk of outliving assets, the Texas study concluded.