Kiplinger

Keys to Lock in Lifetime Retirement Income

Guaranteed income for life, and the peace of mind that comes with it, is within reach. Here's how.

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Most retirement plans blend hard work and diligent saving with a lot of what-ifs. What if the stock market doesn't cooperate? What if we encounter massive unexpected expenses? What if all our calculations are wrong and our savings run dry mid retirement?

Wouldn't it be nice to replace that element of chance with some solid guarantees? Imagine a stream of income, locked in for the rest of your life, that covers all your essential living expenses. That could allow you to take that bucket-list vacation without fear of derailing your retirement, greatly simplify your financial life in the event you face cognitive decline in your later years—and let you shrug off market dips like the one we saw in October. "Why should what you hear on the 6:30 news upset your retirement plan?" asks Jerry Golden, chief executive officer of retirement-planning firm Golden Retirement.

Lifetime guaranteed income—and the accompanying peace of mind—is within reach. By maximizing Social Security benefits and any available pension income, incorporating plain-vanilla immediate or deferred income annuities, and perhaps adding in a reverse mortgage that allows your home to bolster your retirement-income plan, most retirees can build an income floor that will support them as long as they live.

Given longer life spans and rising health care costs, interest in guaranteed income is growing fast. In a 2018 survey of 55- to 75-year-olds with more than $100,000 in household assets, 73% said that guaranteed income was a highly valuable addition to Social Security, up from 61% a year earlier, according to research firms Greenwald & Associates and Cannex.

Yet retirees are often left on their own when it comes to generating retirement paychecks. In the Greenwald survey, only half of people working with an adviser said they'd had a conversation about retirement-income strategies. And most employers have done little to fill the guaranteed income vacuum left by the extinction of defined-benefit pension plans.

No single retirement-income recipe will work for everyone. Each retiree must pick and choose the ingredients that best fit his or her goals—and confront some tricky trade-offs. Delaying Social Security, for example, may mean a few more years in an office that you're eager to leave, and buying an annuity can mean giving up access to a substantial part of your nest egg.

For retirees who find the right retirement-income formula, however, the rewards can include financial security and the freedom to live on their own terms. By cobbling together various sources of guaranteed income, Walt Gajewski, of Farmington, Mich., freed himself from worries about a stock market crash—and from the need to remain in a stressful job. For most of his 35 years in the auto industry, the 61-year-old invested aggressively in his company 401(k) plan. But as he entered his late fifties, he worried that a market slide could crush his nest egg—and working well into his sixties wasn't an appealing back-up plan. If he continued on the same high-pressure career path, he says, "you would have carried me out of there."

After consulting a financial planner, Gajewski realized that he didn't need to swing for double-digit returns in the stock market or work himself into the grave. Instead, he invested about 12% of his nest egg in a couple of annuities that will pay him a steady income in retirement. He decided to pump up his Social Security paycheck by delaying claiming benefits until at least age 67. Throw in some additional income from rental real estate and a pension, and his guaranteed income sources can cover his basic living expenses "by a wide margin," says Gajewski.

Confident that his essential expenses were covered, he retired and now works 30 hours a week managing a farmer's market. It's a lower-paying job, he says, but one that offers "a lot more personal reward."

Build Your Retirement-Income Portfolio

How much income will you need? Some retirees rely on rules of thumb—such as aiming to generate 80% of their preretirement income in retirement.

But there are a couple of problems with that formula. One issue: It “sets up an impossible goal” for retirees who may not have sufficient assets to generate that much income, says Steve Vernon, consulting research scholar at the Stanford Center on Longevity and author of *Retirement Game-Changers* (Rest-of-Life Communications, $19). What’s more, every individual has different ideas about what constitutes an acceptable retirement lifestyle—and those ideas must be reconciled with what’s realistic for his or her portfolio.

Instead of aiming for an arbitrary income-replacement rate, ensure that your income is greater than your expenses, Vernon says. Tally up essential expenses such as food, housing and utilities, then turn to discretionary spending such as travel and entertainment. You may be pleasantly surprised. Retirees who are downsizing or paying off a mortgage, for example, may be able to live on 60% or 70% of their preretirement income, he says. Others may have “pent-up demand as they approach retirement”—perhaps planning to spend more on travel in the first five or 10 years, says Dan Keady, chief financial planning strategist at TIAA. “That’s important to build in, too.”

Next, rethink the word *portfolio*. You probably spent your working years building a stock and bond portfolio. In retirement, expand that concept to include everything that helps you generate income. Social Security, pensions, annuities and any other guaranteed income sources can be considered the “bond” portion of your retirement-income portfolio. Ideally, these dependable income generators will cover your essential living expenses. Now, stocks and other riskier assets can be invested for growth, because they’ll be used to cover discretionary expenses that can be trimmed if the market slides.

The bonus: Knowing your essential expenses are covered by guaranteed income sources, you're less likely to panic and sell when stocks tumble.

Maximize Your Income

Social Security is the starting point for maximizing your retirement income. These benefits are typically retirees' largest single income source, and they're better than any annuity you can buy. "It's actuarially impossible to generate the same level of income today from buying a private annuity," says David Blanchett, head of retirement research at Morningstar, in part because Social Security is only partially taxed, it's adjusted annually for inflation, there's a survivor benefit, and it's not based on today's paltry interest rates.

For each year you delay claiming from your full retirement age to age 70, your benefit increases 8%. It typically makes sense for the primary wage earner to delay claiming as long as possible, Vernon says, but couples' claiming decisions can be complex. It may be well worth enlisting experts to help you maximize your benefits. Social Security Solutions, for example, offers personalized Social Security claiming strategies starting at $19.95.

Of course, delaying Social Security can leave a gaping hole in your retirement-income plan if you want to retire in your sixties or earlier. Taking larger withdrawals from a volatile investment portfolio isn't an attractive solution, says Wade Pfau, professor of retirement income at The American College, because it increases the risk that poor investment returns in the first years that you're drawing down your portfolio will decimate your nest egg. A better option, he says, is to carve out a piece of your portfolio in advance that can be invested in a ladder of bonds or certificates of deposit to help provide income until you claim Social Security.

Working full- or part-time while you delay claiming can bring great rewards. Vernon offers this example: A couple both age 62 have $350,000 in savings, no pension and $100,000 in household income. If they work full-time to age 66, contributing 10% of pay to their retirement savings each year, they could then draw about $15,500—or 3.5%—from their portfolio and claim Social Security benefits of about $41,300. Their total annual retirement income would be just under $57,000. Alternatively, they could work part-time—just enough to cover their living expenses—while forgoing further retirement-account contributions and delaying Social Security until age 70. Those extra years of portfolio growth and Social Security delayed-retirement credits would bring their total annual retirement income to more than $69,000 at age 70—a 22% increase.

Get More Guarantees

If your Social Security benefits and other guaranteed income sources don't cover your essential expenses, it's time to consider an annuity that can fill the gap.

Although annuities come in infinite variety and complexity, advisers say most retirees should focus on two simple products: single premium immediate annuities (or SPIAs), which offer monthly guaranteed income that starts immediately, or deferred income annuities, which offer a guaranteed income stream starting years in the future.

Deferred income annuities are the more natural hedge against the risk of outliving your assets, Blanchett says. "When people first retire, they're not going broke the next day," he says. With a deferred income annuity, payments can start when you're more likely to deplete your savings and need the money—perhaps at age 75 or 85. This type of annuity also offers "the highest leverage, in the sense that for a little bit of money you get a significant amount of income at a future date," Golden says. A 65-year-old man, for example, could fork over $100,000 today and get about $16,000 in annual income starting at age 75, versus just $6,800 if he wants payments to start immediately.

You can also ladder deferred income annuity purchases to lock in stock market gains in your preretirement years, Pfau says. As you get closer to retirement, he says, market returns impact all the contributions you've made over the years, and you become more vulnerable to market losses. You can take some of that risk off the table starting 10 years or so before retirement. In years when market returns are particularly good, use some of those gains to buy a deferred income annuity that offers guaranteed payments starting at your retirement date. That way, you not only trim your market risk but also "get to retirement with most of your spending goal set into place," Pfau says.

If you have substantial savings in a taxable account, that's the best way to fund an annuity purchase, Blanchett says. That's because annuities are relatively tax-efficient compared with traditional stock and bond investments. If you can keep those investments in tax-deferred accounts and buy an annuity in your taxable account, "that increases your effective rate of return over the long term," he says.

Of course, many people don't have sufficient funds in a taxable account for an annuity purchase. Those looking to buy an annuity with retirement-account money can consider a new twist on the deferred income annuity: a qualified longevity annuity contract, or QLAC. In a traditional IRA or employer-sponsored plan, such as a 401(k), you can invest up to $130,000 in a QLAC that will provide guaranteed income starting as late as age 85. The payouts are taxable, but the amount invested in the QLAC is excluded from required minimum distribution calculations until age 85—so this approach can ease your RMD tax burden after age 70½. "If you want that deferred income, here's an extra tax benefit," Pfau says.

Compare annuity quotes using ImmediateAnnuities.com or Income Solutions (available through Vanguard and other major firms). For tips on choosing an immediate annuity, read "How to Shop for an Immediate Annuity" in the October issue. And at press time, Golden was launching a free Income Allocation tool to show how income annuities can affect annual retirement income. Go to go2income.com.

Home Sweet Retirement Paycheck

For some retirees, the numbers just don't add up. They can't afford an annuity that will fill their retirement-income gap, and they're at high risk of outliving their savings. For those who own a home, the answer might be a reverse mortgage.

Homeowners age 62 and older can tap their home equity through a reverse mortgage—a loan that doesn't come due until you move out for 12 months or more, sell the home or die. You can take the loan proceeds in the form of monthly payments that continue as long as you live in the house and pay your property tax and insurance. These "tenure" payments are "not the same as having an annuity, where you have that income for life," says Shelley Giordano, founder and chair of the Funding Longevity Task Force at The American College. But this approach keeps your retirement cash flow intact, she notes, whereas an annuity purchase requires carving a large slice from your nest egg. (You can also take reverse mortgage proceeds as a lump sum or set up a line of credit to tap in an emergency.)

But set-up costs can be high, and recent changes in rules governing the federal government–insured reverse mortgage program have altered many experts’ thinking on how best to use these loans. The changes raised the up-front mortgage insurance premium for many borrowers, lowered the annual mortgage insurance premium and reduced the amount that seniors can draw.

The new higher set-up costs make the reverse mortgage line of credit less attractive, Pfau says. But other strategies are still appealing, he says, such as refinancing a large traditional mortgage into a reverse mortgage—thereby removing that fixed expense from your retirement budget. “That approach has been strengthened by the new rules,” given the lower ongoing insurance premium, he says.