The Golden Years

By Judy Loy, ChFC®, RICP®

Financial planning for individuals and families works towards many goals: college planning, retirement, savings, etc. The primary concern for most investors and the one that is most researched is retirement. The key to a successful retirement is to be able to live the lifestyle you are accustomed to or want in retirement, leave a legacy (if you so choose) and not run out of money for care before you shuffle off this mortal coil. While there are some generalities about retirement planning, each case is specific to the individual and family. For some, a quiet life at home with a good book and friends is all they need. For others, retirement is the time to enjoy travel, meals out and all the things they couldn't take the time to do while working. Many want to leave a legacy for their children or grandchildren. While for others, inheritance for their relatives is of little concern.

Retirement has become a hot button because times have changed. In previous generations, the three legged stool for retirement was pension, social security and savings. Most companies provided a lifetime of income for an employee who retired. My father was the perfect example. He worked for Consolidated Natural Gas (taken over by Dominion Resources in 2000) for his entire 45 year career and in return, Consolidated provided my father and mother with a defined benefit pension and health benefits that lasted their lifetimes. Due to greater longevity and market volatility, defined benefits began to fall short and the 401k and other defined contribution plans slowly took over the retirement landscape. Trouble for pensions continues, as Pennsylvania has $47 billion in unfunded liability in pension obligations. The number of defined benefit plans has been shrinking since 1995. Therefore, more and more retirees need to save for themselves and maximize their social security benefits to have a successful retirement-making the best use of the remaining two legs.

Just as companies and governments have a difficult time saving enough for an employee's remaining lifetime in retirement, employees are having the same difficulties. One reason is the average length of time in retirement. The average U.S. retirement age is 62 up from 60 in 2012. Take this and the fact that a couple aged 65 has a 50% chance that one will make it to age 90, and a person needs to save enough to live at least 25 years without earned income and keep up with inflation. This makes defined benefit plans (i.e. 401k, Simple IRA, etc.) incredibly important and maximizing social security a necessity for retirees. There is also the volatility in the markets. While stocks are a necessity with long retirement horizons, the volatility they bring can be unwelcome to a retiree dependent upon them for their livelihood. For instance, many people who planned retirement for 2007 or 2008 had to delay that plan due to the sharp pullback in equities.

One main way to help retirement planning success for low or middle income families is to plan social security benefits. I did an article on this in the past but it bears repeating. Social security is typically the only guaranteed source of income and for low and middle income families, social security replaces a greater amount of their income in retirement. According to the National Academy of Social Insurance, for a low income worker, social security replaces 56% of preretirement income and for a middle income worker; it replaces 42% at age 65. In general, to help increase this ratio, taking social security later can be quite advantageous up to age 70. If there is a couple, it is most beneficial for the higher earning spouse to wait to pull the benefits. On average, social security benefits gain 8% each year after age 62. Of course, all this is based on the averages. Bad health and short family lifespans can be two reasons that people should claim social security earlier.

The other leg that remains for many employees is the defined contribution plan. If at all possible, maxing out your employer plan is usually advantageous. In 2015, an employee can put away $18,000 and additional $5,500 if you are over age 50 in a 401k. That may be too much to bite off for employees. Do as much as you can as a percentage of gross income so that when you get salary increases, your retirement does too. In particular, if your employer offers a matching contribution, definitely take advantage of it. I can't stress that enough. There is no other way to double your money immediately besides your employer match. To pass that up is a huge retirement mistake.

If you don't have an employer retirement plan available, definitely contribute to a Traditional IRA or Roth. The maximum contributions are much lower ($5,500 with $1,000 more for those over 50) but the accounts are very useful.

Once in retirement, the way money is disbursed from retirement assets plays a vital part in successful retirement years. The typical disbursement pattern is to pull from taxable accounts first, then tax-deductible accounts and finally tax-deferred (Roth accounts). This has been shown to help retirement funds last longer. However, just as with everything else, this rule is made to be broken. The main aim is to create the lowest tax rate possible for the retiree. For example, if a client is waiting to draw social security and living on retirement savings in the meantime with no other income, pulling from the Tax deductible (Traditional IRA, 401k, etc.) accounts may make sense. All money pulled from these accounts is taxed as income so taking it out before social security may avoid taxation on social security later.

For further information and planning, talk to your financial advisor. A comprehensive, personalized plan before and during retirement can lead to better success and less stress. Who doesn't want that?

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