



CWR Monthly

August 2006

This is the final part of a three part series on the subject of retirement planning. This month we will look at the subject of how to make your retirement resources last during your period of retirement. As stated in the last two month's newsletters, this discussion will not attempt to answer every question you may have concerning this critical subject. To try to do so would be well beyond the scope of this monthly newsletter. My goal here is to stimulate you to further examine your own circumstances concerning your retirement planning.

Doing so might provide the needed insight into constructing or modifying your own retirement plan or it might motivate you to seek professional assistance in developing a retirement plan that will accomplish your goals. That decision is solely yours.

***Retirement Planning
Part III***

How do I ensure that my retirement savings will last?

You've made it to retirement! Congratulations! For most people, this means that you are approximately 65 years old. You know how much income you will have from Social Security and your Pension. These amounts are fixed (except for annual adjustments that may be factored in). You also know the amount that you currently have in your Personal Retirement Savings. The amount of income you can receive from this account is not fixed, however. The question then becomes ***How much can I withdraw annually from my Personal Retirement Savings to ensure that I don't outlive my savings in these accounts?***

The answer to this question depends on a number of variables that you need to consider when deciding how much to withdraw annually from your Personal Retirement Savings. Some of these variables include:

1. How long will your retirement last?
2. How will inflation and health care costs affect your retirement savings?
3. What is the best way to manage your retirement savings plan assets?
4. What are the tax consequences of postretirement employment?
5. Which asset accounts should you withdraw from first?
6. Do you have to withdraw a minimum amount from your tax deferred savings accounts?
7. When do you have to start withdrawing from your tax deferred savings accounts?
8. Should you downsize to reduce your living expenses while in retirement?
9. Are there ways you can use the equity in your home to supplement your retirement income?
10. Should you consider converting your retirement savings to an income annuity plan?

As you can see from the few questions listed above, financial planning does not end when you reach retirement. In fact, you are now faced with a completely different set of challenges that you must address in order to ensure that you can live comfortably in retirement.

To address the question of how much you can withdraw annually from your Personal Retirement Savings to ensure that you don't outlive your savings, we must first address the question of how long your retirement will last. The answer may surprise you.....

Research has shown that there is a 50% chance that at least 1 member of a healthy 65 year old couple will live to the age of 92!

That's 27 years in retirement! And while no one knows exactly how long each person will live, you must plan the withdrawal of your Personal Retirement Savings based on a realistic set of assumptions. Most post retirement planning models now assume a 65 year old person will spend 30 years in retirement.

So if you are going to live 30 years in retirement, how much can you withdraw from your Personal Retirement Savings to ensure that it will last?

The answer to that question depends largely on several factors:

1. How much have you saved for retirement
2. Your asset allocation while in retirement (i.e. how you manage your assets)
3. How long you expect your retirement to last
4. Which withdrawal method you plan to use to withdraw your savings
 - a. Dollar-Adjusted Withdrawals- You begin by withdrawing a certain percentage of your savings, then increase this withdrawal each year by the rate of inflation. This amount is predictable for each year.
 - b. Percentage Withdrawals- You begin by withdrawing a certain percentage of your savings, then draw this same percentage each each year. The amount will vary from year to year based on the balance of your retirement savings.

Let's look at how long your savings will last based on the amount you could potentially withdraw each year. The below amounts have been adjusted for inflation.

<u>Percentage Withdrawn Each Year</u>	<u>Years Savings Will Last</u>
10%	10 Years
9%	11 Years
8%	12 Years
7%	14 Years
6%	17 Years
5%	21 Years
4%	27 Years

As you can see, serious considerations need to be made to ensure that your savings will last throughout your retirement years. One of the most eroding realities to your retirement savings is what effect inflation can have on those savings. The following is an example of the loss of purchasing power that inflation can cause on the resources you have available. This example demonstrates what can happen to one dollar that sits idly by.

Average Annual Rate of Inflation

Years	3%	4%	5%
0	\$1.00	\$1.00	\$1.00
5	\$0.86	\$0.82	\$0.78
15	\$0.64	\$0.56	\$0.48
25	\$0.48	\$0.38	\$0.30
30	\$0.41	\$0.31	\$0.23

Increases in living costs can erode your purchasing power and reduce your standard of living. Therefore, to maintain your lifestyle in retirement, your income must rise each year. While it is tempting to park your retirement savings in a secure fixed account, the earnings off such an account will slowly erode away over time and thus may force you to reduce your lifestyle to ensure that your savings will last. Maintaining your retirement savings in a diversified portfolio can help prevent this erosion. How much you should allocate to stocks, bonds, and short-term investments depends on your individual needs and the presence or absence of other sources of income.

In addition to inflationary pressures on your retirement income, health care costs are among the most pressing expenses and can be expected to consume up to 20% of your post retirement income. The person in retirement needs to become extremely familiar with what Medicare and other plans provide to ensure that they have adequate coverage during their retirement years.

Comprehensive financial planning during your retirement years begins with establishing a budget to ensure that your everyday needs are being addressed and consideration is given to those unexpected's that may come up during your retirement years.

Based on the amount that you determine that you will need to maintain a similar lifestyle to your pre-retirement years, you may be forced to consider some alternatives to full retirement at this stage in your life. If you are opposed to possibly working longer before you retire, perhaps working part time for a limited period of time may be the answer. If neither of these appeal to you, you might need to consider downsizing to ensure that you have sufficient resources to meet your needs in retirement.

Another alternative that is available to those who either have paid their mortgage off completely or have a very small balance remaining on their mortgage is to consider taking out a reverse mortgage on your home.

A reverse mortgage is simply a loan that you take out on the equity in your home which you never have to pay back. The loan that you acquire can be used to supplement your retirement income during your years of retirement. Be aware, however, that the loan has to be repaid by your heirs when you pass away. This could be accomplished by selling the property or acquiring separate financing to pay off the balance of the loan. The upfront fees to set up a reverse mortgage can be quite hefty and interest accumulates on the loan until it is repaid. It is advisable to discuss this option with your financial consultant and your family prior to entering into an agreement of this nature.

If you desire an additional consistent steady stream of monthly income to supplement your fixed income amounts, you may also consider purchasing an income annuity from an insurance company. This type of annuity can provide a monthly supplemental income for the remainder of you and your spouse's life. It is advisable however, that no more than 30% of your Personal Retirement Savings be used to purchase an income annuity. Be sure to discuss the pro and cons of this type of supplemental income plan with your financial advisor before deciding to purchase any type of annuity.

The final area that we need to look at concerning withdrawing funds from your Personal Retirement Savings is the order in which you withdraw funds from your various accounts. It is assumed that by the time you reach retirement you could have funds in one or more of the following accounts:

a. Taxable Accounts

b. Tax Deferred Accounts

c. Tax Free Accounts

Taxable accounts may include passbook savings, Certificates of Deposit, Taxable Stocks, Bonds, or Money Market Accounts, etc. Because the earnings on these accounts are taxable it is best to withdraw funds from them first, to allow your tax deferred and tax free accounts continue to grow unencumbered by current interest income, dividends, or capital gains.

Tax Deferred Accounts may include 401(K)'s and Traditional Deductible IRA's. Since the contributions and earnings from both these accounts are taxed as ordinary income, consideration needs to be given to the taxability of Social Security Income when withdrawing from these accounts. Proper tax planning can reduce or eliminate the taxation of your Social Security Income when withdrawing funds from these accounts.

Tax Free Accounts may include Non Deductible Traditional IRA's, ROTH IRA's and some tax free bonds. As with Tax Deferred Accounts proper tax planning should be used when determining the withdrawing of these accounts in association with your Tax Deferred Accounts. Please seek the advice of a professional tax advisor for this type of planning.

In conclusion, while this month's newsletter does not answer all the questions concerning the withdrawal considerations during retirement, it is hoped that the message it conveyed was the critical importance of comprehensive retirement planning in your financial planning process. As stated many times before, and as indicated in this month's newsletter, financial planning is a life long process. And as we complete each stage of this life long process we enter a new stage with its own set of challenges.

Til Next Time,

Charlie

Disclaimer

The information presented in this newsletter is provided as a public service to provide clients and other visitors with general financial information. Every effort is made to provide accurate information; however, errors may occur due to the nature of the subject matter and interpretation of any laws and regulations involved. The information provided on this site should not be construed as legal, tax, accounting or investment advice. You should consult with a legal or financial professional familiar with your circumstances for appropriate financial advice before making any decision. CWR does not warrant the completeness, accuracy or timeliness of the information provided and offers no warranties regarding the content of this site, either expressed or implied.