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Retirement Planning: Hope Isn't a Good Strategy

By Linda Gardner | Retirement Daily Guest Contributor

Retirement planning. What's the big deal? It seems like there's a new article every hour talking about an issue, concern or crisis related to retirement planning. What happened to just turning in your retirement forms and racing off into the sunset for never-ending vacation days, hoping that it will all work out OK? That seemed like a great plan when you were younger.

Now, here you are, racing toward retirement. What do you need to do? Let's start with the obvious: You need retirement income that will be there for the rest of your life.

Unlike our parents' and grandparents' generations, most people don't retire today with a pension. If you are one of the few who do, consider yourself fortunate. Over the past 30 years or so, many employers have eliminated defined-benefit plans and replaced them with 401(k)s, 403(b)s, and other defined-contribution plans -- moving the responsibility for the employee's lifetime retirement income from the employer to the employee. Unfortunately, many workers didn't really understand this change meant they'd be fully responsible for their own financial support when they retire and that the money they set aside during their working years must support them for the rest of their lives.

Historically, retirement income was expected to comprise three equally important elements. The first was the employee's pension, the second would be Social Security benefits and the third would be personal savings. It seemed like a good plan until the pension portion began to shrink and then disappear.

What replaced the pension is the defined-contribution plan, such as a 401(k), 403(b), TSA, TSP or other similar employer retirement plan to which each employee should consistently and significantly contribute. Typically, these are pre-tax contributions that grow tax-deferred over time. The income you take out after retirement will be fully taxable at whatever the tax rates are in the future.

If your employer's plan offers a Roth 401(k) option, which is for after-tax contributions, serious consideration should be given to utilizing that choice to create tax-free income when you retire.

Before employing any strategies mentioned in this article or taking any other actions you should discuss your situation with a qualified financial professional.

The second segment of retirement income is intended to be Social Security for those who participate and qualify for Social Security retirement benefits. Social Security is designed to be an integral piece of retirement income. It was never intended to be the total source of retirement income. Unfortunately, some individuals have the mistaken notion their Social Security benefits will be large enough to live on. However, that's usually not the case.

Since Social Security benefits are such an important piece of your retirement income, the strategies and timing of when to begin taking your Social Security benefits need to be carefully considered and included in creating your optimal retirement income plan.

For some, delaying the start of their Social Security benefits may be the best way to maximize overall lifetime retirement income and/or provide for larger surviving spousal benefits. For others, starting sooner may be the optimal answer. The correct answer of when to start benefits depends on your specific circumstances.

According to a May 2015 report by the Center for Retirement Research at Boston College, 90% of Americans start their Social Security retirement benefits at or before their full retirement age (ages 66 to 67 for today's retirees). Surprisingly, 42% of men and 48% of women start their benefits at age 62 which is the earliest date for normal retirement benefits, thereby permanently decreasing the amount they'll receive from Social Security.

The third segment of retirement income is intended to be personal savings and investments. It was always intended that individuals would have significant personal savings and investments to provide for any other lifetime needs. Personal savings can include IRAs, Roth IRAs, stocks, bonds, savings accounts, annuities, life insurance, rental properties and more.

It's kind of like buying the ingredients to bake a cake. Separately, the flour, sugar, eggs, butter, vanilla, baking powder and other ingredients are just that: ingredients. But, when you follow a specific recipe to mix the ingredients together in the right amounts and bake for the proper time at the optimal temperature, an amazing dessert will be served.

The Recipe for Retirement

You need a recipe for your retirement, a plan for the optimal income, from the right investments and designed to support you throughout the rest of your life.

The best way to do that is to start with a budget. Start by tracking how you spend money today, then subtract what you'll no longer spend in retirement and add in how and when you expect to increase your expenditures during retirement. That could include things like travel, hobbies, new car, motor home, charitable activities, spending more time and money on grandkids, etc.

Rather than creating a detailed retirement income and expense plan, some advisers just suggest withdrawing something like 4% annually from your investment accounts to live on. Recently, some have suggested reducing that withdrawal to 2.5% or 3% of your investment accounts per year.

We prefer to start with a projected budget, then add what you want to spend over and above living necessities to get a more complete picture of what your retirement income needs might be. Ideally, your adviser uses a robust retirement planning software that includes annual inflation increases for spending as well as realistic growth projections for income and investments.

Those steps create a retirement income plan. To take the next step toward a comprehensive retirement plan, additional planning considerations need to be included such as retirement investment strategies, tax strategies, long-term health care, and estate planning.

The Danger of Sequence-of-Returns Risk

One of the most serious dangers a retiree may face is sequence of returns: If you experience significant investment losses during the years just before you retire or the first few years you're in retirement, your chance of outliving your money may increase significantly.

Remember the people who suffered serious investment losses during 2007 and 2008? If you're near retirement or already retired, recovering from that kind of loss could be difficult. Many in 2008 found they either couldn't retire when planned or had to go back to work.

Tax Strategies

Tax strategies still matter when you're retired. In fact, depending on the amount of your retirement income and its tax classification, you may pay as much tax, or more tax, than you paid before retiring. If you've saved large amounts in your tax-deferred retirement accounts, taxes could be your largest expense during retirement. This is especially true for high income earners and high net worth individuals. Tax and investment strategies focused on maximizing retirement income while minimizing retirement taxes should be considered as early as possible. This might include tax-free bonds, IRA to Roth conversions and utilization of specially designed life insurance to create future tax-free income or tax-free benefits at your death. Charitable gift strategies may also yield significant tax benefits.

Long-Term Healthcare

Long-term healthcare expenses may be one of the biggest threats to a retirement portfolio. Government statistics indicate that for a couple reaching age 65, 70% will need long-term care during their retirement years. National monthly average costs for long-term care for a private room in a nursing home exceed $8,100 per month today. The projected monthly average cost in 25 years is $17,004 according to the Genworth 2017 Cost of Care Survey. A hypothetical three-year care event occurring in 25 years could exceed $612,000. In some parts of the country that cost could be even higher. Although most think they'll never need long-term care, a plan to provide for that care needs to be in place. The risk to the family and retirement investments is just too great.

Estate Planning

Lastly, everyone needs to have current, updated estate planning documents in place. These documents will include a will, possibly some type of trust, medical powers of attorney, financial powers of attorney, HIPAA release, advance directives (also known as a living will), and in some states a memorandum of intent for distribution of personal property. Additionally, you need to review all beneficiary documents for annuities, life insurance and retirement accounts to be certain they are current and reflect your intentions today. Work with a qualified legal professional to be certain that your documents are complete and meet your needs as well as the legal requirements in your state. This isn't the time to do it yourself.

Creating a comprehensive written retirement plan is a great step toward a secure retirement. Investments change and life changes, so be sure to update your plan every year.

OK, now it's time to turn in that retirement form and race off into the sunset for those never-ending vacation days! You've earned them.

About the author: Linda L. Gardner is the co-founder of Blue Heron Capital, LLC, a CPA, and an Investment Advisor Representative. She hosts a weekly radio show: "Your Money Your Retirement®" Her focus is on comprehensive retirement planning. She also is a member of Ed Slott's Elite IRA Advisory Group, the American Institute of CPAs and Women's Estate Planning Council. Investment Advisory Services offered through Brookstone Capital Management LLC, (BCM) a Registered Investment Advisor. Blue Heron Capital, LLC and BCM are independent of each other. Insurance products and services are not offered through BCM but are offered and sold through individually licensed and appointed agents. Information provided is not intended as tax or legal advice and should not be relied on as such. Readers are encouraged to seek tax or legal advice from a qualified professional. Ed Slott's Master Elite IRA Advisor Group™ membership requires the advisor to pay fees for membership, attend training provided by Ed Slott and Company, pass semi-annual examinations and meet other membership requirements. Membership does not guarantee investment success and is not an endorsement.

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