Retirees Should Have Spending Plans

Without such strategies, they can risk going through their savings too fast.

Every day, articles appear urging people to save for retirement. These articles are so prevalent that it may seem like retirement planning is entirely about getting people to save.

Actually, retirement planning concerns much more than that. It has another aspect well worth discussing: the eventual spending of all of that money that has been accumulated.

Too few Americans coordinate their retirement spending. Earlier this year, Ameriprise asked more than 1,300 savers aged 55 to 75 if they had a drawdown strategy in mind for the future. Nearly two-thirds of the pre-retirees surveyed did not. A third of the retired respondents to the survey also lacked spending plans.[1]

In retirement, inattention to household spending can have serious consequences. A newly retired couple can travel too much, eat out too frequently, and live it up to such a degree that its savings can be drawn down abruptly. That danger is heightened if a couple's investments start to perform poorly. A spending plan may help retirees guard against this kind of crisis.

Another case occurs when a retiree household becomes overconfident in its decently performing portfolio and its middling level of savings. A decade or so into retirement without a spending plan, that household finds its investment and bank accounts dwindling mysteriously fast. Sunday brunches give way to $3.99 bacon-and-egg specials, and the golf clubs stay in the garage all year. A plan for drawing down retirement savings in moderation when retirement starts might help such a couple maintain its quality of life longer.

There is no standardized retirement drawdown strategy. Each retired household (and its retirement planner) must arrive at one specific to its savings, investment mix, income requirements, and age.

There are some basic principles, however, that may help in configuring the spending plan. It makes sense for many retirees to tap their taxable brokerage accounts as a first step in a drawdown strategy. This allows assets held within tax-advantaged retirement accounts (such as IRAs) more time to grow and compound. By doing this, a retiree can effectively realize a tax break — money coming out of a traditional IRA is taxed as regular income, whereas long-term capital gains are taxed between zero and 20 percent.[1,2]

Of course, Roth IRA withdrawals are never taxed, provided you have followed IRS rules. That brings up another factor in planning retirement spending – what can be done with regard to asset location and tax efficiency *before* retirement.[2]

A retiree with a larger traditional IRA may want to consider a Roth conversion of some or all of those IRA assets before age 70. In the 50s or 60s, an IRA owner may be at or near peak earnings, so handling the tax bite that comes with such a conversion may be comparatively easier than it would be during retirement.

Another tactic is to take earlier, voluntary withdrawals from accounts that would demand Required Minimum Withdrawals (RMDs) beginning at age 70½. These voluntary withdrawals, which would occur before the start of RMDs, would leave an IRA owner with lower RMDs (and less taxable income) in the future.

Retirement spending should never be treated casually. A spending strategy may play a crucial role in preserving a retired household's quality of life.

Contact us for help in retirement planning.

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Citations.

1 - cnbc.com/2016/03/02/spending-in-retirement-is-a-balancing-act.html [3/2/16]
2 - investopedia.com/ask/answers/102714/how-are-ira-withdrawals-taxed.asp [10/17/16]