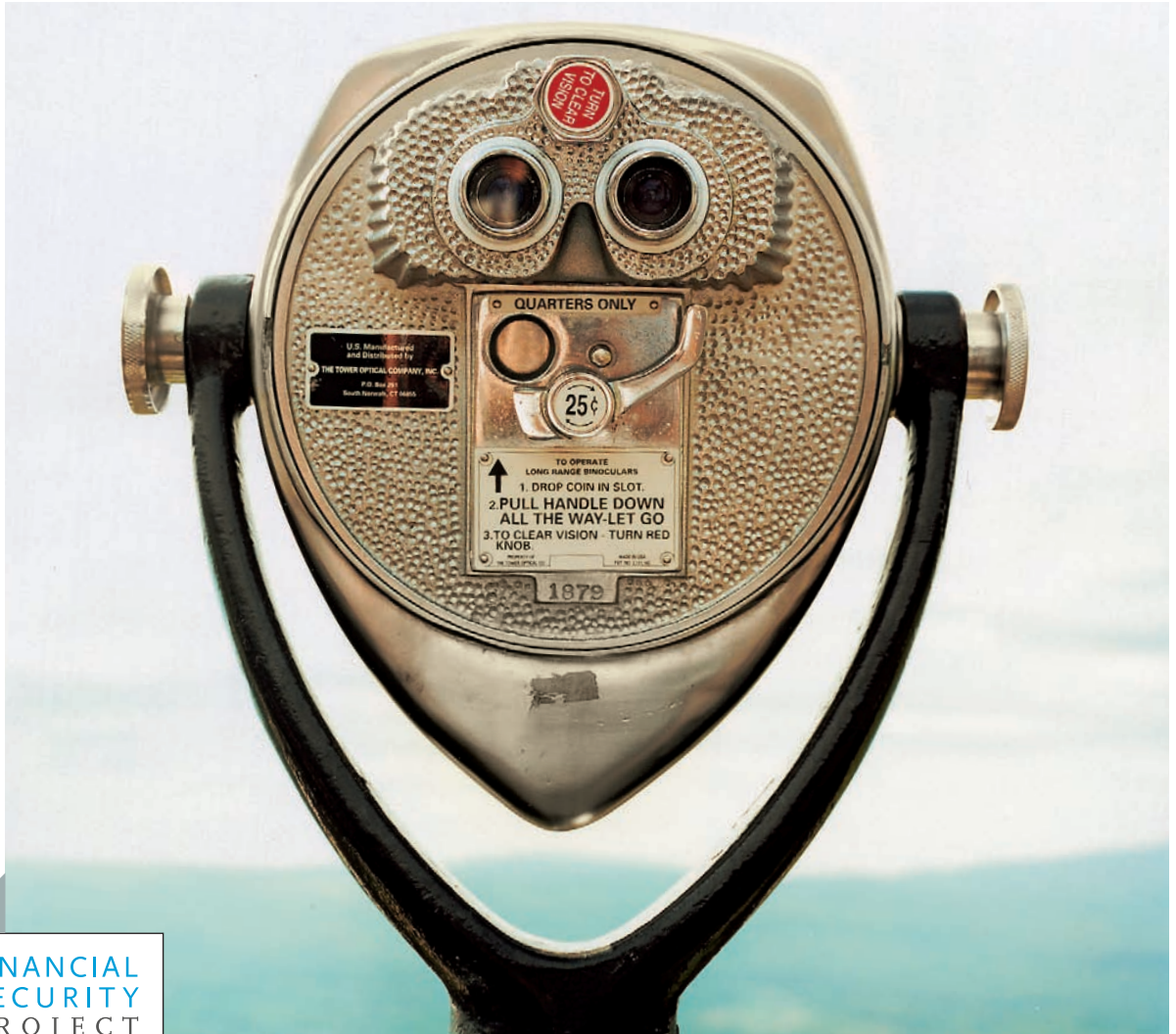


A PLANNING GUIDE FOR THE *newly retired*

MANAGING YOUR MONEY *in* RETIREMENT





Managing Your Money in Retirement

A 3-step process

- 2 *How to see your financial needs are met*

What you need

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After a lifetime of work, it's great to take a trip, help the kids, or get a new TV. But before you get what you want, make sure you have what you need.

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FINANCIAL
SECURITY
PROJECT
at BOSTON COLLEGE

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How to see your financial needs are met

- 1 *Define what you need.*** A reasonable place to begin is what you currently need each month to pay the bills. While spending on trips and entertainment declines with age, rising medical costs could push your monthly expenses higher.
- 2 *Add up what you have.*** Social Security and employer pensions and other income benefits can help pay your monthly expenses. Then there's your savings and your house. You can draw an income out of these assets, hold them as reserves, or leave them to your kids or charity.
- 3 *Decide what to do.*** If you can pay the bills and are well-insured, have enough assets, or can accept the consequences of a bad medical or financial shock, you don't have to do anything. If not, the primary options are to change the way you use your savings or house, return to work, or tighten your belt.

This guide will get you started



Most retirees can put a plan together reasonably quickly. What's important is to start, and follow through.



DEFINE WHAT YOU NEED



ADD UP WHAT YOU HAVE



DECIDE WHAT TO DO



It's not just an arithmetic problem. You also need to think differently about things flagged by the * on the following pages.

For more on *Curious Behaviors That Can Ruin Your Retirement*, go to <http://fsp.bc.edu/curious>

Everyday expenses

To stay in your house, drive the same car, and remain active in your community, you don't need as much income as you did while working.

YOU PAY LESS TAX.

- *You don't pay payroll tax on income from Social Security, savings, or employer pensions.*
- *You don't pay income tax on all of your Social Security benefits.*

YOU DON'T NEED TO SAVE FOR RETIREMENT.

THE MORTGAGE IS OFTEN PAID OFF, OR WILL BE SOON.

YOU'LL PROBABLY SPEND MORE ON MEDICAL CARE.

- *But this rarely offsets the overall cut in expenses.*

Retirees generally need about 70 percent of pre-retirement income for everyday expenses.[□] A surviving spouse needs about half the couple's pre-retirement income.

WORKSHEET

How much do you think you need each month?

\$

How much for a surviving spouse (if married)?

\$

→ Use today's dollars. It makes planning much easier.

Set a reasonable target

Low-income households often need more than 70% of what they had while working.

High-income households often need less, as they see a sharper cut in taxes and saving. They also have more “discretionary expenditures” they could cut, if need be.



It's tempting to ignore your needs down the road. But when tomorrow comes, your needs will be there.



Medical bills

MEDICAL CARE IS something you can't do without. Medicare pays much of the cost. But you are responsible for premiums, deductibles, copays, and items that Medicare doesn't cover. Medigap policies, offered by private insurers, cover many but not all of these costs. The big exception is long-term care.

Medical expenses are rising. In twenty years, your health-care expenses in *today's* dollars, *not* including long-term care, could triple.

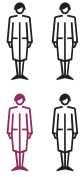
Could you offset this rise in health care costs with cuts in other expenses? If not, how much more income would you or a surviving spouse need?

Health care costs are projected to rise over time about 3% a year above inflation.^[2]

|| **WORKSHEET** ||

| | |
|---|----|
| Additional monthly income for medical costs in your 80s | \$ |
| Long-term care insurance, if you choose to buy it | \$ |

The long-term care dilemma



One in four Americans age 65 is expected to spend at least one year in a nursing home, at a cost of about **\$75,000** a year — and this cost is NOT covered by Medicare.³



It takes time and effort to plan. But if you put it off, you might not be able to afford the care you want, or be forced to deplete the savings you or your survivor will need down the road.

Medicaid, the government program for the poor, DOES cover long-term care — for those with very low income and assets.

You can buy private **long-term care insurance**.

The cost is about \$200 a month for a policy bought at age 65 that pays up to \$60,000 a year.⁴



Social Security

FOR PAYING EVERYDAY EXPENSES, Social Security benefits are especially valuable. It's rarely enough to support your current lifestyle. But the benefits are an annuity that keeps up with inflation, and the checks keep coming as long as you live.

Other sources of income tend to dry up over time. So as you age, Social Security benefits generally become increasingly important.



While Social Security's Trust Fund will be depleted by 2040, continuing tax revenues could still pay nearly 80¢ on the dollar.⁵

|| WORKSHEET ||

How much you get from Social Security: \$

How much your surviving spouse would get (it's the higher benefit): \$

Social Security benefits alone are often inadequate for widow(er)s

Women often outlive their husbands by many years. They get the greater of their own or their spouse's monthly benefit. But it's:

- Much less than what they got as a couple.
- Much less than continuing expenses.⁶

So be sure your plan protects your survivor.



We'd rather not think of painful events. But to protect your loved ones, it's sometimes important you do.

Employer pensions and other income

MANY HOUSEHOLDS entering retirement today still get a traditional employer pension, which provides an income that keeps coming as long as you live.

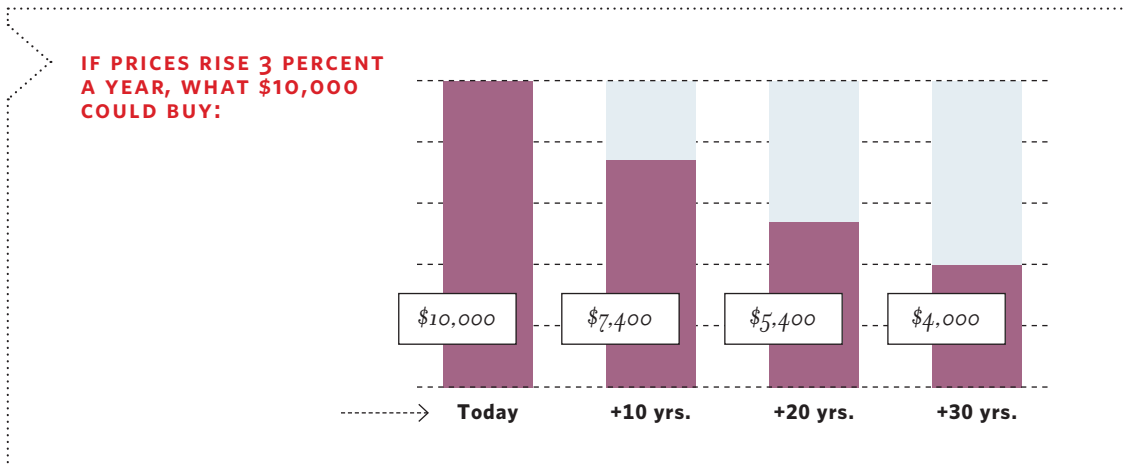
Most private employer pensions, however, are not inflation-proof. If prices rise 3 percent a year, in twenty years that pension benefit will buy barely half what it can today.

So enter how much you and your survivor get from employer pensions.

- The wife is usually the survivor.
- Survivors usually get either nothing or 1/2 of their spouse's pension.
- Inflation could further cut that benefit.

If you have dividends, alimony, rents, or other monthly income, add that as well.

Then take stock, for now, of what you need, what you have, and your monthly shortfall or surplus.



Take stock, for now, of your monthly income and expenses

WORKSHEET

YOU
↓

YOUR SURVIVOR
↓

WHAT YOU NEED:

| | | |
|----------------------------|----|----|
| Everyday expenses | \$ | \$ |
| More for medical insurance | | \$ |
| Long-term care insurance? | \$ | \$ |
| TOTAL (A): | \$ | \$ |

WHAT YOU HAVE:

| | | |
|----------------------|----|----|
| Social Security | \$ | \$ |
| Employer pensions | \$ | \$ |
| Other monthly income | \$ | \$ |
| TOTAL (B): | \$ | \$ |

MONTHLY INCOME SHORTFALL/SURPLUS

| | | |
|-----------------------------------|----|----|
| TOTAL (A) MINUS TOTAL (B): | \$ | \$ |
|-----------------------------------|----|----|

401(k)/IRA savings

Now it's time to make decisions, first about your savings. Using savings to finance retirement is hardly straightforward, because:

SAVINGS HAVE TWO COMPETING **USES**:

- You can draw an income out of your savings to *maintain* your lifestyle.
- You can hold your savings as reserves, or buy insurance, to *protect* your lifestyle.

[NOTE: *Another competing use is to leave a bequest to your children or charities.*]

HOW SAVINGS ARE USED CAN INCREASE **RISK**.

- Using stocks to boost your investment income comes with the risk that a downturn will reduce their value.
- The more income you draw out of your savings, the greater the risk you will outlive your savings.

THESE ISSUES ARE **INTERCONNECTED**:

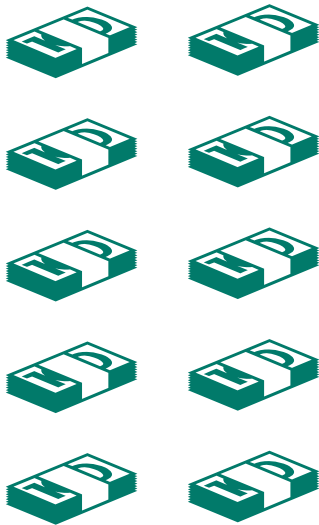
- The less your *risk* – from medical costs, financial shocks, or outliving your savings – the less *reserves* you need and the more *income* you can draw.
- Long-term care typically comes at the end of life. So if you hold reserves to cover the cost of long-term care, you could use the income those reserves produce – income *above* inflation – for everyday expenses.

AND CONNECTED TO YOUR **EXPENSES**:

- The more “fixed” your expenses, the less risk you can bear and/or more reserves you need.

3 ways to draw a monthly income from savings earmarked to produce income

\$10,000



At 65, for every \$10,000 in savings you can



\$33

Draw out about \$400 a year (\$33 a month) with little risk that the amount, adjusted for inflation, will ever fall sharply.



\$42

Buy an annuity that pays about \$500 a year (\$42 a month), adjusted for inflation, as long as either spouse is alive.



\$59

Use savings to delay starting Social Security and increase future benefits about \$700 a year (\$59 a month).^[7]



Preserving principal might seem the only safe bet. But there *are* reasonably safe ways you can draw down your savings.

Home equity

MOST HOUSEHOLDS entering retirement own their home, and the equity in their home – the value of the house less any mortgage – is often greater than their 401(k)/IRA savings.

Even if the mortgage is paid off, housing costs – insurance, utilities, upkeep, and taxes – are often a retired household's largest expense.

If needed, you can tap home equity to boost inadequate incomes, cut costs, or pay big medical or nursing home bills.

Widow(er)s often downsize, as they typically need more income and don't need or can't afford a larger house.

Many needing extended nursing home care sell their house, which they no longer need, to pay the bill.

Individuals and surviving spouses, especially, can use home equity to pay for long-term care.

The most powerful ways to tap home equity



▪ **DOWNSIZING.**
Moving to a less expensive house **1)** adds to your retirement



Leaving your home and the memories it holds is often an emotional break. But most retirees who do move adapt and flourish.

savings; and **2)** reduces your ongoing housing expense.

Moving is also easier, physically and socially, now than when you're older.

▪ **A REVERSE MORTGAGE.**

A reverse mortgage is a new, unfamiliar, and somewhat complicated arrangement.

But it **1)** allows you to stay in your house for the rest of your life; and **2)** provides tax-free income.

Lay out a plan that meets your needs



The example below illustrates the process.

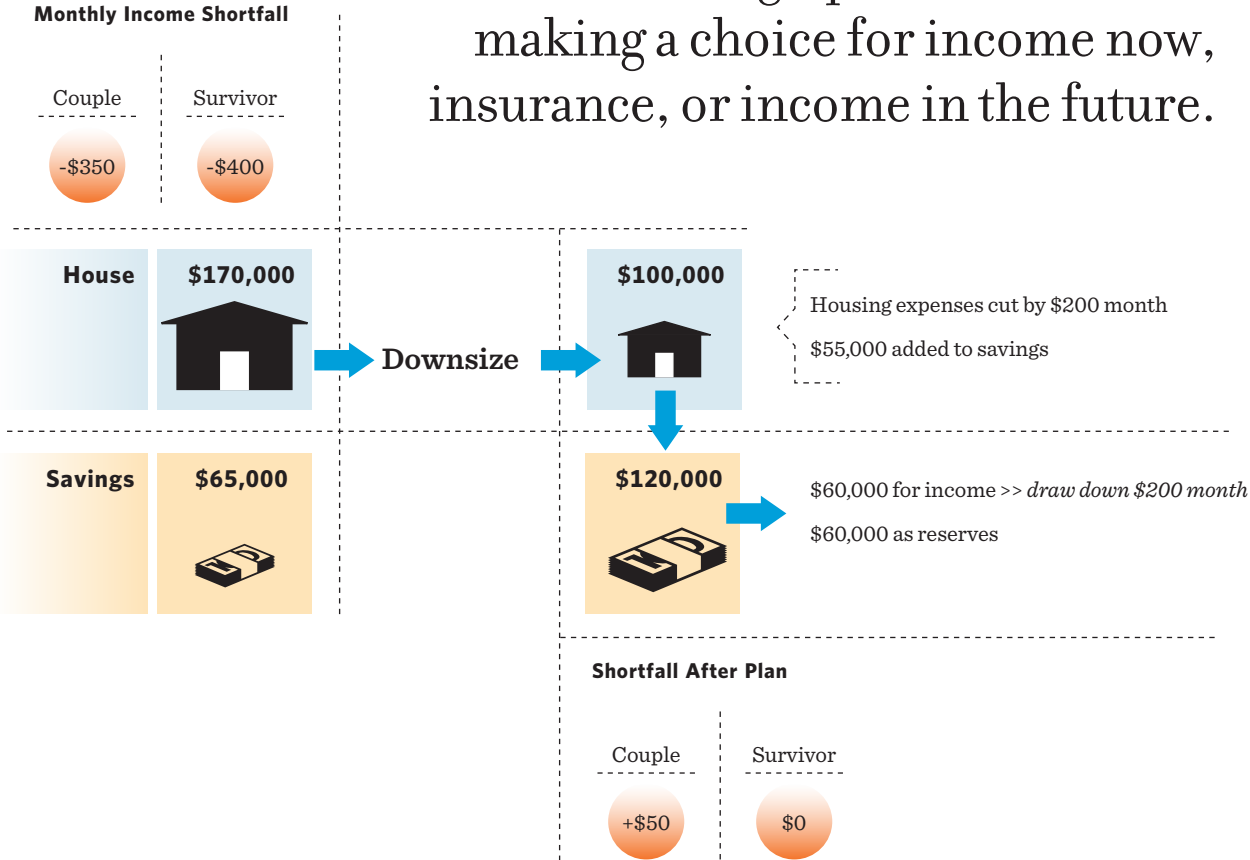
A couple has a \$350 monthly income shortfall, projects a \$400 shortfall for the survivor, has a house worth \$170,000, and \$65,000 in savings.

- They decide to downsize. After \$15,000 in selling and moving costs, they purchase a condo for \$100,000, add \$55,000 to savings—bringing their savings to \$120,000. Downsizing also cuts their housing expenses \$200 a month.
- They decide to use \$60,000 of savings for income, drawing down \$200 a month, and hold \$60,000 as reserves.
- The couple's plan results in a \$50 monthly surplus and no shortfall for the survivor. They plan to cover rising medical costs from savings held in reserve, and any income those reserves produce.

➔ *The couple's plan maintains their standard of living—now and in the future. But they would be hard-pressed to pay for long-term care.*

➔ *When you draw up your plan, would you make the same or a different choice?*

Making a plan often means making a choice for income now, insurance, or income in the future.



If you **don't** have enough

Things to consider if you can't pay the bills or the risks are too great:

• **Tighten your belt.** If you adopt a less costly standard of living today, you reduce the risk of a much sharper decline tomorrow, when you're older, poorer, and less able to adjust.

• **Return to work to conserve your resources.** Jobs can be hard to find and have less status than jobs you held in the past. But each year you don't touch your savings 1) your savings grow and 2) your savings won't have to stretch as far. So your income from savings should be about 5-8 percent more.

• **Change the way you use your savings or house.** Not many retirees today downsize early in retirement, draw down their savings, or buy annuities. But each has advantages that might suit your needs.

Have a plan should things go badly

If you need long-term care and can't afford a nursing home, will you rely on your family or exhaust your assets and go on Medicaid?

If your income from savings falls sharply, how might you reduce your expenses in the least painful way?



If you **do** have enough



IF YOU CAN PAY the monthly bills for the rest of your life and are well-insured or can bear the risks you face, you have options. You can:

- Spend more freely and buy more things that you like.
- Give more to charity or your children.
- Invest your surplus savings in stocks and other assets that are risky, but have high expected returns. If things go well, you can spend more, give more, or leave more to your children. If not, you have the peace of mind that your needs will still be met.

Do it now

WHAT YOU DO MAKES A DIFFERENCE.

So make a plan:

- Think and act long term, which we don't naturally do.
- Plan for your survivor, which means thinking about death (and making a will!)
- Assess your risks realistically, and have a plan if things go badly.

If it's in your plan:

- Move to a less expensive home.
- Adopt a disciplined drawdown strategy or buy an annuity – something most people resist.
- Be prepared to accept less status on the job.
- Or give up things that you think you “can't do without.”



The quicker you act,
the more secure your
retirement will be.

➔ <http://fsp.bc.edu>
For an expanding set of useful tools and information

➔ <http://fsp.bc.edu/curious/>
For an entertaining review of “curious behaviors” that make *Managing Your Money in Retirement* so tough



Fix your finances to get on with your life

Explanations

[1] Aon Consulting. 2008. *2008 Replacement Rate Study*. The 70 percent of pre-retirement income target assumes your mortgage is paid off, and is lower than the Aon estimate, which assumes it is not.

[2] Munnell, Alicia H., et al. 2008. *Health Care Costs Drive Up the National Retirement Risk Index*. Issue Brief 8-3. Center for Retirement Research at Boston College. Chestnut Hill, MA.

[3] MetLife Mature Market Institute. 2010. *Market Survey of Long-Term Care Costs: The 2010 MetLife Market of Nursing Home, Assisted Living, Adult Day Ser-*

vices, and Home Care Costs. Westport, CT: MetLife Mature Market Institute. Nursing home care does not require an additional \$75,000 a year. Essentially all living expenses are covered and Social Security benefits, employer pensions, and other continuing income cover at least a portion of the cost.

[4] National Clearinghouse for Long-Term Care Information, “Long-Term Care Insurance Costs and Receiving Benefits,” Washington, DC.

[5] For information on proposals to fix Social Security, see Center for Retirement Research at Boston College. 2009. *Social Security Fix-It Book*. Chestnut Hill, MA.

[6] Holden, Karen C. and Cathleen Zick. 1998. “Insuring Against the Consequences of Widowhood in a Reformed Social Security System.” In *Framing the Social Security Debate*, edited by R. Douglas Arnold, et al., Washington, DC: Brookings Institution Press and the National Academy of Social Insurance.

[7] Center for Retirement Research at Boston College. 2009. *Social Security Claiming Guide*. Chestnut Hill, MA. Each year you delay starting Social Security you increase future monthly benefits about 7%.



Clear, simple, and indispensable—by far the best starting point for getting a grip on your finances in retirement.

—**Jane Bryant Quinn**, personal finance writer and author of *Making the Most of your Money NOW*

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