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The Retirement Countdown Begins

Bill, 60, and Maryann, 59, are winding down their working life.

In the next two or three years, they want to sell their Jersey home and relocate to Florida. “We want to buy a house or condo equal to or less than net proceeds from sale of our present home,” Bill said. “We have no plans to take another mortgage.” They hope to spend time relaxing, do volunteer work, take a few modest vacations each year and spend time with family and friends.
To date, the couple has saved $782,200 in 401(k) plans, $168,000 in IRAs, $34,700 in a brokerage account, $50,000 in a money market and $1,000 in savings. Bill expects to receive a pension when he leaves work. At age 61, he can receive $50,000 a year, and that amount goes up for every year he delays taking the pension. By 65, it would pay $56,000 a year. All those figures are for the joint and survivor option, which would pay Maryann if Bill died first. He is also eligible for a smaller pension, which will pay $2,000 a year at age 65.

“Our plan for Social Security is to retire at 61, live off the pension and 401(k) until age 70,” Bill said. “At 66 years and 2 months, we’d file and suspend and file restricted application.” **Claudia Mott, a certified financial planner with Epona Financial Solutions in Basking Ridge**, gave a thorough review of the couple’s finances for NJMoneyHelp.com. New changes in the Social Security system mean their initial plans need some important adjustments.

“Bill and Maryann will find themselves relying on their savings and investment portfolios in the early retirement years to make up the shortfall between Bill’s pension of $50,000 which he will receive at age 61 and their estimated living expenses of $86,400,” Mott said.

CHANGES WITH RETIREMENT

Before discussing their retirement income, Mott reviewed their anticipated retirement expenses. Retiring by age 61 is going to leave the couple in need of health insurance coverage for four to five years until they are eligible for Medicare. Right now on the open marketplace, an insurance plan to cover both Bill and Maryann would cost between $14,000 and $16,000 per year, Mott said.
“It is important for Bill & Maryann to understand the deductible they will be responsible for as well as out-of-pocket expenses for co-pays and co-insurance,” Mott said. “These will likely be higher that what they experienced with an employer-provided plan.”
Mott said they need to be sure those additional expenses are accounted for in their annual budget.
Once they are both Medicare-eligible, they may save as much as $6,000 a year in insurance costs, Mott said, but with medical inflation running at 6.5 percent, they could be spending upwards of $45,000 in supplemental plans when they are in their 80s.
In anticipation of retirement, Mott said, Bill and Maryann should be sure they review their current budget and get into the habit of tracking their spending using an online app or software package.
Mott said creating a budget in retirement is especially important when some of the resources needed to meet it will be coming from investment and retirement accounts and not pension income.
“There are many expenses that will be reduced or non-existent once a couple retires, while others may increase,” Mott said. “Because withdrawals from 401(k)s and IRAs are taxed as income, knowing exactly what you need, before you withdraw it, can help reduce taxes.”
Right now Bill and Maryann have $50,000 set aside in a savings account. With the goal of being mortgage-free in retirement, they may not net much in the way of extra cash when they sell their New Jersey home, which could be used to bolster their savings. Mott said.
“They need to consider building up their emergency savings fund prior to retirement, especially knowing they intend to purchase two vehicles, one within the next two years,” she said.
Regardless of age or employment status, every family should have an emergency fund to cover unanticipated expenses, surprise repairs or unexpected purchases, Mott said. While there is no hard and fast rule for retirees, it is often considered prudent to keep nine months to a year’s living expenses in a liquid savings account or CDs, she said.
With a total of $50,000 in their savings account, Bill and Maryann should redirect any excess cash flow they have while Bill is working, Mott said.

THE INVESTMENT PERSPECTIVE

Creating as much income as possible from Bill's and Maryann's investments is going to be an important part of their long-term retirement success, Mott said.

It will it be an important source of cash flow before Social Security kicks in.

The couple has accumulated $950,000 in their retirement accounts, and indicate they have a moderate to low risk tolerance. Their current portfolio allocation of 55 percent stock mutual funds and 45 percent bond income funds is appropriate for that risk level, Mott said.

They also have a well-diversified list of mutual funds and the [allocation across asset classes] does not show any large imbalances, but their retirement projections look better if they split their equity and bond investments 50/50. Their chance of success would go up from 81 percent to 85 percent with that change.

"The ability to generate a bit more income to replace the monies that are withdrawn proves to be a positive for the long-term outcome," Mott said. "This would be accomplished by reducing the exposure to international equity and large-cap growth and value and increasing the short-term bond weighting."

Once Bill retires, he should consider rolling over his 401(k)s into his existing IRAs. [Consolidating accounts] makes it easier to calculate and take [Required Minimum Distributions (RMDs)] when the time comes, Mott said.

It is often recommended that retirees plan to withdraw [no more than 4 percent] from their portfolios on an annual basis. For Bill & Maryann, once they reach 70 and are receiving the pension, Social Security and IRA RMDs, they will be comfortably below the 4 percent level throughout the remainder of the plan, Mott said.

"Stress-testing the financial plan included looking at different options for the payout of Bill's pension, Social Security strategies and higher expenses," Mott said. "If medical or living costs turn out to be higher than are anticipated in the budget, the probability of success will drop. Increasing annual expenses by $6,000 would cause the probability of success to drop to 74 percent."

That makes expenses important to monitor through their retirement years.

Net Worth:

Assets:

- Checking: $1,000
- Money Market: $50,000
- IRAs: $168,000
- 401(k): $782,200
- Brokerage Account: $34,700
- Primary Home: $400,000
- Personal Property: $5,000
- Autos: $25,200

Total Assets: $1,466,100

Liabilities:

- Mortgage: $98,000

Total Liabilities: $98,000

Total Net Worth: $1,368,100

Budget:

Annual Income:

- Bill Salary: $155,000
- Maryann Salary: $45,000

Monthly Expenses:

- Income Taxes: $2,931
- Housing: $2,036
- Utilities: $664
- Food: $850
- Personal Care: $420
- Transportation: $278
- Medical: $1,700
- Entertainment: $300
- Vacations: $1,000
- Charity: $300
- Gifts: $500
- Misc.: $664