10 Steps to a Sustainable Retirement Income

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Introduction

Retirement is an opportunity to focus on what is meaningful to you. Career and family tend to put individual interests and activities on the back burner during the working years. Retirement can be a time to reclaim and explore those interests. Whether your ideal retirement involves leisure, golf, travel, family, or continuing to work as long as possible, a sustainable retirement income gives you the flexibility to enjoy life your way.

While we tend to think in terms of retirement savings, many financial advisors have shifted the conversation to retirement income. This is because people are healthier longer, and active retirement can span decades. As of the 2016 census, there were over 82,000 Americans who were at least 100 years of age.

There are several approaches to creating a retirement income that can cover your expenses the entire span of your retirement without draining the resources you want to pass on to the next generations. A financial advisor who understands the income approach to retirement can help you craft a plan that fits your circumstances and goals. However, here are ten key steps to creating a retirement income that lasts.

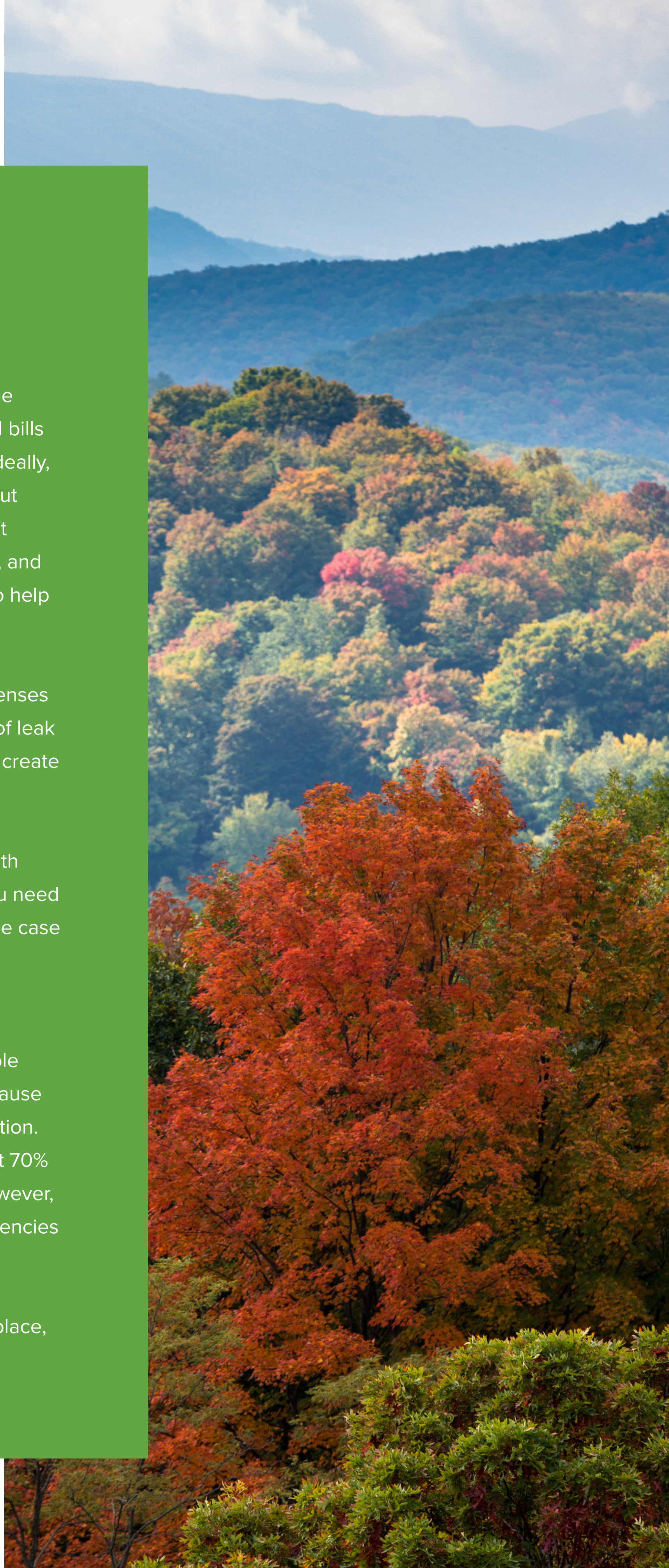
1. Clarify Your Retirement Goals

Where and how do you want to live in retirement? Before defining your income goals, it helps to have a clear picture of your lifestyle. Suppose you've paid off your mortgage and live a relatively simple lifestyle. In that case, your income requirements will be less than if you want to travel extensively, throw lavish parties, or completely remodel your house and garden.

The first step to a sustainable retirement income is to write down your goals and objectives for retirement. Don't worry about the budget as you start; dream first and organize second.

Focus on the activities and ideas you see yourself enjoying, and be specific. For example, instead of "travel," write "trips to Europe" or "Decembers with my kids." Instead of "stay involved with my church," write down "continue with the activities committee at church" or "sing with the choir."

The more descriptive you are, the more substantial your understanding of your future retirement will be. Once you've compiled an initial list, try narrowing it down to your top five or so goals. This step aims to ground your ideas in reality, parse out what just sounds good, and envision a retirement lifestyle that matches who you are (rather than who you would like to be).



2. Estimate Realistic Monthly Expenses

As with any budget, your estimated monthly income requirements need to include quarterly and annual bills so you have what you need throughout the year. Ideally, you want to live comfortably on your income without withdrawing more than necessary. Many retirement account withdrawals are taxed as ordinary income, and a realistic understanding of your expenses will also help minimize your tax liability.

A second component to managing retirement expenses is to prepare for the unexpected. Whether it's a roof leak or a health issue, adequate savings and insurance create a net to protect and extend your retirement funds.

Take some time to discuss the significant issues with your family and financial advisor. How much do you need in liquid reserves? What are your best options in the case of an illness in the family?

For many people, the challenge of this step is formulating realistic expectations. There is no simple formula to calculate your retirement expenses because they depend on your lifestyle and geographic location. As a general starting point, you can estimate about 70% of the annual income you need when working. However, it's essential to do your research and think contingencies through before settling on a number.

Once your retirement income expectations are in place, you are ready to map out a strategy.

3. Make the Most of Tax-Advantaged Accounts

Regular savings or liquid investments are suitable for short-term financial goals or an emergency fund, but when saving for retirement, it's hard to beat the benefits of tax-advantaged accounts.

When you invest in a traditional IRA, 401(k), or a similar account, you add to your retirement savings and reduce your taxable income. That money can grow tax-free until you're ready to withdraw it in retirement.

Many people rely on their employers to establish retirement accounts, but IRAs and 401(k) are easily accessible to self-employed individuals and small businesses owners.

If you've maxed out your retirement account options, there are other tax-advantaged accounts to consider. For example, a health savings account (HSA) allows you to save for medical expenses. They are usually coupled with a high-deductible health plan.

If handled correctly, the funds are tax-free, and there is no time limit on when to use them. If you amass more funds that you can use for medical expenses, you can still benefit. After age 65, the HSA begins to act like a traditional IRA. Any distributions you take for non-medical expenses are taxed as income, while withdrawals for qualified medical expenses remain tax-free.

4. Pay Yourself First (and Keep Savings and Investments Separate)

Compound earnings are a powerful way to build wealth. The longer you can leave investment funds untouched, the more time they have to grow. However, retirement requires significant savings, and as the funds start to amass, it can be tempting to withdraw some funds to cover unexpected expenses or treat yourself to something nice.

The way around this natural tendency is to separate your savings and investments into different accounts, each with a specific purpose.

A simple way to think about these accounts is:

- Short term accounts
- A buffer
- Long term investments

The short-term accounts aim to provide emergency funds and your initial retirement income. It is meant to provide the security of three to five years of income. The short-term accounts can include savings and other conservative and highly liquid investments.

The buffer is an amount of money set aside to protect your long-term investments for as long as possible so that they can maximize their potential for compound earnings. It also gives you a layer of protection from economic contractions close to your retirement. Rather than drawing from the more aggressively-invested long-term funds, you have three to seven years of income in relatively conservative investments.

The long-term investments are meant to grow and compound as long as possible. The precise allocations between short-term, buffer, and long-term accounts will depend on your unique situation and risk tolerance.

Dividing your funds into different levels of risk permits you to take advantage of market opportunities while maintaining some income security. Your financial advisor can help you craft a specific investment strategy that matches your assets, age, and lifestyle.

Another way to pay yourself first is to invest any windfalls you receive for retirement. When you receive a nice chunk of money, like a bonus or an inheritance, it's tempting to spend it. However, when you invest that money and let it grow, you gift yourself an advantage that's hard to beat.

5. Be Smart About Spending and Debt

Some people associate budgeting or smart spending with deprivation. However, the real art of managing your money flow is to live well and enjoy life without excess waste.

There are often simple ways to trim expenses depending on your lifestyle and preferences. Do you have subscriptions you pay for monthly and never use? Are you letting credit card balances ride and collect interest when you have the funds to pay them down? If you wait another year for a new car, can you pay cash instead of taking a loan?

Ideally, you want to be free of significant debt obligations when you retire or shortly after. This includes your primary residence, if possible. However, balance any overpayments on your mortgage with potential earnings if that same money is invested in your financial strategy. Your financial advisor can help you navigate the best pathway between debt repayment and investment.

6. Determine a Sustainable Withdrawal Rate

Few retirees achieve complete financial independence, which means income from their investments covers their living expenses without ever needing to dip into the principal.

For most well-funded retirees, a sustainable retirement income involves establishing a withdrawal rate that allows you to spend annually from your retirement accounts without the worry you might run out of funds.

A safe withdrawal rate is generally between 3-4%, allowing the remaining funds to continue compounding and growing. You might need to adjust your rate up or down during retirement, but this range is a good starting point for planning purposes. The formula for the safe withdrawal rate is:

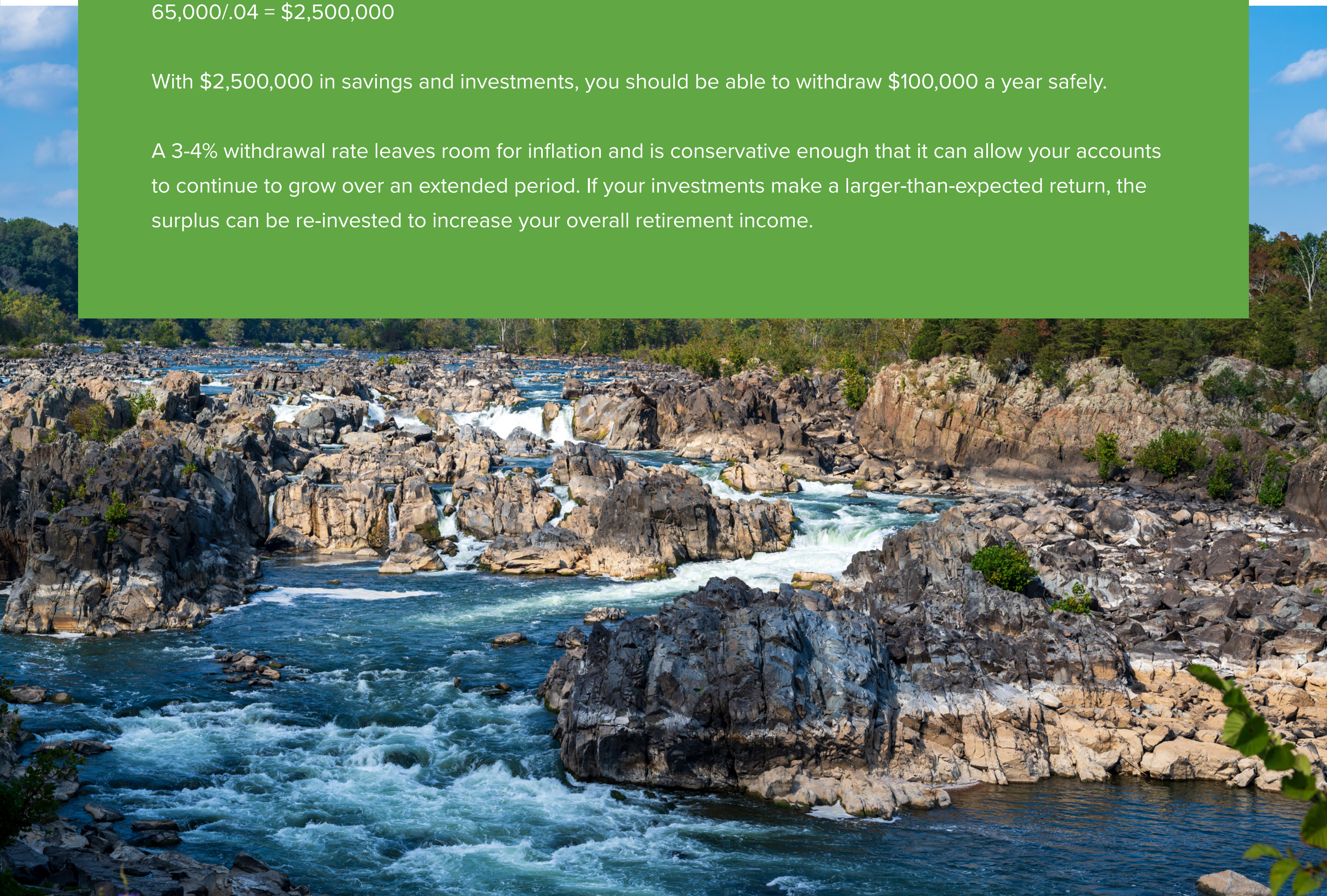
Safe withdrawal rate = annual withdrawal amount ÷ total amount saved

To calculate the principal you need for $100,000 in annual income, the formula for a 4% withdrawal rate is:

65,000/.04 = $2,500,000

With $2,500,000 in savings and investments, you should be able to withdraw $100,000 a year safely.

A 3-4% withdrawal rate leaves room for inflation and is conservative enough that it can allow your accounts to continue to grow over an extended period. If your investments make a larger-than-expected return, the surplus can be re-invested to increase your overall retirement income.



7. As Retirement Approaches, Lower Your Investment Risk

Risk tolerance and risk capacity are individual, and it's best to work with your financial advisor to customize your investment approach to match your assets, personality, and goals at any stage of life. In general, as you approach retirement, you'll want to lower your investment risk, especially if the majority of your funds or essential income funds are in more volatile market sectors.

Historically, market values rise over time. However, there can be steep dips within that rise, and you want to protect core and essential assets from potential volatility when you need them soon.

Another way to reduce risk is to ensure you have adequate insurance. From medical coverage and life insurance to long-term care insurance, it's better to have a safety net you never use than to get caught unprepared.

Consider a range rather than a hard and fast number as you think of your target retirement age. A flexible retirement age range gives you the power to adapt to life circumstances and respond to opportunities. You may find yourself motivated to retire early or arrive at your expected retirement age and want to continue working or running your business for a few more years.

8. Consider Part-Time Work or a Side-Business

With retirement spanning decades for many Americans, even individuals with ample savings and investments worry about running out of retirement funds or not having enough to leave to future generations. Alternatively, some people want to spend more in retirement or enjoy staying busy. These are all valid reasons for continuing to work part-time or starting a side-venture in retirement.

Work means different things to different people, especially in retirement. It can be staying active and involved in something meaningful to you or following through on a hobby you never had time to enjoy. If you decide to continue working for a while after you retire, let your interests lead you.

Some people dread the end of their working life because they imagine having too much time and being bored. If that's your motivation for working, you might want to consider other ways to stay active and involved. Give retirement a chance – there are many wonderful things to do! You can join a public speaking club like Toastmasters, get involved in community service, plant a garden, restore cars, learn something new; the list is endless.

Some hobbies and skills can be turned into real income in your retirement years if you choose to do that. Give yourself time to get oriented in your new lifestyle and stay open to possibilities.

9. Include Your Spouse in the Conversation

Transitions of any kind can stress your relationship, and retirement is no exception. Include your spouse in the planning as you think about your retirement lifestyle. It is constructive to have candid conversations about retirement, including any dreams or concerns they may have about the future. Making decisions together ensures both people are comfortable with the plan.

A good retirement income plan needs to account for both people with contingencies in place so that neither is left to struggle financially if the other person dies or goes through a protracted illness.

10. Get a Second Opinion

Don't leave your retirement income to chance or speculation. Review your retirement plan regularly with an expert. The right financial advisor can help with wealth management, retirement planning, insurance planning, tax planning, business succession planning, and your estate plan. A fee-only fiduciary CFP® (CERTIFIED FINANCIAL PLANNER) can act as a general advisor and help you coordinate with other professionals, like an estate attorney and accountants.

It's also important to check in with your investment strategy regularly. The market changes steadily, and risks and opportunities also evolve with it. Regular check-ins help ensure you have the money you need when you need it.

Enjoy Life Now and Later

Establishing a sustainable retirement income plan is a relatively simple process if you make a consistent effort over time. The first step is to prioritize your financial well-being by reducing expenses and debt and making regular contributions to savings and investments. As you get closer to retirement, adjust your investments and create safety nets for you and your family.

If you have questions about your retirement plan or what it will take for you to establish a sustainable retirement income, the team at Brown Miller Wealth Management is here to help. You can find out more about our process or set up a time to talk with us on our website.

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