11 RETIREMENT REALITIES YOU NEED TO PLAN FOR

2022 Edition

Transitioning from working and earning a paycheck, to living off your savings is a significant lifestyle change.

So, you need to prepare accordingly. There are new things to learn, new rules and regulations, new opportunities and new challenges. And on top of all of that, you will also be facing new financial realities. The better you understand these new possibilities, the better you can prepare for a successful and happy retirement.

This guidebook is designed to help you examine 11 areas of your life that you should consider when making financial decisions, both now and in the future. Inside you'll read about explanations of tactical issues, like planning for taxes on your Social Security benefits, as well as strategic opportunities, like optimizing asset allocations to weather market changes.

How you plan for retirement can make a big difference in your financial well-being. Read on to learn about each of these retirement realities and how taking steps now can ensure that you are able to enjoy your retirement years with confidence.

> **"How you plan for retirement can make a big difference in your financial well-being.**

Here are 11 retirement realities we discuss in this guide:

1. The age you retire will affect your retirement income.
2. You shouldn't retire your emergency fund.
3. You still need to pay income taxes.
4. Your Social Security benefits can be taxed.
5. Working in retirement could reduce your Social Security benefits.
6. Your expenses in retirement may go up—not down.
7. Medicare doesn't cover everything.
8. Rising inflation may threaten your standard of living.
9. You're more vulnerable during market declines.
10. Your nest egg needs to last 30 years, maybe more.
11. Things will get more, not less, complicated.

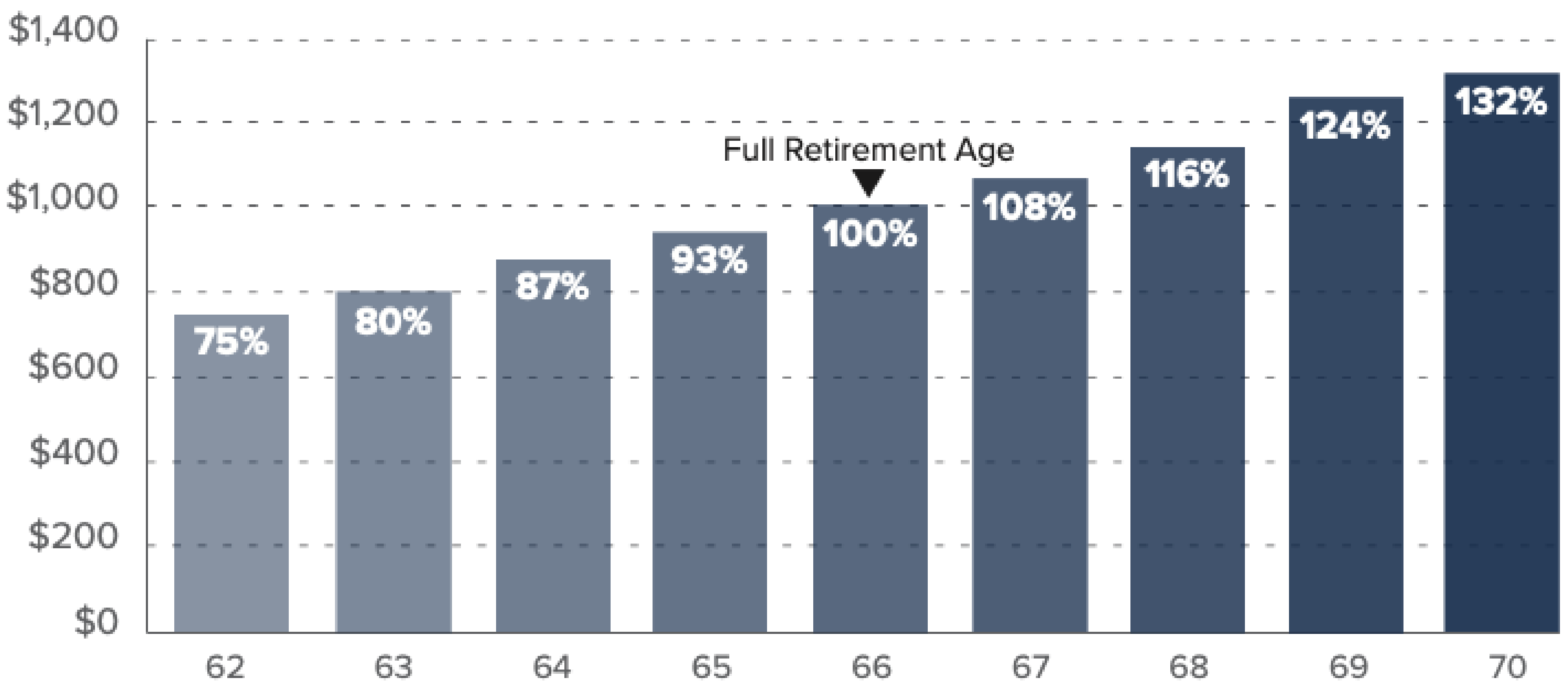
ONE

The age you retire will affect your retirement income.

Deciding at what age you're going to retire is both a lifestyle and a financial decision. As you near retirement, it's important to explore the financial implications of your retirement timeline. Retiring early means you'll have more time to enjoy your new lifestyle, but fewer years to accumulate wealth. On the other hand, waiting to retire will give you more time to build your savings, but leaves you less time to enjoy a well-deserved reprieve from the working world.

Depending on the year you were born, your full retirement age (FRA) will be between ages 66 and 67. You may begin drawing Social Security as early as age 62, but by withdrawing before your FRA, your benefits will be permanently reduced by up to 30% of their full value. On the other hand, as shown below, delaying your retirement beyond your FRA increases your total benefit amount by 8% per year.

EARLY VS. LATE SOCIAL SECURITY ELECTION



Source: Social Security Administration. Assumes birth 1943-1954 with hypothetical $1,000/month FRA benefit.

Another way your retirement age impacts your finances relates to health insurance coverage. If you plan on retiring early, you'll need an insurance plan for the years before Medicare benefits begin at age 65. If you've benefited from employer-subsidized health insurance, be prepared for more expensive annual premiums. For example, in 2016 the average annual health insurance premiums for an individual age 55-64 was $6,960 and the average deductible was $4,358 ($11,318 per year out-of-pocket).[1]

If your goal is to retire before age 65, make sure to plan now for health insurance needs. Even the best insurance may not cover all of your expenses in case of a medical emergency. Fortunately, you can take steps to help ensure you're protected no matter what life throws at you—which brings us to our second retirement reality.

[1] eHealth's Health Insurance Price Index report for 2016. https://resources.ehealthinsurance.com/affordable-care-act/much-health-insurance-cost-without-subsidy

TWO

You shouldn't retire your emergency fund.

One key tenant of personal finance is having an emergency fund for financial rainy days. A common rule of thumb is to set aside about six months' worth of income, which is easy to calculate when you are working full time. However, since you are withdrawing from savings in retirement, you may not think you need an emergency fund, but you do. We recommend having enough cash set aside to cover six to 12 months of living expenses, both before and after you retire.

While that money will come in handy if you need a new water heater or refrigerator, you may also find yourself opening your checkbook for your aging parents or adult children. Maybe you want to help a child with a down payment on a house or help put a grandchild through college. Or, perhaps you find yourself helping to pay a parent's medical bills after an illness. Whatever the occasion, having immediate access to cash means you have more flexibility when needed.

THREE

You still need to pay income taxes.

In the same way it's easy to assume you no longer need an emergency fund in retirement, it's also a shock to some that you must also pay income tax when you are no longer earning an income. You'll continue to pay taxes at ordinary rates on withdrawals made from tax-deferred accounts, like traditional IRAs or 401(k)s. That means if you rely on traditional IRA and 401(k) withdrawals for a substantial portion of your income, you may still pay a significant tax bill. This is why it's important to incorporate tax planning strategies into your retirement savings plan.

While you can't escape taxes, you can put measures in place to minimize your tax liability and its impact on your standard of living. By converting some of your tax-deferred IRA savings into a tax-advantaged Roth IRA, you can potentially save big in the long run by paying taxes when you're in a lower tax bracket. Figuring out when and how much to convert requires careful analysis, so make sure you work with a tax specialist before completing a Roth conversion.

While the fact that you have to pay taxes in retirement won't change, how you pay them may. When you are an employee, your employer withholds taxes from your paycheck on your behalf. When you file your annual tax return, you compare your withholdings with what you owe and either write a check or get a refund. Throughout your retirement, you should work with your advisor to withhold taxes or plan to make quarterly estimated tax payments. Otherwise, you could find yourself owing the government a hefty sum of cash when tax time rolls around.

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FOUR

Your Social Security benefits can be taxed.

Another tax item to keep in mind during retirement is that your Social Security benefits can be taxed at ordinary income tax rates as well, depending on your provisional income. Provisional income includes practically every source of income such as:

- Wages
- Pensions
- Annuities
- Dividends
- Investment returns
- Interest from tax-exempt bonds
- 50% of your Social Security benefit

For example, a married couple with an annual income between $32,000 and $44,000 would pay income tax on up to half of their Social Security benefits. The chart below shows provisional income levels and the percentage of Social Security benefits taxed for both single taxpayers and for married taxpayers filing jointly.

It's important to be aware of these thresholds, especially if you are near the $34,000 (for single filers) or $44,000 (for married filers) levels. There are planning strategies available to help reduce the tax burden on your Social Security benefits. If you think you might fall near either of these income thresholds, working with a financial advisor and/or a tax specialist now can help you put beneficial strategies in place for the future.

	PROVISIONAL INCOME	% OF BENEFIT TAXED[2]
Single	<$25,000	0%
	$25,000 - $34,000	50%
	>$34,000	85%
Married Filing Jointly	<$32,000	0%
	$32,000 - $44,000	50%
	>$44,000	85%

[2] Data updated as of June 22, 2018. Source: www.ssa.gov/planners/taxes.html

FIVE

Working in retirement could reduce your Social Security benefits.

To make things even more confusing, there is another important rule you need to know concerning Social Security, earned income, and full retirement age (FRA). Here's how it works:

BEFORE YOU REACH FRA

You're allowed an employment income of $17,040 per year, or $1,420 per month (in 2018), without impacting your benefits. For every $2 you make over the limit, your benefits are reduced by $1. Only income earned after you start receiving benefits counts toward the annual limit, therefore depending on the month you start receiving benefits your limit could be less than $17,040. So, if you begin Social Security in July, your income earned prior to July doesn't impact your benefit amount and you can earn up to $1,420 a month or $8,520 through the end of the year, without impacting your benefits.

ONCE YOU REACH FRA

Your Social Security benefit amount is reduced by $1 for every $3 you earn over $45,360. *Note, only income earned before the month you reach FRA counts toward the limit.*

AFTER YOU REACH FRA

Beginning with the month you reach FRA, earnings no longer reduce your benefits.

As an example, let's say you started taking Social Security at age 63 while working part time and earning $30,000 a year. Let's also assume your birthday is in September and you will reach FRA. The table below shows the amount your benefit would be reduced each year.

SOCIAL SECURITY EARNINGS[3]

	BEFORE YOU REACH FRA	ONCE YOU REACH FRA	AFTER YOU REACH FRA
Earnings	$30,000	$30,000	$30,000
Earnings Limit	$17,040	$45,360	N/A
Amount Over Annual Limit	$12,960	$0	N/A
Benefit Reduction	$6,480	$0	None

Whether for lifestyle reasons or just to stay active, you may decide a temporary reduction in benefits is worth the trade-off of additional income after retirement. The key is to know your options ahead of time to avoid unpleasant surprises down the road.

[3] Social Security Earnings: www.ssa.gov/planners/retire/whileworking.html

SIX

Your expenses in retirement may go up—not down.

This reality might surprise you. You're likely to spend more when you initially retire than you did when you were working.

The rule of thumb is that you should aim to replace 70% of your pre-retirement income. However, that's not always going to be enough.

Despite having fewer general expenses, the idea that spending goes down in retirement is a myth. While you may not be spending money on commuting expenses, or paying FICA and Medicare taxes, you will likely travel more, eat out more often and may even spend more on hobbies or entertainment. Moreover, some of your largest expenses may still remain as more people are starting their retirement with years of mortgage payments left, sometimes on more than one home.

HERE'S WHAT WE'VE SEEN.

Retirees in their 60s actually increase their pre-retirement spending as they enjoy the freedom of this new stage in life. They are having well-deserved fun, which often costs money.

Those in their 70s start to slow their spending until they fall back below pre-retirement spending levels. Mortgages are usually paid off, even on second homes, and they've settled into a comfortable routine.

For individuals in their 80s, personal expenses may go down even further with one exception—health care costs.

It's important to keep in mind that the more money you spend early in your retirement, the faster you draw down your investments. Having a distribution plan that will allow you some financial freedom in the early years, while ensuring you have money left to meet your long-term needs is vital. By working with a financial advisor who is versed in both accumulating and disbursing wealth, you can get on track for the retirement you've earned.

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SEVEN

Medicare doesn't cover everything.

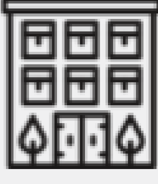
As helpful as Medicare is, without supplemental insurance, it won't cover all of your medical expenses. And not having a supplemental plan could mean that you have to spend more money than we've previously outlined.

If you retire before Medicare eligibility starts at age at 65, you'll likely need to purchase individual insurance to cover medical expenses. Once you become eligible, remember that Medicare coverage is limited. Supplemental insurance plans can cost $150-$300 per person, per month—and that's before considering the costs of prescription drugs.

Another gap in Medicare coverage is long-term care. Generally speaking, Medicare does not cover the cost of treatment in long term care facilities, although there are limited exceptions. Considering that the average amount of time in long-term care for women is 3.7 years, and men is 2.2 years, those costs can add up quickly.[4]

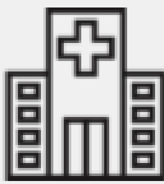
Consider a couple where only one spouse is in long-term care. If the sick or injured spouse is in a nursing home, the average cost of their care over three years could be nearly $300,000. At the same time, all the regular at-home expenses of the other spouse still continue. Combined, these expenses could lead to financial ruin without proper planning.

REALITIES OF LONG-TERM CARE COSTS[5]



Assisted Living Apartment...........**$45,000/year**

Home Health Aide.........................**$49,188/year**



Nursing Home Private Room.......**$97,452/year**

We recommend applying for long-term care insurance in your 50s because the longer you wait, the higher your premium costs will be and you could be denied coverage if health issues surface as you age.

Fortunately, there are many long-term care policies available today with a variety of premium, coverage and deductible options. A financial advisor that understands your unique circumstances and who has access to insurance experts can help you understand your options and pick the most appropriate plan for you.

[4] Average amount of time in long-term care: https://longtermcare.acl.gov/the-basics/how-much-care-will-you-need.html
[5] Realities of Long-Term Care Costs: www.genworth.com/aging-and-you/finances/cost-of-care.html

EIGHT

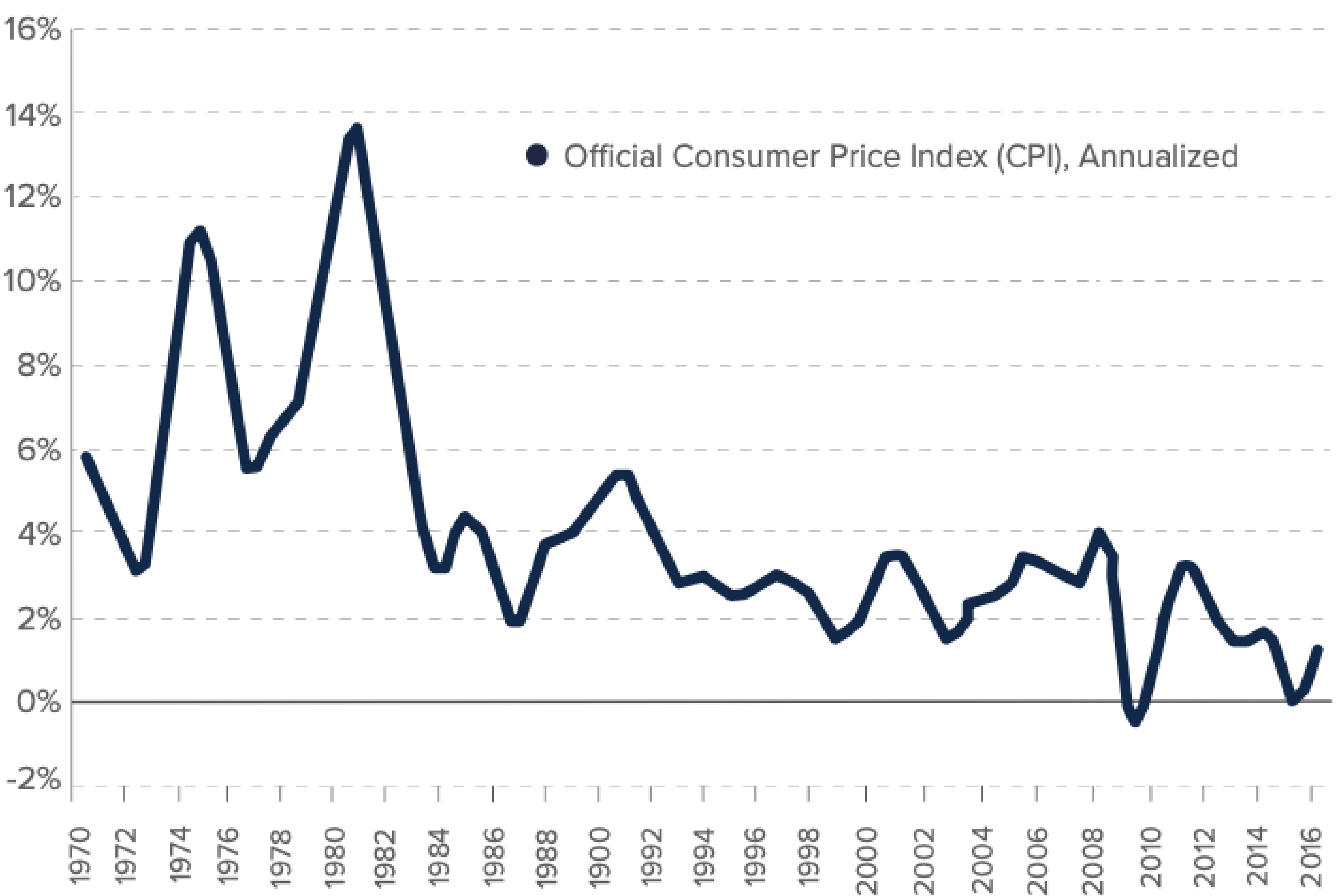
Rising inflation may threaten your standard of living.

It's not always expenses that will eat into your savings. Sometimes, it will simply be the rising cost of living.

Inflation in the cost of goods and services, as measured by the Official Consumer Price Index (CPI), has averaged about 3% a year. As you can see from the chart below, we are in a period of very low inflation. You can also see that the rate of inflation varied quite a bit over the 30 years spanning 1980-2010. That's why it's smart to plan for inflation to raise the cost of living about 3% per year.

AVERAGE RATE OF INFLATION

U.S. Consumer Inflation | Official vs. ShadowStats (1980-Based) Alternate



While 3% may not sound like much, here's how it breaks down. If you need $50,000 per year to live as a retiree today, assuming a 3% inflation rate, in 25 years you'll need $100,000 per year to maintain the same standard of living. That's because every year, the value of your savings will fall by 3%, which adds up to reducing your buying power by 50% over 25 years. Social Security is adjusted for inflation, giving you some measure of protection, but keep in mind your specific inflation rate might be different from the general inflation rate as a result of rapidly rising health care and long-term care costs.

If you're having trouble wrapping your head around this idea, here's another example. The table below shows the cost of a cup of coffee, a movie ticket, a mid-range sedan and the average home price in 1980 dollars, today's dollars and the projected cost in 2040.

RISING COSTS[6]

COMMON EXPENSES	1980	Today	2040
(coffee)	$.45	$3.16	$6.05
(movie ticket)	$2.69	$9.18	$17.59
(car)	$7,210	$35,444	$67,914
(home)	$70,725	$250,400	$479,792

As you can see, you have to keep your investments growing throughout retirement to keep your standard of living consistent. While investing in CDs and low-yield, low-risk bonds may feel safe because your principal is protected, that doesn't take inflation into account. These low risk accounts only assure a reduction in your buying power over time.

Growing your savings to keep up with inflation, while simultaneously making withdrawals is complicated, but with the right plan in place, it's achievable.

[6] Rising Costs: Data for 1980 and today (May 2018) from Bureau of Labor Statistics, National Association of Theater Owners, U.S. Census National Association of Realtors. 2040 data calculated using 3% rate of inflation.

NINE

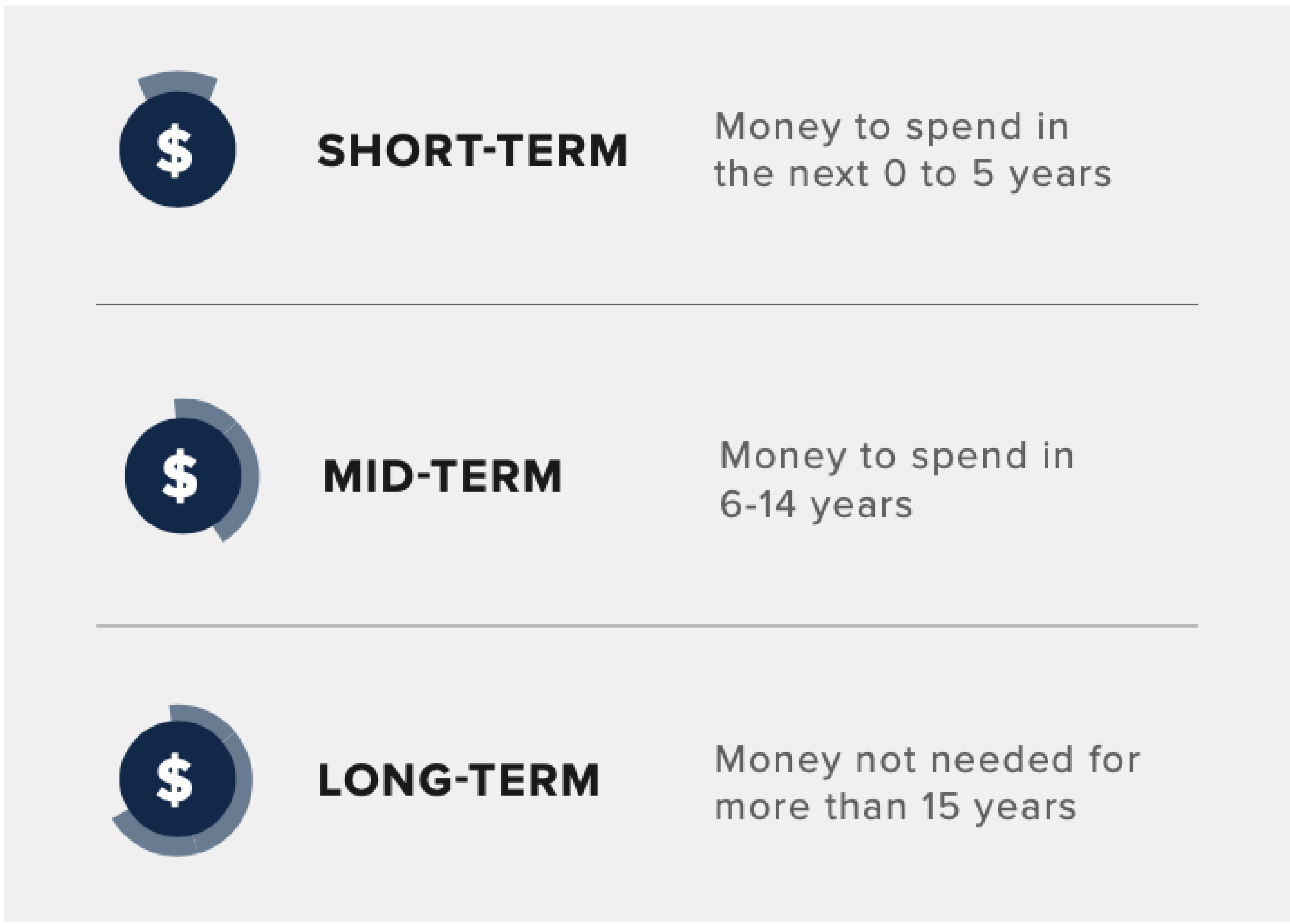
You're more vulnerable during market declines.

As the saying goes, “It's not if, but when.” Bear markets (and recessions) are a fact of our economic system and while most are not as severe as the recession of 2008 and 2009, they still happen.

A bear market is defined as a 20% or more drop in stock market value. While past performance is no guarantee of future results, historically, the stock market has always come back after a bear market run, and usually over a relatively short time period. However, if a bear market hits when you need to withdraw money from stock-based resources, it can be devastating to your retirement savings. And because it's highly probable that you'll experience one to three bear markets during your retirement, you need to be prepared when planning for your future.

Ideally, you don't want to resort to using stock-based savings for living expenses, especially when the market is down. That's why it is so important to diversify your assets according to your withdrawal timeline.

You should think of assets as falling into three main buckets:



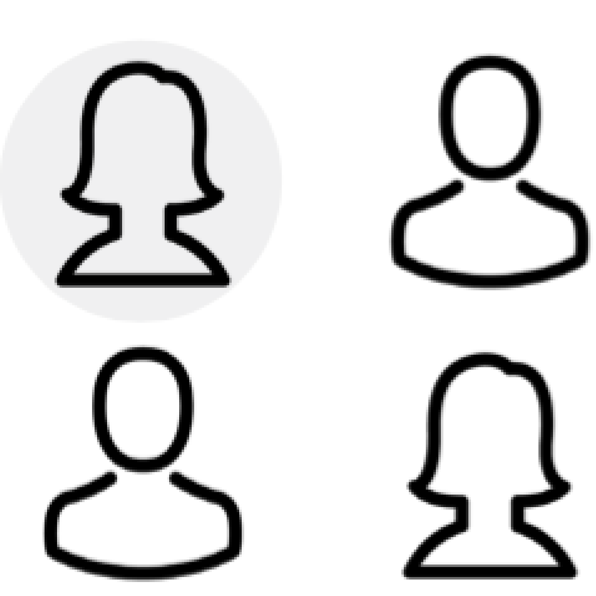
Once you have your buckets, you can apply the proper investment strategy for each. They should be set up to meet your needs now, but can be rebalanced over time or as circumstances change. Each bucket should also be diversified based on your overall goals, risk tolerance and income needs.

Setting up and managing this three-tiered investment plan is both an art and a science—and it requires a deft touch to balance both money and emotions. A skilled financial advisor can help you find the balance by providing you with a level of financial confidence while simultaneously helping you combat inflation.

TEN

Your nest egg needs to last 30 years, maybe more.

Along those lines, one of the biggest retirement concerns for people is that they'll outlive their savings. In our experience, most people underestimate their longevity. While it's impossible to know how long you'll live, you should plan to have your retirement savings last 30 years or more. According to the U.S. Census Bureau, the average American's life expectancy is 79 years. For people who reach age 65, their average life expectancy increases to around 85 years.



ONE IN FOUR PEOPLE who reach 65 will live past age 90.

So, let's say you retire at age 62 and live to age 97. That's a 35-year retirement you have to fund. And it's not just living expenses you need to consider. There's also inflation, health care costs, legacy planning, taxation, market volatility and unforeseen emergency costs. It's a lot to consider and it can feel overwhelming. Having a comprehensive financial plan that's tailored to your unique circumstances and values can help you be prepared for a long, happy retirement.

ELEVEN

Things will get more, not less, complicated.

With longer lifespans, inflation cutting into savings and the complexity added by tax laws and other public policy measures, retirement planning is going to become more complicated as time passes.

You'll need to stay organized and on top of complex and changing tax, estate and legal regulations to ensure your assets are protected. The closer you get to retirement, the bigger your nest egg becomes, which means higher stakes and less room for error.

Take a proactive approach and implement the strategies discussed in this guidebook today.

> “ **Having a comprehensive financial plan that's tailored to your unique circumstances and values can help you be prepared for a long, happy retirement.**

Book a free strategy consultation call by clicking the link in the email this guide was sent to you in.

Talk To You Soon!