3 Phases of Financial Planning in Retirement

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When I first started assisting clients in preparing for retirement nearly three decades ago, we generally planned for about 20 "Golden Years." Life expectancy has increased so much that for healthy retirees in their early 60's we now plan for 30 to 40 years. Many experts now predict that with continued advances in treating chronic diseases and improved understanding of individual genetics, living to 100 will soon be almost commonplace. As a result, we encourage clients to view retirement as a series of phases instead of just the final stage of life. This requires taking a fresh look at the progression of income and expenses and to consider new and creative withdrawal and estate planning strategies.

Traditionally, retirement income planning has been a very linear projection of the same level of income needs annually with an annual adjustment for inflation. A phased approach to retirement income considers the impact of a more active lifestyle in the early retirement years and any "semi-retirement" working income. The desire to remain active in their 60's and 70's motivates many to "reinvent" themselves by working part-time in a new field, starting a business and finding a new balance between work and leisure. It can also be an opportunity to serve others by volunteering for worthy causes in the community.

As a result, early retirees may need less portfolio income in the early years, with increased amounts in later phases. Others may choose to retire completely and immediately trigger income from all available sources. Many choose to focus on hobbies, adventurous travel and family vacations, requiring more portfolio income in the early years; and a scaling back of both income and lifestyle in the middle and late years.

The Early Years: Income and Tax Planning

Early semi-retirees who continue to generate substantial employment earnings may bump themselves into a higher marginal tax bracket in 2016. Retirees who collect Social Security before the year of their full retirement age will see their benefits cut $1 for every $2 earned above $15,720 annually. They may also owe taxes on up to 85% of the Social Security benefit. Increased life expectancy and semi-retirement income may allow those with sufficient earnings and dividend income to delay taking a reduced social security benefit. For each year social security is delayed beyond full retirement age until age 70 filers will receive a benefit increase of 6% to 8%.

Another strategy designed to stretch investments over an increased life expectancy is to delay withdrawals from pre-tax retirement accounts until required at age 70½ and instead spend investment portfolio dividends, interest and possibly even some or most of the capital from your non-retirement accounts. Conversions of Roth IRA's from traditional IRA's should also be considered if the current marginal tax bracket is substantially lower than what it is estimated to be after 70 when the required distributions kick in.

The Middle Years: Distributions and Lifestyle Changes

Required minimum distributions from traditional IRA's and retirement plans must begin by April first of the year after you reach 70 ½. There is a steep 50% penalty for any amount not withdrawn. It is important to adjust other sources of income if possible once required distributions begin and withdrawal strategies should be revised annually. As you enter your 70's it may be time to do a deep dive analysis of your portfolio allocation if you are still relatively healthy and active. Does it have enough growth potential to keep pace with inflation? Or, if you have experienced significant growth in the early phase of retirement, it may be time to dial back on risk assets to minimize the impact of a deep and sustained drop in the stock market on long term values.

Toward the end of the middle years, it is a good time to consider downsizing from your primary residence and potentially excluding up to $500,000 of gains from taxes on the sale. If your plan is to remain in your current home, consider improvements like downstairs bedrooms, walk-in showers and stair lifts which will make it easier physically for you to remain in the home.

If your income and investments are substantially more than you will ever need, consider a focus on charitable and family gifts for your grandchildren's college or commit to funding a destination vacation for your family annually.

Later Years: Your Legacy

We spend a lot of time consulting with our clients who are in their 80's and 90's discussing how they can have the greatest financial impact on their family and favorite charities. One of our favorite strategies is to make their favorite charities the beneficiaries of IRAs and retirement plans (charities pay no taxes, but family members will be subject to taxation) and have the family inherit real estate and non-retirement investment assets-- which receive a step-up in cost basis at death. In addition, many families choose to gift their camp or cottage to their children or to a trust or limited liability company. Potential benefits are a reduction in estate taxes and the ability to keep the property in the family for generations.

In your later years it's important to review all of your estate planning documents with your attorney and or financial advisor to ensure that all reflect your goals for distribution of your assets. It has been said that most people spend more time planning for a family vacation than they do planning for retirement. Retirement has in many ways become like a "phased" vacation…. which could last 40 years! If your goal is to have most of these years be golden ones, commit to working with your financial advisor to create, review and adjust your overall plan as you move through these different phases of retirement.

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