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Remember story problems from high school math? Try this one, taken from an October 2013 *USA Today* article:

Assume that:

> **R - is the amount of money you'll need to retire.**
> **X - is the number of years you'll live.**
> **Y - is your rate of return.**
> **Z - is the rate of inflation.**
> **You have no idea what X, Y, or Z is.**

Solve for R.

This is the reality of retirement planning. While there are many after-the-fact aspects that can be quantified by numbers (accumulation values, rates of return, asset allocation percentages, etc.), success can't be guaranteed by adherence to a mathematical formula. *Because there are too many unknown variables.*

Instead, retirement experts often rely on rules of thumb for guidance. These standards are not exact, but if followed, they give individuals a reasonable chance for success. Many of these rules of thumb are for saving, how much you should set aside each year, the returns you should expect on these deposits, and how big an accumulation you'll want before you retire.

Using these benchmarks to guide the accumulation phase of retirement planning is easy and has little risk. If, for whatever reason, you don't save as much or receive the expected returns, you can adjust. You can save more, reallocate assets, work longer, or reframe your retirement goals.

It's when you get to retirement, to actually spending what you've saved, that using rules of thumb becomes a bit more challenging. Because, if reality doesn't match the assumptions, it's not as easy to adjust, and the consequences may be dire. An example is the Safe Withdrawal Rate.

The Safe Withdrawal Rate

The ultimate objective in retirement planning is to provide the largest possible income from accumulated savings without running out of money. Maximizing income requires the spending down of accumulated principal (as opposed to just drawing off the earnings). But how much can be spent down? That's the question the Safe Withdrawal Rate attempts to answer.

A **Safe Withdrawal Rate** (SWR) is an amount, usually expressed as a percentage, which can be withdrawn over a given period, and not lead to portfolio failure; i.e., running out of money. "Safe" is an SWR expected to have a success rate of 95% based on historical returns over the past 100 years or so. A Safe Withdrawal Rate also usually includes annual adjustments for inflation.

From its introduction as a rule of thumb in the 1990s, a prevalent safe withdrawal rate for a 30-year retirement has been 4 percent. However, several periods in the mid- to late-20th century featured atypically high returns. With a growing consensus that future returns will not consistently reach the highs of the recent past, and with lifespans continuing to inch up, many experts believe the SWR should be adjusted down.

In This Issue…

Now, “3 percent is the new safe withdrawal rate,” says Wade Pfau, a professor at the American College of Financial Services, who is sort of the Albert Einstein of SWR studies. “The 4 percent rule may be too high for those focused on identifying a sustainable withdrawal rate that will not deplete a portfolio over a 30-year period.” This means…

If you have accumulated $1 million for retirement, an SWR of 3% results in a first-year retirement income of $30,000. With a projected annual inflation rate of 2%, next year’s income would be $31,600, and $32,212 in the third year. After 30 years, the total annual income would rise to $53,275.

What If 3% Isn’t Enough?

Lowering the SWR to 3% means a larger accumulation is required to produce the same income. If a first-year income of $40,000/yr. would allow you to retire at 65, a Safe Withdrawal Rate of 4% means accumulating $1 million. To produce the same income with the SWR at 3%, the capital requirement is 33% more, $1.33 million. If you’ve been saving with a 4% SWR in mind, this change could upset your plans, especially if you are close to retirement, and don’t have much time to accumulate additional capital. So what can you do if you want, or need, to spend more than 3 percent?

That’s a question *Wall Street Journal* personal finance writer Anne Tergesen put to several retirement experts in a February 10, 2018, article. Their response: start with a higher withdrawal rate, but be prepared to forgo inflation adjustments, and even reduce income, in the future. One scenario starts at 5%, but stops making inflation adjustments in any year when principal declines. Another begins at 5%, but requires a 10% reduction if the previous year’s withdrawals and investment results make next year’s income greater than 6%, because this indicates that principal is being consumed too quickly. (But you can give yourself a 10% increase if the amount drops below 4 percent.)

But whether you use a safe withdrawal rate or a less-safe modification of it, you alone are responsible for the management and investment risks associated with this approach. And this responsibility isn’t just at the beginning of retirement, but for every year thereafter. Maintaining a Safe Withdrawal Rate requires a lot of work, and a lot of money, and at least a little anxiety. Because, it’s up to you to *not* run out of money.

Given these challenges, it is somewhat surprising that other retirement income strategies don’t seem to get the same attention as SWRs. Like one that eliminates personal management and investment risk, requires less capital, provides more income – and ***guarantees*** you will not run out of money.

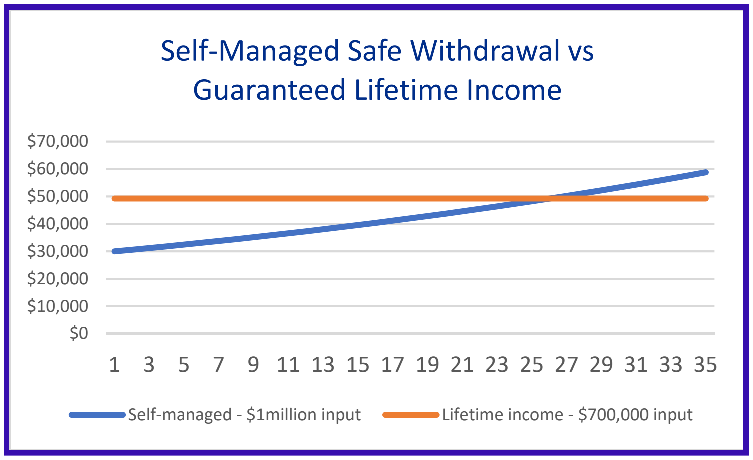
Joining a Group, Buying Guarantees

Individual retirement planning requires each household to account for every possible X, Y, and Z variable by themselves. But when individuals elect to become part of a large group of retirees who pool their funds under an insurance company’s management, in exchange for monthly payments, the math changes.

Instead of one person with an uncertain lifespan, retirees are members of a group with fairly well-defined life expectancies, i.e., out of this cohort, x number will die each year. These very accurate projections allow actuaries to guarantee lifetime payments for all participants. Thus, it becomes possible to make withdrawal plans not on an uncertain, changing rule-of-thumb basis, but from calculations with a high degree of certainty.

Suppose instead of committing the entire $1 million to an SWR plan, a 67-year-old male allocates $700,000 to purchase an immediate lifetime annuity, from which an insurance company promises to provide an annual income of $49,464 for the rest of the retiree’s life, no matter how long he lives.*

Compare this result to the income resulting from a safe withdrawal rate of 3% applied to a $1 million accumulation, with a 2% annual increase for inflation.



Some notes:

- The historic results of a self-managed SWR option would vary depending on the actual rate of inflation. The projection of 2% is close to the most recent 30-year average, and is also the Federal Reserve’s target number.
- The gradually rising income from a 3% safe withdrawal rate doesn’t exceed the guaranteed lifetime income from the $700,000 immediate lifetime annuity until year 28.
- A decision to use an annuity for income leaves $300,000 of “free capital,” i.e., money that doesn’t have to provide retirement income. This free capital can be invested, spent, serve as an inflation adjustment in later years, or left as an inheritance.
- The annuity transfers all management and investment risk to the insurance company.

So…are you sure you want to manage a safe withdrawal rate for the rest of your life?

“Yeah but...”

For someone who lives past life expectancy, a lifetime annuity is a great decision. But what about other situations? Like what if the $1 million has to provide income for a 65-year-old wife, and the husband dies first? Among the possible options:

Buy a lifetime annuity that will guarantee payments as long either one is alive. For $700,000, a joint life annuity provides $39,312 of annual income, which is still 31% more than the SWR starting at $30,000. The crossover doesn’t occur until year 18, and there is $300,000 in reserve to supplement income.

Buy the annuity on the husband, and invest the remaining $300,000. If the husband dies first, the accumulation can buy a life annuity for the surviving wife. If the husband lives to 80 before passing, that’s 13 years of accumulation. At an average annual return of 4%, $300,000 grows to $480,000. Using today’s rates, a lifetime annuity for a 78-year-old female would provide an annual lifetime income of $44,750 – for just one person, not two.

The very worst case would be for the husband to die shortly after starting the annuity, leaving his widow with the smallest principal and the longest period for which to provide income. This scenario could be addressed, if the husband is in good health, by **buying a $700,000 life insurance benefit on the husband** (perhaps using some of the "free capital"), to replace the annuity principal.

There are ways to address these challenges. Details will vary with individual circumstances, but the guarantees of an annuity might prove better than a safe withdrawal rate for both income and security. ❖

If you haven't yet considered how joining a group and buying guarantees might work, this article is a good starting point.

The next step is meeting with a financial professional to see what variation of this concept might work for you.

* An annuity guarantee is based on the claims paying ability of the issuing company.

In the wake of the greatest shift in tax policy in 30 years, financial professionals are scrambling to assess the impact of the changes which went into effect on January 1, 2018. In general, the new tax plan lowers tax rates while eliminating or decreasing deductions. But many households won't know if the changes improve or worsen their tax status until the year ends, and a return is filed.

Then the ripple effects will begin, because every tax produces unintended consequences. The challenge for tax planners is to connect the obvious and immediate impacts with not-so-obvious and usually unforeseen ripple effects.

More and Less…but of What?

President Reagan was fond of repeating this simple explanation for how taxes affect the economy: **"If you want more of something, subsidize it. If you want less, tax it."**

Deductions from taxable income are subsidies. When deductions are eliminated, it is the same as imposing, or increasing, taxes. But when you decrease tax rates ***and*** deductions, what will happen? Considering history, the answers could be interesting.

Will High-Income Homeowners Mow Their Lawns?

On personal returns, all households will receive a significantly higher standard deduction. But the increased exemption is paired with lower limits for itemized deductions, particularly for homeowners. The limits for deductible mortgage interest are reduced, and the amount of state and local taxes, including property taxes that can be taken as additional deductions, is capped at $10,000. This shift is significant. A February 2018 analysis from Zillow estimates that "only about 14% of homeowners, down from 44%, will claim the mortgage interest deduction next year."

For lower- and middle-income homeowners, the new standard deduction may exceed their previous itemized deductions for home ownership, with a net effect of less taxable income. But those with higher incomes, who previously received tens of thousands of dollars in deductions for large mortgages on homes in communities with high property taxes, could find themselves in a curious reversal: in a lower marginal tax bracket, but with more taxable income.

The Obvious: For high-income households, the cost of owning a large home and living in a community with high property taxes is now greater.

A possible, not-so-obvious ripple effect: Landscapers go out of business?

Remember, ripple effects are not immediately apparent, so this is a hypothetical. But suppose the decrease in housing and property tax deductions results in a household with an adjusted gross income of $350,000 paying an additional $5,000 in income taxes. This additional tax probably doesn't cause the homeowners to consider selling and moving to a less-expensive home. But it could certainly affect how much is spent on landscaping and lawn care. Maybe the family cuts the grass themselves, or puts up a canvas canopy instead of having a deck built. With money that could have paid landscapers and lawn care now going to the IRS, these small companies will either be less profitable, or worse, out of business.

Golf Gets Sliced Out?

A similar exchange of lower rates and fewer deductions affects business taxes as well. Entertaining customers, clients and other business contacts has long been essential to developing relationships and getting deals done. Now, many of these "costs of doing business" are no longer deductible.

While no change was made to the 50% deduction for business meals, the new rules eliminate the deductibility for many other business-related entertainment expenses, such as: the cost of tickets to sporting events, license fees for stadium or arena seating rights, private boxes at sporting events. theater tickets, golf club dues, company golf outings for customers, hunting, fishing and sailing outings, etc. In short, a lot of corporate perks are no longer subsidized.

The Obvious: For businesses, the cost of entertaining clients and prospective customers has gone up.

A possible, not-so-obvious ripple effect: Golf dies out?

In both the personal and business examples, the loss of subsidy results in higher costs – for owning a home, or operating a business. The logical response is to reduce other operating costs, especially costs that are seen as non-essentials, like entertainment.

"Consider that you just saw the cost of (business) golf double," says David Rynecki, CEO of a research company that follows the recreation industry. "It will definitely cause more scrutiny of corporate outings." In a sport where participation is already declining because of the high cost of equipment and the time it takes to play, making golf twice as expensive for businesses is not going to improve the sport's prospects for attracting younger generations.

Taxes on Trees and Windows

Maybe the decline of lawn care and death of golf seems over the top. But history tells some strange tax tales.

In the late 18th century, the Ottoman Turks imposed a "tree tax" on the residents of Palestine, Israel and Syria. Trees were taxed for the fruit, their value as timber, even for the shade they provided.

To avoid the taxes, landowners cut down their trees, which was certainly not what the rulers expected. But beyond the loss of tax revenue, historians blame the "Ottoman Tree Tax" for causing an ecological disaster. The widespread deforestation that occurred was comparable to clear-cutting or strip mining, and today, what had once been part of the "Fertile Crescent" is barren and arid. Because of taxes.

The 17th-century English government saw windows as markers of prosperity – the more you had, the wealthier you were. In 1696, England imposed a window tax. Every building was permitted eight "tax-free" windows, but additional windows were taxed on a progressive scale. This tax remained in effect for more than 250 years.

Much like the tree tax in the Middle East, English property owners responded by getting rid of their windows. An Internet search yields a multitude of photos of existing buildings with their (still) bricked-up window wells.

Beyond the loss of curb appeal, fewer windows impacted the health and safety of the residents. Dark, poorly-ventilated dwellings, especially in densely-populated industrialized cities, were breeding grounds for disease and poor health. And fewer windows made it easier for criminals to work mischief inside buildings, and on the street. The Window Tax was finally repealed in 1851 when protesters like Charles Dickens argued that it was a tax "on health," and "on light and air." ❖

And the takeaways are…

- Taxes impact personal finance (but you knew that)
- Taxes change frequently (and sometimes drastically)
- You should include tax professionals in your financial decisions (they may see what is not-so-obvious)

Non-Can:

A Term You Need to Know

Are you…?

- ***A highly-compensated professional for whom career advancement typically includes changing employers?***
- ***A self-employed independent contractor or freelancer?***
- ***A business owner whose active participation is critical to the company's success?***
- ***An employee who could be transitioning to an independent consultant?***

In the next decade, more than 50% of American workers may be answering "yes" to one of these questions. A 2017 NPR/Marist poll found that today, one in five jobs in America is held by a worker under contract. And in the next ten years, it is estimated that contractors and freelancers could comprise half of the American workforce.

This can be profitable work, but it often lacks the financial safety nets available to many employees. "We are seeing the rise of the contract workers taking hold in America. People are hired to work on projects for a fixed period. They bounce from job to job, never earning the title of employee. And this fuels great unpredictability," says NPR's chief business editor Pallavi Gogoi.

Among the benefits that contract workers lack, perhaps the toughest to obtain and maintain is disability insurance.

All workers, even the self-employed, are eligible for benefits from Social Security Disability Insurance (SSDI). But qualifying is difficult, and the payments are minimal, at least for high earners. Nolo.com reports that most SSDI recipients receive between $700 and $1,700 per month (the average for 2018 is $1,197), with a maximum monthly benefit of $2,788. For a consultant or professional earning $150,000/yr., that's not much income protection.

Employer-sponsored group disability insurance, even if it's available to a freelance worker during the contract period, is usually not portable; i.e., the worker can't take the coverage to the next job.

In two-income households, a spouse whose employer provides health insurance may be able to add his/her independent contractor husband/wife to the coverage, and maybe add a modest amount of group life insurance. But disability insurance?

No way.

If you are one of the 20% currently working independently, the best type of disability insurance is a personally-owned individual policy, particularly for protection against incidents of long-term disability (generally defined as those lasting longer than 3 or 6 months). And to find the best policy, you need to know some terms unique to disability insurance.

"Non-Cancelable, Guaranteed Renewable" - Language That Protects the Insurance That Protects Your Income

A starting point for getting the best income protection is understanding a policy's definition of disability. Unlike life insurance, in which death is easy to define, disability insurance policies have a variety of definitions for disability. These definitions are critical in determining how and when benefits are paid. Especially for highly-compensated workers with unique skills, an own-occupation definition of disability is usually a must.

Once you have decided on the definition and benefit period that matches your situation, the next issue is knowing the terms under which you can keep the coverage. This means understanding the policy's renewability clause.

There are three basic types of renewability clauses for disability insurance: renewable at the option of the insurer, guaranteed renewable, and non-cancelable guaranteed renewable.

Renewable at the option of the insurer allows the insurance company to change rates or contract terms, and even cancel coverage. Many group and association disability insurance programs are renewable at the option of the insurance company. If claims are too high or other factors make the insurance unprofitable, the company can terminate the plan.

With a guaranteed renewable policy, the insurance company is obligated to accept premiums and provide benefits according to the terms of the contract, but retains the right to raise premiums. This format allows you to keep the coverage as long as premiums are paid, but with the risk that rising premiums may eventually make the coverage unaffordable.

A **non-cancelable guaranteed renewable** clause means the insurance company cannot change the premium or the contract terms; only the insured can make changes to, or cancel the contract (by electing to decrease coverage or stop paying premiums). The "non-can" clause is the prevailing format for most individual disability policies, and from a consumer's perspective, "non-can" disability has the strongest renewability clause.

The renewability clause affects pricing. All things being equal, non-can policies usually have the highest initial premiums. However, in the long run, having a non-cancelable guaranteed renewable clause is often *less* costly – and more stable.

With a non-cancelable guaranteed renewable policy, you not only have certainty about future premiums and benefits, but you also have some protection against the devaluation of premiums already paid. Suppose 10 years ago you bought a non-cancelable guaranteed renewable policy, paying $300/mo. for a $5,000 monthly disability benefit. Today, the value of the $5,000 benefit is diminished by inflation, but so is the true cost of the premium; i.e., the premium-to-benefit ratio has stayed the same.

In contrast, if you selected a disability contract that's only guaranteed renewable, it's possible that premiums will increase while the benefit remains the same. Between inflation and premium increases, you are paying more to get less. ❖

Contract workers who value their income enough to own personal disability insurance also want to know the coverage can be portable and remain affordable. The non-can provision is a key feature in building an independent financial safety net. Does your work status merit a disability insurance review?

You Should Be a Rate-Shopper

One of the best ways to minimize financial expenses is to regularly review your indebtedness, looking for ways to reduce both interest costs and monthly payment obligations. And, if you find a strategy that's workable, you can take the saving a step further by getting quotes from several lenders to see which one will give you the best terms.

This is because borrowing costs vary, sometimes significantly, between lenders. This applies to new transactions, such as financing for a new automobile, a mortgage for a home, or a business loan. It also fits any debt restructuring scenarios, like re-financing an existing mortgage, or transferring and consolidating other debt.

A March 30, 2018, "Numbers" column in the *Wall Street Journal* cited a study by researchers from MIT and Brigham Young which found that the spread among lenders for home mortgages was half a percentage point for borrowers with similar credit scores, incomes, and debt-to-income ratios.

So under current conditions, a borrower might pay between 3.5 and 4% for the same mortgage, depending on the lender. On a 30-year mortgage for $400,000, this translates to a difference of $114 in monthly payments between the highest and lowest rates. Over 360 payments, that adds up to $41,140 of additional cost. And if you calculate an opportunity cost at an annual rate of 5% for these payments, the projected "real" difference is $95,272 higher. ***For the same loan.***

The same study found that while automobile loans have shorter terms, the spreads between lenders are much greater: 1.3 percentage points. Jo Craven McGinty, the WSJ reporter, says that for a typical car loan, this difference in interest rates would be like paying $1,300 more on the purchase price. ***For the same loan.***

Why Do Interest Rates Vary?

Three things affect the interest rates offered to prospective borrowers:

- A base rate, such as the prime rate commercial banks charge their most creditworthy customers
- A borrower's credit score and debt-to-income ratio
- The lender's markup.

Base rates typically don't vary much among lenders; because most are affiliated with the Federal Reserve, the institutional cost of money is pretty much the same for everyone. Rates may also vary because lenders may have different underwriting criteria. At one institution, a 700 credit score may translate to a preferred borrower, while the same score at another lender puts the borrower one step below prime, and subject to a higher rate. But markups, which can vary from lender to lender and borrower to borrower, are primarily responsible for the differences in rates.

Regardless of the macro-economic factors that affect rates, each lender has unique circumstances where loans may be offered at a premium (marked up) or a discount (marked down). Obviously, smart borrowers should shop for money that's on sale.

Yet studies show many consumers apply to only one lender before making a decision. Researchers blame the lack of interest-rate shopping largely on the process. The time and documentation required to complete one loan application can be daunting, let alone repeating the process several times. But one study showed that most consumers would realize a substantial benefit by getting quotes from ***just three lenders.***

Some consumers may also be hesitant to rate-shop because they have heard that multiple credit inquiries have a negative impact on their credit scores. This information is only partially correct. In general, any application for additional debt has a marginally negative effect on your credit rating, simply because absent other factors (like increased income), more debt is less desirable. Someone who submits multiple credit card applications to radically increase their spending limit makes lenders uneasy, so each inquiry diminishes your credit rating.

But the credit reporting services treat multiple inquiries for mortgages, auto financing and loan applications differently. In these instances, it is assumed you will rate shop. Multiple loan applications, and the subsequent credit checks, are treated as a single inquiry – provided they occur over a short period. Typically, inquiries from multiple lenders within the same two-week period are treated as one inquiry by credit bureaus.

Rate Shopping

To make interest-rate shopping easier, consider asking for help from your financial professionals. If you have an on-line vault for your financial information that's administered by a financial services firm, it should be easy for a representative to assist in assembling the necessary documentation, and digitally transmitting it to prospective lenders. ❖

You can maximize the benefit of reconfiguring your debt by shopping for the best terms. It's a corny line, but shopping is in your best interest.

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