Basic Elements of a Retirement Plan

By Tim Parker
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How many times have you heard that you need to plan for retirement? You could make an appointment with a financial planner – and you should at some point – but how do you get started on your own? The truth is that retirement planning is big, it's complicated, and as you age your plan has to change and grow. It doesn't stop when you reach retirement; in fact, it has hardly begun. The first thing to do is to get all of the information into one document. What would you include?

Your Goal

Your goal is probably to retire comfortably, but are you the type who wants to travel the world or is your idea of a perfect retirement continuing to work but on a schedule you dictate? Those two goals require very different funding models.

How Much Do You Need?

Remember that retirement planning starts long before you retire – the sooner, the better. Your "magic number," the amount you need to retire comfortably, is highly personalized, but, depending on whom you ask, you can get an idea of how much to save.

Some people say that you need around $1 million to retire comfortably, while other professionals stick to the 80% rule: You need enough to live on 80% of your income at retirement. If you made $100,000 per year, you would need savings that could produce $80,000 per year for roughly 20 years – $1.6 million. Others say that most retirees aren't anywhere near saving enough to meet those benchmarks. They simply adjust their lifestyle to live on what they have.

Whatever method you, and possibly a financial planner, use to calculate your retirement savings needs, start early and don't see it as a long way off. Time flies when you're in the workforce. As most people haven't saved enough, the simple answer is to save as much as you can starting now.

How Will You Earn Money?

Once you reach retirement age, you go from accumulating assets to what planners call the distribution phase. You're no longer paying in; your decades of saving are paying out. But as you're building wealth, think about this: Multiple sources of income during retirement are ideal, especially if you fell a little short in your savings goals.

More People Working

You might have noticed more people of retirement age in the workforce. According to a study by Merrill Lynch, from 2000 to 2014 the percentage of people 55 and older in the workforce has increased 8%, but most are working because they want to – not because they have to. As it gets increasingly harder to save for retirement, working after age 55 is expected to become more commonplace to shore up the shortfalls in Generation Xers' and Millennials' savings.

Social Security

There are also questions as to the longevity of Social Security, although it's generally felt that solutions will be found. By the time Millennials reach retirement age, it is prudent to expect that Social Security will be able to cover less of the cost of retirement than it does now.

Currently, the average monthly benefit check is $1,335 per month or $16,020 per year and Social Security remains a major source of income for retirees. Part of an efficient retirement plan is deciding when to take benefits and how that would work with your full- or part-time job, if you have one – at least in the earlier years of retirement.

Your Portfolio

Ideally, the cornerstone of your income are the tax-advantaged retirement accounts that you have built up for decades. Remember the 80% rule? You'll need that kind of money for potentially 20 to 25 years. If you make $50,000 per year and earn $16,000 in Social Security, you would need to withdraw about $2,000 per month. That would mean you would need at least $480,000 in your account to fund retirement for 20 years, not counting any other income source.

As you age, your investment accounts should become more conservative, which means that growth slows. A good plan will get highly detailed on what your account balances look like as you age. A miscalculated financial forecast could be disastrous. If you own or are a part owner in a business, or if you will have inherited income, your plan should conservatively factor in those revenue sources as income.

Your Home

For most Americans, their home is the single biggest asset they own. How does that fit into your retirement plan? In the past, a home was considered an asset – but as we've seen with the housing-market crash, planners see it as less of an asset than they once did. With the popularity home-equity loans and home equity lines of credit, many more homeowners are entering retirement in mortgage debt instead of well above water.

Once you reach retirement there's also the question of whether you should sell. If you still live in the home where you raised multiple children, it might be larger than you need, stairs could be difficult to go up and down, and the expenses that come with holding onto it might be considerable. Your retirement plan should include an unbiased look at your home and what to do with it.

Estate Plan

Nobody wants to spend a bunch of time thinking about death, but what happens to all of your assets once you're gone? Your estate plan addresses these issues. It should include a will that lays out your plans, but even before that you should set up a trust or use some other strategy to keep as much of it as possible shielded from estate taxes. The good news is that the first $5.4 million is exempt from estate taxes, but more and more people are finding ways to leave their money to their children in a way that doesn't pay them in a lump sum. The larger your estate, the more you need the help of an attorney to work through all of these questions.

Tax Efficiency

Once you reach retirement age and begin taking distributions, taxes become a big problem. Most of your retirement accounts are taxed as ordinary income tax. That means you could pay as much as 39.6% taxes on any money you take from your traditional 401(k) or IRA. Early in your retirement planning you should consider a Roth IRA or a Roth 401(k), if it's offered through your employer. These accounts allow you to pay taxes now rather than later. If you believe you will make more money later in life, it pays to make a Roth conversion now, but there's an art to the conversion as well. All of these tax considerations and more are best thought through with the help of an accountant or financial planner.

Insurance

A key component to retirement planning is protecting your assets. Age often means more medical expenses. It also means navigating the super-complicated Medicare system. Many people feel that original Medicare doesn't provide adequate coverage, so they have to decide on aMedicare Advantage or Medigap policy to supplement it. And if you plan to work, how does Medicare work with your employer-sponsored policy, and what about the Part D drug plan?

Then there’s life insurance and long-term-care insurance. These come in many shapes and sizes. How do you know which is best? An insurance agent or fee-only insurance advisor can help you figure all of this out.

Many financial advisors will try to sell you an annuity. An annuity is much like a pension. You put a bunch of money on deposit with an insurance company that later pays you a set monthly amount. There are many different options with annuities, and they may or may not be right for you.

Jason Hull, CFP, is the CTO of the online comprehensive financial planning service myFinancialAnswers. He suggests low-cost, single-premium immediate annuities (SPIAs) for two scenarios.

“One, you’re at a point where your investable assets would purchase an annuity that only covers your income needs. If you’re at this point, then you want to make sure you convert your assets to income, because a down year or two could be a tipping point where you’d never recover from, as you’d have the double whammy of withdrawing to meet your living expenses as well as having your assets decline in value due to a downturn. Retirees simply cannot afford that risk.

“Two, you watch the markets, and every down day gives you heartburn. Although generally stocks go up in the long run, if you’re a retiree who watches your nest egg daily and cannot emotionally stand the fluctuations of the market, then converting to an annuity will help you sleep easier at night knowing that you’re not going to have to worry about whether or not stocks go up or down.”

Hull cautions that there’s a lot more to consider when deciding if an annuity is right for you. You’ll need help navigating the insurance side of your retirement portfolio, but it’s a key part of your planning.

The Bottom Line

Your retirement plan includes a lot more than simply how much you will save and how much you need. It takes into account your complete financial picture. You can put together a basic plan on your own.

http://www.investopedia.com/articles/personal-finance/011116/basic-elements-retirement-plan.asp?partner=YahooSA