Bonus Chapter

Calculation Details of the
Spend Safely in Retirement Strategy
For
Don't Go Broke in Retirement

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The following bonus chapter supplements the book *Don't Go Broke in Retirement: A Simple Plan to Build Lifetime Retirement Income*. It is intended to provide readers with additional insights to help implement the strategies that are discussed in *Don't Go Broke in Retirement*.

Calculation Details of the
Spend Safely in Retirement Strategy

Chapter 12 of *Don't Go Broke in Retirement* included two examples of the *Spend Safely Strategy,* plus a few basic refinements. This bonus chapter contains the calculation details of these examples, which show you how the math works for the *Spend Safely Strategy.*

Both examples illustrate how you can potentially increase your total annual retirement income by thousands of dollars by using your savings to fund a Social Security bridge payment. With this strategy, you use a portion of your retirement savings to help maximize your lifetime Social Security payout by delaying the start of your benefits.

The examples also show that for many people, a very large portion of their total retirement income will be delivered by Social Security income which is protected from longevity risk, stock market risk, and inflation risk. Only a small portion of your total retirement income will be generated as a "retirement bonus," which isn't risk-protected.

Joan, a hypothetical single woman who plans to retire at 65, is the focus of the first example. This example illustrates the potential increase in retirement income that results from working for a few years after leaving a full-time job, even if that employment is only part time.

The second hypothetical example profiles a married couple, Jack and Mary, who both plan to retire at age 65. This example illustrates in more detail how the travel fun bucket can work. Our 2019 research report, *Viability of the Spend Safely in Retirement Strategy*, which is identified in the "Helpful Resources" section at the back of *Don't Go Broke in Retirement*, includes similar examples. However, I updated these examples for the proposed IRS rules effective in 2021 regarding the Required Minimum Distribution, as described in Chapter 3 of *Don't Go Broke in Retirement*.

There are a bunch of numbers in both of these examples that help illustrate some key concepts, so try to work through them. They'll help you more clearly understand each situation.

Example 1: Joan, a single woman who plans to retire at age 65

Joan is single and plans to retire from her full-time job at age 65 in 2021. Here are the assumptions for Joan's example:

- Her current salary is $50,000 per year.

- In her first year of retirement, Joan can devote $250,000 in retirement savings to her RIG, after setting aside an emergency fund of $10,000 to cover unexpected expenses, such as home and car repairs, and out-of-pocket medical and dental expenses.

- If she starts receiving Social Security benefits at age 65, her estimated benefits will be $19,476 per year.

- The online Social Security calculator Joan used suggested her optimal strategy would be to delay starting her Social Security benefit until age 70. At that age, her estimated Social Security income would be $27,646 per year, or $8,000 more annually compared to the amount she'd receive if she started her benefits at age 65.

Joan is considering three different retirement scenarios to help her decide whether to work part time for a while, and also how to deploy her retirement savings:

- Scenario 1: Retire completely at age 65, and immediately start both Social Security benefits and drawing down savings.

- Scenario 2: Retire completely at age 65, but use a portion of her savings to fund a Social Security bridge payment to enable her to delay taking Social Security benefits until age 70. To do this, Joan would set up her Social Security bridge fund to pay her $27,646 each year between ages 65 and 70. This amount is equal to the annual Social Security benefit she expects to receive if she starts benefits at age 70.

- Scenario 3: Employ a downshifting strategy, in which she works part time between ages 65 and 70. Joan plans to earn just enough to cover her living expenses so she can delay both starting Social Security and drawing down savings until age 70.

With the baseline Scenario 1, Joan would retire immediately at age 65 and start both her Social Security benefits and drawing down her savings using the RMD to generate a retirement bonus.

Here's how her total retirement income adds up for Scenario 1:

Social Security paycheck:	$ 19,476	
RMD retirement bonus:	$ 7,396	(2.9586% of $250,000)
Total:	$ 26,872	

Note: 2.9586% is the RMD withdrawal percentage that would apply at age 65 starting in 2021, using the RMD methodology as described in Chapter 3 in *Don't Go Broke in Retirement.* The actual RMD rules won't apply to Joan until age 72; Chapter 3 shows the RMD percentages that would apply at earlier ages using the same methodology to calculate withdrawal percentages.

In this example, Joan's total retirement income is a little more than half (54%) of her pre-retirement employment salary, so she would need to find a way to live on less money in retirement.

Here's the breakdown between her risk-protected retirement income and her other retirement income:

- Almost three-fourths (72%) of Joan's total retirement income would come from her Social Security retirement paycheck. This money is protected from longevity, stock market, and inflation risks.

- 28% of her retirement income would be the retirement bonus that comes from her savings and is subject to the risks noted above.

Now let's look at Scenario 2, where Joan considers using part of her savings to fund a Social Security bridge payment that will enable her to delay Social Security benefits until age 70. In this scenario, she'll still retire at age 65, as in the first scenario.

To carry out this plan, Joan would establish a Social Security bridge fund that would pay her $27,646 per year from age 65 to age 70 (this is the amount of the Social Security benefit Joan expects to receive if she starts getting benefits at age 70). In order to do this, she'd set aside $138,230 from her savings, an amount equal to five years times $27,646. She'd invest this amount in a money market, short term bond, or stable value fund to protect against stock market fluctuations. She'd withdraw $27,646 in the first year for her Social Security bridge payment. Interest earnings can increase her payments in future years.

Joan's remaining savings after funding the Social Security bridge payment equals $111,770 (that's $250,000 – $138,230). She'd invests this savings in a low-cost balanced or target date fund and use

the RMD to calculate her annual retirement bonus. Here's how her total retirement income at age 65 would add up under Scenario 2:

Social Security paycheck:	$ 27,646	(paid by savings from age 65 to 70)
RMD retirement bonus:	$ 3,307	(2.9586% of $111,770)
Total:	$ 30,953	

Now she's significantly increased her risk-protected retirement income:

- 89% of her total retirement income would come from her Social Security retirement paycheck or from her Social Security bridge payment. This money is protected from longevity, stock market, and inflation risks.

- 11% would come from her retirement bonus and is subject to the risks noted above.

Using the Social Security bridge payment, Joan would increase her total annual retirement income by $4,081 without changing her retirement date. Her total retirement income would be equal to almost two-thirds (62%) of the salary she earned while she was working. She'd also increase the percentage of her total retirement income—from 72% to 89%—that's risk-protected.

To enable these increases in her retirement income, Joan would need to commit $138,230 of her savings to her Social Security bridge payment, which she will spend down between ages 65 and 70. This would leave $111,700 for the retirement income generator (RIG) that pays her lifetime retirement bonus. At any time, she could always change her retirement income strategy with any savings that remains in either her Social Security bridge payment fund or her retirement income generator (RIG).

Joan then considers Scenario 3, a downshifting strategy, in which she'd work just enough to enable both delaying her Social Security benefit from age 65 to age 70 and delaying drawing down her retirement savings until age 70. She wouldn't make any additional contributions to her $250,000 savings, but her savings would grow at a real rate of return of 3% per year. In this case, her savings would grow to $289,819 by age 70.

Here's how her retirement income would add up at age 70 under Scenario 3:

Social Security paycheck:	$ 27,646	
RMD bonus:	$ 9,959	(3.4364% of $289,819)
Total:	$ 37,605	

Note: 3.4364% is the RMD withdrawal percentage that applies at age 70 starting in 2021.

At age 70, Joan's total annual retirement income would be $10,733 higher than the retirement income she would have received at age 65, had she started her Social Security benefits and savings drawdown then. She would also replace three-fourths (75%) of the salary she earned when she was working.

For Scenario 3, here's the breakdown between Joan's risk-protected retirement income and her other retirement income:

- 74% of her total retirement income would come from her Social Security retirement paycheck. This money is protected from longevity, stock market, and inflation risks. However, between ages 65 and 70, she'd be subject to employment risk (i.e. whether she can continue working).

- 26% would come from her retirement bonus and is subject to the risks noted above (except the employment risk).

Note: Under Scenario 2, Joan uses a different strategy for a Social Security bridge payment, compared to Bob's example in Chapter 2 of *Don't Go Broke in Retirement.* Joan sets up her Social Security bridge payment to equal the benefit she expects to receive if she starts it at age 70. Bob sets up his Social Security bridge payment to equal the benefit that he would have received had he started his Social Security at age 65. Joan and Bob's methods are both reasonable, and each has its pros and cons:

- Compared to Joan's method, Bob's method uses less of his savings to fund his Social Security bridge payment, since Bob only replaces the Social Security benefit that would have started at age 65. However, Bob's method also delivers less retirement income between ages 65 and 70 compared to Joan's. In this case, Bob would enjoy an increase in his total retirement income at age 70, when he transitions to his actual Social Security benefit that's been fully increased for delaying the benefit.

- Joan's method produces more retirement income than Bob's between ages 65 and 70. It also produces a smoother transition of income before and after age 70. However, she needs more money to fund her Social Security bridge payment than Bob does.

Example 2: Jack and Mary, both age 65

Jack and Mary both plan to retire at age 65 in 2021. Here are some relevant assumptions for this hypothetical example:

- Their current annual salaries are $75,000 for Jack and $25,000 for Mary.

- In their first year of retirement, they can devote $400,000 in retirement savings to their RIG, after setting aside an emergency fund of $15,000. This fund will cover unexpected expenses,

such as home and car repairs; out-of-pocket medical and dental expenses; and potential financial assistance to family members.

- Jack and Mary consulted an adviser who is trained in optimizing Social Security benefits for retirees. The adviser recommended that the optimal strategy is for Jack to start his Social Security benefits at age 70, while Mary should start her benefits at age 66.

- Here are estimates of Jack's annual Social Security income:

- If he starts at age 65: $25,344

- If he starts at age 70: $35,977

- Here are estimates of Mary's annual Social Security income:
    o If she starts at age 65: $12,492
    o If she starts at age 66: $13,406

Jack and Mary are considering three different retirement scenarios to help them decide if they'll need to reduce their living expenses in retirement. They also want to see if they can responsibly spend extra money on travel for the first 10 years of their retirement by using a "travel fun bucket" without jeopardizing their long-term financial security. Using a travel fun bucket will reduce the amount of their ongoing retirement income that's devoted to regular living expenses.

Here are the three scenarios they're considering:

- Scenario 1: Retire at age 65, and immediately start receiving Social Security benefits and drawing down savings.
- Scenario 2: Retire at age 65, and use a portion of their savings to fund a Social Security bridge payment. This would enable Jack to delay his Social Security benefits until age 70 and Mary to delay her benefit until age 66.
- Scenario 3: This scenario is the same as Scenario 2, except they would also create a travel fun bucket to pay for additional travel expenses of $5,000 per year for the first 10 years of their retirement, when they anticipate they'll still be vital and healthy. To do this, they'd reduce the amount of their savings that would be generating their RMD retirement bonus by $50,000, which they'd set aside to fund their travel fun bucket.

With Scenario 1, they'd both retire immediately at age 65 and start both their Social Security benefits and drawing down their savings using the RMD percentages to generate a retirement bonus. Here's how their total retirement income adds up:

Social Security paycheck:	$ 37,836	($25,344 + $12,492)
RMD bonus:	$ 11,834	(2.9586% of $400,000)
Total:	$ 49,670	

In this example, their total retirement income is equal to about half of the amount of their salaries while they were working, so they'd need to find a way to live on less money in retirement.

Here's the breakdown between their risk-protected retirement income and their other retirement income:

- Over three-fourths (76%) of their total retirement income would come from their Social Security retirement paychecks. This money is protected from longevity, stock market, and inflation risks.

- Less than one-fourth (24%) would come from their retirement bonus and is subject to the above-noted risks.

Now let's look at Scenario 2, where they wish to use a portion of their savings to establish a Social Security bridge payment that would enable Jack to delay Social Security benefits until age 70 and for Mary to delay Social Security benefits until age 66. In this scenario, they'd both still retire at age 65.

In order to enable them to delay their Social Security benefits, they'd fund a Social Security bridge payment that would pay them $35,977 per year from age 65 to age 70—this is the amount of the Social Security benefit that Jack expects to receive at age 70. In addition, from age 65 to 66, they'd pay themselves $13,406—this is the amount of the Social Security benefit that Mary expects to receive at age 66. In order to do this, they'd set aside $193,291 (five years times $35,977 plus one year of $13,406) from their retirement savings. They'd invest this amount in a money market, short term bond, or stable value fund to protect against stock market volatility.

Jack and Mary would withdraw $49,383 ($35,977 + $13,406) for their Social Security bridge payment in the first year of their retirement. They'd then start Mary's actual Social Security benefit of $13,406 in the second year of retirement and pay themselves Jack's Social Security benefit of $35,977 each year from age 66 to age 70. Interest earnings on the Social Security bridge fund could increase their payments in future years.

Their remaining savings—after funding the Social Security bridge payment—would equal $206,709 (that's $400,000 – $193,291). They'd invest this amount in a low-cost balanced or target date fund and

use the RMD to calculate the annual withdrawal. In this case, here's how their total retirement income at age 65 adds up:

Social Security:	$ 49,383	(mostly paid by savings from age 65 to 70)
RMD drawdown:	$ 6,116	(2.9586% of $206,709)
Total:	$ 55,499	

Now they've significantly increased their risk-protected retirement income:

- 89% of their total retirement income would come from their Social Security retirement paycheck or from their Social Security bridge fund. This money is protected from longevity, stock market, and inflation risks.

- 11% would come from their retirement bonus and is subject to the above-noted risks.

Using the Social Security bridge payment, Jack and Mary would increase their total annual retirement income by $5,829, without changing their retirement date. They would also increase the percentage of their total income—from 76% to 89%—that's protected from longevity, stock market, and inflation risks.

To enable these improvements in their retirement income, they'd need to commit $193,291 of their savings to their Social Security bridge payment, which they would spend down between ages 65 and 70. This would leave $206,709 for the retirement income generator (RIG) that would produce their retirement bonus. At any time, they could change their retirement income strategy with any savings that remains in either their Social Security bridge payment fund or their RIG.

Now let's look at Scenario 3. In addition to setting up a Social Security bridge payment, Jack and Mary also want to spend an extra $5,000 per year on travel for the 10 years between ages 65 and 75 when they think they would still be fit and healthy. To do this, they'd set aside a "travel fun bucket" of $50,000, and they would invest the money in a stable value fund or short-term bond fund. They would withdraw $5,000 per year for each of 10 years. Interest earnings could slightly increase the annual payments in the future.

After setting up the travel bucket, they would have $156,709 ($206,709 - $50,000) to apply to their retirement bonus, which they would use the RMD to calculate. Here's the amount of retirement income that they would have to cover their regular living expenses, starting at age 65:

Social Security paycheck:	$ 49,383	(mostly paid by savings from age 65 to 70)
RMD retirement bonus:	$ 4,636	(2.9586% of $156,709)
Total:	$ 54,019	

Setting up the travel fund bucket would reduce the amount of lifetime, annual retirement income they'd receive to use to cover ongoing living expenses by $1,480 per year—from $55,499 to $54,019. However, their annual income would still be higher than with Scenario 1 by $4,349. Using the Social Security bridge payment would help "pay" for their travel fun bucket, with money left over.

This information helps Jack and Mary make an informed decision about when to retire, how to deploy their retirement savings, and whether it's reasonable to pay for additional travel in the first 10 years of their retirement at the expense of reducing their ongoing lifetime retirement income.

Congratulations on working through these examples! Both examples illustrate that the *Spend Safely Strategy* is a flexible strategy that you can customize to meet your goals and circumstances. It's well worth your time to consider how to personalize the strategy to your situation.

KEY TAKEAWAYS

▶ You'll have a variety of options available to you when it comes to determining the best financial strategy to employ in your retirement. Be sure to investigate your options before deciding on the one that will work best for you.

▶ The examples in this chapter show how you can potentially increase your total annual retirement income by thousands of dollars with a Social Security bridge payment.

▶ These examples also show how you can responsibly budget for additional travel expenses during the initial years of your retirement.