Bonus Chapter

The Retirement Income Scorecard For *Don't Go Broke* in Retirement

STEVE VERNON, FSA

RoLC *Rest-of-Life* Communications
Oxnard, California

ALSO BY STEVE VERNON

Don't Go Broke in Retirement: A Simple Plan to Build Lifetime Retirement Income

Retirement Game-Changers: Strategies for a Healthy, Financially Secure, and Fulfilling Long Life

Money for Life: Turn Your IRA and 401(k) Into a Lifetime Retirement Paycheck

Recession-Proof Your Retirement Years: Simple Retirement Planning Strategies That Work Through Thick or Thin

The Quest: For Long Life, Health and Prosperity (DVD/workbook set)

Live Long and Prosper! Invest in Your Happiness, Health and Wealth for Retirement and Beyond

Don't Work Forever! Simple Steps Baby Boomers Must Take to Ever Retire

For bulk purchases of *Don't Go Broke in Retirement*, *Retirement Game-Changers*, *Money for Life*, *Recession-Proof Your Retirement Years*, or *The Quest* DVD, please email steve.vernon@restoflife.com.

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*.

For more information:
Rest-of-Life Communications: www.restoflife.com

Project management: Markman Editorial Services, www.MarlaMarkman.com

Design: Lisa Winger, WinBach Marketing Images, www.winbach.com

Bonus Chapter

The Retirement Income Scorecard

How much retirement income can your savings generate? Determining the answer to this question can help you decide how to best deploy your savings in retirement, and whether you want to adopt variations on the baseline *Spend Safely in Retirement Strategy* that's described in the book *Don't Go Broke in Retirement*.

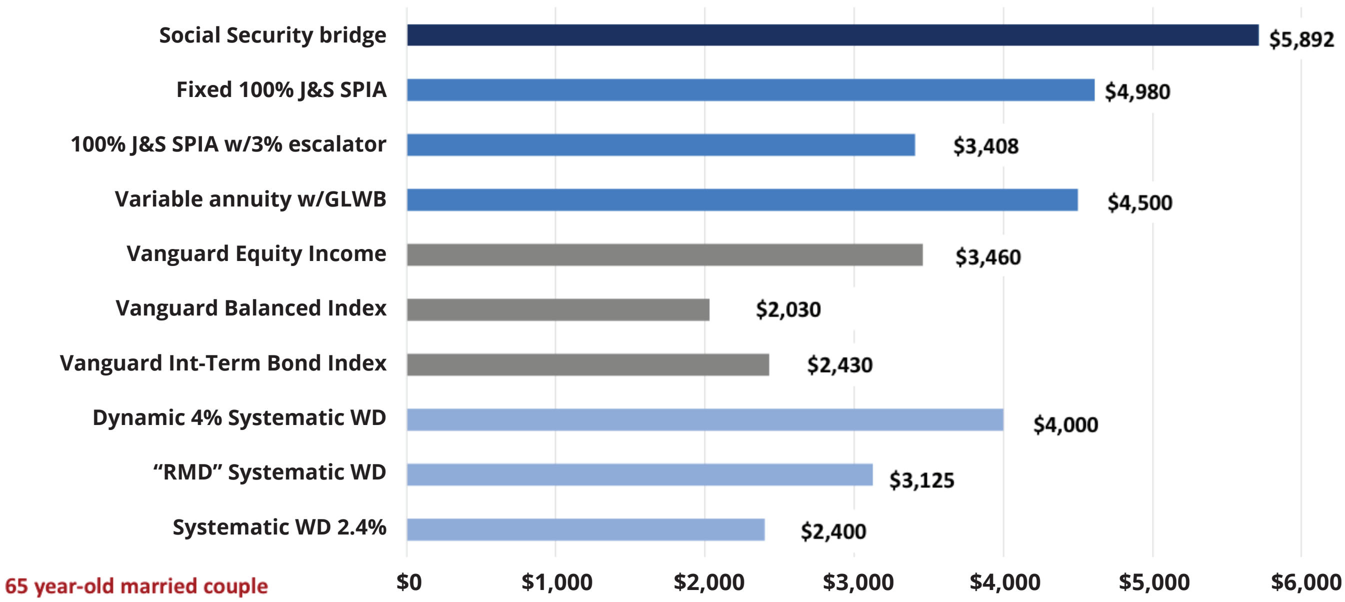
To help you make these decisions, let's look at the "Retirement Income Scorecard" that I developed for this purpose. It illustrates estimates of the annual retirement income that $100,000 in savings can generate for a hypothetical 65-year-old married couple. The scorecard looks at 10 different retirement income generators (RIGs) that are all viable methods for providing retirees with lifetime income. Each specific RIG in the scorecard belongs to one of these four general types of RIGs:

- Implementing a Social Security bridge payment
- Purchasing a guaranteed lifetime annuity from an insurance company
- Using interest and dividend payments from investments, leaving principal intact
- Investing savings and making systematic withdrawals of principal and investment earnings

As you'll see in Figure 1 on the following page, the amount of retirement income you can generate from your savings will vary considerably, depending on the specific RIG, or combination of RIGs, that you select. In Figure 1, the four different types of general RIGs used are represented by four different colors.

Figure 1: The Retirement Income Scoreboard

How much annual retirement income does $100,000 in savings generate?



Notes: The annuity amounts shown in Figure 1 are based on annuity purchase rates from ImmediateAnnuities.com and payout rates that are common for VA/GLWB products. The investment income amounts are based on yields on investments from Morningstar. These analyses are as of June 2020.

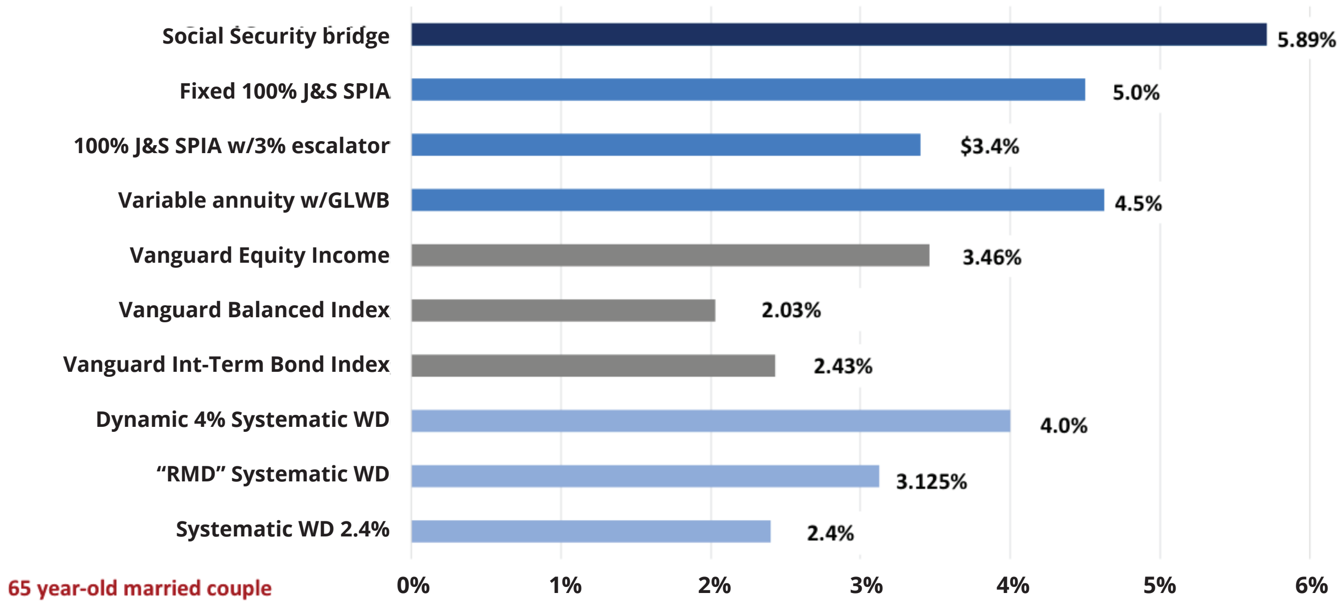
Please see the section titled **“DETAILS”** later in this bonus chapter for more detailed descriptions of the specific RIGs shown in Figure 1.

What are the payout rates?

When you’re trying to determine which RIG or RIGs you should use to generate retirement income, one common metric you can use to assess and compare retirement income generators is the “payout rate,” which is simply the amount of annual retirement income you’ll receive in the first year of retirement divided by the amount of savings devoted to the RIG. Figure 2 below shows the payout rates (listed as a percentage) for the RIGs analyzed in Figure 1.

Figure 2: The Retirement Income Scoreboard

What are the payout rates for various retirement income generators?



The payout rate is just one metric you can use when determining which RIG or combination of RIGs you should choose. You might have other goals that can influence your decision regarding the RIG(s) that might work best for your goals and circumstances, such as your preference for savings you can access throughout retirement or your desire to leave a legacy.

The 10 RIGs considered here are all viable ways to generate retirement income. But there are many other possible RIGs that will generate retirement income for you, and each has its own advantages and disadvantages.

Building a portfolio of retirement income for a potentially long retirement is a critical task. Take whatever time is necessary for you to learn about your options in order to make an informed choice.

DETAILS

There are four basic ways to use your retirement savings to generate lifetime retirement income:

- Implementing a Social Security bridge payment
- Purchasing a guaranteed lifetime annuity from an insurance company
- Using interest and dividend payments from investments, leaving principal intact
- Investing savings and making systematic withdrawals of principal and investment earnings

The Retirement Income Scorecard uses one or more of each of these basic methods, as discussed below.

Social Security bridge payment

Most people can maximize their Social Security income if they delay starting their Social Security benefits for as long as possible but no later than age 70. If you retire before the date at which you've determined it would be best to start your Social Security benefits, you can use a portion of your retirement savings as a temporary substitute for the estimated income you'll receive from Social Security once you start getting benefits. This strategy is called a "Social Security bridge payment."

The $5,892 amount shown in Figure 1 is an estimate of the *additional* annual retirement income a 65-year-old couple can generate if they use $100,000 of their retirement savings to fund a Social Security bridge payment until age 70 (the age at which they plan to start their Social Security benefits), compared to starting Social Security at age 65.

For more details regarding the Social Security bridge strategy, this particular example, and exactly how I estimated the $5,892 amount, see my May 26, 2020 column in Forbes.com titled *Boost Your Risk-Protected Retirement Income with a Social Security Bridge Payment*.

It's important to understand that the amount of additional income that a Social Security bridge payment can generate highly depends on a retiree's specific circumstances. Nevertheless, the estimate for this hypothetical couple is representative of the potential income that such a strategy can generate.

Guaranteed lifetime annuities

You can purchase an annuity by investing a portion of your retirement savings with an insurance company that will then guarantee to pay you a monthly retirement income for the rest of your life, no matter how long you live. You can also choose to continue this income to your spouse or partner with a joint and survivor annuity.

The Retirement Income Scorecard in Figure 1 includes these three annuities:

- A "single premium immediate annuity (SPIA)" with a fixed dollar amount and 100% joint and survivor coverage
- A SPIA that increases the income at an annual rate of 3% per year, with 100% joint and survivor coverage
- A VA/GLWB annuity, which stands for "variable annuity with guaranteed lifetime withdrawal benefit"

One important feature of a SPIA is that once you give your money to an insurance company to purchase an annuity, you can't change your mind later and withdraw any remaining funds. By contrast, most VA/GLWB products allow you to withdraw your remaining savings, although fees and penalties may apply.

Another important feature of a fixed SPIA is that the retirement income you'll receive will never change. A SPIA with an annual increase will only increase by the specified percentage increase factor. By contrast, a VA/GLWB annuity might generate future increases in the amount of retirement income you receive, depending on investment performance and the terms of the contract.

There are other types of annuities in addition to a SPIA or VA/GLWB that will produce different amounts of retirement income. Note also that the income generated by an annuity typically depends on your age and gender, as well as the age and gender of your spouse or partner if you continue the income to them after your death.

If you're interested in buying a guaranteed annuity to supplement your Social Security benefits, just understand that shopping for an annuity is like shopping for a car: There are many types of features that annuities can include, with different price tags. Shop carefully and pay attention to the details!

Investment income

With this type of RIG, you invest your savings and spend just the investment earnings, which are typically interest and dividends. The principal remains intact. You can invest in a variety of mutual funds, individual stocks and bonds, and real estate investment trusts.

This RIG generally produces the least amount of retirement income compared to the other three types of RIGs, but it maximizes your flexibility to redeploy the principal at any point in the future.

While there are literally thousands of investments that can generate investment income for you in retirement, the Retirement Income Scorecard included here looked at the following Vanguard mutual funds:

- Vanguard Equity Income Fund, Admiral Shares (VEIRX)
- Vanguard Balanced Index Fund, Admiral Shares (VBIAX)
- Vanguard Intermediate-Term Corporate Bond Index Fund, Admiral Shares (VICSX)

The scorecard used the "30-day SEC yield" shown on Morningstar's website as of May 30, 2020, and it applied this yield to $100,000 to estimate the annual amount of retirement income the hypothetical couple described above could generate. This yield calculates a fund's hypothetical annualized income as a percentage of its assets, based on the fund's holdings over a trailing 30-day period.

Systematic withdrawals

With systematic withdrawals, you invest your savings and then withdraw investment earnings and a portion of principal each year. There are various methods you can use to calculate the annual amount you withdraw annually. The Retirement Income Scorecard uses these three withdrawal methods:

- A dynamic withdrawal method that calculates your annual income in the first year of retirement by applying 4% to the savings that you devote to this RIG. Each year thereafter, the withdrawal amount is adjusted to reflect investment performance. To determine the annual withdrawal each year, you would apply 4% to your remaining assets that year.
- The IRS method to calculate the "required minimum distribution" (RMD) each year. This method is Step 2 of the *Spend Safely in Retirement Strategy* that's described in my book *Don't Go Broke in Retirement*. With the RMD method, you determine the annual amount of your withdrawal by applying a withdrawal percentage to your assets at the beginning of each year; the withdrawal percentage increases every year. The RMD is currently required at age 70 with a withdrawal percentage of 3.65%. If you decide to use the same methodology at an earlier age, the withdrawal rate at age 65 would be 3.125%. Please see my book *Don't Go Broke in Retirement* for withdrawal factors that would apply at each age from age 60 until the RMD is required. (Note that the IRS recently proposed changes to the RMD methodology that would apply in 2021 and would slightly reduce the required withdrawal percentages, if they're finalized in their proposed form. If you decide to use this method to generate retirement income, be sure to look for updates on these changes.)
- A strict application of the "four percent rule," which, if used today, would adjust the withdrawal rate to 2.4% of assets to calculate the withdrawal amount in the first year of retirement. With this method, the withdrawal amounts increase in the future for cost of living adjustments, regardless of your investment earnings. The low withdrawal percentage recommended for this method is designed to create a high probability that your assets won't be depleted, even if your investment performance is very poor.

For a discussion that compares a dynamic withdrawal method to a strict application of the four percent rule, see my May 20, 2020 Forbes.com column titled *Withdrawing From Retirement Savings: Is Four Percent a Safe Rate?*

The above methods describe just three possible systematic withdrawal options; there are other methods you could use that could produce different amounts of retirement income.

As you can see, there's a lot to learn about retirement income strategies. Each method described in this Bonus Chapter is a reasonable way to use your retirement savings to generate retirement income, and each method has its pros and cons. And as shown in the Retirement Income Scorecard, these methods can generate different amounts of retirement income, both initially and throughout retirement.

It's a very good use of your time to find the RIG or combination of RIGs that best suit your goals and circumstances. After all, you're planning for your financial security for 20 to 30 years or more!