Nest Egg Knowhow: Income Planning for the Retirement-Minded

It has long been part of the American Dream: to earn and save enough money during our working years to live the lifestyle we choose throughout our retirement years, without worrying about running out of money along the way.

Fulfilling that dream requires planning — a strategy for accumulating a sizable enough retirement nest egg, accompanied by a strategy for converting those nest egg assets into income to support your desired lifestyle for the duration of retirement.

A retirement plan with a solid, well-thought-out income strategy serves as vital protection against the many risks that threaten a person's income during retirement, risks such as outliving one's assets (longevity risk), losing a sizable portion of a retirement nest egg in a financial or real estate market downturn (market risk), getting ambushed by a health crisis or long-term care need, and seeing assets erode faster than anticipated due to rising inflation.

"To feel at ease about retiring, you really need to lay everything out in front of you and plan accordingly," says certified financial planner Jan Valecka, principal at Valecka Wealth Management in Dallas, Texas. "Otherwise it can be a panic situation when those paychecks stop coming in."

In this case, planning is the best antidote to panic. And the most effective retirement income plans tend to be those devised in consultation with a financial planning professional. To find a Certified Financial Planner™ (CFP®) in your area, check out the Financial Planning Association's national database at www.PlannerSearch.org.

Here's a look at some of the key steps and considerations involved in the retirement income planning process:

Crunch numbers to determine net worth: Start by taking stock of your net worth, accounting for all your assets (what you own), debts, inflows (all sources of income) and outflows (expense) per month during retirement. In doing so, don't overlook important line items like health care, the cost of which is substantial and escalating, even for a healthy couple. Indeed, a 2015 report from HealthView Services estimates that a healthy 65-year-old couple retiring in 2015 will pay an average of about $395,000 in lifetime retirement health care costs. For a 55-year-old couple retiring in 10 years, that figure rises to about $464,000. The report also notes that the U.S. Department of the Actuary projects health care inflation remaining at a lofty 6% for the next decade.

Identify income sources — Social Security, pension and other retirement accounts, rental income, part-time work, an annuity contract and the like. Figure out how much they will supply, when they'll supply it, for how long and in what form (lump sum or in a series of payments).

Optimize your Social Security benefits. People approaching retirement age should carefully consider when to start taking Social Security payments. While they can opt to start payments as early as age 62, if they don't need that income immediately, it is often best to delay payments at least until full retirement ag**e** (age 66 or 67, depending on year of birth), when they become entitled to full or unreduced Social Security benefits.

In some cases the best way to maximize Social Security benefits is to delay payments until sometime after full retirement age, such as to age 70. Doing so can earn a person valuable "delayed retirement credits" that increase the monthly benefit when they do start taking payments.

Take taxes into account. Identifying the tax status of your assets is another key step in retirement income planning. Having a tax-diversified portfolio, with retirement assets held in tax-exempt accounts (such as a Roth IRA), tax-deferred (qualified) accounts [such as a traditional IRA or 401 (k)] and taxable accounts (such as a brokerage account) provides a retiree with the flexibility to let market conditions dictate from which account(s) to withdraw income, potentially minimizing the damage a market decline can do to the value of their assets.

In the context of retirement income planning with a financial professional, it's also important to discuss potential tax-minimization strategies, since minimizing taxes extends the life of the retirement assets from which you will draw income.

Consider options for addressing projected income shortfalls. If in crunching the numbers it's clear you'll need additional income above what Social Security, retirement plans and other sources are likely to provide, consider other vehicles to provide reliable income. In some cases that may be a drawdown or liquidation strategy involving investment assets such as stocks, bonds or real estate. It also may be worth considering purchasing some type of an annuity — an insurance contract designed to provide an income stream for a defined period or for a lifetime, starting immediately or at some predetermined point in the future. Annuities come in a variety of configurations, with a broad range of features, so consult a financial professional for guidance in determining whether one is suitable for you, and if so, what kind is appropriate for your situation and needs.

Another lesser-known income-generation tool for people who own a qualified retirement account such as a 401(k) or IRA is called a QLAC, or qualified longevity annuity contract. Essentially these are fixed-rate deferred longevity annuities purchased with funds from a qualified retirement account. Instead of taking required minimum distributions in lump sum from such an account beginning at age 70.5, a person can use some of that RMD money to purchase a QLAC that's guaranteed to provide an income stream beginning at a later point in retirement. Since QLACs are a relatively new phenomenon, it's best to ask a financial professional for help determining if one is right for you.

Take protective measures. Worried about the bite a health care crisis or long-term care need could take out of a nest egg and retirement income, or about outliving your assets? Insurance products are available to address these types of risks, including long-term care insurance to address the former and an annuity with a guaranteed lifetime income feature to address the latter. Since these products usually come at a substantial cost, talk to a financial professional before investing in one.

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