Managing Your Cash Flow in Retirement

Retirement "Planning"

<<<<<<<<<<<< Accumulation Phase >>>>>>>>>> | <<<<<< Distribution Phase >>>>>

Distribution phase

Income: 3-legged stool: Pension, Social Security, Retirement portfolio
Expenses: First cut = 80 % of final salary (No retirement plan contributions, commute expenses, SS taxes, etc)
Retirement planning software: T. Rowe Price, Vanguard, Fidelity, Schwab, AARP, etc.
Marital status, age, SS benefits, portfolio return, fixed/variable expenses, etc.
Travel plans, increased medical expenses, long term care, etc.

C**ustom budget** is better if you are comfortable with Excel spreadsheets
Balance Sheet: Assets and liabilities as of December 31, 2017, say
Investment assets: Taxable and tax-advantaged accounts less margin loans, etc.
Non-investment assets: Home, furnishings, cars, less mortgages, car loans, etc.
Investment net worth, Total net worth

Income/Expense Statement: for the calendar year 2017, say
Income: Salary, pension, SS benefits, investment income, etc.
Expenses: Recurring … everything except non-recurring expenses (Food, clothing, insurance,)
Non-recurring … Mortgage, income taxes, vacations, health care, etc.

Master spreadsheet: Set up columns for …
… Year, Age thru 100, Spouses age
… Income from various sources (separate column for each source)
… Recurring expenses (lumped into one total sum)
… Non-recurring expenses (separate column for each)
… Portfolio balance = Initial value from balance sheet + Income – Expenses

What-if scenarios and sensitivity analyses
What if you decide to work 2 years longer? Delay taking SS benefits ?
What if portfolio return is less? Inflation is greater than estimated? etc.
Example at www.siliconvalleyaaii.org > Discussion groups

Problems with all retirement planning software
Beware precision output to 5 significant figures; Garbage in … garbage out!
Output is only as good as input assumptions
Life expectancy; actuarial tables only give averages
Rate of return assumptions for your retirement portfolio
Sequence of return risk
Tax rate forecasts, inflation estimates
Compounding these unknowns 35 years into the future is not an exact science!

Best uses for retirement planning software
Learning tool: show how all the pieces play together
Comparison of various scenarios and sensitivity analyses
Even a rough plan is significantly better than no plan. Update and re-evaluate annually.

What if I can't stretch the portfolio to age 100?
Unattractive solutions: Start saving earlier, save more, work longer, reduce withdrawals, seek higher return
Other possible solutions: Tap into home equity; reverse mortgage
Buy insurance; annuity

Home Equity Conversion Mortgage, HECM: insured by Federal Housing Administration, FHA

- Requirements: Age 62 or older, significant equity in principal residence, pay taxes, insurance
- Maximum loan: Lesser of appraised value or $625,000, adjusted for age of youngest borrower
- Form of loan: Lump sum, monthly payments, non-cancellable line of credit, combination
- Cost of a HECM: Closing costs, origination fee, interest, mortgage insurance, service fees
- Possible uses for HECM credit line:
  - Defer Social Security benefit to late retirement
  - Allows smaller short-term cash bucket for emergencies; lower "dead money" cost
  - Reduces sequence-of-return risk; minimizes need to sell equities in a bear market
  - Can provide living expenses if retirement portfolio is exhausted.
    - Non-recourse credit line, unused portion grows at interest rate

Consider an Annuity www.immediateannuities.com

- Insurance contract transfers the risk to insurance company for a fee; inherently expensive
  - Premium payment = actuarial cost of risk + overhead cost + profit
  - Best for low probability risk with high financial cost

- Single premium income annuity, SPIA
  - Supplement income for life; use balance of portfolio for discretionary spending
  - May want to consider a charitable gift annuity
  - Safety rating of insurance company is critical

- Single premium deferred annuity, SPDA; Longevity insurance
  - Example: Purchase SPDA at age 65, defer income stream up to age 85
  - Cost is lower than SPIA, i.e. cash flow rates are higher
    - Insurance company has use of $ for many years before first payment
    - Many purchasers never collect any payments; collect for fewer years
  - Longevity insurance is not underwritten; use adverse selection to your advantage

Potential Train Wrecks to a great financial plan

- Long term care: Provides assistance with the activities of "daily living" www.aaltci.org
  - Bathing, dressing, continence, eating, toileting, transferring (cognitive impairment)
  - 70% of those age 65 and up will need some sort of long-term care
  - Costs >$100k pa for assisted living facility; not covered by Medicare
  - Average stay is about 3 years; If you can afford this, what can go wrong?
    - Must insure for worst-case scenario, e.g. mental incapacitation for 20 years
  - Need a policy with longest term available, with inflation rider if possible
  - Hybrid life insurance or annuity policies available with long term care riders.

- Liability litigation: Umbrella insurance www.whatsmyliability.com
  - Limited coverage included on auto and homeowner's policies
  - Protects against bodily injury to others, property damage, lawsuits for slander, etc.
  - How much coverage do you need?
    - $1M - $2M minimum to incentivize the insurance company
    - $2M - $5M typical; Say net worth + delta
    - $5M - $10M maximum except for HNW individuals.
  - Cost: Approximately $150 - $300 per $1M per annum

Next month, February 14th, 2018: Safe Withdrawal Rates

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