RETIREMENT PLANNING

Up Your Retirement Planning Game

Think of it like playing chess. Making sense of the strategic interplay between investments, taxes and retirement income can position you for a winning retirement.

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When I was 12, I attended a weekend church camp for young men. I was brand new to the group, and as the youngest attendee, I was, as to be expected, mostly ignored by the older boys. But this rebuffing turned out to be a blessing, as it allowed me to learn one of my favorite games, chess. I enjoyed other games, like checkers, but the complexity of chess appealed to me, as it required more thought, planning and strategy. In retrospect, it was clear that I was a retirement planner in the making.

"How is retirement planning like chess?" you may ask. Retirement planning resembles chess due the complex number of factors at play in both endeavors.

Whenever I embark with a new client on their retirement planning journey, it is as if they have a checkerboard and a baggie full of red and black checkers, which represent their current investments and financial plans. My first step is to set up that checkerboard and help place the pieces in their correct spaces as I organize their finances, tax situation and potential legacy issues.

This is where my chess skills come into play as I swap out each checker with a specific chess piece. Why the replacement? Each chess piece has a particular job to do, unlike checkers, which all move in the same way. By assigning each piece of a client's financial plan a specific task, our goal is to maximize the efficiency of that piece and the entire plan.

But that doesn’t entirely do justice to the complexity that can come with retirement planning, which is why I like to think of retirement income planning as akin to the tri-dimensional chessboard featured in *Star Trek*. Level One is the investments and retirement income; Level Two is the taxes; and Level Three is the legacy planning. Understanding that interplay can help position you to reach your goals in retirement.

When you understand these factors and how they relate to each other, you can apply these lessons to your own retirement planning. This involves three steps:

Step #1: Organize your retirement assets

Put pen to paper – or open Excel – and list each of your investment-type assets. These should include assets in your retirement accounts and assets earmarked for retirement outside of your retirement accounts:

- Cash
- Certificates of deposit
- Cash value life insurance
- Stocks
- Bonds
- Mutual funds
- Exchange-traded funds
- Investment real estate

Then create a sub-category that groups them according to their tax treatment. That means anything held in a traditional retirement account, such as a traditional IRA, 403(b) or 401(k), would be labeled as tax deferred. Any accounts outside of retirement accounts in a brokerage account would be classified as taxable. Any accounts in a Roth IRA or Roth 401(k) would be categorized as tax-free. Do not include your primary home or personal property.

Tax treatment is important because assets subject to taxes can be worth less in retirement than assets not subject to taxes. This means that assets in a Roth are usually the most valuable because their qualified distributions are tax-free, while assets in a taxable account are next in line because they potentially qualify for favorable long-term capital gain tax treatment. Assets in a tax-deferred retirement account come in last because you pay taxes at ordinary income rates when you withdraw money in retirement. In addition, when you turn 72, you must take a required minimum distribution from your tax-deferred retirement accounts whether you need that money or not.

Step #2: Determine your retirement goals, needs and wishes

If you don’t know where you’re going, then it will be difficult to determine how to get there. What do you see yourself doing with your newly discovered free time in retirement? Will you be volunteering? Working part-time? Turning a hobby into a business? Spending more time on your hobbies? Traveling? Seeing family?

Also, where will you be living? Will you have two homes? Will you downsize, upsize or just move? Or maybe you will hit the road as a full-time RV'er or live on a houseboat.

And then the big question: How long might you live in retirement? Yes, it's time to consider longevity. What's your family history? How do you take care of yourself? I get it, no one knows how long they will live, but it helps to have a target. And don't be afraid to add an extra five years to it. Medical advancements are growing at an exponential rate – you may live longer than you planned.

Financial advisers commonly plan for their clients to live to age 90, 95 or 100. It's much better to overestimate how long you might live than underestimate.

Step #3: Make a plan on how to get from what you have to what you want

There are many areas here that will need to be addressed, but I feel the most important is creating a lifelong income plan. This process starts with estimating the pre-tax income you will need in retirement. This can be easier said than done, but a good starting point is using 70%-80% of your employment income.

Now that you know your "guesstimated" need, list the income sources that you can count on. These include Social Security, any defined benefit pensions, part-time work, etc. That will help you figure out what gap exists – if any – between the income you need and what you'll have. If, for example, your estimated need is $8,000 a month and your Social Security and part-time work income is estimated at $7,000, you have a $1,000 gap to fill.

You also need to consider the tax implications of your assets and how that flows down to your retirement income plan. If, for example, your income sources – such as tax-deferred retirement accounts – are subject to taxes, then you will need to subtract the estimated amount of taxes from the income you will receive. That means if you plan to withdraw $3,000 a month from your tax-deferred retirement account and you are in the 20% federal tax bracket, you will owe $600 a month in taxes, reducing the actual income you can use to $2,400 a month.

Once you've determined your income gap and taken any taxes into consideration, you will need a plan to fill that gap. There are many options and strategies available, depending on your risk tolerance, and your knowledge about what is available, as well as the reasons why and why not for each. Some of the possible strategies could include a high-dividend investment account, a guaranteed* income annuity, a laddered bond portfolio, or just taking a chance and withdrawing from the stock market.

A final word

Whatever you decide, I believe that the income plan is most critical part of an overall holistic retirement plan. That's because covering your spending needs in retirement brings financial and emotional stability to your retirement years. When you know your need for income is covered, you can relax and enjoy your retirement, confident you will not be running out of money.

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As co-founder of MasterPlan Retirement Consultants, Mark Fricks prides himself on providing clients the tools to help with planning and executing retirement strategies. With over 25 years in the financial services field, Mark concentrates on helping clients strategically navigate their retirement income, while taking steps to consider possible future risks. Mark also has a deep understanding of federal benefits and can help federal employees with their retirement decisions.

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