Retirement Income: Where Will Your Money Come From?

Most people can expect to spend at least 18 years in retirement, yet less than half of all American workers have begun to save for that period of their lives. While it is never too soon or too late to save for retirement, many people put it off until about 10 years before they expect to retire.

But the truth of the matter is you should start planning for retirement well ahead of the last day you expect to work. The earlier you start planning, the more choices you have and the greater your chances for a successful retirement.

If you've wondered whether you will have enough income at retirement to continue your current standard of living, here are some common sources of income to consider as you develop your retirement income plan.

Social Security

Most people expect to collect social security benefits in retirement, either due to their own work record or because they are the spouse of a worker. The amount of your monthly check is based on your earnings during your working years.

The normal retirement age for people retiring now is age 65. Social security calls this a full retirement age and entitling recipients to receive their full retirement benefit. However, for people born after 1938, the full retirement age increases in gradual steps until it reaches age 67. Your social security benefit will be reduced if you retire early - before 65 (or your applicable delayed age) - and increased if you delay retirement past 65 (or your applicable delayed age).

You are eligible to collect social security retirement benefits if you are at least 62 and you worked and earned income for a specified number of years. Laws governing eligibility and how benefits are calculated have changed recently and will undoubtedly change again. While the federal government adjusts your social security income for inflation annually, Congress could amend this rule. So, it is important to keep track of the latest changes and how they may affect the benefits you receive. Visit www.ssa.gov for more information.

Pensions

Ask your employer if your pension will increase with inflation. If so, ask about the method used to calculate the increase. Corporate pensions frequently have little or no inflation protection. Government pensions typically do provide inflation protection, but the actual amount depends on the plan.

Your retirement benefit from a pension plan will be in the form of either a single or a joint and survivor annuity. A single annuity provides benefits until the worker's death, whereas a joint and survivor annuity also provides benefits to the surviving spouse. To fund these additional survivor benefits, the employer reduces the amount of the pension payment. The amount of the reduction sometimes depends on the age difference between the two recipients.

If you and your spouse have adequate pensions, you are less likely to need a joint and survivor annuity. The only way to be sure of this, however, is to develop a retirement budget before you make this important decision.

Personal Savings and Investments
As a general rule, people need 60 to 80 percent of their pre-retirement income to maintain their present standard of living in retirement. Consider that social security benefits may provide about 20 to 33 percent of that sum. Company-sponsored retirement plans may provide an additional 20 percent. To make up for this shortfall, you will likely need to supplement this income with personal savings and investments.

People who do not save for retirement during their employment years may be disappointed in the quality of their retirement life. You may have to curb certain aspects of your lifestyle or take on a part-time job to extend your savings. You also need to be aware of how inflation and taxes can erode the purchasing power of your assets.

Creating Your Retirement "Paycheck"
Whether you have saved adequately for retirement, or you need some additional assistance, you will need an effective strategy for spending your assets.

When developing your retirement income stream, create an income strategy to cover your expenses - both essential and discretionary - in retirement. Once you know what your social security and pension payments will be, use a conservative rate to determine how much you need to withdraw from your investment portfolio annually to support your lifestyle. It is important to determine which sources you will withdraw from first for retirement income. For most people entering retirement, it is best to withdraw from taxable accounts first and to keep tax-deferred accounts growing.

When you do withdraw assets from your tax-deferred accounts (e.g., IRAs and 401(k)s), you need to consider your options carefully, as your decision will affect the amount of taxes you'll pay on the amount withdrawn. Following are some tax rules that could affect your decision.

- All withdrawals from pensions and tax-deferred plans are subject to ordinary income tax rates, unless the amount was set aside from after-tax income.
- Any lump-sum withdrawals are subject to a 10% penalty if you are not yet age 59½.
- You can defer withdrawals from tax-deferred accounts until age 70½. At age 70½, withdrawals must begin based on your life expectancy, or your joint life expectancy with your spouse.

Ultimately, retirement income planning is about funding your lifestyle objectives without running out of money. Longer life expectancies and younger retirement ages have added years to the retirement phase of life. Having a sound strategy for your hard-earned savings can provide peace of mind and a fulfilling retirement. A qualified financial professional can help you develop a strategy that's appropriate for you.

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