BUILDING A RETIREMENT PLAN

After years of saving for your retirement, the day comes when you need to start spending your nest egg. And for many, that can be a scary day. Knowing how to stretch your lifetime savings is just as crucial to your retirement security as the years you spent saving and investing.

Being smart with your retirement funds goes beyond following a budget and balancing your checkbook. Robert Weiss, global head of J.P. Morgan Private Bank's Advice Lab, offers the following tips on how to spend your money wisely in retirement:

Boomer: When it comes time to shift from saving mode to spending mode, what are the biggest factors retirees need to take into account?

Weiss: Sound retirement is within reach for many if they educate themselves on the key opportunities and risks associated with saving and spending. They also need to take the appropriate actions to secure their financial future. Some of the most important considerations for retirees and pre-retirees are:

One very important factor that is often overlooked is the emotional component of retirement. New retirees may become concerned about maintaining and protecting their family's financial security when confronted with the loss of steady earned income. Having to rely solely on financial assets may cause them to feel a lack of control over their financial wellbeing. Uncertainly can lead to emotional decision making, which can also lead to sub-optimal decision making regarding investments. Since new retirees are facing the transition from saving to spending, their emotional vulnerability and behavioral-based investment decisions can take the forefront.

Other non-financial factors that should be considered when retiring is the hurdle of leaving the social network that comes from a job, learning how to make the most of retirement time and truly understanding personal spending patterns.

Boomer: What are the biggest mistakes boomers make when spending in retirement?

Weiss: Spending in retirement may be very different from what people were planning for – meaning most people spend more at the beginning of retirement when they have health and time, and naturally spend less as they age.

Overestimating spending needs late in retirement can leave individuals with regret that they did not spend money when they could enjoy it. Conversely, underestimating retirement spending needs can potentially create tremendous lifestyle risks for a retiree in later years. In order to effectively manage their spending rates, retirees must take into account many factors, including:

- Actual lifestyle spending
- Long-term impact of inflation
- Health care costs
- Emotional vulnerability
- Timing of Social Security
- Benefits of a cost-effective diversified investment approach by asset class and by account type

For example, individuals do not often consider inflation, yet if this important factor is underestimated by 1% (projected 2% instead of 3%), by year 10 a retiree would spend 10% more than their plan projected – potentially putting their family's lifestyle at risk. The timing of expenses is also a key factor, as often retirees decrease spending over time, which may not be accurately reflected in their plan.

Boomer: What tax implications should boomers take into account when they tap their retirement funds?

Weiss: Taxes are one of the most important expenses any investor faces; effectively managing taxes can add substantial value to any wealth plan pre and post-retirement. Retirees should specifically work with their tax advisors to understand factors such as:

- Tax loss carry-forwards
- Alternative Minimum Tax (“AMT”) optimization
- Best accounts from which to seek liquidity
- Income tax optimization with charitable giving
- Transfer tax planning (to family and charity)
- Current and future state of domicile

A good example of the importance of proper tax planning can be shown with the Alternative Minimum Tax (AMT). By timing distributions from taxable retirement accounts to occur in years when a retiree is subject to the AMT, that individual may be able to reduce their overall federal tax bill from that distribution by more than 20%.

Another situation faced by many is that retirees often consider moving to a state that has more favorable tax rules (e.g., Florida, Texas, Wyoming, etc.) than their current state. This is important since the elimination of state tax liabilities on future income would positively impact their ability to enjoy an improved future lifestyle. Interestingly, though, some of the states that have a state income tax also offer exemptions, exclusions, or favorable tax consequences for retirement plan distributions and Social Security (e.g., Pennsylvania), broadening the choices of favorable retirement states .

All that being said, selecting a state of domicile for retirement should primarily be driven by the desire to reside in that state, with an eye toward the tax implications.

Boomer: How do boomers determine what “pots of money” they should tap and in what order?

Weiss: The old rule of thumb of tapping taxable assets first allowing tax-deferred assets to grow may be outdated because people ultimately pay more tax on their tax deferred savings if they have to pull incremental funds from them to pay the tax owed.

Tactically managing the tax picture--particularly early in retirement--to either move money out of tax-deferred assets at low marginal rates or converting portions of the balance to Roth can give greater control over the taxes ultimately paid, and give flexibility longer term in where taxes are paid from.

While hard to talk about, personal mortality needs to be factored into the order of liquidation rules since taxable accounts would qualify for a step-up in basis upon the passing of the owner (eliminating income tax liabilities for any unrealized capital gains); a benefit that is not available to tax-deferred accounts.

Boomer: What policy risks are on the table that could jeopardize or reduce boomers' income in retirement?

Weiss: While an overhaul of the tax code appears unlikely in the near term, some proposals have been floated that could form the basis of a future tax reform package. Pertinent to boomers is the Roth RMD requirement or the Traditional IRA forced distribution within five years of death which really are intended to make IRAs retirement vehicles not wealth transfer vehicles.

Another proposal that could affect some retirees is the proposal to place a lifetime limit on retirement savings. The president's fiscal 2014 budget also included a provision that would tax future contributions to any defined contribution (DC) plan, defined benefit (DB) plan, or IRA if the individual's total balance across all tax-preferred plans (including DB plans) exceeded the amount needed to fund an annuity of $205,000 per year beginning at age 62.

For instance, those living in a state taxing jurisdiction at the time of deferral, those assets are subject to federal and state income tax. In the event the taxpayer moves to a non-taxing jurisdiction upon receipt of those assets, proper distribution planning may reduce state tax.

It is worth restating that these policy proposals are just that, proposals, and nothing appears to be imminent for them. What's more, most policy proposals impact the next generations rather than affecting people close to or in retirement (given voting power and this is an election year).

Boomer: What are the biggest spending hogs that many boomers don't take into account in retirement?

Weiss: Often, the largest dips retirees make into their savings are driven by lifestyle choices or personal interests. Some of these spending habits can be hard for an individual to eliminate, but others, such as second homes, care for aging parents, college tuition for a grandchild, and spending on a child's weddings, can be managed.

One of the unavoidable expenditures for retirees is health-care costs, which historically inflate at 5.1% and closer to 7% or 8% when increased consumption of that category when people age is factored in. Taxes, including income and real estate taxes and housing costs (maintenance costs increase as both the family and home ages), often come as the biggest surprise to newly-retired individuals--and that category continues to be where people spend the most on a percentage basis.

Long-term care costs are another big retirement spending item, averaging $120,000 or more per year in New York and in the Northeast. This cost is important to evaluate given that there is a one in 10 chance of a five year stay or more in one. And women having a 75% chance of needing some form of care during their lifetimes.

Overall, sound planning around retirement spending can have a meaningful and positive impact on an individual’s ability to live how they want in retirement.