



## Managing Your Money in Retirement

In most cases, necessary expenses such as food, shelter, utilities, and health care are likely to be almost the same as when you were working. That's why the path you plot to retirement should include specific plans for managing your money so that it lasts as long as you'll need it.

A good way to start is by doing a trial run of your financial plans for retirement through AARP's online Retirement Calculator, at [www.aarp.org/retirementcalculator](http://www.aarp.org/retirementcalculator). To complete the calculation, you'll need to collect some information, such as how much you expect to receive from Social Security or a pension. This exercise will give you three useful types of information:

- ❖ An estimate of the amount of retirement income you'll need
- ❖ The sources of money, such as Social Security and a 401(k), you'll have to fund your retirement
- ❖ Alternatives for meeting your income needs

### Financial Risks in Retirement

Throughout life, everyone faces personal risks that can have an impact on their finances, such as job loss, an accident or illness, a business failure, or bad investment decisions. In retirement, when your income is usually lower and your prospects for earning are smaller or do not exist, you need to be especially aware of other risks such as:

- ❖ Inflation, which can lower the spending value of the savings you are using to pay expenses
- ❖ Investment ups and downs, especially in the stock market
- ❖ Rising, often unexpected, medical and caregiving expenses

- ❖ Living longer than expected, and longer than your financial plan supports

### Money Management Options

After using the AARP Retirement Calculator, you'll have a pretty accurate idea of how much money you'll need for a comfortable retirement, and how much money you can count on to finance those "golden years."

Most retirees have two types of income. One type is a reliable, usually monthly, source such as Social Security, a pension or an annuity. The other is retirement savings, which may be in the form of bank savings accounts or investments. The investments may be in a retirement account such as a 401(k) or IRA, in a regular brokerage account, or in real estate. Or they may simply be mutual funds or stocks and bonds that you've bought directly.

Your first challenge is to maximize the regular income streams by making informed decisions about when to start withdrawing Social Security or a pension. See AARP's financial publications on Social Security and pensions for details. Then use AARP's free online Social Security Benefits Calculator, at [www.aarp.org/socialsecuritybenefits](http://www.aarp.org/socialsecuritybenefits), to help you time your claim.

The next challenge is to figure out what to do with your cash and investments to protect yourself against inflation risk and running out of money too soon.

### An Example

To understand the challenge, consider this hypothetical example: Ann and Sam Miller are both retired. They are 65-years-old and assume they'll live until 90. The Millers need \$40,000 a year to pay their basic expenses. Their Social

Security checks add up to \$20,000, and Sam's pension adds another \$10,000. That leaves them with \$30,000—\$10,000 a year short. Their only other possible source of income is \$100,000 in their IRA. What could they do with the IRA money to get them closer to the \$40,000 a year they need?

### Here are their choices:

- ❖ Withdraw a certain amount of money out of the IRA every month, hoping it won't run out too soon.
- ❖ Cash out the IRA to buy an immediate annuity—a contract with an insurance company that guarantees a minimum income for the rest of your life.
- ❖ Do some of each: Use some money to buy an annuity, and keep the rest to invest (hopefully to keep up with inflation) and withdraw as needed.

### Factors to Consider

There is no one, simple solution to the Millers' problem. If you face a similar situation, you need to consider several factors, and do some financial calculations. Here are some of the most important things to consider:

- ❖ Your age and life expectancy: Your age, your health status and family medical history can help you estimate how many years you may need your money to last.
- ❖ Types of assets: If you have money in a 401(k), IRA or similar retirement account, Uncle Sam requires you to start withdrawing it—at a specific rate based on your life expectancy—by April of the year after you turn 70½. If you don't make the withdrawals the IRS requires, you must pay a penalty of 50 percent on the amount you should have withdrawn. There is no similar rule for a traditional pension or for Roth IRAs.
- ❖ Tax situation: Check on the taxes you'll have to pay for receiving income from different sources. You do not have to pay

income tax on money withdrawn from your Roth IRA (if you've had the account for at least five years and are 59½ or older), but you must pay tax on income from a 401(k) or a traditional IRA. The profit you receive from selling stocks, real estate or other investments will also be taxed, but at the capital gains rate, which may be less than your income tax rate, especially if you've held those investments long-term.

- ❖ Your investing and money management expertise: Some people feel more secure and believe they can make more profits making their own investment decisions or working with a financial advisor. Others feel more secure by putting the money into a fixed annuity, which they do not have to invest, and which guarantees them a certain amount of money for the rest of their life.

### Making a Plan

Now let's go back to the three types of options, to figure out what's best for you.

- ❖ Set up a withdrawal plan. Many investment advisors recommend withdrawing 4 percent of the value of your total cash and investments per year, and giving yourself a 3 percent "raise" each year to keep up with inflation. But you should calculate to see how much income this will provide you, and how long your money will last at that or another rate. You'll also have to decide whether to make your own investment decisions, or to work with a financial professional. In any case, your minimum goal should be to increase the value or receive enough income from your investments to keep up with inflation.
- ❖ Buy an immediate annuity: Take money out of your account(s) and purchase an annuity that pays a certain amount for the rest of your life. There are many different kinds of annuities, including a variable annuity that does not guarantee a certain amount of income. Other types may not provide a cost-of-living increase.

If you are tempted to buy an annuity, make sure the insurance company is financially sound and read AARP's financial publication called "Annuities" (at [www.aarp.org/orderfinancialpubs](http://www.aarp.org/orderfinancialpubs)) to learn more about the pros and cons of this type of investment.

❖ Do some of each: Use some money to buy an annuity and keep the rest to invest (hopefully in a way that keeps up with inflation) and withdraw as you need it.

### Your To-Do List:

- ❑ Learn more about money management options by reading "Don't Run With Your Retirement Money" on the Actuarial Foundation's website. Search for it at [www.actuarialfoundation.org](http://www.actuarialfoundation.org).
- ❑ Estimate how long your retirement savings will last at different withdrawal rates using the calculator at [www.money-zine.com](http://www.money-zine.com). Search for "Retirement Withdrawal Calculator."
- ❑ Learn more about managing your money from the AARP website, [www.aarp.org/money](http://www.aarp.org/money).
- ❑ Learn about the IRS' required minimum withdrawals from retirement accounts at [www.aarp.org/RMD](http://www.aarp.org/RMD). For more information, you can search for "Publication 590" at [www.irs.gov](http://www.irs.gov).
- ❑ If you need help creating a retirement money management plan, read AARP's financial publication called "Working with a Financial Professional," at [www.aarp.org/orderfinancialpubs](http://www.aarp.org/orderfinancialpubs).
- ❑ To estimate how many years you might live, use the life expectancy calculator at [www.livingto100.com](http://www.livingto100.com).



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