Government Executive

Why Your Retirement Spending Estimates Are Probably Wrong

By Tammy Flanagan

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This week, I thought it would be interesting to conduct a roundtable interview with five financial planners who work with federal employees. I spoke with Diana Davis from Money Concepts; Karen P. Schaeffer with KarenSchaeffer Financial, LLC; Micah Shilanski at Shilanski & Associates Inc.; Kristina E. M. Sturgis, with Valenstein & Patterson; and Joe Sullender with the Financial Strategies Group of Wells Fargo Advisors.

How do you plan for retirement in a volatile market?

Sturgis: As we are several years into a bull market, we frequently recommend that clients approaching retirement with significant wealth in their TSP consider two allocations: a more conservative one for the wealth they have already built, and another allocation for future contributions, which takes advantage of the market roller coaster. This allows them to not only reduce loss during market declines, but to have a place to draw from to buy into a correction at attractive prices.

Shilanski: A basic rule of thumb is not having any money you are going to spend in the next 5 years in the market, and this would go for the TSP as well.

Sullender: You have to first evaluate your need for the funds. Today is no different than yesterday or tomorrow – the market always has volatility and we should prepare for it at all times. The best way to prepare is by diversifying your assets across multiple asset classes.

Does the strategy change if you are already retired?

Shilanski: Not really, if you keep focused on how much money you will need to spend out of your investments in the next five years that helps in determining how it should be invested.

Sullender: Absolutely. In that case you should be much more conservative. I would always have at least the next 3 to 5 years' worth of needed withdrawals in something safe in case you need a withdrawal during a particularly poor market environment.

Sturgis: The TSP is an efficient accumulation vehicle but generally unattractive in the distribution stage of retirement. (Currently the TSP does not allow an investor to choose to take only dividends and interest, and forces sells across all funds for monthly distributions).

How do you gauge how much money a client needs to live on and why is it so hard to estimate spending?

Davis: Spending is not linear. I find most people spend a lot of money the first 18 to 24 months of retirement. They are retired, not dead, so most are out having a great time traveling, etc. I recommend to many clients that they reduce TSP contributions in the last few years to 5 percent so they can pay down debt and build up cash to go spend.

Shilanski: Everything they are spending before retirement. The reality is, with rare exception, what you spend before you retire you will spend after retirement unless there is some large expense that goes away (like paying off your mortgage). Short of that we, are creatures of habit.

Sullender: I think people go about it the hard way. When I ask a client to estimate spending, often they bring in a spreadsheet of itemized expenses. This is very often underestimated and doesn't take into account non-monthly expenses or just simply omits some smaller items. For 20 years I have always taken the approach that the best way to estimate one's expenses is by simply looking at after-tax take home pay (and any other income coming into the household) and subtracting monthly savings from this number. Bottom line is, if it is coming into your household and not being saved, it is being spent.

What are some of the big ticket items that people miss?

Shilanski: Miscellaneous monthly expenses. We all have unexpected items that come up just about every month. The next is another car. The third would be housing. We forget that even though our house is paid off we have taxes, insurance and repairs.

Sullender: Non-monthly expenses like travel, holiday gifts, car repairs, medical expenses, pet costs, etc. Or they simply miss the $20 here and there that we spend without thinking. Those things tend to add up over the year and don't normally get counted the way that a phone bill or mortgage payment would.

How often do you advise your clients to curtail their spending?

Shilanski: We look at spending from a macro perspective, so we look at the bank account and credit card balances when we meet and look to make sure everything is in line. When it is not, then we talk about it and see how we need to get back on track.

Schaeffer: Many people underestimate what they need to live on for two reasons: They know that at one time they did live on less, and they know they spend money on things that are totally discretionary. Often times they are rounding down on every expense category or completely forgetting very routine things—dry cleaning, expenses related to again parents and pseudo adult kids, hobbies, gifts, etc. Couple the assumption that they can easily live on less with the desire to retire as soon as possible and they start to mislead themselves.

Sullender: I would only do this if necessary. If you can afford to spend lavishly and still meet your other longer-term goals, then go for it! But if you need to cut spending, I would recommend doing an itemized budget. Simply track your expenses for a few months—don't cut, just track it—and at the end of 3 to 4 months evaluate the numbers. Usually, looking at the real numbers on paper illuminates the possible solution.

How do you approach a conversation like that?

Shilanski: Carefully. Money is one of the top reasons people get divorced. What we have found to be the most helpful is to focus on goals and not so much on what they are not doing.

Sullender: It is important to frame the conversation: We aren't eating peanut butter sandwiches four times a week just because an advisor said we need to cut our spending; we are doing so for the benefit of our future goals. It's just getting people to think beyond the upcoming month or two weeks.

Do you work with clients' children, as well?

Schaeffer: Once clients get into retirement and/or have a health scare, we always tell them we need to meet the children. It's totally unfair to put a child in the situation of not knowing what to do for an incapacitated parent and worse yet, not have the legal authority to step in. We insist that the appropriate estate planning documents are not only drafted, but that good conversation between the clients and people named in the documents (often adult kids) takes place.

Sullender: Yes. Many clients want their children to meet me so they "know who to call" if something were to happen to them.

How do you help your clients prepare for long-term care? Do you advocate for all of your clients to buy

long-term care insurance?

Schaeffer: We recommend long-term care insurance to all our clients who can afford it without jeopardizing a higher priority financial goal (getting more money in to TSP, paying down expensive debt, for example). We educate them on the limitations of Medicaid and the risks of giving assets away in order to qualify for it. We also can give them real examples from the client files of people who had very serious health issues as young retirees. Good news, they recovered. Bad news, the out of pocket costs were $300,000.

Sullender: No. Many do not need long-term care insurance. First, some people have more than enough assets to cover even a long stay in a long-term care facility (or having care at the home). In those cases, buying the policy is simply what I would call “inheritance insurance” to protect your assets for your beneficiaries. It isn’t a matter of affording the care, it’s a matter of minimizing the cost. As it is with most insurance, it is a peace of mind protection you are purchasing.

What are some other aging concerns that come up?

Sullender: I think most people need to meet with an estate attorney to draw up the basic documents: a will, power of attorney and living will. Beyond that, there may be more planning you wish to implement, particularly if you have a more complicated estate or beneficiary situation.

Sturgis: We have seen an increased need for developing family strategies to respond to gradual cognitive decline, which is coordinated with our legal experts.

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http://www.govexec.com/pay-benefits/retirement-planning/2015/10/why-your-retirement-spending-estimates-are-probably-wrong/122670/