Social Security Case Study

Mr. & Mrs. Smith present us with the following facts:

Husband, 62 and wife, 64 have both stopped working full-time and have come to me for advice.
Mr. Smith continues to work part-time playing in a band making $1,200.00 per month and intends to play "until his last breath". Wife no longer works. At the meeting, the Smith's advise me that they plan to start taking Social Security benefits immediately, have a monthly income goal of $5,500.00 and would like to fund that with as much guaranteed income as possible. Their assets: a cash balance pension plan of $265,417.00 and $160,000.00 in IRAs. Their total pool of assets: $425,417.00. They have no children.

Mr. Smith tells you their plan to achieve this goal is to take the monthly payment option on his pension of $1,305.00 and file for Social Security benefits immediately. His PIA is $2,124.00 and Mrs. Smith's PIA is $1,417.00. Because he is only 62, his benefit would be reduced by 25% to $1,593.00 and Mrs. Smith at 64 would suffer a 13.33% reduction resulting in a benefit of $1,228.00.

Monthly Income Goal:	$5,500.00
Earned Income:	$1,200.00
Pension:	$1,305.00
Mr. Smith SS:	$1,593 (@ 62)
Mrs. Smith SS:	$1,228 (@ 64)
Monthly Shortfall:	**$174.00**

Mr. Smith advises he intends to draw the $ 174.00 monthly shortfall from their $160,000.00 in IRA money. A rate of return of only 1.5% can easily achieve their income goal. Their plan basically meets their goal of maximum guaranteed income, falling short by only a de minimis amount each month.

Sounds like a well thought out plan, right? Well, let's look at how this plan fares in the face of the triple threat of longevity, inflation and taxes.

% of income that is guaranteed **75%**

We arrive at that percentage by totaling their guaranteed sources of income and dividing that figure by their monthly income total: $1305 (pension) + $2,821 from Social Security/$5500 monthly income: 75%

% of income goal adjusted for inflation **51%**

We arrive at that percentage by totaling their income from Social Security $2,821/$5500 monthly income: 51%

% of income goal that is taxable **64% ($42,460)**

The following reviews the method by which the tax percentage is calculated.

Other Taxable Income:	32,148
½ Social Security	+16,926
`	49,074 (Provisional Income)

First Threshold:	Second Threshold:	Total Taxable SS:	Total Taxable Income:
49,074	49,074	8,537	32,148 (Other)
-32,000	-44,000	1,775	10,312 (Taxable SS)
17,074	5,074	$10,312	$42,460
X .50	X .35		
$ 8,537	$ 1,775		

Total taxable income $42,460 / Total Income $66,000 = 64%

Beyond the fact that the Smith's will meet their monthly income goal, their plan fails to effectively address the three biggest threats to their financial stability in the long-term: only three quarters of their money is guaranteed, only half is inflation adjusted and a whopping 64% is taxable.

First, consider the fact that they are both taking a reduction on their Social Security benefit to meet their monthly needs. Modifying this approach is a first step towards achieving a more sustainable plan. Second, Mr. Smith intends to elect a monthly payment option from his pension, but can choose to take a lump-sum distribution and this should be considered as a potential source of funding.

With those facts in mind, this Mr. and Mrs. Smith will meet their needs and improve the sustainability of their plan in the long term.

Proposal 1: The "Some Now, More Later" Option
This plan assumes that the couple delays taking benefits until FRA, which will not only improve the sustainability of the plan will also significantly improve the survivor benefit, and utilizes their pool of assets between 62 and 70 to meet their monthly needs. Given their age difference of 2 years, it's easiest to separate this case into phases, identifying their age and the steps they should take in each phase.

Phase I

From Husband's age 62 to age 64, where wife is age 64 to age 66:

Income Goal:	$5,500
Earned Income:	1,200
Husband SS:	0
Wife SS:	0
Monthly Shortfall:	$4,300 (x 24 months = $103,200)

The income shortfall in this phase is met utilizing funds from the combined retirement asset pool of $425,417.

Phase II

From Husband's age 64 to age 66, where wife is age 66 to age 68

Income Goal:	$5,500
Earned Income:	1,200
Husband SS:	0
Wife SS:	1,417(where she files and takes a full benefit at FRA)
Monthly Shortfall:	$2,883 (x 24 months = $69,192)

Here again the income shortfall is funded from the remaining amount of the combined retirement asset pool of $425,417 and the added income comes from Mrs. Smith filing for her full benefit at FRA.

Phase III

From Husband's age 66 to age 70, where wife is age 68 to age 72

Income Goal:	$5,500
Earned Income:	1,200
Husband SS:	708 (where he files a restricted application for spousal benefits only)
Wife SS:	1,417

Monthly Shortfall: $2,175 (x 48 months = $104,400)

Mr. Smith having reached FRA can file a restricted application for spousal benefits only and receive half of his wife's PIA, she continues to receive her full benefit and the income shortfall is funded from the remaining amount of the combined retirement asset pool of $425,417.

Culmination of Plan

From Husband's age 70 +

Income Goal:	$5,500	
Earned Income:	1,200	
Husband SS:	2,804	(His PIA at 2,124 x 1.32% reflecting DRCs)
Wife SS:	1,417	
Monthly Shortfall:	$ 79	

With Mr. Smith achieving age 70, he now files for his full benefit which has grown from $2124 to $2804 monthly and the monthly shortfall of $79.00 drawn from the remaining amount of the combined retirement asset pool of $425,417.

IMPORTANT REMINDER: None of the figures in these calculations include any adjustment for COLA, therefore recognize that the Social Security amounts are lower than the amount the Smith's will actually receive.

Total Asset Spend Down:	$103,200	Phase I
	69,192	Phase II
	104,400	Phase III
	$276,792	

Assets Remaining	$425,417 (Combined Retirement Asset Pool)
at Culmination	(276,792)
of Plan:	$148,625

By utilizing the "Some Now, More Later" option, what have we accomplished?

	Before	**After**
% of income goal guaranteed	75%	77%
% of income goal adjusted for inflation	51%	77%
% of income goal that is taxable	64%	30%
	($42,460 v. $19,685)	

The pool of remaining assets of $148,625 needs to earn less than 1% to meet their income needs, we've increased their guaranteed income to 77%, increased the amount of their inflation adjusted income to 77% and reduced the amount of their taxable income at the culmination of the plan to just 30% utilizing this claiming strategy.

Proposal 2: The "More Now, Less Later" Strategy

This plan assumes that the older spouse, Mrs. Smith, takes benefits early at 64 and utilizes their pool of assets to meet their monthly needs. We propose this plan to lessen the impact on their retirement assets, as this could be a potential concern for the Smith's.

Phase I

From Husband's age 62 to age 66, where wife is age 64 to age 68:

Income Goal:	$5,500	
Earned Income:	1,200	
Husband SS:	0	
Wife SS:	1,228	(where reduced by 13.33% for taking at 64)
Monthly Shortfall:	$3,072	(x 48 months = $147,456)

The 48 month shortfall is funded from their retirement asset pool of $425,417.

Phase II

From Husband's age 66 to age 70, where wife is age 68 to age 72

Income Goal:	$5,500	
Earned Income:	1,200	
Husband SS:	708	(where he files a restricted application for spouse benefits only)
Wife SS:	1,208	
Monthly Shortfall:	$2,384	(x 48 months = $114,432)

Mr. Smith, having attained FRA, files a restricted application for spousal benefits only and receives half of Mrs. Smith's PIA (refresher: it is half of her PIA, not half of the reduced benefit), Mrs. Smith continues taking her reduced benefit and the income shortfall is funded from the remaining amount of the combined retirement asset pool of $425,417.

Culmination of Plan

From Husband's age 70 +

Income Goal:	$5,500	
Earned Income:	1,200	
Husband SS:	2,804	(His PIA at 2,124 x 1.32% reflecting DRCs)
Wife SS:	1,208	
Monthly Shortfall:	$ 288	

With Mr. Smith achieving age 70, he now files for his full benefit which has grown from $2124 to $2804 monthly and the monthly shortfall of $79.00 drawn from the remaining amount of the combined retirement asset pool of $425,417.

IMPORTANT REMINDER: None of the figures in these calculations include any adjustment for COLA, therefore recognize that the Social Security amounts are lower than the amount the Smith's will actually receive.

Total Asset Spend Down:	$147,456	Phase I
	114,432	Phase II
	$261,888	

Assets Remaining	$425,417 (Combined Retirement Asset Pool)
at Culmination	(261,888)
of Plan:	$163,529

By utilizing the "More Now, Less Later" option, what have we accomplished?

	Before	**After**
% of income goal guaranteed	75%	73%
% of income goal adjusted for inflation	51%	73%
% of income goal that is taxable	64%	35%
	($42,260 v. $22,820)	

The pool of remaining assets of $163,529 needs to earn 2% to meet their income needs, while their guaranteed income has decreased by 2% (as a result of Mrs. Smith taking benefits prior to FRA) we've increased the amount of their inflation adjusted income to 73% and reduced the amount of their taxable income at the culmination of the plan to just 35% utilizing this claiming strategy.

Summary of Plans:

1. **The Smith's Plan:** Take Social Security early and take monthly pension payments.
   - % of income goal guaranteed: 75%
   - % of income goal adjusted for inflation: 52%
   - % of income goal that is taxable: 64%
   - Assets remaining at culmination of plan: $160,000

2. **The "Some Now, More Later" Plan:** Lump-sum pension distributions, Mrs. Smith at FRA, Mr. Smith files restricted application at FRA then takes maxed benefit at 70.
   - % of income goal guaranteed: 77%
   - % of income goal adjusted for inflation: 77%
   - % of income goal that is taxable: 30%
   - Assets remaining at culmination of plan: $148,625

3. **The "More Now, Some Later" Plan:** Lump-sum pension distributions, Mrs. Smith takes early, Mr. Smith files restricted application at FRA then takes maxed benefit at 70.
   - % of income goal guaranteed: 73%
   - % of income goal adjusted for inflation: 73%
   - % of income goal that is taxable: 35%
   - Assets remaining at culmination of plan: $163,529

Survivor Benefits

An *extremely important* issue that must be taken by the Smith's into consideration as they ponder their options electing Social Security benefits is the issue of survivor benefits. Recall that the amount of the survivor benefit paid at the time of a workers' death is dictated by when the worker elected (or chose not to elect) benefits during their lifetime. As a result, timing of the retirement benefit election has a lasting impact on the survivor benefit paid. With regard to the Smith's, if the information provided thus far regarding the sustainability of their plan isn't compelling enough to consider alternatives, a mere cursory review of the survivor benefit payable under each plan should be convincing.

Plan	Survivor Benefit at Plan Culmination
The Smith's Plan	$1,503/$19,116 per year
"Some Now, More Later"	$2,804/$33,648 per year
"More Now, Some Later"	$2,803/$33,648 per year

By utilizing either of the proposed strategies, the surviving spouse will receive an *additional 57%* as a survivor benefit upon culmination of the plan. This factor alone should give the Smith's pause to consider that their original plan is likely not their best option. Again, the figures reflected above assume the proposed plans reach their culmination. But what happens to the survivor benefit if either party dies prematurely?

Even if, in the worst case scenario, one of the Smith's passes before plan culmination under either proposal, the survivor benefit in nearly all years, based on the methodology used to calculate the benefit, will be greater.

In short, the survivor benefit is a key element in plans that include Social Security as their foundation. It is strongly recommended that all plans that include Social Security as a funding vehicle take into consideration this important and lasting element of a married worker's claiming strategy.