CAN YOU AFFORD TO RETIRE?

6/29/17

RETIREMENT PLANNING

As investment executives who specialize in helping our clients meet their financial goals, we understand that you may have questions about the areas you need to focus on during this phase in your life. This special report presents the main areas that need to be addressed to make sure that you are on track for a successful retirement.

WWW.STONEHEARTHCAPITAL.COM
199 ROSEWOOD DRIVE, SUITE 200 • DANVERS, MA 01923 • {978} 624-3000

CAN YOU AFFORD TO RETIRE?

Retirement is not a dress rehearsal. You want to make sure that you get it right the first time. While the question is relatively simple, the analysis to answer the question can be rather complex. We would like to highlight the areas that need to be explored when asking yourself whether or not you can afford to retire.

AREAS INCLUDE:

- Pension
- Social Security
- Health Insurance
- Required Minimum Distributions

1. PENSION

Traditional pension plans are becoming obsolete. Most employers have switched to offering 401k/403b plans with matching employer contributions as part of a cost savings exercise. For those fortunate enough to collect a pension in retirement, there are a handful of decisions that you will need to address before you begin collecting benefits.

1. Some employers give you the choice to collect your pension as a monthly income stream or as a lump sum. The decision on which is right for you will depend upon the terms of the offer and which scenario improves your financial plan. There are some additional factors that might also influence your decision, such as whether or not you have kids. If you have kids, you may lean towards the lump sum option because the monthly income stream option terminates when you and/or your spouse pass away, potentially reducing the amount that you pass onto your children.

2. If you elect to take a lump sum, your employer will typically send you a package that will outline your options. Most plans will give you the option to rollover the funds to an IRA preserving its tax-deferred status.

3. If you elect to receive a monthly income stream, you will need to make a survivor election if you are married. This election impacts your spouse and whether or not they will receive your monthly pension in the event that you pass away. Most employers will present your options as follows:

Option	Your Pension Benefit	Survivor Election	What Your Spouse Receives
1	$5,000	0%	$0
2	$4,700	50%	$2,350
3	$4,425	100%	$4,425

The first option entitles you to $5,000/mo of pension benefits, but if you predecease your spouse, then your spouse will not receive any of your pension benefits going forward. The second option means that you agree to collect a lower monthly benefit of $4,700/mo in exchange for your spouse receiving $2,350/mo if you predecease your spouse. The final option is to further reduce your monthly pension benefits in exchange for passing 100% of your pension benefits to your spouse if you predecease him/her.

One strategy to consider is if you are healthy enough to qualify for life insurance, you can elect the 0% survivor to receive the higher monthly pension benefits and use some, or all, of this excess to purchase a life insurance policy that will benefit your spouse if you predecease him/her. Be sure to get the insurance in place before you elect a 0% survivor.

2. SOCIAL SECURITY

If you are entitled to Social Security retirement benefits, then you can claim benefits anytime between the ages of 62 – 70 (age 60 – 70 for widows and widowers). You are entitled to 100% of your benefits when you reach your full retirement age (66 - 67). If you claim benefits early, they are permanently reduced and if you claim later, they are permanently increased. Claiming decisions can have a profound impact on your overall finances.

Similar to the pension analysis above, it is best to run the different claiming decisions within a *financial planning software*. There are a growing number of *Social Security only calculators* available, but remember that these only look at your Social Security benefits and do not take into consideration how these decisions will impact other areas of your finances. Financial planning software will be able to handle the impact that different claiming decisions will have on your portfolio. The software will highlight which claiming decision will prevail at any given age. In most cases, if you project a shorter than average life expectancy, then claiming early makes sense. If you project a longer than average life expectancy, then delaying benefits makes sense. However, the challenge with this generalized statement is that spousal and widow benefits need to be taken into consideration and they can have a real impact on the results.

Claiming decisions can be rather complex and it is best to consult with a professional who can help you navigate your options. To help you learn more about Social Security, we have written a whitepaper that can be found here[1].

3. HEALTH INSURANCE

If you retire prior to age 65 (when you may become eligible for Medicare), you need to take into consideration health care costs. Some employers offer retirees access to the same, or similar, health insurance coverage they had leading up to retirement. Sometimes this is subsidized by the employer, and sometimes it is not. If your employer does not offer health insurance to bridge the gap between retirement and age 65, then you will need to see if you can get coverage through your spouse or obtain a private health insurance policy. The cost of a private policy varies by state and will depend on the benefits you elect. The greater the benefits, the greater the cost. We use $1,000/mo per person with 5% inflation for private policies when we are projecting whether or not someone can afford to retire.

At age 65, most people will be entitled to Medicare. Each family will need to do an analysis to determine which coverage works best for them. When analyzing your choices, just remember that you get your health insurance through either Medicare Advantage or Original Medicare. Medicare Advantage can be described as a "one-stop shop" solution, while Original Medicare is more of an "a la carte" solution (ex. Parts A, B & D coverage). Both have their pros and cons. It is really a personal decision.

1 http://www.stonehearthcapital.com/p/whitepaper-archive

Within client financial plans, we presume Medicare (either Advantage or Original) cost around $400/mo per person inflated at 5%/year going forward. This is a rule of thumb, and there are certainly exceptions. Check with your employer to see if they offer any health insurance benefits once you reach age 65.

There are a handful of resources out there to help you and your family decide which option is best for you and which insurance offers the greatest amount of coverage based on your needs. A great place to start your research would be with your State's Health Insurance Program (SHIP). This is a free service allowing you to schedule an appointment with a Medicare trained counselor who will help review your options. You can find contact information for your state's SHIP team here[2].

4. REQUIRED MINIMUM DISTRIBUTIONS

When you turn 70.5, the IRS requires that you start taking minimum distributions (RMD) from your retirement accounts (excluding Roths). Most of us have never paid taxes on the monies within our retirement plans, and the IRS would like to start collecting some tax revenue (hence why it is required). The penalties are steep if you fail to take your RMD, so you want to make sure that you are addressing it. When possible, consider automating the process so that it is not forgotten.

The first year that you take an RMD, the RMD will amount to approximately 4.5% of your retirement account value. The following year, it will increase to approximately 4.75%. The percentage steadily increases as you get older requiring that you take out more each year. There is an actual formula that needs to be calculated using your prior year-end account value and your age. Remember that this will be reported as taxable income, and your effective tax rate, and potentially your tax bracket, may go up as a result.

There is one exception to this rule. If you are still working and you are less than a 5% owner, then you can delay taking an RMD from your employer sponsored retirement plan 401k/403b (other retirement plans do not qualify such as old 401k accounts or IRAs) until you retire. We would still suggest that you verify this with your employer sponsored plan administrator. They can go over your options and when you must begin taking RMDs. Once again, the penalties for failing to satisfy your RMD are steep, so you want to make sure you are compliant with the rules.

5. ADDITIONAL OBSERVATIONS

Generally speaking, your expenses right after you retire will drop by about 15% - 35%. When you retire, your wages are eliminated. This means you are no longer contributing 7.65% to Social Security and Medicare taxes. Also, your taxable income is reduced resulting in lower taxes, and potentially a lower tax bracket. Don't get too excited because the bracket usually increases when you turn 70.5 due to RMDs, although the bracket usually stays lower than it was during your preretirement days. The other reason that expenses typically go down is because you are no longer contributing to your 401k/403b plans.

After you retire, you should expect that your expenses will rise over time with inflation. Inflation is one of the biggest known challenges that retirees face, and it needs to be taken into consideration when analyzing your ability to retire. We use 3.74% assumed inflation going forward. Lately, inflation has been hovering around 2%, but we expect it will continue to fluctuate over time. A family with expenses of $100,000 today, growing at 3.74% over 19 years, can expect those expenses to grow to $200,000 while living the SAME lifestyle they were 19 years ago.

We would be remiss if we didn't point out some additional variables that need to be explored and discussed that may or may not surface during your retirement.

[2] http://www.seniorsresourceguide.com/directories/National/SHIP/

ADDITIONAL VARIABLES INCLUDE:

- Higher than normal inflation
- Higher tax rates
- Higher health insurance costs
- Nursing home costs
- Lawsuits
- Portfolio drawdowns

There are tools to address each of these potential issues. You *cannot* fully insulate yourself from all risks but you can often *reduce* your exposure to these risks if/when they become present by planning ahead.

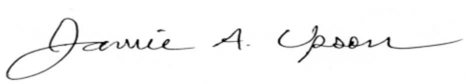
SUMMARY

So can you afford to retire? If you want to do the analysis right, then be prepared to roll-up your sleeves because you will be getting a little dirty. There is no way to fast track this analysis (sorry robo-advisors). I have highlighted the main areas that need to be explored for most families to properly analyze whether or not they can afford to retire. If you have the time, energy and resources to properly analyze your financial situation, then you will be well on your way to an answer. If not, then I would consider hiring a professional.

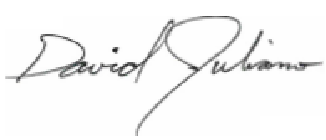
If you have been thinking about retiring, you will be happy to know that we have been thinking about it too for over 35 years. We are here to help you answer the question, can YOU afford to retire?

If you would like to discuss your personal financial situation, please do not hesitate to give our office a call at (978) 624-3000. We would be happy to talk to you.

Sincerely,



Jamie A. Upson, CFP®, CMFC, AAMS
President & CEO
Jamie@stonehearthcapital.com



David Juliano CLU, ChFC, RICP
Senior Financial Advisor
David@stonehearthcapital.com

Footnotes and disclosures:

Stonehearth Capital Management, LLC is a Registered Investment Advisor. Registration does not imply a certain level of skill or training.

Opinions, estimates, forecasts and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice.

This material is for information purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security.

Investing involves risk including the potential loss of principal. No investment strategy can guarantee a profit or protect against loss in periods of declining values.

Diversification cannot guarantee a profit or protect against loss in a declining market.

Opinions expressed are not intended as investment advice or to predict future performance.

Past performance does not guarantee future results.

Consult your financial professional before making any investment decision.

Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. Please consult your financial advisor for further information.

These should not be construed as investment advice. Neither the named representative nor the named Broker dealer or Investment Advisor gives tax or legal advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. Please consult your financial advisor for further information.

By clicking on these links, you will leave our server, as they are located on another server. We have not independently verified the information available through this link. The link is provided to you as a matter of interest. Please click on the links below to leave and proceed to the selected site.