
On the Case: A Solution from 'Retirement NextGen'

By Kerry Pechter Thu, Aug 17, 2017

Robert Fourman, a colleague of Curtis Cloke at Acuity Financial, uses their Retirement NextGen software to create a retirement income plan for Andrew and Laura, a near-retirement couple with \$1.24 million in savings and \$1.8 million in real estate assets.



As you may remember from last week's installment of "On The Case," Andrew, 64, and Laura, 63, two psychotherapists, continue to wonder how to generate enough retirement income from their \$1.24 million in savings. Laura wants to go part-time right away. Andrew is willing to work until age 70, but he'd like to retire earlier.

So far, three advisors have analyzed the case, each using his own proprietary software. Now comes a new [analysis](#) by Robert Fourman, CFP, EA of Acuity Financial. Fourman uses the [Retirement NextGen](#) software, which he and Curtis Cloke, the well-known founder of Thrive Financial in Burlington, Iowa, developed.

Fourman encourages Andrew and Laura to annuitize part of their savings and to increase their equity exposure, as did Mark Warshawsky in his ReLIAS software-driven solution, published in RIJ on **July 20**. Fourman makes a few different assumptions and comes up with a somewhat different solution. He provides detailed projections of the couple's cash flows and balance sheet.

Andrew and Laura are clearly approaching retirement in better shape than most American couples will. But their expectations are also much higher. They're accustomed to a gross income of about \$300,000. Social Security, a small pension and some rental property income will bring in a guaranteed, inflation-adjusted \$114,000 each year. But how much income will they really need, and how should they generate it?

Quick take-away

Andrew and Laura estimate that they'll need a gross income of \$140,000 in retirement. That's less than half their usual income, but it reflects the fact that they won't be contributing \$50,000 apiece to SEP-IRAs every year. That leaves a \$36,000 annual income shortfall.

Fourman's proposal would generate \$180,000 or more for Andrew and Laura by annuitizing \$467,000 of their \$1.24 million (producing \$35,000 a year for life) and taking sustainable withdrawals from their remaining \$773,000, which he expects will grow by about 4% per year. Without the annuity, their money might not last 30 years. With the annuity, they should be able to spend more and tap their investment sparingly.

Advisor assumptions

- Andrew and Laura said they needed only about \$140,000 per year before taxes in today's dollars, which is about 70% of their current gross, minus contributions to retirement accounts. Fourman thought the couple was underestimating their needs. He set their income goal at closer to \$200,000.
- Andrew and Laura will both live until age 95. If the client desired, the advisor could model a strategy that assumes that one or the other spouse will die at an earlier date. Such a model would involve adjustments related to personal and medical expenses, taxes and insurance.
- The plan aims to produce 80% of the couple's income from guaranteed sources, and to limit the withdrawal rate from invested assets to 4% per year throughout retirement.
- Andrew will work full-time until age 69 and Laura will work part-time until age 68. If they delay Social Security benefits to their retirement date, they will each receive about \$3,000 per month, minus Medicare premiums.
- The plan includes rental income from the couple's second home as part of their income, to continue indefinitely. Otherwise, the market value of both homes is excluded from the income plan but will be listed as assets after they are paid for. Because both houses are mortgaged, reverse mortgages aren't considered.
- Income needs are inflated at the rate of 2% a year. On average, stocks are assumed to yield 5.5% going forward (less one percent in fees) and bonds were assumed to yield 2% going forward (less 50 basis points in fees).
- Andrew and Laura want to leave at least \$500,000 to each of their children.

Advice Points

- The advisor measures the clients' risk tolerance by the amount of their monthly income they would like to get from guaranteed sources (as opposed to their tolerance for a one-year drop in market indexes). In this case, without special guidance from the clients, he aims to derive 80% of the couple's monthly income from guaranteed sources, including Social Security, pensions and annuities.
- The clients can reach 80% with a combination of Social Security, pensions, rental income, and partial annuitization of their invested assets.
- The clients can draw the remaining 20% of their income needs from their invested assets at a sustainable rate of about 4% per year.

- The advisor compared two income options: a variable annuity with a guaranteed lifetime withdrawal benefit and a deferred income annuity with an installment refund. The analysis showed that the payout from the DIA would be higher for these clients, who intend to retire in about six years. To get the maximum value from the VA-GLWB, the client would need to defer income for 12 years. “The client must begin taking required minimum distributions in 6 years,” Fourman told *RIJ*. “This would require holding some qualified assets in lower returning investments in the variable annuity to cover those obligations, potentially dragging down performance. The DIA, if started at age 70, can cover their income needs as well as RMD obligations.”
- The couple will probably want to travel during the first few years of retirement, which are sometimes called the “go-go” years, so they should budget for travel expenses during that period.

Recommendations

- Delay Social Security. Andrew and Laura should each delay Social Security benefits until they stop working in order to maximize their benefits.
- Buy a DIA with 35% of savings. They should convert \$467,000 of tax-deferred savings to a joint deferred income annuity (DIA) with guaranteed installment refund, starting when Andrew and Laura retire at ages 70 and 69, respectively. The DIA doesn't need to be inflation-adjusted because the couple's expenses will be lower after their mortgages are paid off.
- Feel free to travel. The plan budgets \$15,000 per year in the first four years of retirement for international travel.
- Take more equity risk. Since the couple will depend on their investments for only 20% of their income, they can afford to take more risk with their portfolio. Fourman recommended that they raise their equity allocation to 80% from the current 65%.
- Try to draw less than 4% from savings each year. Your average rate of withdrawal rate from investments will be under 4% annually, minimizing your exposure to market risk in down markets and allowing you to increase your risk exposure and periodically rebalance your portfolio to more equities.

Bottom line

Fourman tried to satisfy several key objectives: He wants his clients to pull most (80% in Andrew and Laura's case) of their retirement income from guaranteed sources, he wants to free up as much savings as possible for long-term investment in equities, and he wants to cap their maximum draw-down rate from invested assets to 4%. Running the couple's numbers through the Retirement NextGen software, he produced a recommendation that they annuitize \$467,000 of their \$1.24 million right away, with income starting in five or six years.

With Social Security (\$6,000 per month), pension (\$585 per month), rental income (\$2,500 per month for life) and an annuity paying \$2,900 for life, Laura and Andrew will be able to limit withdrawals from their investment portfolio (\$773,000 in 2017, after the annuity purchase) to between \$3,100 and \$4,700 per month. At that rate of withdrawal, the Retirement NextGen software showed, their portfolio should survive even a rough sequence of returns.

Andrew and Laura have a net worth today of about \$2.68 million, including investments and real estate. According to Fourman's projections, based on average net returns of about 4% from an 80% equity/20% fixed income portfolio, their children's inheritance in 2048 will have an after-tax value of \$3.19 million (\$1 million in investments and the rest in real estate).

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