
On the Case: An Income Plan from ReLIAS

By Mark Warshawsky Thu, Jul 20, 2017

To solve for one couple's retirement income needs, Mark Warshawsky of ReLIAS LLC proposed SPIAs and 7.5% annual withdrawals from an all-equity portfolio. RIJ will publish solutions from other experts in the coming weeks.



A few weeks ago *RIJ* challenged its readers to suggest solutions to the real case of a near-retirement professional working couple (“Andrew” and “Laura”) whose qualified and non-qualified savings amount to about \$1.2 million and whose two homes have a combined market value of about \$1.8 million.

Mark J. Warshawsky, Ph.D., was among the first responders, and his solution is described below. A prolific author (e.g., “Retirement Income: Risks and Strategies,” MIT Press, 2012), he has worked in government (Assistant Treasury Secretary for Economic Policy, 2003-2006), consulting (Director of Retirement Research, Towers Watson) and academics (he’s a Senior Research Fellow with the Mercatus Center at George Mason University).



He has also been an entrepreneur. Four years ago, Warshawsky (right) founded [ReLIAS LLC](#), a “design firm for personalized retirement income solutions.” He submitted Andrew and Laura’s case specifics (see tables at bottom of this story, or click [here](#) to see prior story) to the ReLIAS software (making some assumptions where needed) and produced the following preliminary solution.

Quick take-away

Warshawsky’s solution matches the school of thought that says: Use life annuities to fill any gaps (beyond Social Security and pensions) in required essential income and then exploit the increase in risk capacity by putting all other investable assets in equities. Since this couple can afford to keep paying down the mortgages on two homes (a primary residence worth \$1.23 million and an income-producing property worth \$435,000), he recommends that they hold onto their real estate equity for potential application to health care expenses, if necessary.

ReLIAS’ assumptions

- The Social Security income at age 70 will be \$36,000 annually for each member of the couple.
- No new contributions were being made to IRAs.
- Both members of the couple are in good health, are moderately risk averse and are conservative in their future spending profile.
- Each strategy starts at age 70.
- Annual investment expenses on the portfolio will be 75 bps.
- The taxable assets are tax-favored (unrealized capital gains) or tax-exempt.
- The couple's non-health spending needs will decline after age 80.

Advice point: Create an analysis for each spouse

Because both members of the couple have their own IRAs, and seem to have complete work histories, he ran the software separately for each, giving each an independent strategy, with no joint-and-survivor annuities purchased, or spousal benefits in Social Security and the pension.

Advice point: Continue to build real estate equity for future use

- Reserve the real estate assets for the provision of housing services and as a contingent reserve for future uninsured health and long-term care needs.

Advice point: Use the couple's SEP-IRAs for their retirement income

- Set aside the taxable assets for the desired bequests and any emergency family or personal needs.
- The retirement assets will be used mainly for producing retirement income. Minimum distribution requirements would force some of that anyway.

Recommendation for 'Andrew': Single-premium immediate annuities

- Andrew should purchase a fixed \$288,000 SPIA at age 70 from the IRAs.
- To maintain inflation-protected income, he should make smaller annual purchases of SPIAs for 15 years (\$2,200 at age 71 increasing slightly every year to \$3,100 at age 85 and none thereafter).
- Why not buy inflation-indexed SPIA instead of buying more income each year? "They have larger loads and therefore I avoid them. Annual purchases of SPIAs allow us to do some inflation adjustment, interest rate hedging (pricing of SPIAs) as well as control the slope of income," Warshawsky said. That is, some retirees may want to change their real income.
- The remaining retirement portfolio should be allocated 100% to equities.
- Andrew should distribute 7.5% of the portfolio balance (whatever dollar amount that is) annually to be consumed.
- Why is the payout rate so high? "The plan is determined by the goals, preferences and resources available," Warshawsky said. Why not annuitize more wealth to meet the income goal? "Income is the combination of payouts from immediate annuities and withdrawals," he said. "SPIAs are great for steady income but lack liquidity and growth potential, so a combination approach is best."

Recommendation for 'Laura': Similar to Andrew's

- Laura should purchase a \$330,000 SPIA at age 70 and make smaller annual purchases of SPIAs (\$3,300 to \$4,300 from age 71 to 82).
- She should allocate 100% to equities and distribute 7.5% of her portfolio balance each year.

Bottom line

- Andrew’s annual income starting at age 70, with Social Security, will average about \$90,000 in pre-tax income (at historical rates of interest, inflation, and investment returns), or about \$67,000 post-tax, declining, in real terms, to \$60,000 at age 75, and \$54,000 at age 80, as the couple’s non-health spending needs likely decline.
- Laura’s annual income starting at age 70, with Social Security and her DB pension of \$7,000 per year, will be \$110,000 pre-tax (\$80,000 post-tax) at age 70, declining gradually, in real terms, to \$71,000 at age 75 and \$63,000 at age 80, on average.
- The amounts could be higher or lower, depending on economic and financial realizations, with Social Security, the annuities, and pension providing (real or nominal) floors.

| Current Asset Allocation | | |
|---|-------------|------|
| Classes | Amount | Pct. |
| Cash and cash investments | \$49,500 | 4% |
| Fixed income (Index funds, ETFs and actively managed funds. Largest single position: DoubleLine Total Bond, ~\$100,000) | \$340,000 | 27% |
| Equities (Index funds, ETFs and actively managed funds in all sectors and style boxes. Largest single position: Apple, ~\$90,000) | \$745,000 | 60% |
| Alternatives | \$60,500 | 5% |
| Other | \$44,000 | 4% |
| Total | \$1,239,000 | 100% |