Will You Outlive Your Money?

Before you retire, take the time to figure out just how much money you'll need for retirement. One of the biggest concerns for retirees is whether their retirement savings will last the rest of their lives — will they run out of money? Social Security is not the guaranteed source of retirement income it once was, and people generally don't want to depend on public assistance or their children during their retirement years. Whether you might run out of money hinges upon several factors; how much money you've saved, how long you need your savings to last, and how quickly you spend your money. You'll be better off if you can tackle these issues before retirement by maximizing your retirement nest egg. But, if you are entering retirement and you still have concerns about making your savings last, there are several steps you can take even at this late date. The following are tips and ideas to help make sure you don't outlive your money.

Tips to help make your savings last longer

You may be able to stretch your retirement savings by adjusting your spending habits. You might be able to get by with only minor changes to your spending habits, but if your retirement savings are far below your projected needs, drastic changes may be necessary. Saving even a little money can really add up if you do it consistently and earn a reasonable rate of return.

Make major changes to your spending patterns

If you have major concerns about running out of money, you may need to change your spending patterns drastically in order to make your savings last. The following are some suggested changes you may choose to implement:

- Consolidate any outstanding loans to reduce your interest rate or monthly payment. Consider using home equity financing for this purpose.
- If your home mortgage is paid in full, weigh the pros and cons of a reverse mortgage to increase your cash flow.
- Reduce your housing expenses by moving to a less expensive home or apartment.
- If you are still paying off your home mortgage, consider refinancing your mortgage if interest rates have dropped since you took the loan.
- If you have more than 20% equity in your home and are paying PMI, contact your lender to have it removed.
- Sell your second car, especially if it is only used occasionally.
- Shop around for less expensive insurance. You'd be amazed how much you can save in a year (and even more over a period of years) by switching to insurance policies that have lower premiums, but that still provide the coverage you need. Life and health insurance are the two areas where you probably stand to save the most, since premiums can go up dramatically with age and declining health. Consult your insurance professional.
- Have your child enroll in or transfer to a less expensive college (a state university as opposed to a private one, for example). This can be a particularly good idea if the cheaper college has a strong reputation and can provide a quality education. You could save significantly over the course of just two or three years.

Make minor changes to your spending patterns

Minor changes can also make a difference. You'd be surprised how quickly your savings add up when you implement a written budget and make several small changes to your spending patterns. If you have only minor concerns about making your retirement savings last, small changes to your spending habits may be enough to correct this problem. The following are several ideas you might consider when adjusting your spending patterns:

- Buy only the auto and homeowner’s insurance you really need. For example, consider canceling collision insurance on an older vehicle and self-insure instead. This may not save you a bundle, but every little bit helps. Of course, if you do have an accident, the amount you saved on your premium could be wiped out very quickly.
- Shop for the best interest rate whenever you need a loan.
- Switch to a lower interest credit card. Transfer your balances from higher interest cards and then cancel the old accounts.
- Eat dinner at home, and carry "brown-bag" lunches instead of eating out.
- Consider buying a well-maintained used car instead of a new car.
- Subscribe to the magazines and newspapers you read instead of paying full price at the newsstand.
- Where possible, cut down on utility costs and other household expenses.
- Get books and movies from your local library instead of buying or renting them.
- Plan your expenditures and avoid impulse buying.
- Look at services you subscribe to and are automatically billed each month/year. Cancel the ones you’re not using.

Manage IRA distributions carefully

If you're trying to stretch your savings, you'll want to withdraw money from your IRA as slowly as possible. Not only will this conserve the principal balance, but it will also give your IRA funds the opportunity to continue growing tax deferred during your retirement years. However, bear in mind that you must start taking required minimum distributions (RMDs) from traditional IRAs (but not Roth IRAs) after age 72. If you don't withdraw at least the required minimum, you'll be subject to a 50% tax on the difference.

Use caution when spending down your investment principal

Don't assume you'll be able to live on the earnings from your investment portfolio and your retirement account for the rest of your life. At some point, you will probably have to start drawing on the principal. You'll want to be careful not to spend too much too soon. This can be a great temptation particularly early in your retirement, because the tendency is to travel extensively and buy the things you couldn't afford during your working years. A good guideline is to make sure you don't spend more than 5% of your principal during the first five years of retirement. If you whittle away your principal too quickly, you won't be able to earn enough on the remaining principal to carry you through the later years.

Portfolio review

Your investment portfolio will likely be one of your major sources of retirement income. As such, it is important to make sure that your level of risk, your choice of investment vehicles, and your asset allocation are appropriate considering your long-term objectives. While you don't want to lose your investment principal, you also don't want to lose out to inflation. A review of your investment portfolio is essential in evaluating the lasting potential of your nest egg.

Continue to invest for growth

Traditional wisdom holds that retirees should value the safety of their principal above all else. For this reason, some people shift all of their investment portfolio to fixed-income investments, such as bonds and money market accounts, as they approach retirement. The problem with this approach is that it completely ignores the effects of inflation. You will actually lose money if the return on your investments does not keep up with inflation. The allocation of your portfolio should generally become progressively more conservative as you grow older, but it is wise to consider maintaining at least a portion of your portfolio in growth investments. Many financial professionals recommend that you follow this simple guideline: The percentage of stocks or stock mutual funds in your portfolio should equal approximately 100% minus your age. So, for example, at age 60 your portfolio might contain 40% stocks and stock funds (100% - 60% = 40%). Obviously, how you apply this guideline depends on your risk tolerance and other personal factors.

Basic rules of investment still apply during retirement

Although you will undoubtedly make changes to your investment portfolio as you reach retirement age, you should still bear in mind the basic rules of investing. Diversification and asset allocation remain important as you make the transition from accumulation to utilization.

Caution: *Asset allocation and diversification cannot guarantee a profit or insure against a loss. There is no guarantee that any investment strategy will be successful; all investing involves risk, including the possible loss of principal*

Laddering investments

Laddering is a method of staggering the maturities of your investments so that they don't all mature at the same time. You can apply laddering to any type of deposit, loan, or security having a specified maturity date, such as bonds.

Laddering can reduce interest rate risk

Interest rates rise and fall in response to many factors. Consequently, they are largely unpredictable. Whether you apply laddering to a cash reserve or use it in portfolio investing, minimizing interest rate risk is one of its most important benefits. Laddering investments minimizes interest rate risk because you will be investing at various times and under various interest rates. Thus, you are unlikely to be consistently locked into lower-than-market interest rates.

A single large deposit or investment that matures during an interest rate slump will leave you with two undesirable choices regarding reinvestment. You can hold the money in a low-interest savings account until rates improve or roll it over at the current low rate. However, a later rebound of interest rates can catch you locked into the prior low rate for an extended period. Breaking your investment into smaller pieces and laddering maturity dates allows you to avoid this situation.

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How do you do it?
When you first begin your laddering strategy, you will need to acquire several term deposits (e.g., certificates of deposit) or securities with specified maturity dates. Initially, your individual investments should have terms of varying lengths, and you should intend to hold them until maturity. This will set up your staggered maturity dates. For example, you might purchase three separate certificates of deposit — one with a three-month term, one with a six-month term, and one with a nine-month term. When you reinvest as your CDs mature, your new investments should each be of the same length to perpetuate the staggering, or laddering, of maturity dates. Keep your laddering strategy intact by promptly redepositing each maturing investment for a new term.

Long-term care insurance
A catastrophic injury or debilitating disease that requires you to enter a nursing home can destroy your best-laid financial plans. You will need to decide whether to take out a long-term care insurance policy that may cover nursing home care, home health care, adult day care, respite care, and residential care. If you decide to purchase such a policy, you'll need to choose the best time to do so. Typically, unless you have a chronic condition that makes you more likely to require long-term care, there is generally no reason to begin thinking about this issue before age 50. Usually, there is no reason to purchase such a policy before age 60.

Won't Medicare pay for any long-term care expenses you might incur?
Contrary to popular belief, Medicare will not pay for most long-term care expenses, and neither will any health insurance you may have through your employer. Medicare benefits are only available if you enter a nursing home within 30 days after a hospital stay of three days or more. Even then, Medicare typically will only provide full coverage for 20 days of skilled nursing home care in Medicare-approved facilities. After 20 days, Medicare will cover a portion of the cost of care through day 100. No further coverage is available after 100 days.

What about Medicaid?
Medicaid is sponsored jointly by federal and state governments. Each state's Medicaid program is required to provide certain minimum medical benefits to qualified persons, including inpatient hospital services, nursing home care, and physicians' services. States also have the option of providing additional services. All states require proof of financial need. However, each state has different rules regarding benefits and eligibility, so it is essential that you understand your state's Medicaid program before you decide that Medicaid will provide adequate long-term care coverage.

How much does long-term care insurance cost?
Unfortunately, long-term care insurance can be quite expensive. If you begin coverage when you are younger, premiums will be more reasonable, but you will likely be paying for the insurance for a much longer period of time. The cost of LTCI will vary depending on your age, the benefits, and the insurer you choose.

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