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How Much Money Will You Be Able To Spend In Retirement?

Answer These Questions First.

A lot will depend on your health, how long you work, when you take Social Security and more. Here's how small adjustments can make a big difference.

By Shlomo Benartzi

AS PEOPLE prepare for retirement, much of their focus is on making sure they save as much as possible, or at least as much as they think they'll need.

Too often, though, we forget that people don't just accumulate savings over time—they also accumulate differences. By the time workers are approaching retirement, some are in excellent health; others have multiple health risk factors. Some want to claim Social Security right away; others want to delay claiming for a bigger benefit. Some want to cross items off their bucket lists; others want to put money aside for bequests.

These individual differences and others will affect how much workers will be able to spend as they start drawing on their savings for their retirement income. Combined, they can make a huge difference.

Unfortunately, the providers of 401(k) retirement plans typically offer minimal guidance on how to account for such differences, although some are trying to close the gaps. Retirement-income calculators generally are no better, forcing retirees to rely on a generic set of assumptions about factors such as their health and retirement goals.

In a recent survey of workers in their 60s, I asked them a series of questions about their

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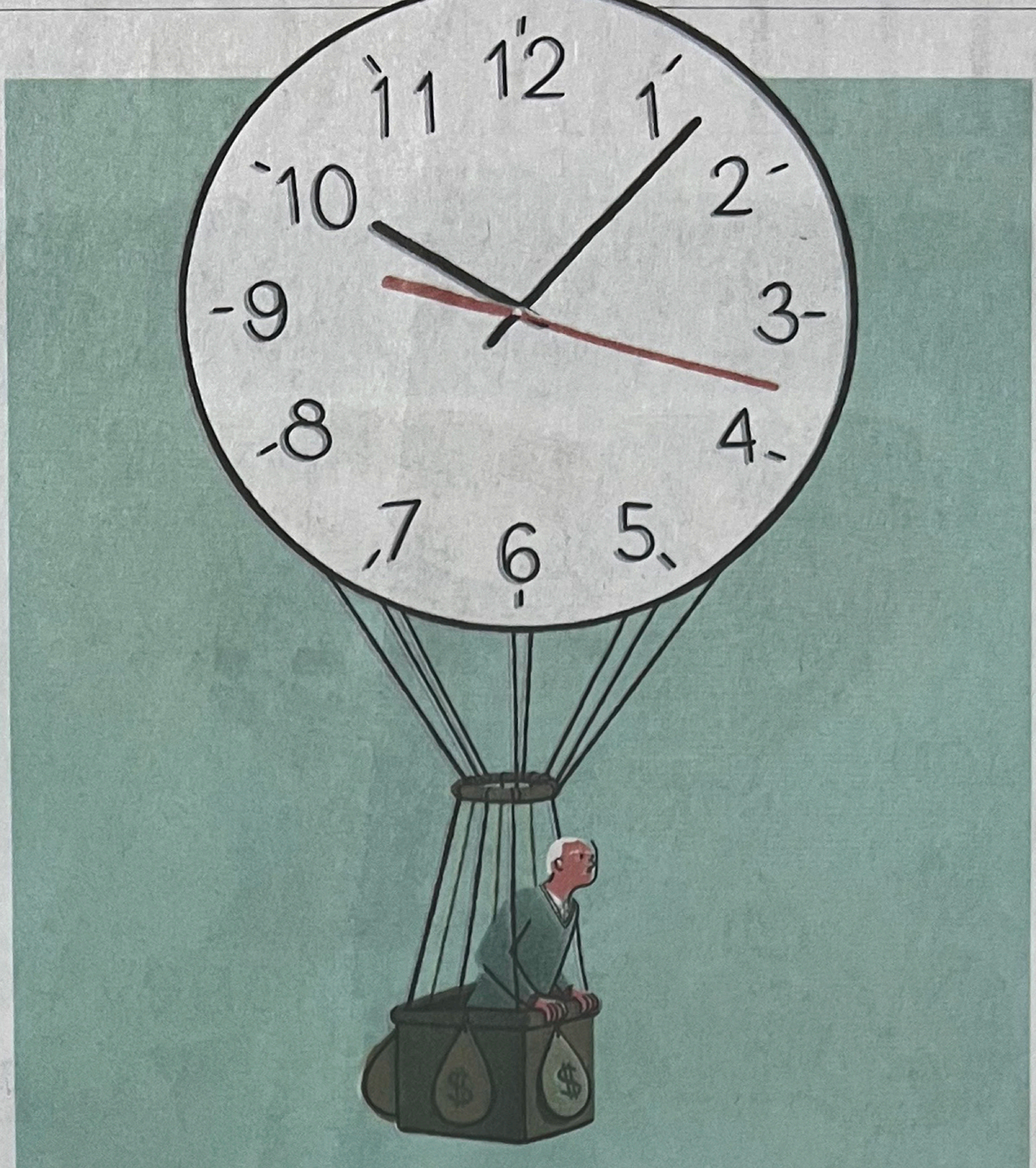

Spending in Retirement

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health and their retirement preferences. I found that the assumptions of the typical retirement-income calculator—people are in good health, don't want to make a bequest and will claim Social Security as soon as they retire, among others—fit only 4% of people.

That means it's mostly up to individuals to factor in their own preferences and needs as they think about their income stream from retirement savings. With that in mind, below are some questions to help them through that process.

To illustrate the differences that decisions can make, my colleague Ehud Peleg, an adjunct associate professor of finance at UCLA, and I calculated the effect of various circumstances and choices by a hypothetical 60-year-old man with an annual income of $150,000 before retirement and a 401(k) balance of $750,000. Keep in mind that in each case below, a woman with the same account balance should expect to draw a slightly lower monthly income from retirement savings than our man, because her slightly longer expected lifespan means her money will have to last longer.

Health

How would you describe your current health status?

1. *Poor*
2. *Fair*
3. *Good*
4. *Very good*
5. *Excellent*

When it comes to planning for retirement, perhaps the most important uncertainty is how long you'll need your money to last, which is highly correlated with your health.

For some guidance on this score, numerous research studies have found that the question above can go a long way toward predicting longevity. One review of more than 22 studies found that the difference in longevity at the point of retirement between someone who says they're in poor health versus someone who says they're in excellent health is about five years.

If the 60-year-old man in our model is in excellent health, he has a roughly 30% chance of living into his 90s, studies show. To make his savings last over that lifespan, our model estimates that he could withdraw $2,014 every month if he retired and started taking Social Security at age 65, chose a moderate-risk drawdown strategy, spread his monthly income evenly over time and opted not to leave a bequest.

If he's in good health, which is most common, he could withdraw $2,166 monthly from his retirement savings, or 8% more, without running out of money. That's because he needs his savings to last for a shorter time, given the shorter projected lifespan for someone in good versus excellent health. If he's in poor health, he could withdraw $2,546 monthly, or 26% more than if he were in excellent health.

Of course, poor health at retirement could mean that his medical expenses will be higher than if he were in good or excellent health. But that wouldn't change how much he could withdraw from his savings each month without raising the likelihood of outliving his money. It would simply mean that more of that money would go to healthcare.

This won't always be the case, however, because studies have found that medical expenses in retirement, unlike expected lifespan, aren't highly correlated with health status at the time of retirement.

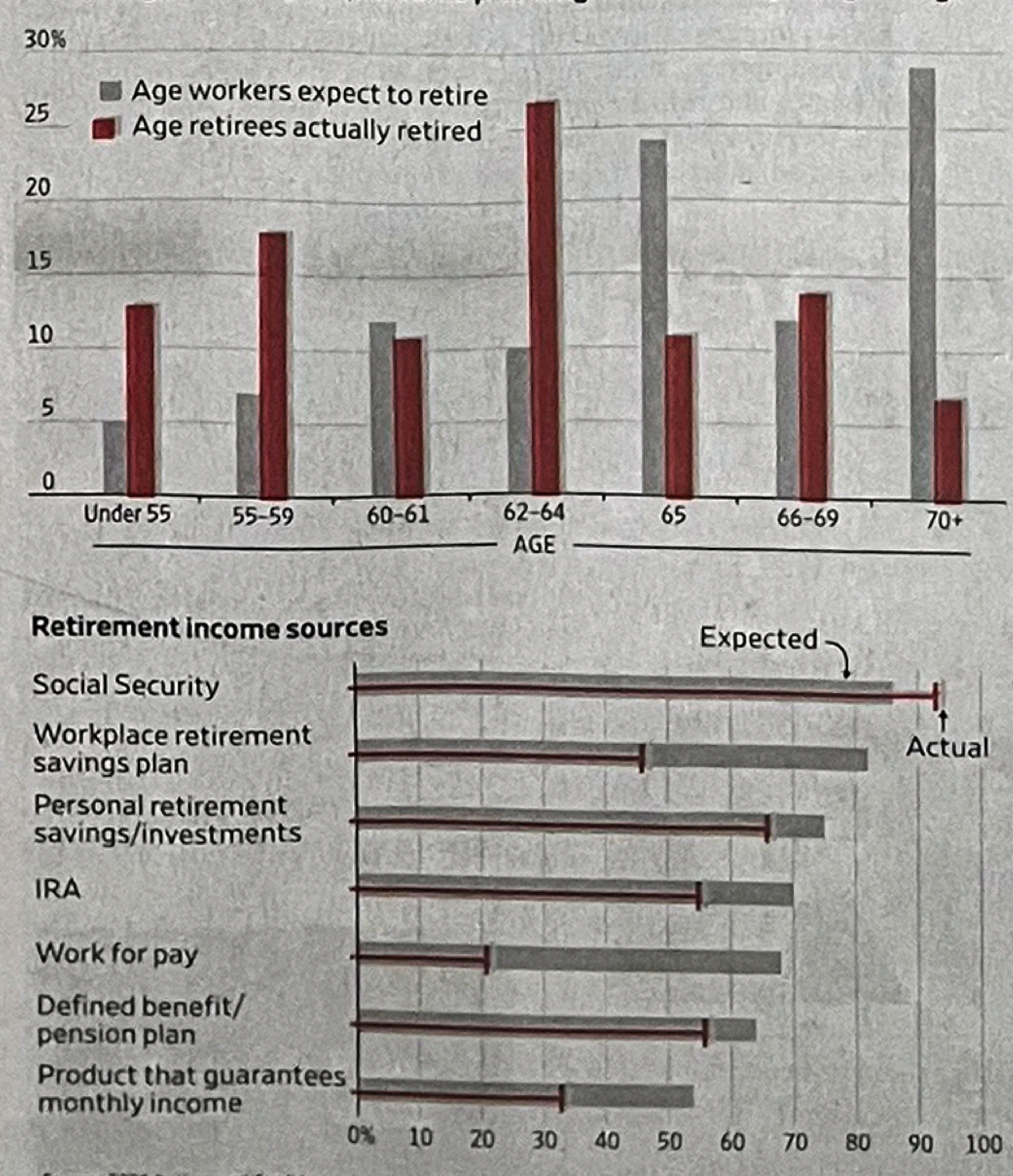
Retirement timing

At what age are you thinking of retiring?

1. *60 or earlier*
2. *62*
3. *65*
4. *67*
5. *70 or later*

Expectations vs. Reality

Percentage of survey respondents planning to and retiring at a given age



Source: 2022 Retirement Confidence Survey by Employee Benefit Research Institute/Greenwald Research

One of the most important financial decisions you'll ever make involves the timing of your retirement.

As we noted in our first question, a 60-year-old man in good health could withdraw $2,166 a month from his retirement savings if he retired at age 65. But if he chose to retire at 62, he could withdraw only $1,846 monthly to ensure that he doesn't run out of money before he dies. That's a decrease of 15%.

But what if he loves his job and wants to work until 70? By working longer, he will be able to take $2,892 a month from his savings. That means his monthly retirement income will be 57% larger than if he retired at 62.

Given the impact of retirement timing on your lifelong income, it's essential to fully consider the implications of this decision. Many retirees return to work part time, often to make up for income shortfalls. But people might also want to consider working a couple of years longer before retiring.

Social Security

When are you planning on claiming Social Security?

1. *62, or as soon as I can get it*
2. *63-64*
3. *65-67, or at the "full retirement age"*
4. *68-69*
5. *70, when I can get the biggest benefit*

Social Security claiming is such a complex and consequential decision that nearly everyone could benefit from additional guidance and personalization.

If our 60-year-old man begins collecting Social Security at age 62, his monthly benefit will be $2,129. If he collects just one year later, at 63, it will increase to $2,281, a boost of 7%. And if he waits until he's at full retirement age, or 67, he will receive $3,042, an increase of 43%.

But if he plans on working until he's 70 and won't start claiming Social Security until then, he will get his maximum possible benefit of $3,772 a month, an increase of 77% from what he would get if he started collecting benefits at age 62.

Health also comes into play here. If the 60-year-old is in poor health, delaying Social Security might not be the best option, as the bigger monthly benefit is offset by the reduced number of years he is projected to live. He likely would collect more over his lifetime if he started taking Social Security sooner. In contrast, a person in good health should consider delaying claiming Social Security, even if it requires creating a so-called Social Security bridge—using more retirement savings to fund early years of retirement, until Social Security kicks in.

A person's claiming strategy could also be influenced by their marital status and the benefit amounts of their partner, highlighting the importance of a personalized claiming strategy.

Risk tolerance

Which risk strategy do you prefer?

1. Low risk: the smallest monthly income and the safest plan

3. Moderate risk: an average income and an average plan

3. High risk: the largest income and the riskiest plan

It's no surprise that if you spend more each month—drawing down your assets at a faster pace—you also increase your risk of outliving your savings.

38%

Pre-retirees who are concerned about outliving their assets and plan to reduce spending by at least 15% during retirement

Source: McKinsey Retirement Readiness Survey April 2022

But looking at the exact options faced by retirees gives a better sense of the risks of running out of money. If our model retiree wants an extremely safe plan, which gives him a 1 in 100 chance of outliving his savings, his monthly income from savings would be $1,628, assuming he retires at 65. However, he could sleep well knowing that he's very unlikely to run out of money.

A more moderate approach to risk, which gives retirees a 1 in 20 chance of running out of money, increases that monthly income by 33%, to $2,166.

And then there's a riskier strategy, which gives retirees a 1 in 5 chance of outliving their savings. For our man, this leads to a monthly withdrawal of $3,022, which is 86% higher than the safest plan.

There is no right or wrong approach to risk in retirement. There is only the plan that best fits a person's own risk preferences.

Spending over time

Which spending plan do you prefer?

1. I want to spend more earlier in retirement.

2. I want to spend more later in retirement.

3. I want to spend the same year after year.

Although withdrawing the same amount from savings every month is the only option in the typical retirement-income calculator, I found that many people prefer a personalized spending path that gradually changes over time.

Some people want to spend more earlier in retirement, often because they're eager to travel while they're still healthy. Others want to spend more later—they want their income to grow over time, perhaps to ensure they have enough money for possible future medical expenses.

If our 65-year-old retiree wants to spend more early in retirement, one possible path is to start monthly income from his retirement savings at $2,809 and gradually decrease it to $1,818 by the time he is 85. On the other hand, if he wants to spend more later, another possible path would be to start his income at $1,564 and gradually increase it to $2,489 by the time he is 85.

Bequests

How interested are you in leaving a bequest?

1. *Not interested at all*
2. *Slightly interested*
3. *Moderately interested*
4. *Very interested*
5. *Extremely interested*

According to an estimate by researchers at Columbia University and the Federal Reserve, roughly 75% of single retirees are motivated to leave some form of bequest. Of course, the exact size of that bequest can have big consequences for retirement income.

In our model, a man in good health who retires and claims Social Security at 65 and has a moderate risk tolerance can expect to draw down $2,166 monthly from his $750,000 of savings if he doesn't want to leave a bequest.

If he chooses a relatively small bequest—say, $75,000, or 10% of his retirement assets—his monthly withdrawals would decline by roughly 10%, to $1,936.

If he leaves a bigger bequest of, say, $250,000, however, his monthly income would decline to $1,350, which is 38% less than if he made no bequest.

As these questions illustrate, the impact of relatively small changes in any one of a variety of preferences can significantly alter the amount of money you can safely withdraw each month from your retirement savings. Differences in several preferences combined can result in extremely different outcomes.

Consider this combination: A 60-year-old man who wants to maximize his monthly retirement income could retire and take Social Security at 70, opt for a higher-risk drawdown plan and choose to spend more early in retirement. His initial monthly withdrawals from his $750,000 retirement savings would be $4,959.

A colleague with the same 401(k) balance could create a very different income stream. If he retired and took Social Security at 62, chose the lowest-risk drawdown plan, decided to increase his income over time and made a $75,000 bequest, his initial monthly income from retirement savings would be only $761—less than one-sixth of the amount his colleague is taking.

The questions above are only the start of figuring out the right retirement income stream for you. Many retirees might also want to tailor their plan to account for long-term care, or to optimize withdrawal strategy for tax reasons. Some retirees might have a partial pension or additional spousal considerations.

Unfortunately, we have failed to create an easy process that helps retirees to better personalize their income plans. It's like being stuck in a shoe store with thousands of options, but there's no one to help you find a pair that fits. In the 21st century, we can and should create a process that helps Americans save and spend in ways that fit their current financial circumstances and future financial dreams.

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