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LPL Financial

Closing a Retirement Income Gap

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When you determine how much income you'll need in retirement, you may base your projection on the type of lifestyle you plan to have and when you want to retire. However, as you grow closer to retirement, you may discover that your income won't be enough to meet your needs. If you find yourself in this situation, you'll need to adopt a plan to bridge this projected income gap.

Delay retirement: 65 is just a number

One way of dealing with a projected income shortfall is to stay in the workforce longer than you had planned. This will allow you to continue supporting yourself with a salary rather than dipping into your retirement savings. Depending on your income, this could also increase your Social Security retirement benefit. You'll also be able to delay taking your Social Security benefit or distributions from retirement accounts.

At normal retirement age (which varies, depending on the year you were born), you will receive your full Social Security retirement benefit. You can elect to receive your Social Security retirement benefit as early as age 62, but if you begin receiving your benefit before your normal retirement age, your benefit will be reduced. Conversely, if you delay retirement, you can increase your Social Security benefit.

Remember, too, that income from a job may affect the amount of Social Security retirement benefit you receive if you are under normal retirement age. Your benefit will be reduced by $1 for every $2 you earn over a certain earnings limit ($18,240 in 2020, up from $17,640 in 2019). But once you reach normal retirement age, you can earn as much as you want without affecting your Social Security retirement benefit.

Another advantage of delaying retirement is that you can continue to build tax-deferred (or in the case of Roth accounts, tax-free) funds in your IRA or employer-sponsored retirement plan. Keep in mind, though, that you may be required to start taking minimum distributions from your qualified retirement plan or traditional IRA once you reach age 72, if you want to avoid harsh penalties. [Due to the Coronavirus Aid, Relief, and Economic Security (CARES) Act, required minimum distributions (RMDs) are waived in 2020.]

And if you're covered by a pension plan at work, you could also consider retiring and then seeking employment elsewhere. This way you can receive a salary and your pension benefit at the same time. Some employers, to avoid losing talented employees this way, are beginning to offer "phased retirement" programs that allow you to receive all or part of your pension benefit while you're still working. Make sure you understand your pension plan options.

Spend less, save more

You may be able to deal with an income shortfall by adjusting your spending habits. If you're still years away from retirement, you may be able to get by with a few minor changes. However, if retirement is just around the corner, you may need to drastically change your spending and saving habits. Saving even a little money can really add up if you do it consistently and earn a reasonable rate of return. Make permanent changes to your spending habits and you'll find that your savings will last even longer. Start by preparing a budget to see where your money is going. Here are some suggested ways to stretch your retirement dollars:

- Refinance your home mortgage if interest rates have dropped since you took the loan.
- Reduce your housing expenses by moving to a less expensive home or apartment.
- Sell one of your cars if you have two. When your remaining car needs to be replaced, consider buying a used one.
- Access the equity in your home. Use the proceeds from a second mortgage or home equity line of credit to pay off higher-interest-rate debts.
- Transfer credit card balances from higher-interest cards to a low- or no-interest card, and then cancel the old accounts.
- Ask about insurance discounts and review your insurance needs (e.g., your need for life insurance may have lessened).
- Reduce discretionary expenses such as lunches and dinners out.

Earmark the money you save for retirement and invest it immediately. If you can take advantage of an IRA, 401(k), or other tax-deferred retirement plan, you should do so. Funds invested in a tax-deferred account may grow more rapidly than funds invested in a non-tax-deferred account.

Reallocate your assets: consider investing more aggressively

Some people make the mistake of investing too conservatively to achieve their retirement goals. That's not surprising, because as you take on more risk, your potential for loss grows as well. But greater risk also generally entails potentially greater reward. And with life expectancies rising and people retiring earlier, retirement funds need to last a long time.

That's why if you are facing a projected income shortfall, you may want to consider shifting some of your assets to investments that have the potential to substantially outpace inflation. The amount of investment dollars you might consider keeping in growth-oriented investments depends on your time horizon (how long you have to save) and your tolerance for risk. In general, the longer you have until retirement, the more aggressive you can typically afford to be. Still, if you are at or near retirement, you may want to keep some of your funds in growth-oriented investments, even if you decide to keep the bulk of your funds in more conservative, fixed-income investments. Get advice from a financial professional if you need help deciding how your assets should be allocated.

And remember, no matter how you decide to allocate your money, rebalance your portfolio periodically. Your needs will change over time, and so should your investment strategy. Note: Rebalancing may carry tax consequences. 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.

Accept reality: lower your standard of living

If your projected income shortfall is severe enough or if you're already close to retirement, you may realize that no matter what measures you take, you will not be able to afford the retirement lifestyle you've dreamed of. In other words, you will have to lower your expectations and accept a lower standard of living.

Fortunately, this may be easier to do than when you were younger. Although some expenses, like health care, generally increase in retirement, other expenses, like housing costs and automobile expenses, tend to decrease. And it's likely that your days of paying college bills and growing-family expenses are over.

Once you are within a few years of retirement, you can prepare a realistic budget that will help you manage your money in retirement. Think long term: Retirees frequently get into budget trouble in the early years of retirement, when they are adjusting to their new lifestyles. Remember that when you are retired, every day is Saturday, so it's easy to start overspending.

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