THE WALL STREET JOURNAL.

MONDAY, DECEMBER 11, 2006 © 2006 Dow Jones & Company, Inc. All Rights Reserved.

THE RETIREMENT *Lies* WE TELL OURSELVES

The biggest—and most risky—assumptions that people make when planning for the future

By GLENN RUFFENACH

HOW MUCH OF YOUR RETIREMENT planning is based on wishful thinking?

It's a question more people need to ask themselves as they approach later life. Developing a successful retirement plan is both an art and a science: sketching out how you wish to spend your time after leaving the office, and estimating what your income and expenses might be. Some information is relatively easy to find; Uncle Sam, for instance, sends you a letter each year that forecasts the size of your Social Security check in retirement.

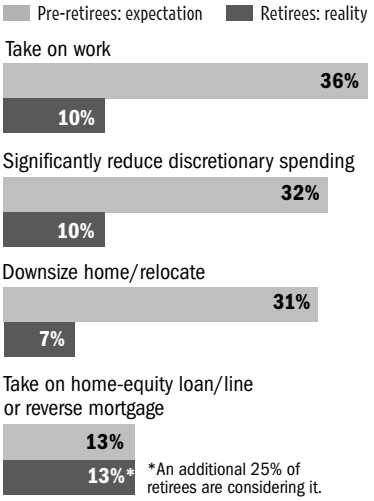
But some answers—about nest eggs, taxes and long-term care—are harder to come by. And that's where people can end up deceiving themselves.

"We're not exactly a nation of savers," says Rande Spiegelman, vice president-financial planning at the Schwab Center for Investment Research, a division of Charles Schwab Corp. Thus, "we are in denial, to a certain extent, about retirement planning," Mr. Spiegelman says. "Maybe we need a reality check."

MR. RUFFENACH IS A REPORTER AND EDITOR FOR THE WALL STREET JOURNAL IN ATLANTA AND THE EDITOR OF ENCORE.

False Hopes?

Many people approaching retirement may have unrealistic expectations about how to pay their bills in later life. The following numbers illustrate expectations versus reality for these methods of meeting expenses during retirement:



Source: McKinsey & Co.

We asked financial planners, educators and economists across the country to share with us some of the most risky assumptions—or outright lies—that people are crafting as they approach retirement. The thinking usually goes something like this: "I might not be in the best shape when it comes to planning for later life, but that's OK because . . ."

"I'm going to work in retirement."

The idea of working in later life is one of the most prominent features of what's frequently called the "changing face of retirement." A number of surveys have shown that about two-thirds to three-quarters of baby boomers expect to work for pay after retiring. It certainly sounds good; staying active as we age can promote mental and physical health. And the added income, obviously, could help patch any cracks in your nest egg.

The problem is that you might not be able to work in retirement. You might develop health problems; you might not find the kind of work you want, or jobs in your area could be in short supply. Indeed, many workers in their 50s and 60s are having a tough time keeping the jobs they have—never mind finding new jobs in retirement. A study published

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this year by McKinsey & Co., a consulting firm, found that 40% of surveyed retirees had to stop working earlier than planned, a consequence primarily of layoffs and poor health.

Predicting what boomers actually will do as they age is always a chancy exercise. But one way to gauge expectations about working in retirement is to look at the experiences of people who have already collected their gold watch. A survey published earlier this year by the Employee Benefit Research Institute in Washington found that just 27% of surveyed retirees had ever worked for pay while in retirement. A similar study published in September by the Pew Research Center, also in Washington, found that only 12% of current retirees are collecting a salary.

REALITY CHECK: For the moment, "there's a big disconnect between what people say they will do, or might do, versus what people are doing," says Cary Funk, senior project director at the Pew Center.

Yes, that could change: The sheer size of the baby-boom generation could mean that more boomers, in contrast to their parents, will end up working in retirement. But if you're counting on a paycheck in your 60s and 70s to help compensate for inadequate retirement savings, you could be in for a nasty surprise.

"My home is my safety net."

To listen to many people in the 50-plus crowd, they have little to worry about when it comes to financing their retirement. That's because they can always turn to the equity in their homes.

A recent study by Spectrem Group, a consulting firm in Chicago, found that almost two-thirds of affluent baby boomers (with investable assets of at least $500,000) intend to finance their retirement by selling their homes. That should come as no surprise; housing prices in many locales have skyrocketed in recent years. (The median value of the primary residence among Americans age 55 to 64 rose to $200,000 in 2004 from $139,000 in 2001, according to the Federal Reserve.)

The home-as-piggy-bank strategy, though, may not be as easy or attractive as it first appears.

Most people have two options: trade down to a smaller, less- expensive home, or borrow against their equity. The first option, in theory, will result in lower annual expenses and a nice addition to your nest egg (if you walk away with a profit). Most Americans, though, wish to remain in their homes and communities as they age. Selling might sound good today, if you're several years from retirement. But when the time comes, will you actually want to pack up and move? And will you be able to adjust to a smaller residence?

Borrowing against your home, meanwhile, could be tricky. If interest rates rise in coming years, the value of your property could fall, meaning you may not be able to pull as much money from your home as you wish. Reverse mortgages are attracting more borrowers, but fees are high, and many loans are capped. (Depending on your age and where you live, a $300,000 home might yield $115,000).

REALITY CHECK: "A home is not a panacea for shortfalls in retirement savings," says Andrew Eschtruth, an associate director at the Center for Retirement Research at Boston College. At best, "you can tap only a portion of your equity," he says.

If you decide to trade down, the sooner the better. Given that many retirements today will last 20 years or more, it's never too early to reduce expenses and shore up savings. If you plan to apply for a reverse mortgage, think of those funds as a last resort—to help pay for medical bills or long-term care—and not as money for groceries or vacations.

"I can live on 70% or 80% of my pre-retirement income."

It's among the most frequently heard maxims in retirement planning—and among the most misleading.

Ask yourself: Will you be able to live the life you want in retirement on 20% to 30% less income than you have right now? The key phrase in that question is: "the life you want." Beyond generalities ("I plan to travel more"), most people don't think about how they want to spend their time in retirement, and thus have no idea how much income or what size nest egg they will need to support themselves in later life.

Yes, some expenses—like commuting and wardrobe costs—will drop off after we leave the office. But many costs will increase in later life—for travel, home improvement and, most important, health care. All of which means you could be spending just as much, if not more, in retirement as when you were working.

(There is one group of people who can safely follow the 80% guideline: "If you're saving 20% of your paycheck, then the 80% rule works fine," says Mr. Spiegelman at Schwab. "But most people aren't saving anything close to that.")

The most telling evidence regarding income needs in retirement comes from current retirees. Fully 55% of surveyed retirees, according to research published earlier this year by the Employee Benefit Research Institute, said they were living in retirement on 95% or more of their pre-retirement income.

REALITY CHECK: Adolph Neidermeyer, professor of accounting in West Virginia University's College of Business and Economics, who has studied income needs in retirement, says the most important step would-be retirees can take is to put pencil to paper.

"There needs to be a detailed projection of spending in retirement," Dr. Neidermeyer says. "It has to be documented. And it should take place as early as possible—ideally, by your mid-50s."

"My taxes will go down in retirement."

They might. But chances are good you'll end up in the same tax bracket, if not a higher one, once you leave the office.

The explanation is tied to the likely source of your income in retirement. With fewer employers today offering pensions, many people in later life will turn to their 401(k)s and individual retirement accounts for the bulk of their money. Any dollars withdrawn from these accounts (with the exception of Roth IRAs and Roth 401(k)s) are taxed as ordinary income, which means you could be paying as much as 35% to Uncle Sam.

In short, "if you need as much money in retirement as when you were working, you could end up in the same tax bracket," says Barry Kaplan, a certified financial planner with Cambridge Southern Financial Advisors in Atlanta. The numbers "don't go down as significantly as people think they will."

Other factors may conspire to keep taxes in retirement higher than you imagined. If you pay off your mortgage before retiring—normally a prudent move—you may find that you no longer can itemize deductions on your income-tax return, Mr. Kaplan notes. As much as 85% of your Social Security benefits

could be taxable. After age 70½, you're required to withdraw funds from your retirement accounts, generating still more taxable income. And in many areas, property taxes may continue climbing.

REALITY CHECK: We always hear about the importance of diversifying our investments. But it's just as important to think about diversity in terms of taxes—having several different accounts you can tap for retirement income, says Clark Randall, a certified financial planner with Lincoln Financial Advisors in Dallas.

"Putting all your money in a traditional IRA or a 401(k) is risky," Mr. Randall says. "You could end up a 'tax prisoner' in retirement—stuck with one source of income." That's why it's important, he explains, to invest in Roth IRAs and Roth 401(k)s, among other products, to help minimize the tax bite in later life.

"I'm comfortable with debt."

Older adults today, unlike previous generations, are carrying unusually high levels of debt—juggling mortgages, credit-card balances and installment loans. According to new research by Dr. Neidermeyer in West Virginia, 45% of people in their 60s were still carrying a mortgage in 2000, up from 34% of that age group in 1980, and 20% were carrying a second mortgage in 2000, up from just 7% in 1980.

The problem: When medical bills kick in during later life, as they are wont to do, you could end up carrying the equivalent of yet another mortgage in retirement, says Charles J. Farrell, a partner at Dorman Farrell LLC, a financial consulting firm in Medina, Ohio.

According to Mr. Farrell's calculations, a couple retiring today could easily incur annual health-care costs of about $7,000. That includes about $2,400 for Medicare Part B premiums; almost $800 for Medicare Part D; almost $2,800 for a supplemental Medicare policy; and about $1,000 in out-of-pocket costs (for basic prescriptions and doctor visits). Toss in premiums for long-term care insurance, and the total could hit $9,500 to $10,000 a year.

That would seem to be a major incentive to pay off your mortgage (and most other debt) before you begin living on a fixed income. But most people don't recognize the costs associated with health care in later life, or how cash flow in retirement can be disrupted.

"The timing [of your retirement] is so important," Mr. Farrell says. "If you retired in 2000—just before the markets fell—and you were carrying a lot of debt, that really put you behind the eight ball."

REALITY CHECK: One way to begin preparing for health-care costs in retirement is to open a health savings account. This tool allows people with high-deductible health plans to save pretax dollars—and eventually withdraw the money tax-free—to pay for Medicare Part B premiums, qualified long-term care premiums and out-of-pocket medical bills, among other expenses.

"My spouse is taking care of everything."

In many households, one person pays the bills, manages the money and oversees planning for retirement. And just as often, that person's spouse is more than content to remain financially detached.

If that describes your relationship, ignorance is not necessarily bliss.

The risks of one person holding the reins should be obvious: If the spouse handling the retirement finances becomes incapacitated or dies—or if you and your spouse divorce—the person who's been left in the dark could face retirement with little or no savings and no idea how to make up the shortfall. But many couples are approaching later life in just that fashion. Frequently, the victims are women.

"In general, women still aren't adequately prepared for their own retirement," says Emily Sanders, president and chief executive of Sanders Financial Management Inc., an advisory firm in Norcross, Ga. "They tend to put off thinking about it because they're so busy taking care of other people—first the children, and then elderly relatives."

A common mistake, Ms. Sanders says, arises in divorce cases, where a wife will agree to give up pension benefits in exchange for keeping the house. "They don't want to uproot the kids," she explains. But "they don't realize that they're robbing their own retirement."

REALITY CHECK: Beyond the basics (knowing where documents like wills and powers of attorney are kept), both spouses should be aware of: the size and location of all retirement accounts, investments and insurance policies; what funds are being directed to retirement accounts and other investments; whether beneficiary forms have been filled out for all accounts and whose names are on those forms; any and all debt; and how much money might be available from Social Security.

"I'm going to get an inheritance."

Yes, you might. But chances are good it will be smaller than you think.

The numbers certainly sound impressive: Paul G. Schervish, director of Boston College's Center on Wealth and Philanthropy, estimates that as much as $41 trillion could be passed down through estates in the U.S. during the next five decades. But then there's the fine print. About two-thirds of the amount transferred will be concentrated among the wealthiest 7% of estates. ("It's top-heavy, as all wealth is," Dr. Schervish says.) And a good chunk of the money will go to taxes, settlement costs and charity.

Those factors will reduce the amount of money that boomers may inherit during the next several decades to about $7.5 trillion. The whittling, though, doesn't stop there. Boomers' parents are living longer, and much of their money will go to annuities, health costs and long-term care expenses. In short, the odds of your seeing a windfall are slim.

A study published earlier this year by AARP, based on the Federal Reserve's most recent Survey of Consumer Finances, found that only 15% of boomers today anticipate receiving an inheritance. Among those boomer households that had received an inheritance by 2004, the median value was $49,000.

REALITY CHECK: If you do receive an inheritance, the amount will likely be less than six figures. "That might help remodel your home or get your kids through college," Dr. Schervish says. "But for the vast majority of people, it won't solve their retirement issues."

"I'm going to get a pension—and it's safe."

It's one of the more mystifying assumptions in retirement planning: the firm belief among many workers that they will receive a pension check in retirement—even though hundreds of pension plans nationwide are underfunded, and growing numbers of companies are freezing or eliminating benefits.

Research published earlier this year by the Employee Benefit Research Insti-

tute found that 61% of surveyed workers anticipate receiving money from a pension in retirement. But only 40% of working couples currently are covered by such plans. And even though more and more companies, including giants like General Motors Corp., International Business Machines Corp. and Verizon Communications Inc., are cutting or freezing benefits, almost 70% of workers in the same survey said they were very confident or somewhat confident about their financial prospects in later life.

Today, insured pension plans nationwide are underfunded by about $350 billion, according to the Pension Benefit Guaranty Corp. (The federal organization guarantees the payment of basic pension benefits—if the pension is insured—up to an annual cap currently set at $47,659.) If you're approaching retirement and have the option of taking a lump sum from your pension or a monthly check, the latter choice could be a risky decision if your company's pension plan is ailing.

REALITY CHECK: Arthur Conat, executive director at accountants Ernst & Young, says workers need to take a "much more active role in their own retirement" and ask several questions about their pension plans: How financially sound is my employer? How well-funded is my plan? If my plan is not well-funded, is my ability to earn additional pension benefits going to be restricted? And if I plan to take a lump sum, will my plan's funding levels affect my ability to take that money?

If you're lucky enough to be covered by a pension, you can find out how to check on the health of your plan at the Pension Benefit Guaranty Corp. Web site, www.pbgc.gov.

"I won't need long-term care."

Actually, this is one assumption where the odds are slightly in your favor. Many Americans won't face large bills for extended care in later life. But those who do could end up exhausting their retirement savings.

A study published earlier this year in the health journal Inquiry by Lewin Group (a consulting firm in Falls Church, Va.) and professors at Pennsylvania State University and Georgetown University projects that 65% of all people age 65 will at some point in the future spend some time in their homes requiring long-term care. The good news: Family members will provide much of that assistance. The not-so-good news: Some 35% of 65-year-olds eventually will spend time in a nursing home, with 5% staying more than five years.

And who will pay for that care? About 45% of expenses, will be paid out of pocket, the authors estimate. (Government programs and private insurance will pick up the balance.) The average person would need to set aside $21,000 at age 65 to pay those future bills, but 6% of patients will need to invest more than $100,000 at age 65 to pay for future care.

REALITY CHECK: Every family should make the possibility of needing long-term care a part of their retirement planning. One possible solution—long-term care insurance—is pricey and complicated. That said, some insurers are starting to simplify policies, and more companies are giving employees the option of buying long-term care insurance at the office.

"If your net worth is less than $3 million, you need to consider long-term care insurance," says Ms. Sanders in Georgia. Even for estates larger than that, she adds, such policies "can offer peace of mind."

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