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Retirement Distribution Strategies That Will Make Your Money Last

Want long-term financial security? Don't tap into your retirement savings without a plan.

By Maryalene LaPonsie May 27, 2021

Having control over when and how you use your money is a key component of stretching funds across a long retirement.(GETTY IMAGES)

Saving money for retirement is only part of ensuring a financially secure future. The other half involves making smart decisions about withdrawing that cash.

"It's having a plan for how and when to take money out of your retirement accounts," says Andrew Meadows, senior vice president of HR, brand + culture at Ubiquity Retirement + Savings, a firm that provides 401(k) accounts to small businesses.

Finance experts say there are a handful of retirement distribution strategies that can be used to stretch money further for a long retirement, and these can be combined and changed over time. Current market conditions, tax rates and a person's expected longevity are all factors that need to be considered.

Rather than pick a single method to use throughout retirement, talk to a financial advisor about how to make the following retirement withdrawal strategies work together.

- Use the 4% rule.
- Take fixed dollar withdrawals.
- Limit withdrawals to income.
- Consider a total return approach.
- Create a floor.
- Bucket your money.
- Minimize mandatory distributions.
- Use account sequencing.

Use the 4% Rule

Financial advisor William Bengen is credited with originating the 4% rule, which many people use to guide their retirement withdrawals. The rule determined that withdrawing 4% from a retirement fund in the first year, followed by inflation-adjusted withdrawals every year after, should ensure money is available to sustain a 30-year retirement.

It's been more than 25 years since Bengen created his rule, and current advisors say people shouldn't be too wedded to the idea of withdrawing 4%. While the concept is sound in theory, the right percentage for a retiree should be customized for a person's age and life expectancy.

"I've heard numbers as high as 10% to 15% of portfolios," says James Regan, financial advisor and partner with Phoenix-based wealth management firm SharpePoint. However, withdrawing that much is risky and could deplete an account well before the end of retirement. "Even 4% can be a bit high," according to Regan, who recommends a 2% to 3% withdrawal rate as being more prudent.

Take Fixed Dollar Withdrawals

Some seniors treat their retirement accounts like piggy banks, withdrawing money whenever it is needed. However, a smarter approach is to make systematic

withdrawals of the same amount every month, quarter or year. Of these, monthly distributions typically make the most sense.

Some mutual funds and other investments, such as annuities, promise regular payments of a specific amount. Retirees can also decide to take out a specific amount from their own retirement funds.

This retirement distribution strategy can provide reliable income in retirement, but it doesn't take into account a fund's performance. Taking out a fixed dollar amount each month or year can eat away at an account's principal.

Limit Withdrawals to Income

Another way to approach retirement funds distribution is to limit withdrawals to income generated by investments. That means taking out dividends and interest each year but leaving an account's principal intact.

This method ensures an account doesn't run dry since the principal isn't touched. However, the downside is that annual income can be unpredictable. What's more, unless the principal amount is sizable, it may be difficult to live on dividends and interest alone.

Consider a Total Return Approach

While limiting withdrawals to income feels safe, it may not be practical for everyone. "I think the next generation of retirees needs to be comfortable withdrawing a part of the principal," Regan says.

That is often done as part of a total return approach to retirement distribution. A total return strategy takes into account dividends, interest, growth and principal for purposes of taking systematic withdrawals. These withdrawals are often used to create a predictable paycheck each month based on the 4% rule or a similar percentage of the total fund.

Although distributions from a retirement plan may equal the same percentage each month, the source of the money can vary. A financial advisor can help determine which funds to withdraw money, based on fund performance, and then rebalance the portfolio as needed.

Create a Floor

Some retirement accounts provide guaranteed income. These include Social Security, pensions and annuities, and retirees can count on them to deliver cash on a regular schedule.

A flooring strategy involves building up enough of this guaranteed income to meet basic needs. One way to do that is to purchase an annuity with an income rider that is inflation-adjusted. Another option is delaying the start of Social Security benefits. For each year you delay the start of benefits past your full retirement age until you reach age 70, you'll get an 8% boost in your monthly Social Security payments.

However, workers younger than age 50 may want to leave Social Security out of their equations for now, says Ron Brown, a certified financial planner and president of R.L. Brown Wealth Management in Lexington, Kentucky. He notes that until issues surrounding the long-term solvency of the program are addressed, "leave it as the cherry on top. Don't plan on it."

Regardless of its makeup, a strong financial floor provides peace of mind that no matter how the markets perform, a person will be able to pay necessary expenses.

Bucket Your Money

For funds that don't provide guaranteed income, such as 401(k)s and IRAs, a bucket strategy ensures some money is protected for short-term use while other money is allowed to grow for long-term use. While the details can vary depending on a person's needs and life expectancy, a typical strategy might use three buckets.

The first bucket holds money needed within the next three years in cash or bond funds. There, the money won't see significant gains, but the stability of these funds should insulate it against losses. Money that will be needed in three to 10 years may be put into a mix of stocks and bond funds where it may see more moderate growth. Funds not needed for 10 years or more may be invested more aggressively in growth funds.

Using a bucket strategy helps ensure retirees won't have to pull money from stocks in a down market. If a recession is on the horizon, it may make sense to put even more money in cash and bond funds.

Minimize Mandatory Distributions

Having control over when and how you use your retirement money is a key component of stretching funds across a long retirement. However, traditional 401(k) accounts and IRAs have required minimum distributions, known as RMDs. These distributions have the potential to significantly increase a retiree's taxable income.

In the past, retirees had to start taking RMDs at age 70½. However, the SECURE Act pushed that age back to 72. "People hitting that age can look forward to a few more years of tax-free growth," says Brent Lipschultz, partner with EisnerAmper Personal Wealth Advisors in New York City.

Still, people may want to reduce or eliminate RMDs by converting money from traditional retirement funds to Roth accounts. Money in Roth accounts grows tax-free and can be withdrawn tax-free. However, tax is due on any amount converted from a traditional fund to a Roth account. New retirees who delay the start of Social Security may find they have several years of low income early in retirement, which may be a good time to complete a conversion.

Use Account Sequencing

When it comes time to make systematic withdrawals, people should be strategic about where they pull money. Known as account sequencing, the optimal order for withdrawing funds is the one that will minimize taxes and allow money in long-term buckets to continue to grow.

A person's tax bracket can play a significant role in when to withdraw money from tax-advantaged funds. "Save traditional accounts until that time later in life when you'll be in a lower tax bracket," Brown advises.

The best approach for many retirees may be to withdraw cash from a combination of savings and investment accounts. Many advisory firms use software to help clients determine the best method and order to dip into funds.

Match the Right Distribution Method to Each Retirement Account

Retirement withdrawal strategies can be applied across a variety of investment vehicles: 401(k) accounts, IRAs, annuities and life insurance, among others. However, each investment has its own withdrawal rules that can and should affect how you treat money in that account.

For example, "Some people would prefer to continue to (withdraw from) their 401(k) before taking out Social Security," Meadows says. There are no limitations on withdrawals made from a 401(k) after age 59½, and by using money from these accounts first, it can allow Social Security benefits to be deferred and grow until age 70.

Likewise, if someone has both traditional and Roth accounts, they need to be smart about where they pull their money. "The beauty about the Roth account is that income in that account is not taxed," Lipschultz says. "Let that money grow as long as it can in a tax-free environment."

However, if someone has reason to believe their tax bracket will be lower later in retirement, using money from a Roth account first may make sense.

All these factors mean retirement distribution strategies can be daunting for many retirees to navigate. However, with professional guidance, selecting the right combination of methods can help ensure retirement accounts don't run dry.