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How to create and manage retirement income

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If you are at the stage of your life where you will stop working or you have a desire to work less you will need to develop a plan to create an income stream from your investments. When I work with clients I emphasize our goal is to create an increasing and growing future income stream to at least keep pace with the cost of living in the future and ideally exceed the cost of living or inflation.

Gather the information

The first step is to prepare a retirement budget or a listing of your estimated expenses in retirement. Many times clients will ask me if they have enough investment assets to retire and I always tell them it depends on how much you plan on spending in retirement. Some of my clients need $50,000 annually and others need $250,000 annually. The amount they need many times has nothing to do with their accumulated assets. The second step is to prepare a complete inventory of all of your investment assets including your home. The third step is to determine guaranteed sources of income such as social security and or pension and annuities. You or your financial advisor would then need to prepare a spreadsheet projecting your expenses into the future and showing your income from guaranteed sources and your projected income from your investments. This is where a financial advisor/planner can really come in helpful.

Different types of income producing investments

The following are the investment options you have to create an income stream:

1. Bonds: Bonds are basically loans to corporations, the U.S. government or municipalities. Bonds generate interest payments in the 5% range. They are typically very safe and throw off a good income stream. They can help to offset losses within a stock portfolio and provide some stability. The disadvantage of bonds is the income stream does not increase with the cost of living and in the long term your income may not exceed the inflation rate thereby lowering your future purchasing power. Treasury inflation protected bonds have been created to provide an inflation adjusted income however the current yield- in the 2% range - is very low.

2. Money market/ CDs: Money market funds and CDs are ideal for short term savings and may make sense in a rising interest rate environment. As I write this article, money market rates are in the 2% range and CDs are in the 2% to 4% range depending on the duration of the CD. One of the biggest problems I see with our new clients portfolios is an over reliance on these so called safe investments. They are safe in the short term (as long as your money is with multiple banks) however they are risky to a long term retirement income plan. Why? Because if the inflation rate is 4% and a CD is yielding 3% - 2.1% net after tax - then your future purchasing power is declining not rising.

3. Dividend Paying Stocks: Dividend paying stocks can be a very good investment for a retiree because they offer current income and the best chance for a growing future income stream. If the dividend paying stocks appreciate by 7% annually and throw off a 2% dividend the income stream will double in about 11 years. In addition you will have an account value growing much greater than

the cost of living. The obvious disadvantage is stocks decline on average one out of every four years and are subject to annual corrections in the 5% to 10% range. For this reason, 50% - more or less depending on the investor - seems to be the ideal allocation to stocks for the average retiree.

4. Real Estate Investment Trusts: REIT are publicly traded entities owning properties such as apartment, office, and industrial buildings. These investments typically produce about 5% annually in dividend income and over the longer term offer some upside growth potential.

REITS are stocks and are subject to the same risks. These are best held in a tax deferred account such as an IRA. A small allocation - typically 5% to 10% - is usually recommended.

5. Annuity/Pension/ Social security: Lifetime guaranteed annuities; company pensions and social security are guaranteed sources of income, for the most part. Pensions are only guaranteed as long as the employer stands behind the promises. These sources of income are very desirable to a retiree because typically the income is paid for as long as you live and you do not have to control or monitor the investment allocation. These sources of income make up the starting foundation of your retirement income plan.

6. Yourself: Many retirees will work because they want to others will work because they have to. Consider this, if you generate $25,000 annually in part time enjoyable work it is the equivalent of having $500,000 earning 5%. So if you are $500,000 short of your retirement goal this may be a good solution. If you don't need the money it still helps your overall portfolio by tapping into less each year or delaying social security payments.

Part two will appear in the October 10th edition of the New England Real Estate Journal in the Financial Digest section.

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