With retirement savings, don't plan on dying young

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There's one risk to retirement savings that is often overlooked: living longer than expected.

Those additional years can be expensive, particularly if they aren't part of the planning. Key decisions about retirement are commonly based on expected longevity. They include deciding when to start Social Security benefits, what lifestyle to adopt in retirement, which investments to select, and how much insurance to carry.

If your retirement planning doesn't consider the possibility of a very long life span, all those decisions could add up to outliving your money.

Take, for example, the decision of when to take Social Security. People can start claiming benefits as early as age 62, but they'll get a much higher monthly benefit if they wait until 66 or 70. Someone who might get $1,000 a month in benefits at their full retirement age - which is 66 for those born between 1943 and 1954 - would get only $750 a month if they filed at age 62. And the amount would jump to $1,320 if they waited until age 70.

That's a 76 percent difference in benefits. For many, that can mean a difference of tens of thousands of dollars in benefits annually, and hundreds of thousands over a lifetime.

Of course, not everyone can wait until 70. Some need the money to pay monthly bills. Others don't actually need the benefits, but they file early because they figure they won't live long enough to make waiting pay off. Still others fear the system will run out of money before they get to collect their share.

But that misses the point, said Rick Miller of Sensible Financial Planning in Waltham. People shouldn't be calculating their odds of breaking even. Rather, they should be trying to lock in the highest possible level of monthly income as a hedge against a potentially very long life.

"Even if we plan for survival to 95, we'll underestimate lifespan for 13 percent of men and 20 percent of women,'' Miller told a recent gathering of National Association of Personal Financial Advisors members at Bentley University.

So what number should you use in your planning? Online calculators like the one at www.livingto100.com can give you an idea of your life expectancy. They ask questions about everything from your blood pressure and marital status to your alcohol consumption to come up with a number.

The results can be surprising. Dana Levit was figuring she'd live to 85. Then she tried the calculator, which said she would likely live seven years longer.

"It is sobering to think that I could be alive at 92,'' said Levit, a fee-only planner at Paragon Financial Advisors in Newton. "It makes me think more about medical care. I may be spending my money very differently than I expected.''

Levit's conservative approach to finances means she'll be covered if she does live to 92 - or beyond. But lots of people peg their financial planning directly to life expectancy tables, not realizing the numbers are just averages. As such, anyone has a 50 percent chance of living longer than the tables indicate. And some will live much, much longer

Most planners at Miller's presentation said they plan for clients to live to 95 or 100. It's not uncommon, however, for clients to argue for a plan based on a shorter lifespan, since that would provide a better lifestyle while they are still in their 60s or 70s.

Annuitizing assets to guarantee a stream of income for life is one way to hedge longevity risk. This purchase, however, can be a hard sell because people tend to think of annuities as an investment, and the return isn't great unless you live a long time.

At current rates, a $500,000 inflation-adjusted income annuity might pay out only $30,000 a year. That means you'd have to live about 17 years just to get your money back. Moreover, unless you specifically buy a product that provides for payouts to heirs, they won't see a penny once you're gone.

Viewed as insurance, however, the product can make sense, particularly if used strategically as part of overall planning that might include stocks for growth, fixed-income investments for stability, and perhaps some pension payments. Someone who annuitizes $50,000 of assets today, for example, might get $3,000 a year of guaranteed income. Then, if they wish, they could gradually annuitize more assets, perhaps locking in better payout rates in the future.

Annuitizing isn't for everyone. People with enough money to cover their expenses through age 100 probably don't need that guaranteed income stream, Miller says. And people who are in poor health might not live long enough to reap the benefits of an income annuity. But they still need good planning.

Dave Stoeffel, vice president of financial planning and product delivery at Northwestern Mutual, said that people need to regularly reassess their needs and their spending to stay on track in a world of ever-increasing longevity.

“Planning is an ongoing process,’’ he said, “and it doesn’t stop at retirement.’’