Making Your Nest Egg Last

These days, most Americans realize that they need to accumulate as much money as possible to finance their own retirement. However, the amount of money you withdraw for income each year during retirement will also be a major factor in your ability to maintain long-term financial security.

That’s because the more money you withdraw each year, the less there will be to pay for future expenses. In other words, your withdrawal strategy, also known as your distribution strategy, is as important during retirement as your contribution strategy was before retirement.

Even a slight adjustment to your distribution strategy — such as lowering your withdrawal rate by just one or two percentage points — can make a big difference. Now, let’s examine that concept in greater detail.

This chart illustrates how long it could take to deplete a $500,000 retirement account balance, assuming different distribution scenarios. For example, if you opted to withdraw 8% of your balance each year, you could expect to run out of money in about 15 years, assuming you earned a 6% average annual return on the money that remained invested, and the withdrawal rate was adjusted to keep up with the rising cost of living each year. That may seem like a long time, until you consider that given expanding life expectancies, retirement can last 20 or 30 years, or even more.

Now consider how long the money may last if you were to reduce your annual distribution by just two percentage points to 6% of the balance. The account’s lifespan could then increase to about 23 years. Reduce your distribution rate by an additional one percentage point, to 5%, and the account could provide income for about 30 years. Reduce it to 4% annually, and the account could last more than 40 years.

Of course, you’ll need to consider your particular income situation. You may need more or less income from your retirement savings vehicles, depending on your other sources of retirement income.

As you can see, your retirement account distribution strategy is directly related to how long you’ll be able to provide yourself with income after leaving the workforce. As you approach retirement, therefore, it’s important to give serious consideration to exactly how much income you’ll need each year. That involves thinking seriously about not only your minimum spending requirements, but also anticipating any new expenses that are likely to emerge, such as health care expenses. You’ll also need to consider the tax implications of your distribution strategy, including the potential for penalty taxes if you make early withdrawals.

Working closely with a financial or tax professional may be the best way to identify and respond to your retirement income needs.