Optimize Your Retirement Income
A Guide to Maximizing Cash Flow and Minimizing Taxes to Make the Most of Your Post-Working Years
For decades, you worked hard, earned a good living, and diligently saved and invested for retirement. But now that your career is coming to a close, you find yourself thinking: “I don’t know how to convert my nest egg into retirement income.”

You’re not alone.

At Level Financial Advisors, we’ve seen firsthand how much angst accompanies retirement—and for good reason. Compared to your working years, there are many moving parts and complexities to consider that most people have never had to think about.

Fortunately, there are steps you can take to begin the process of planning your retirement distribution strategy. Your goal? To optimize your assets to achieve the quality of life and fulfilling retirement you’ve been aiming for.
**STEP 1: Setting Your Vision**

The first step to a successful retirement plan is giving serious thought to how you want to spend your retirement. Most of our clients come into the retirement planning process thinking that it is nothing but a numbers game. But the point of thoughtful retirement planning isn't just to make the numbers work; it's doing everything you can to get the most out of life.

That means figuring out what you really want out of the expanse of free time now (or soon to be) at your disposal—a task easier said than done. You might say, “I’ll golf” or “I’ll sign up for that pottery class I’ve been meaning to take,” which are perfectly good hobbies, but alone, they aren’t enough. What happens if circumstances change, and you can’t make it out to the course as often as you’d like? What if you get bored of making vases?

What you need is a retirement vision. Not only will it help you find purpose and fulfillment in your non-working years, it will also be the basis for your financial planning. The goals and to-dos you identify in your vision will have a huge impact on your financial strategy.

Here are some questions to get you started on your vision, but don’t limit yourself to what we’ve listed here. Only you know what your ideal retirement looks like.

- What makes you happiest?
- What makes you feel purposeful?
- Are you generally healthy? How might your health impact what you can and can’t do in retirement?
- What have you always wanted to do or accomplish that you haven’t had time for?
- Do you want to travel? If so, to where, for how long, how often, and who with?
- Do you want to downsize your current home or buy a second home? Where? What size? With what features and amenities?
- What hobbies and interests do you want to pursue? How frequently?
- Do you want to spend more time with your family and friends? What does that look like?
- Do you want to provide financial support to your loved ones such as helping a grandchild pay for school?
- Do you want to volunteer your time at a nonprofit or support one financially?
- Do you want to leave money to loved ones or to a cause close to your heart?

Take some time to work through these questions and others you’ve come up with, keeping in mind that you may very well be retired nearly as long as you worked. That’s a lot of golden years to account for. Collaborate with your spouse/partner, if applicable, and write down your answers until you’ve arrived at something like a sketch of your ideal retirement.
STEP 2:
Determine Your Expenses

Next, you want to assign each component of your vision a monthly or annual cost. It's important to be as dialed in as possible here, which is why getting specific with your vision is so important. For example, you might have identified travel as essential to your retirement, but taking a single (albeit luxury) trip to Paris is a very different expense than taking the grandkids on an epic Disney vacation every year, and you want to be able to plan accordingly.

Once you've identified the cost of your vision components, add them up. Coupled with your standard living expenses (e.g., utility bills, groceries, car payments, health care), you will arrive at an estimate of how much money you need to lead a happy retirement. If you don't know this number, literally nothing else matters.

STEP 3:
Inventory Your Income Sources

Having a complete understanding of the money you will have to draw from in retirement is another layer of essential groundwork. This can include a wide variety of assets, commonly including:

- Social Security
- Savings
- 401k
- IRAs
- Pension
- Other investment accounts

It's not enough to just identify the sources of income that you have, however. You'll want to take some time to apprise yourself of their standing and value, how they have performed historically, and what rules govern their management. With that in mind, let's break down each common income source in a little more detail.
Once you understand your income sources and have a full account of your available assets, you have to compare that to what you think you need to spend to be happy. That’s when you’ll start to get an understanding of whether or not you are in good, bad, or okay shape to lead the retirement you’ve envisioned.

**SOCIAL SECURITY**
Practically all of us are eligible for Social Security benefits, but the payout each of us receives varies wildly, and it’s up to everyone to determine for themselves when to begin payment. To make the most strategic decision possible, it’s important that you know what your benefit is projected to be at full retirement age. Other considerations certainly matter, but that’s your first step.

**SAVINGS**
Having cash in hand for emergencies is a good thing. But if you hold too much of your wealth in your savings account when it could be earning more in an investment account, you are potentially missing out on critical returns that could fuel your retirement. So, consider whether some portion of your savings would be better off elsewhere.

**PENSION**
If you’re lucky enough to have a pension, you’ll need to know when it starts and how much your benefit is worth. Eventually, you will have to decide whether to take it out as a lump sum or in installments.

**401K, IRAS & OTHER INVESTMENT ACCOUNTS**
Obviously, you’ll want to know how much your investment portfolio is worth, but you’ll also want to be aware of your investment portfolio rate of return. That means looking at how each of your accounts is performing as a percentage of its value. For example, maybe your 401k is earning 5% on average in its current allocation. You’ll want to know that number for each account that you have. Furthermore, you may be familiar with the old rule of thumb that you should reduce investment risks in retirement. And while that’s true for many if not most people, it’s not a clear-cut best practice. Under certain circumstances, it would behoove you to invest more aggressively, even after you’ve stopped working.
STEP 4: Create Your Cash Flow Strategy

Now is when you actually activate the cash flow you need to support you through retirement. And we aren’t going to sugarcoat it; this is where things begin to get complicated, especially if optimization—not merely survival—is your goal.

Optimizing your retirement cash flow requires strategy. Which asset you draw from first, when you start benefits like Social Security and pension, and how you build your investment portfolio can all have huge implications on how much money you have in retirement, and it’s a difficult thing to get right because of complex tax laws and regulations that saddle each income source.

Take Social Security. The age at which you choose to collect seems like a straightforward decision, but there are many factors to take into account. For one, your marital status matters. The government has established unique rules for married, single, divorced, and widowed recipients that affect your benefit.

Your health is also a major factor. If you are, say, 62 years old and in failing health that considerably shortens your life expectancy, you probably ought to start Social Security right away because you won’t reap the benefits of delaying benefits. On the other hand, if you eat a healthy diet, exercise daily, avoid smoking, keep your mind stimulated, don’t have any serious preexisting conditions, and have parents who lived well into old age, there’s a good argument for delaying Social Security as long as possible.

And that’s just Social Security. The rest of your retirement plan is likewise subject to hard-to-predict but critical variables such as:

**YOUR LIFESPAN**

Nobody knows how long they are going to live, which means retirement can last four decades—or more! That has a huge impact on planning. At Level Financial, we generally err on the side of caution and assume our clients are going to live into their nineties. Even if that doesn’t turn out to be the case, it’s best to be prepared.

**INFLATION**

For many people, inflation will be one of the largest risks they face in retirement. What makes it so problematic is that it does its damage silently and slowly. At any given moment or any given year, no one feels the effects of inflation, but over the course of an average retirement—20 to 25 years—an annual inflation rate of 2% (for example) adds up and is felt most severely at the backend of retirement, when suddenly your $40,000 annual pension spends more like $25,000 when adjusted for
purchasing power. It can be especially challenging for retirees because a large proportion of their expenses are for things like prescriptions and medical services, which generally rise in price due to inflation faster than commodities like food. If you don’t plan for inflation and the increased cost of living that comes with it, it can be devastating to your retirement plan.

**INVESTMENT PORTFOLIO RATE OF RETURN**

In step three, we asked you to make note of the rate of return for each account in your investment portfolio. From that number, you should draw your investment portfolio rate of return assumption, or your best guess as to how your accounts will perform for the foreseeable future. You’ll want to base your rate of return assumption on how your portfolio is performing currently as opposed to how it has performed in the past, so you are not banking on a return you’re not going to get. Arriving at this number will help you determine how much you can sustainably take out of your various accounts in any given year. For example, if you have $100,000 in your 401k, it would be unwise to take out $20,000 a year, or 20%, because you would be depleting your account faster than it can replenish through investment returns, and it wouldn’t be very long before you ran out of money. But let’s say that in step three, you determined that you could expect your 401k to earn an average of 5% each year over the life of your retirement. You could reasonably take out 3.5% annually, and in theory, never run out of money. Of course, this is a variable that should be evaluated and adjusted for regularly.

Speaking of returns, an old line of thinking suggests you could live off the interest your assets earn, but that approach wasn’t conceived for our modern world. In theory, it may be possible, but it will needlessly limit your spending in retirement, shortchanging you on a lot of well-earned enjoyment.
STEP 5:  
**Don’t Forget About Taxes**

This isn’t so much a step as it is a firm, friendly caution—one that you should keep in mind throughout the retirement planning process. In fact, you should regard the income tax levied on the money you draw from your retirement account as another major expense you must account for.

Determining how much you’ll pay in taxes requires figuring out the total amount of taxable income that you have from various sources like Social Security, which has its own (very complex) tax formula.

When it comes to pre-tax retirement accounts like your 401k, traditional IRA, and pension, generally 100% of the money you draw will count as taxable income. On the other hand, any money you take out of your savings account or a Roth IRA will not count as taxable income because you’ve already paid taxes on those funds.

With regard to your general, non-retirement investment accounts, your taxable income will depend on a plethora of factors like what you paid for each stock, how long you owned it, when you sold it, how much it went up in value, and the amount in dividends or interest it has paid. Your income from selling stock might not even be taxed if your other retirement income is low enough.

**DON’T JUST STRATEGIZE, OPTIMIZE**

At Level, when we are working with clients to minimize their taxes in retirement, we work from these incredibly complex tax formulas to determine your taxable income and tax rate for each type of retirement income you draw from. Then, we then take things like your standardized deduction and itemized deductions into account to arrive at an approximation of what you’ll owe.
But we don’t stop there. Optimizing your retirement plan entails minimizing the taxes you owe, not merely planning for them.

The financial payoff of lowering your taxes in retirement isn’t limited to the money you save on your tax bill. There’s also the compounding effect of investment. For example, let’s say we helped a client save $12,000 in taxes in a given year. That’s obviously good news. But it also means that $12,000 is still invested and available to grow. If it earns 5% for the next 20 years, it turns into nearly $32,000. That can have a massive effect on our client’s quality of life.

**DEPLOYABLE TAX STRATEGIES**

There is no simple or universal solution to minimizing taxes in retirement. Everyone’s situation is different and the tax code is too convoluted to prescribe one course of action that suits everybody. At Level, we deploy an integrated series of tax strategies in concert over the entire retirement life cycle to save our clients money.

**INVESTMENT PORTFOLIO ASSET ALLOCATION**

On this level, we design an investment portfolio model that matches your risk profile and has the potential to produce the desired total return to outpace inflation. This entails things like:

- Diversifying investments across all asset classes (stocks, bonds, and cash) with periodic rebalancing
- Sending dividends to cash first to create the liquidity needed for regular withdrawals
- Selling investment holdings strategically based on what is happening in the markets to remove the perils of behavioral investment mistakes and take advantage of market volatility (both up and down), mitigating portfolio risk in the long run

**TAX DIVERSIFICATION**

A good tax strategy will spread your investments across four tax buckets: pre-tax (401ks and 403bs), tax-free (Roth IRAs), health savings accounts (HSAs), and after-tax savings and brokerage accounts (where taxes have been paid but the growth or interest is taxable). Generally, pre-tax accounts tend to be larger because people with high incomes fill them up first or exclusively, but a more diversified approach will maximize your potential to time your taxable income to your advantage.

**TIMING OF TAXABLE INCOME**

Speaking of timing taxable income, the goal in retirement is to draw enough income from your accounts to meet your quality of life standards while still remaining in a 0%, 10%, or 12% tax brackets. In the first leg of retirement, that’s easier to manage because you are in complete control of how much you take out, which means you can delay things like Social Security to keep you in a lower tax bracket and keep pre-tax account withdrawals (traditional IRAs, 403bs, and 401ks) to a minimum. At age 70.5 however, you will have begun Social Security, and you will be forced by the government to take income from pre-tax retirement accounts, catapulting you to a tax rate of 22 to 35% in many cases. Fortunately, there are ways you can minimize your tax burden.
Timing Is Everything

When we talk about timing of taxable income, we are referring to a strategy of voluntarily taking money out of your pre-tax accounts in early retirement when your tax bracket is naturally low—even if you don’t need the money—so you can pay a substantially smaller percentage of your withdrawal in taxes.

One way we do this for our clients is through Roth conversions. That’s where we withdraw from a pre-tax account like a 401k early in retirement to take advantage of a low tax rate and transfer it to a Roth IRA, where it can continue to appreciate over time. Then, when our client needs to access that money later in retirement when their tax rate is naturally higher, it won’t add to their taxable income because the taxes on it have already been paid. So, not only did they save in taxes, but they also had more funds available to invest, compounding the advantage.

Additional Considerations

Of course, Roth conversions are just one of many ways to support a happy, fulfilling retirement that truly lives up to its “golden years” moniker. There are countless strategies you can deploy. Which ones you choose will depend on your circumstances.

That said, no matter how well you plan and how disciplined you are, your future is bound to include life events that you simply cannot anticipate. Moreover, the tax, legal, and financial landscape will continue to change. It will be critical to stay on top of the changes, chart your progress, regularly reevaluate, and systematically modify your strategies accordingly.

While it is possible to successfully manage this process yourself, it may make sense to consult with a knowledgeable and experienced wealth management firm to ensure you are reaching your financial goals and making the most of your retirement.

If you have any questions about the material presented in this guide, please don’t hesitate to reach out.

Call 716-634-6113 or email us at invest@levelFA.com
About Level Financial Advisors

Since 1979, we’ve helped high-net-worth individuals in the greater Buffalo area retire with dignity, achieve their financial goals, manage their wealth, minimize taxes, and leave a legacy. Unlike most financial advisors, our CERTIFIED FINANCIAL PLANNER™ professionals are fiduciaries in the truest sense. We aren’t compensated for the products we sell, and we don’t work on commission, so you can be confident our advice is in service of your goals—not our own bottom line.