How to Calculate Your Ideal Retirement Withdrawal Rate

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If you’re worried about draining your retirement wealth too quickly, you’re not the only one. A 2016 survey from the American Institute of Certified Public Accountants found that 41 percent of financial planners say running out of money ranks as the top concern among their clients, including high net worth individuals.
How you pace withdrawals from your retirement accounts can have a significant impact on how far your money lasts.

Traditionally, retirees have been encouraged to follow the 4 percent rule when taking retirement distributions. This rule dictates withdrawing 4 percent of your portfolio in the first year of retirement, then making subsequent annual withdrawals on an inflation-adjusted basis. The rule, conceived by financial advisor William Bengen in the early 1990s, has been the standard that financial planners use to help clients establish retirement income strategies but its continuing relevance has been questioned.

“A major problem with relying on the 4 percent rule today is that we don’t live in the 1990s anymore,” says Justin Fort, president of Fort Wealth Management in Austin, Texas. “Bengen’s model relies on several assumptions that are not the case for today’s retiree.”

Fort says those assumptions center on things like initial bond yields of 5 percent and average equity returns of 12 percent, conditions which are no longer the norm in today’s economic environment. He says that makes the 4 percent rule a less than reliable benchmark for determining how much you can safely withdraw in retirement.

With that in mind, there are several key issues to consider as you formulate a plan for spending your assets in your later years.

Life expectancy may outpace your savings rate. How much you have saved for retirement may be less important than how long you expect to

need it, says Stephanie McElheny, manager of financial planning for PNC Investments in Pittsburgh.
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“Life expectancy is a crucial component in determining the ideal withdrawal rate as the 4 percent rule is based on a 30-year period,” McElheny says. “If your retirement period is longer than 30 years, you run the risk of potentially exhausting your assets.”

The Social Security Administration estimates that a man turning 65 today can expect to live to age 84 on average, while women reach age 86 on average. What’s more concerning for retirees is the projection that one in four 65-year-olds today will live past age 90, while one in 10 will live to be 95 or older.

Lou Cannataro, a partner at Cannataro Park Avenue Financial in New York, says life expectancy is the starting point when determining a target withdrawal rate.
“The ideal withdrawal rate is discovering what one can spend, based on all of the variables that would deliver the highest probability of not running out of money during your life expectancy,” Cannataro says.

Those variables include how much you’ve accumulated in your various investment accounts, your pre-retirement income and monthly expenses. Cannataro says that analyzing these factors, in the context of life expectancy, can help you pinpoint how much you can realistically afford to spend once you retire.

Consider how diversified your investments are. Steve Azoury, owner of Azoury Financial in Troy, Michigan, says investors must look beyond savings and life expectancy to their risk tolerance, goals and objectives.
“A well-balanced mix of investments can serve you well, as it allows for annual adjustments,” Azoury says.

Azoury says one strategy retirees may employ is to withdraw funds from equities when the market is high and make withdrawals from fixed accounts when the market is low. “This forces you to do the right thing,” Azoury says. “Sell high and avoid selling low.”

Taking a broad look at your overall asset allocation can be helpful in guiding your decision-making as you transition from saving to spending. Your asset allocation should be appropriately aligned with how long you have until you reach retirement.

Roger Cowen, owner of Cowen Tax Advisory Group in Hartford, Connecticut, says skewing your investments too conservatively could affect your safe withdrawal rate.

“As workers get closer to retirement, I recommend they get more conservative with their portfolio,” Cowen says, but he notes that it’s important to maintain the right investment balance.

“If you put 100 percent of your money in bonds, you probably won’t earn enough income to make your money last 30-plus years in retirement,” Cowen says.

Your withdrawal rate may also hinge on the types of investments you own outside of stocks and bonds. “If you have some resources to fall back on, like home equity, a pension or cash value life insurance, you may want to start closer to a 4 percent withdrawal rate,” Cowen says.
On the other hand, if you the bulk of your investments are concentrated in the market, opting for a lower withdrawal rate initially allows you to err on the side of caution.

Remember to account for factors that can erode your spending power. As you work toward determining your ideal withdrawal rate, don’t overlook how inflation, investment fees and taxes can potentially diminish your retirement wealth.

“Inflation is one of the biggest factors we must all consider when planning for retirement,” says Marcy Keckler, vice president of financial advice strategy for Ameriprise Financial in Minneapolis. “Whether we’re retiring 10 years from now or 30, the future is going to be more expensive and it’s important to estimate your retirement expenses considering future inflation.”

Keckler says investors need to understand that they may need to increase their income year over year in retirement to maintain the same standard of

living as prices rise. She also says it's a mistake to assume that taxes will be lower in retirement.

"If you plan to maintain your current lifestyle, it's possible your income will be similar to the amount you earned while you were working, which means you could end up in the same tax bracket with fewer eligible deductions," Keckler says.

In terms of investment fees, Azoury says the lower they are the better, since fees can detract from performance over time.

"Fees should be reasonable but not excessive," Azoury says.

Creating a contingency plan is important if you're concerned about outlasting your portfolio.

"Retirees must face reality," Cannataro says. "They may have to adjust their lifestyle and spending habits to reduce expenditures or take a higher amount in the early years while they're more active and slow down spending later. Taking on a part-time job in retirement may relieve financial pressure, especially in the early years. This may deliver a strong tailwind for a successful retirement as they ease out of the working life."