Social Security Tradeoffs: It's Not Just About Your Finances

(Contributed by Justin Fundalinski, MBA)

In financial planning, the best advice is sometimes counterintuitive or difficult to conceptualize. The merits of delaying Social Security for a higher benefit have been iterated over and over, but there should always be a discussion beyond the complicated financial projections that focuses on preferences, opinions, and tradeoffs. Specifically, there are a few key topics that will help a retiree decide what is best (beyond a financial projection) when it comes to claiming Social Security/funding your retirement lifestyle. The key items to discuss are the tradeoffs of generating a higher Social Security benefit, your opinions and family history in regards to longevity, and one's personal feelings regarding the possibility and effects of outliving their assets.

The Tradeoffs:

The most substantial tradeoff for generating a higher Social Security benefit is the fact that a retiree will have to spend from their assets early in retirement. Because these large withdrawals are in the beginning of retirement a significant portion of the assets (the portion that is spent) will never have the opportunity to grow as an investment; thus putting a handicap on the overall lifetime value of the portfolio. However, there are some tradeoffs that benefit this handicapped portfolio over the long run. Those tradeoffs are that a retiree will have to spend less from their portfolio once a higher Social Security benefit is turned on, that Social Security income is backed by the Federal Government (unlike an investment portfolio), and that Social Security income is taxed differently than other sources of income creating a smaller tax burden.

There are clearly many variables that come into play that will ultimately decide whether or not delaying Social Security was the best decision in regards to a retiree's portfolio value and *most of those variables become more important as longevity becomes a factor*.

Longevity:

When it comes to longevity hindsight is always 20/20, but hindsight doesn't help when a decision has to be made now that will affect the rest of one's life. As alluded to above, a retiree's opinion on how long they expect to live plays an important role when deciding the best methods to fund retirement. Longevity will decide whether or not a late Social Security claiming strategy would indeed pay off not only when considering total Social Security income received, but also when you look at total taxes paid, retirement account drawdown rates, and the retiree's perception/reality of financial security. The math is fairly straightforward when it comes to estimating most of these considerations and an analysis can certainly help explain how much longevity is needed for one strategy to trump the other. However, there is one key item that cannot be projected - that being the retiree's perception and the reality of financial security.

Security If One Outlives Their Assets:

The key reason why delaying Social Security is often recommended is simple; to generate guaranteed income that is on par with expenses that cannot be cut. If there is enough income to ensure that a basic standard of living is guaranteed, retirees have the freedom to spend their assets in a manner that they choose opposed to a manner that is dictated by the performance of equity and fixed income markets. With the appropriate amount of guaranteed income (often referred to as Secure Income at the office) the freedom to spend assets as one chooses and to override the risk of becoming destitute becomes a real possibility. However, without sufficient guaranteed income the potentials of poor market performance or overspending assets can wreak havoc on the later years of retirement. The key point being made here is that when one perceives and has the reality of a certain level of financial security no matter how quickly they spenddown their assets, it is more likely that they will be able to enjoy their retirement rather than worry about their retirement and every dollar they spend.

The Million Dollar Question:

Are the upfront tradeoffs on portfolio value worth the perception and reality of a certain level of financial security? Hopefully you and your retirement plan have considered this.

Questions, comments, and submissions to the million dollar question can be sent to:
Justin@jimhelps.com