The Benefits of Social Security Alternatives

This may be the most important paper you can read before retiring!

People seldom realize the benefits from higher Social Security payments. Unless they decide to work longer, many people will have to save more for the higher benefits. They should always make sure that they have enough savings left for known large purchases (think autos), expensive maintenance (think roof, furnace) and even unknowns (perhaps a half-year living expenses).

Even the simplest plan to get much of what's possible requires the savings to successfully complete the plan.

Let's begin with the simple plan to maximize Social Security with an example of a couple, "Hi" and "low." Hi has a **full-retirement-age (FRA)** benefit that's more than twice Lo's FRA benefit. The FRA benefit is the age 66 monthly benefit for most people now. This age will gradually increase to 67 in the future. You can find your FRA age on www.ssa.gov or in the annual report from the Social Security Administration.

The simplest plan for a couple is usually for Lo to start Social Security at 66 and Hi at age 70. That gives Hi 32% more Social Security income than Hi would get at Hi's FRA of 66. By Lo waiting till age 66, Lo will get ½ of Hi's FRA benefit, the most Lo can get until Hi dies. After Hi dies, Lo can get whatever Hi was actually getting at the time of Hi's death. This is a VERY generous survivor's benefit.

So let's put some numbers to the example. We'll do this in values corresponding to today's purchasing power even though the SSA adjusts all of the amounts up with inflation each year. Using future inflated values would give a false sense of the true value of the amounts.

Suppose Hi's FRA benefit at 66 is $2,000 per month and Lo's is $500. If both are 62 and each starts Social Security then, they will each get 75% of their own FRA benefit except that if Lo's "spousal" benefit is higher, Lo will get that. The spousal benefit at Lo's age of 62 is 32.5% of Hi's FRA benefit, so Lo will get 32.5% of $2,000, or $650 which is higher than 75% of Lo's $500 FRA benefit. Hi's benefit will be 75% of $2,000, or $1,500. Both together would get $650 + $1,500, or $2,150. Lo's benefit on Hi's death would be $1,500. All these amounts are monthly.

In order to get the maximum annual benefit for the couple, Hi would delay the start of Social Security until 70 and Lo until 66. That would give Hi 32% more than Hi's FRA benefit, or $2,640 per month. Lo would get the maximum spousal benefit of 50% of Hi's FRA benefit, or $1,000. Together, they would get $3,640 per month. Lo's survivor's benefit would be $2,640. Those are big numbers compared to both starting at 62. Annual income would be $43,680 instead of $25,800 and Lo's annual survivor's benefit would be $31,680 instead of $18,000.

In order for Lo to benefit for a spousal benefit, Hi must have already filed for Social Security. Hi would not want to do this at age 62 because then he would not ever get the benefit that would come from starting at 70. So Hi must "file and suspend." This maneuver can only be done after Hi's own FRA, i.e., at age 66. At that point Hi will get no Social Security because he has suspended his payments, but Lo can start drawing a spousal benefit. By going four years without these payments, Hi can start at 70 and get Hi's maximum amount.

We're going to call the interim support savings a "cost." It's a cost that is equal to what it would take to support a constant level of retirement income before any survival benefit starts.

The costs to delay Social Security depend on when retirement starts and Social Security begins. The later retirement begins, the smaller the costs. The primary cost is the savings required to support the years without (or reduced) Social Security, but there may be a secondary effect from a loss of $1 of Social Security for every $2 or $3 of wages while working. These reductions depend on the wages earned compared to wage thresholds that are set every year as well as whether work continues before the FRA. There is no Social Security reduction for working wages after the FRA. In the long run, the pre-FRA reduction is not much of a penalty, because future Social Security payments will ultimately be increased to compensate for the temporary reduction. We'll focus on the savings differences which can be very large indeed.

It the couple retired at 62 and each started Social Security at 62, there would be no "cost" because they both already had reached their maximum Social Security amounts under those conditions. On the other hand, if they retired at 62 and Lo started Social Security at 66 and Hi at 70, the cost would be enough savings to replace the Social Security payments missing until Hi reached 70.

There would also be a "benefit" for starting Social Security later. That would equal the difference in lifetime income between the retirement age of 62 and death of each partner. Sometimes the cost is higher than the benefit, so it might not be advantageous to implement that strategy. That is usually the case when the partners die relatively young. On the other hand, many alternative strategies look good if both partners live to very old ages. It takes some judgment and trying different conditions to determine what might really be best for Hi and Lo. That judgment includes considering the differences between the pre-death retirement annual income and the survivor's annual income.

The free Strategic Social Security Planner from www.analyzenow.com makes these trades easy. The program is very flexible and requires just a few entries: single or married, current ages, age to retire, ages to start Social Security, FRA monthly amounts, and ages to die. Then there are four optional strategies: Normal, file and suspend, just plain suspend and file a restricted application. You simply click on a button to see what a difference the three optional strategies make. The charts below are from that program.

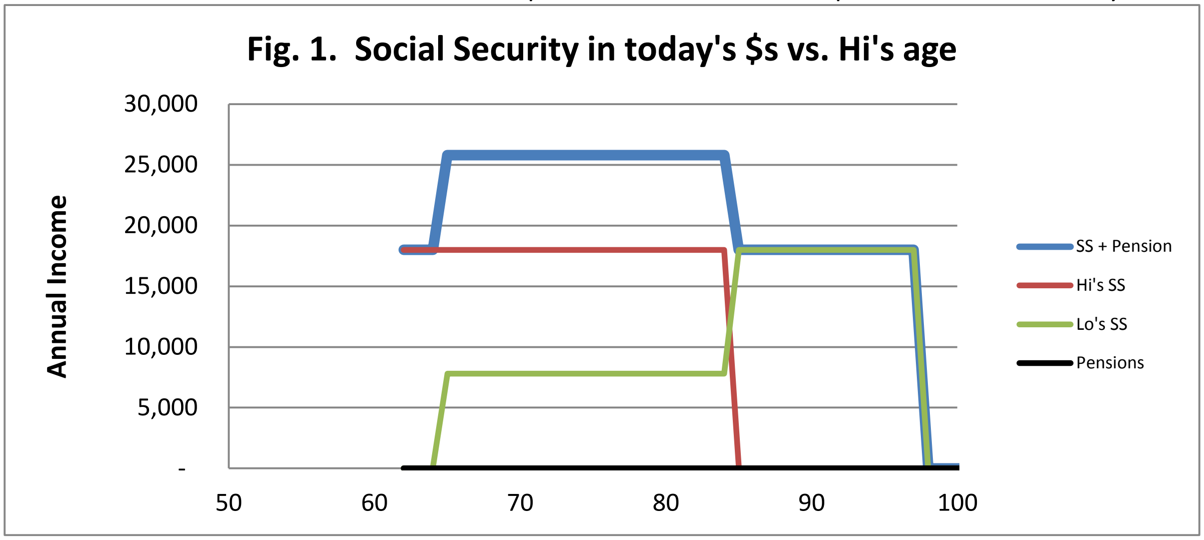
Unlike most supposedly free planners, this site does not require any personal data such as name, address, email or phone. Simply download and use. The programs on this site do require the full power of Microsoft's Excel. Some users report they can use other worksheet programs, and others say they can't. You just have to try if you don't have Excel—or go to a public library, almost all of which have full versions of Microsoft Excel. Just remember to take the FRA dollar quotes with you.

Also, unlike most free programs, the free Strategic Social Security Planner has a comprehensive introduction that fully describes what is needed and the rules that govern results.

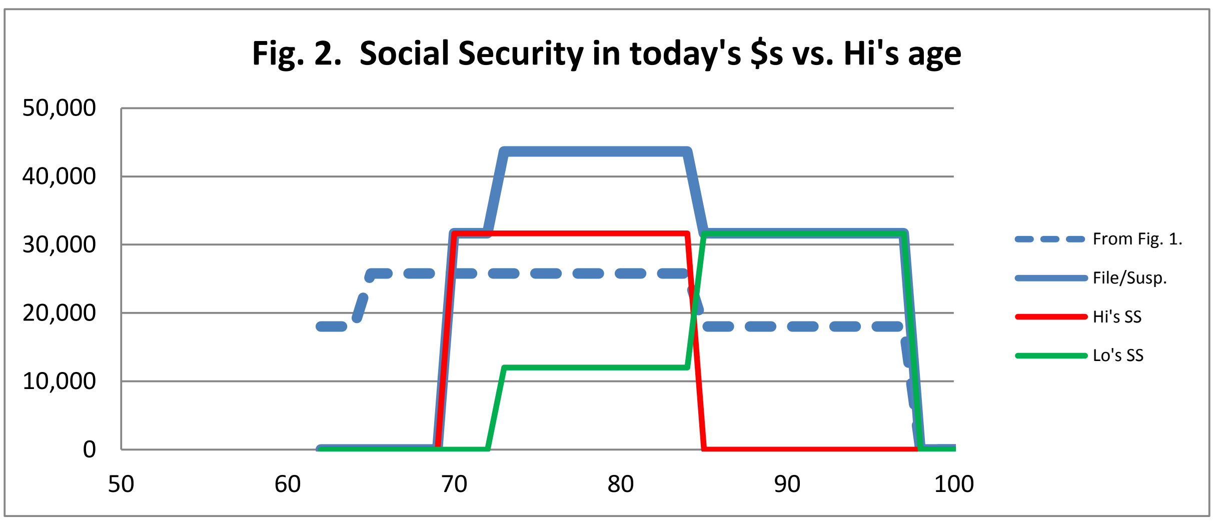
The program also helps people pick a good strategy for stating pensions, but that's beyond the scope of what we what to cover here. So we'll enter zero for the pensions in the program in the following example.

Let's use this planner to make a comparison of the two cases above, but we'll have Lo be three years younger to see the different incomes more clearly. We'll assume that Hi will die at 85 and Lo at 95.

Figure 1 shows the Social Security income for both retiring at 62. The red line represents Hi's income and the green Lo's. Note that Lo starts three years later because she is younger. Lo gets 32.5% of Hi's FRA benefits right away because Hi had already started Social Security and 100% of Hi's Social Security income value when Hi dies. The blue line represents the sum of both partners' Social Security.



The situation is more complex for Lo starting Social Security at 66 followed by Hi filing and suspending at age 66 until restarting at 70. Results are displayed in Figure 2 below. The chart shows the total from Figure 1 in a dashed blue line. The strategy to start later has obvious income benefits, both before death as well as after death of Hi. (The chart also shows pensions which we have not used here.)



Although there are large income gains over simply starting at 62, it will take substantial savings to provide the income to provide support from retirement at Hi's age of 62 until Hi reaches 70. These savings will be large because they not only must cover the Social Security shortfall from 62 until Hi is 70, but the amount needed will be the same $43,680 that they will get after Hi starts receiving benefits. The program assumes that their savings will generate a return equal to inflation. Money market accounts are unlikely to produce such returns, so it may be appropriate to consider short term bonds or CDs or some other allocation. Different allocations would require more or less savings.

We don't have to make a bunch of hand calculations to determine the savings required. The program does that for us. In the particular cases illustrated, the copy of a program chart displays the following:

Fig. 3. Cost Benefit Analysis.

Results:	Case 1	**Case 2**	Higher (lower) by	
Annual income from retirement till first death	26,000	44,000	**18,000**	
Annual survivor's income	18,000	32,000	**14,000**	
Minimum savings at retirement	23,000	385,000	**362,000**	<Cost
Total income over retirement (Depends on death ages)	827,000	1,416,000	**589,000**	<Benefit
		Benefit less cost (Depends on death ages)	227,000	

There is a lot to think about here. For the case where both start Social Security at 62, the minimum savings is small, but so is the lifetime income. Low saving is why so many people are forced to start Social Security early. By contrast, when Lo starts Social Security at 66 and Hi at 70 via file and suspend, both the required savings and lifetime income are much larger. It's the difference between retiring with only $26,000 annual income and $44,000.

One way to reduce the cost is to retire later. The extra working income can contribute to savings and the later retirement age will reduce the amount of savings required. It may also increase the FRA benefits just as working longer increases a pension benefit.

Another possibility is to work AND draw Social Security before retiring. That may have a short time penalty in the amount of Social Security while working, but the penalty will gradually be wiped out with adjustments the SSA will make in subsequent benefit payments.

When there is a large age difference between spouses or when Hi and Lo both have nearly the same FRA benefits, then the only way to find the best strategy is to try some different alternatives by changing the ages to start Social Security and trying the suspend alternatives with the program. Switching between alternatives is easy on the free Strategic Social Security Planner with a click of a button.

The "suspend" (only) alternative applies only after Social Security has already started. Therefore, it's often used to enhance future benefits when people understand that they could have done better. It is only possible to initiate the suspend option after reaching the full-retirement-age. Suspending for the years from age 66 to 70 would increase the Social Security benefit by 32%. For example if the suspending partner started Social Security at 62 and suspended at 66 and resumed at 70, the Social Security would be the following percentages of the FRA benefit: 75% at 62, 0% from 66 to 70, and 99% for all years thereafter. It could also enhance the survivor's benefits significantly because the survivor would get 100% of whatever the deceased was getting at the time—but the savings must be there to support the years with no Social Security during the suspension.

There are so many alternative combinations, that it's difficult to make general statements about what is best other than, if the savings are adequate, the later the starting age, the better ultimate retirement income. You just have to use a projection of savings at retirement to see if your savings will support better paying alternatives.

One other generality: There is no commercial annuity that will provide the benefits of Social Security with its inflation indexing, spousal benefits and generous survivor payments. Save at least the minimum required from the program plus some reserves for known future purchases of high value items, replacing things that wear out, and unknowns—perhaps even long-term-care.

This may be one of the most important financial decisions you will make.

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