Retirees Aren't Spending Enough of Their Nest Eggs. Here's Why.

By

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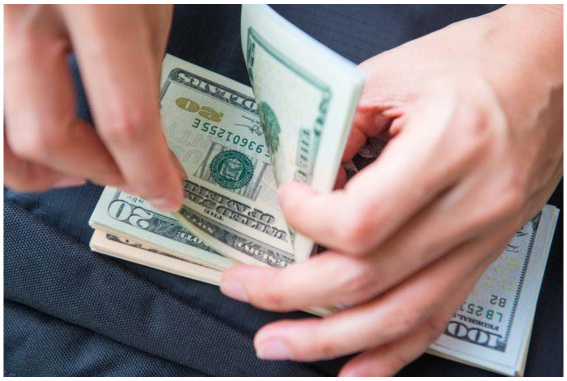

Linda Cooley of Florida has seen her nest egg grow dramatically since she retired more than five years ago as a lawyer.

Cooley, 69, lives off pensions and Social Security and has yet to touch her retirement portfolio of several million dollars. Her financial advisor, Susan Elser of Indianapolis, frequently reminds Cooley she could be spending more in retirement.

"She asks, 'Are you doing everything you want to do? Are you buying everything you want to buy?'" Cooley says. "And the answer to that is yes."

Cooley isn't alone. A recent study from the Employee Benefit Research Institute surveyed average retirees between age 62 and 75 and found that three-quarters of them had seen their assets remain the same or grow in retirement.

"Very few plan to systematically spend down assets," said a report from asset manager BlackRock issued in conjunction with EBRI. "If assets do decrease, there is a clear desire to keep assets above a certain, minimum level."

A robust stock market has also been a key factor in this dynamic—helping retirement portfolios stay steady or even grow as many retirees still spend what they need.

Such growth strengthens the case for increased spending in retirement. So why the reluctance to spend? Academics and financial advisors say the fear of running out of money is the biggest reason. Retirees don't know how long they are going to live, what medical expenses they'll face, and how their investment portfolios will perform over decades. So they protect themselves by spending less than they could.

Mark Berg, a financial planner near Chicago, tells affluent, relatively young retirees that now is the time to spend. "You're in a window which may not always be open where you have your health and you have the means," he tells them.

But many live modestly, no matter what he says. "I don't push it with people who are happily frugal," Berg says.

A fear of needing long-term care can also discourage retirees from spending down their nest egg. A yearslong stay in a nursing home, for instance, can cost hundreds of thousands of dollars—the average lifetime cost, according to PwC, is $172,000.

Jonathan Harrison, a financial advisor in the Kansas City area, says he has a client in her early 80s who wanted to give much of her wealth to family members but worried she wouldn't have enough money if she ended up in long-term care. So he set aside $150,000 of her money for long-term care and put it in safe investments. Knowing there was a dedicated pool of money to pay for care allowed her to make bigger gifts to family members.

"This gives her peace of mind," he says.

Retirees are heavily influenced by the experience of family members. "We have clients where the parents died at a young age, and they think very differently than people whose parents died in their 90s and needed care," says David Frisch, a financial advisor in Melville, N.Y.

Other factors affect spending rates. Research has found that retirees who get most of their income from pensions and annuities spend more freely in retirement than those who rely on income from an investment portfolio.

J.P. Morgan looked at both types of clients and equalized their retirement wealth by creating net present values for Social Security, pensions, and annuities. It found that among clients with $1 million to $3 million in net worth, those that received 60% to 80% of their income in regular payments spent 26% more in retirement than did those who got only 20% to 40% of their income from regular payments. Those with $3 million to $5 million with more regular income spent 47% more.

"They spend significantly more than households that are staring at account balances," says Katherine Roy, chief retirement strategist for J.P. Morgan Asset Management.

One fix would be to create more pension-like income for retirees living off portfolios, Roy said. Asset managers could do it by sending retirees something that resembled a regular paycheck, she adds.

Or course, retirees can create more stable income on their own by spending down their assets to delay taking Social Security. The government pension is an inflation-adjusted annuity where the payout rises by 8% for every year you wait beyond full retirement age to claim it.

The problem is that many retirees don't like the idea of spending down their assets to get higher Social Security payments, Roy says.

Moreover, spending habits built up during a life of saving can be tough to overcome in retirement. "The skill-set required to create a nest egg is the exact opposite of the one you need to spend it," says David Blanchett, head of retirement research at the PGIM unit of Prudential Financial , who co-wrote a paper on underspending in retirement with Michael Finke, a professor of wealth management at the American College of Financial Services.

Dr. Michael Dick, 73, saved at least 15% of his salary during 40-plus years as a dentist in Rutland, Vt. He said he now has an eight-figure investment portfolio.

His portfolio has grown since he retired five years ago. Dr. Dick said he got satisfaction out of seeing his portfolio grow when he worked, and that hasn't changed in retirement. He has no use for ostentatious displays of wealth, he says.

"I wouldn't go out and spend $100,000 on an automobile when I could buy a very nice one for $30,000," he says.

Dr. Dick says he currently spends around $200,000 a year plus he donates at least an additional $50,000 a year to charity.

"He can afford to spend more," says Dr. Dick's financial advisor, Neal Van Zutphen of Tempe, Ariz., "He doesn't need to spend more. He has a great life."

Dr. Dick is planning to leave substantial legacies to his children and to charity when he dies. But advisors say that leaving money to heirs is usually a secondary motivation for restrained spending in retirement.

"We don't have any clients that come to us and say, 'I want to spend everything and not leave anything to our children,'" says Van Zutphen. "All of them want to make sure they don't run out of money before they run out of life. And none of them want to be a burden to their children."

A big predictor of how someone will spend in retirement is how they spend while they're working. Elser, the Indianapolis advisor, says clients that tend to save money while working tend to keep saving money after they retire. And clients that tended to overspend while working keep doing so as retirees.

"You really cannot change the core values people have," she says. "We can help people to change at the margins."

Deb Stecklein, one of Elser's clients, worked as a school dietitian, never had more than a five-figure salary, but still built up a portfolio of more than $1 million. She and her husband, George Lennox, who has similar net worth, travel a lot but are otherwise careful in their spending.

“I was a single parent for most of my life and raised two children, and that’s an important nest egg,” says the 75-year-old Stecklein, who lives in Naples, Fla. “I still want to be prepared for the rainy day.