Government Executive

A Case of Savings Envy

By Tammy Flanagan

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When it comes to retirement readiness, it generally doesn't pay to compare yourself to other people. It can lead to unnecessary disappointment -- or unwarranted joy.

This week I had a casual conversation with "Heather" about how disappointed her aunt, "Brenda," was when the two of them compared Thrift Savings Plan balances. But a look at the bigger picture shows they are simply in very different stages of the retirement planning process.

Here's Heather's situation:

Age 36 with 10 years of federal service; in the Federal Employees Retirement System
TSP balance: more than $200,000
Employed as a GS-14 project manager in the Washington area, at a salary of $112,224
Contributes at least 10 percent of basic pay to her TSP account and is diversified between the five TSP options with a substantial percentage split between the C, S and I funds.
More than 20 years from retirement
Single mom raising a young son

Here's Brenda's situation:

Age 57 with 30 years of federal service; in FERS
Lives away from a major metropolitan area in the "Rest of U.S." category at GS-11, Step 3, with a salary of $61,234
TSP Balance: $145,000
Contributes 5 percent of salary to the TSP and currently is paying back a TSP Loan
TSP is invested 50 percent G Fund and 50 percent F Fund
Divorced with grown children; no benefits payable to or from her former spouse

Brenda had an intense and emotional reaction to realizing how far behind she was in retirement savings compared to her niece. She thought she might never be able to afford to retire. To help Brenda see she wasn't as bad off as she imagined, I walked her through the process of understanding where she is now and where she can be five years down the road.

Estimated Retirement Income at 57:

Brenda will be eligible to retire in 2014 because she will have 30 years of federal service and is already past the FERS minimum retirement age. I recommended that Brenda request a formal retirement estimate from her human resources office. In the meantime, we did a quick estimate based on a high-three average salary of about $55,000.

FERS Benefit:

FERS Basic Retirement Benefit: 30 years of service (for simplicity, I'm not including months of service or sick leave

credit) x 1% x $55,000 = $16,500
FERS Retirement Supplement (shortcut estimate): 30/40 (years of FERS civilian service / 40) x $1,200 (age 62 Social Security benefit) = $900 x 12 months = $10,800
$16,500 + $10,800 = $27,300 representing approximately 45% of her current salary.
No adjustments for inflation until cost of living adjustments begin after she turns 62.

Social Security: Not payable at age 57; replaced by FERS Supplement (see above).

TSP: I asked Brenda how she came up with the 50-50 split in her allocation between the G and F funds, and she said she couldn't remember. I suggested she might want to speak with a financial adviser or consider the Lifecycle Funds to get exposure to all five TSP investment options. Then, using the TSP's Retirement Income Calculator, Brenda ran different scenarios involving various monthly payments based on a set dollar amount as well as a life expectancy payout using her current age and balance:

Option One: Withdraw $600 per month with an assumption that the balance would earn a 6 percent return. In that case, she would still have money available at age 90. But would she be able to achieve a long-term growth rate of 6 percent?
Option Two: Withdraw $700 a month with the balance earning a 3 percent rate of return. In this scenario, she would run out of money at age 81.
Option Three: Purchase a life annuity with cash refund and inflation protection. She'd get $412 per month at 57, increasing to $554 a month at 67 and $1,000 a month at 87 (if the rate of inflation averaged 3 percent a year). The cash refund feature provides that if Brenda were to die before receiving her initial investment, the balance would be paid to her beneficiary.

If Brenda chose Option One, she could theoretically get $7,200 per year in TSP income in addition to her FERS retirement benefit of $27,300, for a total retirement income of $34,500. That's about 56 percent of her current salary. Based on her current debt and expenses, Brenda thinks she'll need to work longer to be able to afford to retire on less than her current salary. But she was relieved to realize that she wasn't as financially unprepared as she thought she was.

Here's what happened when we re-ran the numbers by extending Brenda's career another five years:

Estimated Retirement Income at 62:

Brenda will be eligible to receive Social Security retirement at 62, although it would be reduced by 25 percent of the amount payable at 66, since she's under her full retirement age. By working five years beyond her first eligibility, Brenda also would be eligible for a more substantial FERS basic retirement benefit -- with cost of living adjustments payable in the first year. Five more years of saving in the TSP and working on reducing her debt will also go a long way towards better financial security in retirement. Brenda also believes she can afford to increase the amount she is saving in the TSP to more than her current 5 percent of basic pay.

FERS Basic Retirement Benefit: 35 years of service x 1.1% (must be age 62 with at least 20 years of service to use the 1.1% factor) x $61,234 (current salary) = $23,575

Social Security: At her current salary projected to age 62, Brenda would receive a Social Security benefit of approximately $1,200 a month or $14,400 a year.

TSP: If Brenda increases her savings from 5 percent to 6 percent of her basic pay, and if she can get an average return of 6 percent on her current and future savings, her TSP balance will grow to $232,877 by age 62. If her savings only grow an average of 4 percent, the balance would be $212,552. If she could increase her savings to 8 percent of her basic pay, with a 4 percent rate of return, her balance would be $219,325. If she could earn a 6 percent return, the balance would grow to $240,007.

Using the TSP's calculator, Brenda ran a variety of different scenarios of withdrawing a series of monthly payments based on a set dollar amount as well as using the option for a life expectancy payout based on beginning payments at 62 with a balance of $210,000.

Option One: Withdraw $1,500 per month with an assumption that the balance would earn a 6 percent return. Unfortunately, under this scenario, she would run out of money by age 80.
Option Two: Choose payments based on life expectancy and receive $745 a month initially, but due to annual recomputation based on her increasing age and increasing earnings (with a 6 percent growth assumption), increasing to $1,800 a month by age 90 with a balance of more than $239,000.
Option Three: Purchase a life annuity with cash refund and inflation protection: $697 a month at 62, increasing to $937 a month at 72 and $1,460 a month at 87, assuming a 3 percent annual inflation rate.

Using the life expectancy TSP option, Brenda's retirement income at 62 would total $46,903, representing 77 percent of her current salary. For the first time, she might feel financially comfortable to retire.

Of course, there are benefits to working beyond 62:

Brenda's Social Security benefit at her full retirement age (66 and 4 months) would be unreduced and would also reflect the additional wages of working an additional four years. Her Social Security estimate shows a monthly benefit at 66 and 4 months of $1,728 per month.
She can continue to increase her savings and decrease her debt and retirement expenses by paying off her mortgage and consumer debt.
Her FERS basic retirement would reflect the additional years of service as well as any upcoming pay increases that would increase the salary her retirement will be based on.

The bottom line for Brenda is that it will pay to wait, and she's well within reach of a financially stable retirement.

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