Optimizing Social Security

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As Americans approach retirement, they face the important decision of when to claim Social Security benefits. The Social Security Administration ("SSA") reported that in 2015, 70% of men and 75% of women claiming Social Security did so before their Full Retirement Age ("FRA").[1] This may be the best—or the only—option for those who lack additional sources of guaranteed income or are facing serious health concerns. For many others, considering several retirement income strategies, rather than simply claiming Social Security as early as possible, may be the better approach and may allow pre-retirees to optimize their retirement income.

This paper discusses a method for optimizing lifetime Social Security income.

A single person may be able to collect more lifetime income by delaying his/her Social Security claiming age:

- we use two simple calculations: **Present Value** of Social Security income and **Cumulative Social Security Benefits collected.**
- we examine the variables of discount rate, expected long-term inflation, claimant's tax rate, and his/her life expectancy.[2]
- we find that for reasonable rates of return and inflation assumptions, **delaying Social Security results in a higher present value dollar amount and considerably higher cumulative balance of Social Security payments,** than claiming Social Security early.

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Present value and cumulative Social Security income collected

Full Retirement Age ("FRA") is currently 66 for those born between 1943 and 1954,[3] at which point a retiree is entitled to his/her Primary Insurance Amount ("PIA"). An individual is eligible to start collecting Social Security as early as age 62; however, this locks in a reduced benefit for the rest of the retiree's life. Alternatively, delaying the start of benefits every year past age 66, up to age 70, enhances annual lifetime Social Security income by a predetermined factor which reflects the delayed retirement credits.[4] For example, a retiree who starts to receive retirement benefits at age 68 would see her PIA increase by a multiplier of 1.16, as seen in the chart below.

Factor Applied to Annual Social Security Income Based on Age[5]

Claiming Age	62	63	64	65	66	67	68	69	70
Multiplier	0.75	0.80	0.87	0.93	1	1.08	1.16	1.24	1.32

* Reduction Scale varies slightly based on year of birth. This example reflects Full Retirement Age at 66.

For an investor who may have a conservative view of the rates of return that can be earned in the market, as well as one who may face the probability of living longer in retirement (as health standards improve), deferring Social Security and collecting delayed retirement credits presents a valuable strategy.

For example, a 62-year-old individual is considering the trade-offs of claiming Social Security at age 62 versus age 70. She has earned, on average, $70,000 every year of her working career; her PIA is $2,788.[6] In order to conduct a present value analysis, we use a discount rate, which represents a long-term, conservative rate of return that she expects to earn in the market, net of fees and net of taxes; we use 5%. Her long-term inflation expectation is 2%—her Social Security income grows annually by this amount. Her earnings are taxed at 25%. We also present a side-by-side view of results if she planned through age 88 versus through age 94[7] (Table 1).

For her—whose expectations and market assumptions mirror those of a large body of today's investors—the benefits of delaying the Social Security claiming age to 70, in both present value and cumulative terms, are pronounced. Table 1 shows the present value amount of her Social Security income, as well as the cumulative value of benefits collected, at ages 88 and 94.

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Table 1.

Planning Horizon to age 88

Claiming Age	Social Security Payment in 1st Year	Present Value through age 88	Cumulative Benefits Collected at age 88
62	$1,829	$457,163	$1,266,360
70	$3,773	$520,248	$1,462,538
$ Difference between 70 and 62		$63,086	$196,178
% Difference between 70 and 62		14%	15%

Planning Horizon to age 94

Claiming Age	Social Security Payment in 1st Year	Present Value through age 94	Cumulative Benefits Collected at age 94
62	$1,829	$536,604	$1,840,070
70	$3,773	$660,578	$2,285,764
$ Difference between 70 and 62		$123,975	$445,695
% Difference between 70 and 62		23%	24%

If she can delay claiming until age 70, she will collect approximately $196,000 (or 15%) more in cumulative Social Security benefits by age 88, and $63,000 (or 14%) more Social Security income in present value terms. In general, the benefit of Social Security deferral grows the longer she lives, as evidenced by extending the planning horizon to age 94—the age to which the average 62-year-old female has a 25% probability of living.

The impact of the four variables, discussed in present value terms in Table 2, on Social Security claiming age can be summarized as follows:

Table 2.

The higher the discount rate, the lower the benefit of deferring Social Security claiming age, since it reduces the relative impact of payments far in the future.

Present Value Analysis (in $ Thousands)			
Discount Rate*	**Claiming Age: 62**	**Claiming Age: 70**	% Difference between 70 and 62
4%	**$499**	**$587**	17%
5%	**$457**	**$520**	14%
6%	**$420**	**$463**	10%
7%	**$387**	**$412**	6%
8%	**$358**	**$368**	3%

The higher the long-term inflation assumption, the higher the benefit of deferring Social Security, since inflation is applied to a larger base when it is applied to deferred payments.

Present Value Analysis (in $ Thousands)			
Inflation Assumption	**Claiming Age: 62**	**Claiming Age: 70**	% Difference between 70 and 62
2.0%	**$457**	**$520**	14%
2.5%	**$484**	**$563**	16%
3.0%	**$513**	**$610**	19%

The longer the planning period (i.e., longer life expectancy), the higher the benefit of deferring Social Security, since the difference between the early, reduced payments and the deferred, enhanced payments is experienced for a longer period of time.

Present Value Analysis (in $ Thousands)			
Planning Period**	**Claiming Age: 62**	**Claiming Age: 70**	% Difference between 70 and 62
82	**$369**	**$365**	-1%
88	**$457**	**$520**	14%
94	**$537**	**$661**	23%

** i.e. Life Expectancy assumption
* i.e. The Rate of Return in the market, net of fees and taxes

The higher the Tax Rate, the higher the benefit of deferring Social Security, since taxation reduces the post-tax discount rate.

Present Value Analysis (in $ Thousands)			
Tax Rate	**Claiming Age: 62**	**Claiming Age: 70**	% Difference between 70 and 62
15%	**$456**	**$507**	11%
25%	**$457**	**$520**	14%
28%	**$457**	**$524**	15%
33%	**$458**	**$530**	16%

Conclusion

Investors, interested in holistically planning for their retirements, should decide when to start collecting Social Security after taking into consideration other variables, such as expected rates of return in the market, expected long-term inflation, the rate at which one will be taxed, and one's outlook on life expectancy. They may often find that deferring Social Security benefits to age 70, thereby benefiting from delayed retirement credits, is a highly valuable strategy.

For those who want to optimize Social Security income by delaying benefits, but have an income need for that period during which they are not receiving Social Security, **there are ways to use annuities to structure an income bridge.** These approaches can provide income for the years between the start of retirement and the optimal start of Social Security. Among these options, fixed period annuities and single premium immediate annuities ("SPIAs") may provide the income retirees need during that time:

- *A fixed period annuity* can provide a stream of guaranteed income payments for a duration that matches the years between retirement and the start of Social Security benefits.
- *A SPIA with a rider that allows annuity payments to be decreased in the future*[8] can also provide income. The SPIA provides income for life, and the addition of this type of rider permits the retiree to receive larger income payments at the beginning of the contract—while not receiving Social Security—and then decrease the annuity income when Social Security payments begin.

In both cases, the retiree could utilize his/her savings to fund one of these annuities and generate an income bridge.

Sources

[1] https://www.ssa.gov/policy/docs/statcomps/supplement/2015/5b.html#table5.b8.

[2] For another study that uses these factors, see Doug Lemons, When to Start Collecting Social Security Benefits: A Break-Even Analysis, JOURNAL OF FIN. PLANNING, available at https://www.onefpa.org/journal/Pages/When%20to%20Start%20Collecting%20Social%20Security%20 Benefits%20A%20Break-Even%20Analysis.aspx.

[3] https://www.ssa.gov/planners/retire/agereduction.html.

[4] https://www.ssa.gov/planners/retire/retirechart.html and https://www.ssa.gov/planners/retire/delayret.html.

[5] https://www.ssa.gov/planners/retire/1943.html and https://www.ssa.gov/planners/retire/delayret.html.

[6] For illustrative purposes, we assumed this retiree earned the maximum taxable income amount in each of her working years, which equated to a maximum PIA amount of $2,787.80. https://www.ssa.gov/oact/cola/Benefits.html.

[7] Ages 88 and 94 are shown because they represent the life expectancy and the 75th percentile of mortality, respectively, for a 62-year-old female. See SOC'Y OF ACTUARIES, Annuity 2000 Mortality Tables, available at file: http://www.pgcalc.com/pdf/singlelife.pdf.

[8] Rider subject to availability, limitations, and restrictions, which may include: must be elected at time of purchase and the exact date and percentage of the changing need must also be determined at time of purchase.

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