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Optimizing Social Security Benefits

The most common question regarding Social Security is when to start claiming benefits. Every client is unique, each with diverse needs and goals, so there is no universal answer. However, we believe the proper lens to use when considering this question is, "What will maximize my net worth?". When making the decision on which strategy suits you best (claiming early, at full retirement age, or delaying), it is important to not just focus on Social Security benefit payouts in isolation but in the context of your total net worth. To achieve this, it is crucial to analyze income, expenses, retirement age, other sources of income, life expectancy, and projected portfolio growth rates. When done in this manner, we challenge some of the mainstream thinking of Social Security timing and offer a framework for making the decision on when to claim benefits.

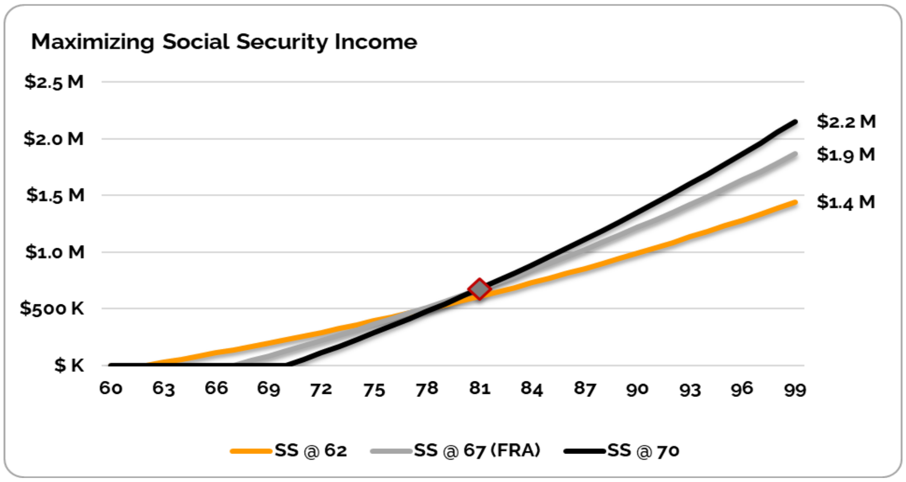
The Basics

During working years, Social Security tax of 12.4% is applied to earned income (up to an annual wage base - $147,000 in 2022). If you are an employee, you pay 6.2% and your employer pays the other 6.2%. If you are self-employed, you pay the full 12.4. An individual gets credit for how long and how much they contribute to Social Security during their working years. In retirement, you can claim your benefits and start receiving Social Security income. For everyone born in 1960 or later, full retirement age (FRA) is 67.

Now the question of timing. By claiming earlier than FRA, or later, you will reduce or increase your Social Security benefits. If taken at 62, your benefit is reduced by 30% (20% for the first three years and 10% for the next two). If claimed at 70, your benefits increase by 24% (8% per year). Given these options, let's review the most common way Social Security timing is decided, cumulative benefits.

Case Study

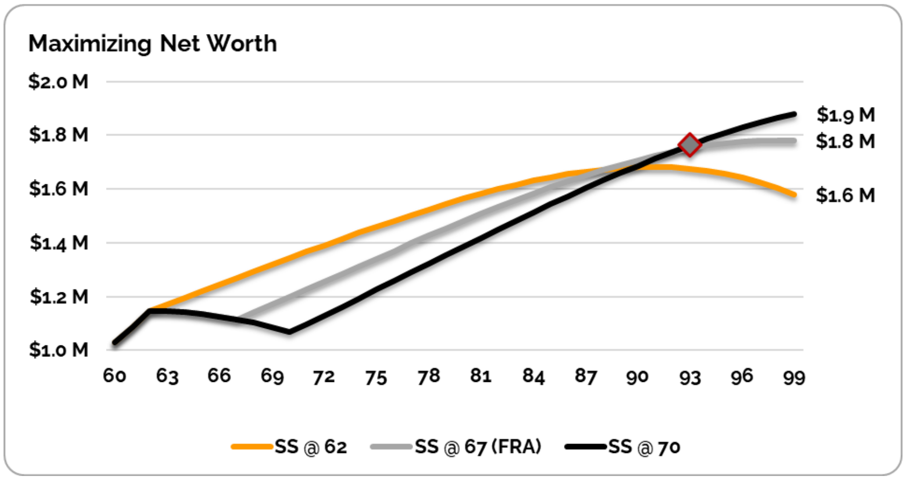
For our case study, our beneficiary is born in December 1962, currently age 59, and will receive $3,000 in monthly benefits at FRA (age 67). We first analyze the maximum benefit strategy in isolation, Graph 1. This is done to mimic the often-referenced method used in determining whether to delay taking benefits. It represents the cumulative Social Security income and shows the age at which the benefits of claiming at age 70 break even with claiming at FRA. Breaking even occurs at the age where the



Graph 1

increase in benefits cross over the initial amount forgone from filing early. The crossover age in cumulative Social Security benefits is at age 81. With this information, it would seem anyone expecting, with high certainty, to live past age 81 should delay claiming benefits to age 70; however, this ignores many other variables impacting net worth and the risk of life expectancy.

Adding some additional details to our case study and looking at the overall picture, the individual has $1 million in liquid assets and $60,000 in total expenses per year. The portfolio is allocated 70% equity and 30% fixed income, the assumed return is 5.45% pre-tax. Graph 2 shows the crossover of net worth given the different claiming ages.



Graph 2

When benefits are delayed, investment assets are used to cover income shortfalls that would otherwise be covered by Social Security income. Investments used to cover the shortfall lose out on long-term compound growth within the portfolio. When maximizing net worth is considered, the crossover age increases from age 81 (cumulative benefits) to age 93 (net worth). Therefore, if your objective is to maximize net worth, claiming Social Security earlier, at FRA, is a better strategy. The risk of life expectancy will aid in deciding how to maximize Social Security income received and/or net worth.

The Social Security Administration's actuarial data suggest that a male, currently age 60, will live to about age 82, on average, and a female till age 85. An individual choosing to delay receiving benefits until age 70 must live to 93 to maximize their net worth.

Current Age	MALE	FEMALE
	Average Life Expectancy	Average Life Expectancy
60	81.8	84.8
61	82.0	85.0
62	82.3	85.1
63	82.5	85.3
64	82.8	85.5
65	83.1	85.7
66	83.4	85.9
67	83.7	86.1
68	84.0	86.3
69	84.3	86.5
70	84.6	86.8

Graph 2 also helps visualize the deviation in liquid assets for the three scenarios. Delaying benefits to age 70 will see a decline in liquid assets due to distributions from the portfolio which would otherwise be growing. Now investment returns come into play. It can be looked at as an opportunity cost – what is the cost of drawing from investment accounts opposed to collecting benefits? There is an additional risk of poor market returns during the delayed years, causing an individual to draw on the portfolio when the market is down. The earlier a drawdown is locked in, the greater the impact on the compounding of your wealth. Consequently, Social Security should be your first stop for income when aiming to maximize wealth.

Some individuals will be fortunate to have the choice on whether to delay benefits or not, signifying that they either have other sources of income or have accounts they can distribute from. Clients with lifestyle constraints in retirement are more likely to be tolerant of this opportunity cost, as current income takes priority for them over accumulating wealth. Taking time to understand your objectives and needs in retirement and in your estate plan is essential to optimize a strategy to maximize your wealth.

Tax Considerations
In addition to the three basic claiming strategies, there are steps you can take to make whichever strategy you choose the most tax efficient. A maximum of 85% of Social Security benefits are taxed; however, if an individual has income between $25,000 and $34,000 they will only pay taxes on 50%. Social security is only partially taxable but 100% of pre-tax retirement account withdrawals are taxed at ordinary income rates. If you have significant pre-tax retirement investments, it may make sense to execute annual Roth conversions after working years, but prior to claiming Social Security. This will lower your taxable income by reducing future required minimum distributions.

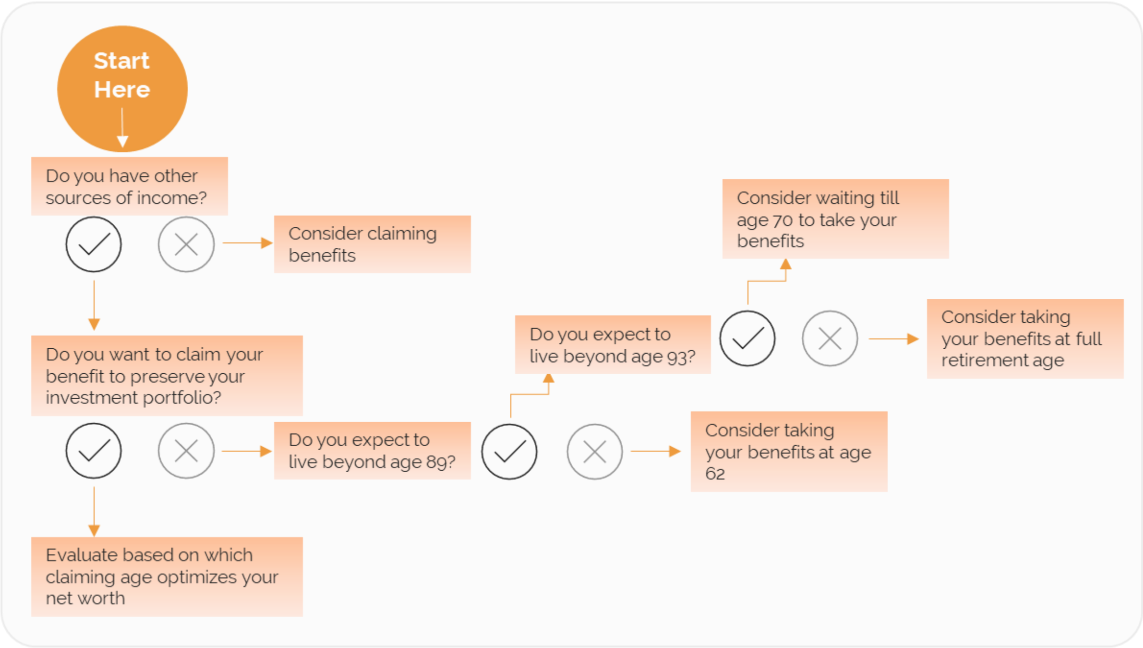
Will Social Security Run Out?
According to the 2022 Annual Report of the Board of Trustees of the Social Security Trust Funds, the income (or Social Security Tax receipts) to the Trust Fund would be sufficient to pay scheduled benefits until 2035. After that, if there are no policy changes, 80% of scheduled benefits will be covered by continuing Social Security income tax.

Another advantage of keeping taxable income lower, is keeping Medicare premiums low as they are income-based.

As you can see, there are many ways to approach this, and each one specific to each client. Understanding when it is optimal to claim Social Security benefits can help clarify the framework for important discussions with your advisor.

Decision Tree

Although there is not a one size fits all strategy, determining the best strategy to achieve your objectives requires a uniform, analytical approach. Exploring the decision factors in the chart below is a helpful place to start to make the best choice for each individual.



Summary

Ultimately, you should consider how to maximize the impact of Social Security benefits rather than focus narrowly on maximizing Social Security income. Choosing the right strategy for you is certainly a complex matter with many choices to be considered but working with an advisor to study and conclude empirically is the best choice for you.

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