How to Retire at 65 With $2 Million

Does $2 million go as far in retirement as it used to? It can if you take these action steps.

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Having the right retirement budget goes with generating the income you need to meet your unique household financial needs. GETTY IMAGES

For many savers, having $2 million stashed for retirement would make them feel light years ahead of where most Americans stand with their long-term savings. But if you don't manage that $2 million correctly, you risk running out of cash during your golden years.

That scenario is more likely than you may think, considering U.S. retirees may easily live 20 or 30 years in their golden years or even longer. Additionally, when you stop working, you stop earning.

"Since your income stream falls significantly – or even goes away entirely for a time – when you retire, it's necessary to understand how your assets can be turned into an income stream," says Jill Fopiano, CEO at O'Brien Wealth Partners in Waltham, Massachusetts. "This income stream, plus any Social Security or pension income, should be compared to your anticipated expenses to ensure you can cover the lifestyle you are planning."

What's the optimal strategy to build a suite of income streams with $2 million in retirement savings at or around the traditional retirement age of 65? Here's what the experts advise.

- Work in retirement.
- Stick to the 4% rule.
- Build a retirement budget.
- Delay taking Social Security.
- Leverage your IRA.
- Factor in tax planning.
- Focus on asset allocation.

Work in Retirement

Depending on your sources of income outside of your retirement savings – Social Security and pension income, for example – you may want to consider supplementing your cash flow with part-time work or a contract job.

"This could also help to defer your Social Security to receive higher benefits when you start collecting," Fopiano says.

Stick to the 4% Rule

When you start drawing down that $2 million at retirement age, try sticking to a reasonable annual withdrawal rate. May wealth managers believe a 4% annual drawdown rate makes sense at 65.

"I am still comfortable with the 4% rule," says Michael Wagner, chief operating officer at Omnia Family Wealth in Miami. "I'm always more comfortable with people underwriting a lower withdrawal rate in retirement."

If you average 7% annual returns through a market cycle and only take out 4% annually, that means you're leaving 3% of growth that you're reinvesting back into the portfolio.

"I have no problem with that, but you have to be aware of your portfolio composition," Wagner says. "Is it set up in a way that you can reasonably expect to earn 7% returns after taxes and fees over a market cycle? Chances are, you can't be totally out of risk assets like stocks."

Build a Retirement Budget

Having the right retirement budget goes with generating the income you need to meet your unique household financial needs.

“If you don't know your spending, the $2 million may be a great 'retirement number' or may be light,” Wagner says. “During their working years, many folks do not budget well, but if they are wrong, the paycheck will come in another two weeks. That is not the case when in retirement.”

At the 4% annual withdrawal, a retiree with $2 million would generate $80,000 per year or $6,666 per month.

“This must cover mandatory monthly spending, mandatory annual spending (like property taxes and insurance if you own your own home) and also income taxes,” Wagner says. “Many Americans have all their retirement in IRAs (pretax). If that’ s the case, that $80,000 per year may be subject to 22% or more in income taxes.”

Delay Taking Social Security

Since Americans are living longer, it makes sense to delay taking Social Security payouts – even to age 70.

“All else being equal, you can get a significantly higher Social Security benefit by deferring until age 70 or as long as you possibly can,” Fopiano says. “If you can cover your expenses through other means and are in reasonably good health, it likely makes sense to defer your benefits.”

Data shows that every year you wait to take Social Security after your full retirement age adds 8% more cash annually to your payout.

Leverage Your IRA

One big issue when handling retirement income needs is deciding what type of account holds the $2 million in savings.

Most of the time the account is a pretax IRA, which can be a big advantage when managing millions of dollars in retirement.

“When people retire, their taxable income drops and so does their tax bracket,” says Jeremy Finger, founder at Riverbend Wealth Management in Myrtle Beach, South Carolina. “This is a perfect time to start withdrawing from IRA accounts for retirement income, especially when you couple the IRA with delaying Social Security every year so you get that annual 8% increase in pay.”

This combination strategy accomplishes three key objectives for retirees, Finger says.

- You are paying lower taxes on IRAs because your tax bracket is usually lower.
- You also lower the future required minimum distributions when you turn 73, which could force you into a higher tax bracket.
- You are maximizing a government pension that goes up with inflation and that you won't outlive.

“The 4% rule could work here, but you could be left with a larger estate than you may want,” Finger adds. “A better way is using guardrails. Guardrails are adjusting spending on discretionary expenses. When times are good, take a little more. When times are tough, take a little less. Think Paris for a month or Florida for a week.”

Factor in Tax Planning

There are two major tax issues to consider when planning to retire.

Different types of investment accounts: Many investors have a mix of taxable and tax-advantaged accounts. “The amount of spending afforded by $2 million depends heavily on the tax character of the accounts in which it resides,” says Roni Israelov, president and chief investment officer at asset manager NDVR.

Tax profile: Depending on where you live (or if you’re planning to move), the tax liability can significantly reduce your spending power in retirement. “It’s important to account for this in your financial and investment plan,” Israelov says.

For instance, withdrawals from most retirement accounts other than Roth IRAs are taxed as ordinary income, while distributions from brokerage accounts are taxed at capital gains rates.

“Depending on an individual’s overall income level, taxation at ordinary income levels tends to be more onerous than capital gains,” Fopiano says. “People with assets concentrated in retirement accounts need to factor in the tax obligations when they are determining the net income they will have from their investments or they risk ignoring a potentially large expense which can curb spending power in retirement."

Focus on Asset Allocation

As you get close to retirement, pay special attention to your investment portfolio makeup.

“If you’re in your early 60s and you want to retire in the next few years, pay attention to what’s going on in the financial markets,” Wagner says. “Remember, what happens in the last few working years can have a huge effect on the rest of your financial path in life.”

As you approach your retirement runway, work with a trusted financial advisor, conduct a prelanding audit and evaluate the risk in your portfolio.

“If you have a lot of money in the wrong investment bucket and the U.S. economy enters a 'Great Recession' scenario, you might end up with $1 million instead of $2 million, and you might have to end up working a bit longer because the market took away half of your retirement savings,” Wagner says.

That’s why it’s always important to regularly vet your retirement portfolio’s asset allocation before and during retirement.

“In doing so, remind yourself of the amount of risk you’re willing to take on because odds are, it’s a lot lower now than it was when you started saving for retirement,” Wagner adds.