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The Retirement Income Gender Gap: Dealing with a Shortfall

If you (or you and your spouse) find yourself facing a shortfall, the best solution will depend on several factors, including the severity of your projected deficit, the length of time remaining before retirement, and how long you need your retirement income to last.

When you determine your retirement income needs, you make your projections based on the type of lifestyle you plan to have and the desired timing of your retirement. However, you may find that reality is not in sync with your projections, and it looks like your retirement income will be insufficient to meet your estimated expenses during retirement. This is called a projected income shortfall.

There are many reasons why women, on average, are more likely than men to face a retirement income shortfall. Because women's careers are often interrupted to care for children or elderly parents, they may spend less time in the workforce. When they're working, women tend to earn less than men in similar jobs, and they're more likely to work part-time. As a result, their retirement plan balances and Social Security benefits are often smaller. Compounding the problem is the fact that women often start saving later, save less, and invest more conservatively than men, which decreases their chances of having enough income in retirement.[1] And because women tend to live longer than men, retirement assets may need to last longer.

If you (or you and your spouse) find yourself facing a shortfall, the best solution will depend on several factors, including the severity of your projected deficit, the length of time remaining before retirement, and how long you need your retirement income to last. In general, you have five options--save more now, delay retirement, find new sources of retirement income, spend less during retirement, and/or seek to increase the earnings on your retirement assets (but by doing so you could also increase your risk of loss).

Save more, spend less now

Save as much as you can. Take advantage of IRAs, employer plans like 401(k)s, and annuities, where investment earnings can potentially grow tax deferred (or, in the case of Roth accounts, tax free). Utilize special "catch-up" rules that let you make contributions over and above the normal limits once you've reached age 50 (you can contribute an extra $1,000 to IRAs, and an extra $5,500 to 401(k) plans in 2014). If your employer matches your contributions, try to contribute at least as much as necessary to get the maximum company match--it's free money.

If you don't have enough discretionary income to save more for retirement, try adjusting your spending habits to free up more cash. Depending on how many years you have before retirement, you may be able to get by with only minor changes to your spending habits. However, if retirement is only a few years away, or you expect to fall far short of your retirement income needs, you may need to change your spending patterns drastically to save enough to cover the shortfall. You should create a written budget so you can easily see where your money goes and where you can reduce your spending.

Delay retirement

One way of dealing with a projected income shortfall is for you (or your spouse, or both of you) to stay in the workforce longer than you had planned. This may allow you to continue supporting yourself with a salary rather than dipping into your retirement savings.

Delaying retirement might allow you to delay taking Social Security benefits (which may increase your benefit) and/or delay taking distributions from your retirement accounts. The longer you can delay tapping into your retirement accounts, the longer the money will last when you do begin drawing down those funds. Plus, the longer you delay retirement, the longer you may be able to contribute to an employer-sponsored retirement plan, or earn additional pension benefits.

While you might hesitate to start on a new career path late in life, there may actually be certain unique opportunities that would not have been available to you earlier in life. For example, you might consider entering the consulting field, based on the expertise you have gained through a lifetime of employment.

Consider investing more aggressively

If you are facing a projected income shortfall, you may want to revisit your investment choices, particularly if you're still at least 10-15 years from retirement. If you're willing to accept more risk, you may be able to increase your potential return. However, there are no guarantees; as you take on more risk, your potential for loss (including the risk of loss of principal) grows as well.

It's not uncommon for individuals to make the mistake of investing too conservatively for their retirement goals. For example, if a large portion of your retirement dollars is in low interest earning fixed-income investments, be aware that the return on such investments may not outpace the rate of inflation. By contrast, equity investments--i.e., stocks and stock mutual funds[2] --generally expose you to greater investment risk, but may have the potential to provide greater returns.

Your investment portfolio will likely be one of your major sources of retirement income. As such, it is important to make sure that your level of risk, your choice of investment vehicles, and your asset allocation are appropriate considering your long-term objectives. While you don't want to lose your investment principal, you also don't want to lose out to inflation. A review of your investment portfolio is essential in determining whether your current returns are adequate to help you meet your goals.

Use your home

There are a number of ways you can use your home to help you spend less, and free up cash to save more. Consider using home equity financing to consolidate outstanding loans and reduce your interest costs or monthly payment (but be careful--increasing your debt could put you at risk of losing your home if you can't make the increased payments). If you're still paying off your home mortgage, consider refinancing your mortgage if interest rates have dropped since you took the loan.

You may also be able to use your home as a source of income during retirement. If you're willing to move, you may be able to free up a large amount of cash by selling your home. How much you'll realize depends on the amount of equity you have and where you'll live when the "sold" sign appears in front of your house. You could rent, live with your children, buy a smaller home or a condominium, or move into a retirement community. If you don't want to sell your home, and you have extra space, you might consider renting out a room.

Reevaluate your expectations

If your projected income shortfall is severe enough or if time is too tight, you may realize that no matter what measures you take, you will not be able to afford the lifestyle you want during your retirement years. You may simply have to accept the fact that your retirement will not be the jet-setting, luxurious, permanent vacation you had envisioned. In other words, you will have to lower your expectations and accept a more realistic standard of living. Recognize the difference between the things you want and the things you need, and you'll have an easier time deciding where you can make adjustments. Here are a few suggestions:

- Reduce your housing expectations. Perhaps you've always planned to live out retirement in a luxury beachfront community. If you are facing a significant income shortfall, you might have to shop around for a more affordable housing option in a less exclusive location.
- Cut down on travel plans. If you'd always planned an extended tour of Europe or a cruise around the world to celebrate your retirement, you may have to downgrade these plans to a driving trip to visit relatives or a train trip across the Rockies. Simple trips can be just as much fun as extravagant vacations, and they don't put as big a dent in your retirement funds.
- Consider a less expensive automobile. You may dream of driving a shiny new car off the dealer's lot right after you collect your retirement gift from your employer, but shiny new cars come with big, thick payment books. Consider purchasing a used car of the type you want. If you must have a new car, think about buying a less expensive model.
- Lower household expenses. There are numerous ways to decrease your everyday expenses. You might find that simply cutting back on your spending (for example, eating out less often) will help stretch your retirement dollars.

As a woman, you face special retirement planning challenges, but with careful planning you'll hopefully be on track to a secure, fulfilling retirement.

Sources:

[1] U.S. Department of Labor, "Women and Retirement Savings," (October 2008); U.S. Government Accountability Office, "Retirement Security, Women Still Face Challenges," (July 2012).

[2] Before investing in a mutual fund, carefully consider the investment objectives, risks, charges, and expenses of the fund. This information can be found in the prospectus, which can be obtained from the fund. Read it carefully before investing.