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Figuring Out Your Income Needs in Retirement

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By Jane Leibbrand

CAPTRUST Financial Advisor Mike Gray says that figuring out your income needs in retirement is really all about your expenses—understanding how much you spend each year and what you're spending it on. Your income in retirement is relatively easy to calculate. All you need to know is what you'll receive from Social Security (plus any pension or annuity payments), how much you've saved, and how much income you'll get from other assets such as real estate rentals.

Figuring out how much you spend takes more time and effort. Gray says that most of his clients need some level of coaching to complete a thorough examination of their spending and to ensure all outflows and expenses are being considered.

Beware of Conventional Wisdom

In the past, standard guidance from many financial advisors was to plan on replacing approximately 80 percent of your pre-retirement income when you retire. However, Gray advises his clients to be prepared to replace 100 percent of it. Why? Because what you spend per year now is approximately what you'll spend in retirement—unless you downsize dramatically.

"Saying that you're going to spend 80 percent of what you're spending now is not a safe path," says Gray. "It's more realistic to look at what you're spending now." Many of Gray's clients exceed their current spending the first few years into retirement by devoting additional resources to travel and leisure activities they did not have time for

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during their working years.

Adding Up Expenses

Most credit card companies provide annual summaries of your spending. These summaries itemize every dollar spent broken into general categories like restaurants, groceries, gas, and other buckets. Gray asks his clients to bring in their credit card summaries, and together, they will sort and group the spending in various ways to build out a bigger financial picture. Are there surprises? Yes. Are there lessons learned? Yes. “You’ll find it amazing how much you can spend on pizza in 12 months!” he says.

Gray also asks clients to review their checking account activity over the past year. Studying your credit card and banking activity usually captures most of your monetary outflow. But it’s easy to overlook costs that are included with other payments and costs that only come up occasionally. For example, you need to figure in property taxes, which are often included with your mortgage, as well as home and car insurance premiums, HOA fees, vehicle registration fees, and medical costs.

Lastly, your employer may be paying for more than half of your health insurance now. That cost will almost always go up significantly in retirement. Find out approximately what you’ll pay for Medicare and a supplemental Medicare plan by visiting www.medicare.gov.

Gray also looks at income tax returns, analyzing taxable income and reducing that by the amount of tax liability, which is somewhat representative of available cash flow.

The Big Reveal

Studying all these expenses will not only help you understand how much you spend each year and what you’re spending on, it will reveal how well your assets and future retirement income match up with your spending levels. Gray runs the numbers and has the task of telling some clients they won’t have the ability to spend like they’re spending now. Why? “It’s largely a matter of not saving enough during your working years and living beyond your means,” says Gray.

Looking at what you’re spending compared to what your income will be in retirement “is where the rubber hits the road,” says Gray. When he runs the numbers to see if a client’s income will last until 95, and it does not, reality usually sinks in during the appointment. He reviews various options to help the couple or individual increase income or reduce expenses. For example, if they haven’t already retired, he may suggest they work a few years longer than planned. If that’s not possible, Gray may suggest they use their career expertise in a new way—perhaps consulting part-time.

“In the course of these discussions, other possibilities often emerge,” says Gray. The stories that follow are examples of how couples adjusted their lifestyles or mindsets to create good outcomes.

Mark and Vicki: Moving to Close the Gap

Occasionally, the changes you make when you enter retirement can take care of the income gap. For example, if you live in a high-cost area or in a suburb of a large city with high housing costs and you plan on retiring to a lower cost area, producing 80 or 90 percent of your current income—instead of 100 percent—might work well for you. “Shrinking your housing costs by moving to a lower-cost area or downsizing can have a pretty big impact,” says Gray.

One example of how moving to a less expensive area can provide a financial boost in retirement can be seen in Mark and Vicki’s story. They bought a home on a one-acre lot in Northern Virginia in the mid-1980s. They recently retired and sold this home. After commuting into the District of Columbia for many years, Mark wanted to live in a less congested area. Vicki wanted to maintain access to art and the theater. The couple investigated several cities and decided to move to Richmond, Virginia, where comparable housing is considerably less expensive and cultural opportunities abound.

After living in Northern Virginia for 30 years, Mark and Vicki's mortgage was almost paid off. The sale price of their house in Fairfax, Virginia, was four times what they paid for it, netting them a handsome surplus. Plus, property taxes on their home in Richmond are significantly lower. They were able to move to a beautiful new home in a 55+ community and invest the proceeds from the sale of their house in Fairfax for future income needs and recreational pursuits.

Doug and Andrea: Phased Retirement

On the other hand, Doug and Andrea moved from their home outside of Tampa, Florida, to the Atlanta area to help take care of their grandchildren. They were met with sticker shock at house prices in the Atlanta area and needed to produce 110 percent of their current income to afford the home they wanted. Doug, a retired builder who likes working and isn't ready to give up his professional status, decided to gain a certification to become a real estate appraiser so that he could set his own part-time hours, cover the shortfall, and be able to invest the remainder of his earnings.

Tom and Carmen: Finding Plan B

Tom and Carmen bought a townhouse in Riverside County, near Los Angeles, California, as an investment before the recession in 2008. They got caught, as did thousands of others, in an underwater mortgage when the downturn hit. Instead of a financial bonus, the townhouse became a liability, losing almost 40 percent of its value. It's still valued at about 10 percent below the price they paid for it. The townhouse does generate a positive cash flow, however, which they use to bank and invest.

Tom and Carmen's plan to reap a windfall from the sale of the townhouse hasn't materialized yet, and likely won't happen. They had hoped to use that money to help fund a vacation home. Becoming aware that they would need to give up their dream of a vacation home hasn't permanently marred Tom and Carmen's vision for retirement. Once they understood where they stood, they could start looking at what was possible. Tom and Carmen are now in the process of developing a Plan B, deciding to set aside some of the rental income for month-long stays in Spain, home of Carmen's grandparents. Adjusting to a different plan for retirement, the couple says they're excited about how travel can enrich their life experience.

Gray says one of the biggest problems of figuring out income needs in retirement is taking the time and effort to analyze your spending and ensure all expenses are listed. He leaves this piece of wisdom: Don't wait too long to see how you're doing. Take your financial temperature periodically. Start early in your career and work with a planner to ensure that you know what your financial goals are and that you're on track to meet them. Evaluate your progress. The closer you get to retirement, the more you need to review your plan.

Have questions? Need help? Call the CAPTRUST Advice Desk at 800.967.9948, or schedule an appointment with a retirement counselor today.