Determine How Much Money Is Enough for the Rest of Your Life

By Garry Good, MBA

Think of your retirement as the most expensive purchase decision you'll ever make. Even more daunting: You have only one chance to get it right. A wrong decision has implications for the rest of your life. Before pulling the plug on a career and current income stream, develop a clear image of what you're buying and how much it's going to cost.

So what's a good retirement worth these days? How much do you need for the rest of your life? To solve this dilemma, the following formula should be useful:

> "Rest of life" cost = (annual expenses – retirement income) × (life expectancy – retirement age)

In this formula, retirement income includes Social Security and/or pensions, and annual expenses should be adjusted for inflation.

The following sections look at these variables and discuss strategies you can use to take advantage of the variables you do control and manage the risk created by factors beyond it. ***Note:*** This simplified equation merely identifies the key factors involved and illustrates the basic concept of retirement planning; you need more actual number crunching to figure out that magic retirement number.

Create a Fact-Based Retirement Budget

How can you really predict your expenses over the remainder of your lifetime? Believe it or not, this is one area where you have considerable control. The following process can enable you to allocate enough funds to withstand the ups and downs of your retirement years:

1. **Establish a current budget based on actual expense data.**

   Five or six months' worth of data should be sufficient, but be sure the period you choose is representative of your average spending patterns.

2. **Develop a reliable post-retirement budget.**

   Don't factor in inflation. While focusing on the future, simply conduct a line-by-line review of your expenses:

   - Look for expenses that'll be reduced or eliminated at retirement (work clothes, commuting expenses, professional dues, and so on).
   - Identify spending categories that are likely to increase, such as healthcare.
   - Add a budget line for unforeseen expenses. You don't know exactly what or when, but count on the fact that unforeseen expenses will occur — auto repairs, appliance repairs or replacement, general home maintenance, and so on.
   - Envision your retirement on a day-to-day basis. What have you been looking forward to? How do you see yourself spending all that free time? Chances are this time won't really be free.

When you make budget cuts during the planning process, you leave no room to compensate later for events that are beyond your control. People tend to adopt optimistic assumptions to trick their plans into telling them what they want to believe. For example, to make an earlier retirement look viable, you may rationalize that you can easily get by with less. Making a deliberate choice to reduce your lifestyle can be a legitimate component of retirement planning — but only if you'll remain committed. Ideally, your budget should include expenses that you can trim to stay on track even in the face of change.

Imagine that you're retired and the economy isn't cooperating with your well-crafted plan. Inflation is heating up. The stock market (and your portfolio) is taking a dive. These events are all beyond your control. The good news? With appropriate planning, you can mitigate the damages. This is the time to beat your budget. You can tighten your belt by choosing to eliminate or delay selected activities — as long as these expenses were in your original plan.

Limit Your Reliance on the Unknown

After you estimate your retirement expenses, you can deduct any retirement income that you'll receive from Social Security and employer-paid pensions to determine your actual (net) cash flow needs. The balance will have to come from your personal retirement savings.

Social Security and pensions provide a valuable hedge against longevity because they promise an income stream that'll last as long as you do. Unfortunately, you have little control over these fixed income sources. But although the future solvency of Social Security is out of your hands, you do have a say in how much you rely on this "guaranteed" source of income.

Every year, you're provided a current estimate of your future monthly Social Security benefit. Most experts agree that this estimate is fairly reliable for those who are nearing retirement. But what if your retirement is years away? You can reasonably assume that the younger you are (and further from retirement), the greater the risk that your eventual payment will be reduced.

A proactive decision to adjust your Social Security expectations downward, based on age, can limit the downside risk to your planning assumptions. The following chart provides an example you may want to adopt:

Age	*Expected Benefit*
65	100%
60	88%
55	75%
50	62%
45	50%
40	38%
35	25%
30	12%
25	0%

Although time (years to retirement) may reduce your confidence in future benefits, time (and the principle of compounding) is also your biggest ally in accumulating money to supplement Social Security and any pension income you may have in retirement.

Estimate Your Life Expectancy — Then Plan to Live Longer

Fortunately, most people aren't born with an expiration date tattooed on their bottoms. Count your blessings. This is one uncertainty you should embrace! At the same time, the risk of longevity is one of the greatest challenges you face in retirement planning.

TIP

Plan to live longer than you expect to live. Consider this: The average person has a 50 percent chance of exceeding life expectancy. In other words, planning for your expected life results in a fifty-fifty chance of running out of money too soon.

What type of longevity should you plan for? This depends largely on how much risk you're willing to assume. The current life expectancy for a 65-year-old American is about 83 years. You can see this individual's likelihood of surpassing additional milestones in the following chart from the National Center for Health Statistics:

Age Reached	*Likelihood (Percent)*
Age 83	50%
Age 85	44%
Age 90	25%
Age 95	10%
Age 100	3%

Making financial provisions for your life expectancy plus 17 years doesn't even guarantee success! On the other hand, you may be reluctant to fund this contingency, fearing your financial sacrifice could be wasted if you live a normal life or happen to die prematurely. Think of longevity planning as buying insurance with an interesting twist: Insurance compensates you for a loss, but longevity planning pays off when you win!

Make the Final Call: When to Retire

REMEMBER

Whereas life expectancy is the great unknown, the timing of your retirement (health permitting) is a decision that belongs to you. This call has the potential to stabilize your plan or jeopardize your financial life. Make an active decision considering all options and implications. Don't retire simply by default.

When contemplating retirement, ask yourself the following questions:

- Are you really prepared financially for a secure retirement?
- Would you still want to retire if you were very happy with your job? Your boss? Your employer? Your career?

Sometimes a retirement goal is merely an escape from a bad situation. If you still enjoy working (though not necessarily at your current job), you should consider a job or career change instead — or simply focus on doing your current job better. To expand your options and retire on your terms, invest in yourself through continuous education, network to tune in to new opportunities, and embrace change throughout your working life.