

How to Solve Your Retirement Spending Need

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If you're more than 10 years from your targeted retirement date, it might be valuable to simply use some standard rules of thumb that will offer pretty close approximations of what your spending need will be when you decide to retire. Fidelity Investments suggests that 85% of your projected final year of payroll on an after tax basis will get you in the ballpark of your requirement. It appears this is a reasonable estimate based on a few calculations that I've made for my own situation and also applying that rule to numerous financial plans that I've prepared for clients. Assume you have \$175,000 in household income and you have an effective tax rate of 20%. The 85% estimate would suggest you will need about \$10K in monthly sources of cash to achieve your spending goal. My experience in working with many clients in that income category tells me that is a rational appraisal.

For those individuals or couples who are within ten years of freedom from working more specific projections become possible and probably desirable. To achieve a good answer, the best place to start is to track your current spending. The personal budget worksheet that you can download off this website is an excellent expense tracking device that has a comprehensive list of all of the possible expense categories that a family might be incurring. If you track your expenses for about six months you can get an accurate assessment on what your average costs are in a month. For items that might be non-recurring events like: autos, HVAC or appliance replacement you should be sure to use an estimated monthly average figure for these larger ticket items that might come around periodically.

Once you have budget information you can make some adjustments for how you're spending might change once you retire. You'll no longer be commuting to work and you'll no longer need to save. Also, your housing expense will likely decline either through the payoff of your mortgage or your choice to downsize your home. Areas where you might need to increase allocations would be your vacations, hobbies and dining out.

Without a reasonable estimate of your spending need, it's awfully hard to draw any kind of conclusion about how much you need to have saved and invested for the future. Completing the budget exercise is an important first step in planning a successful retirement.