The truth about retirement costs

Many financial gurus say that it will take between 70% and 80% of your final employment earnings to support a comparable mode of life after retirement.

This is at best a wild guess. A highly paid athlete or celebrity will not need 70% of his or her earnings to retire in luxurious style. On the other hand, those of more modest means who intend to travel widely, to purchase a second home in the Sunbelt, or to treat themselves to season tickets to their favorite *corps de ballet* or NFL team may well need more than 100% of their final working income.

Retirement realities

Of course, for most people certain expenses will fall after retirement. The costs of commuting and business clothes will disappear. Children will be grown, and those outrageous college costs may be just a painful memory. The mortgage may be paid. Charitable contributions can drop. Taxes are usually less, and there's no longer the need to put a portion of earnings into a retirement plan. And senior citizen discounts can reduce the costs of travel, entertainment and even banking fees.

Health care expenses, however, tend to rise with age. If you retire early, you'll need to purchase insurance until Medicare kicks in at age 65. Even after that, copayments can become a burden on a limited income. Likewise, an aged parent in financial need, that second home or a long-anticipated redecoration project really can make expenses soar.

There's no easy formula for the income that you'll need in retirement or the nest egg it will take to provide it. The best you can do is cost out your plans. Take a hard look at all your current expenses and project how they will change in retirement. Factor in the lifestyle changes that you hope to make.

Change: the one constant

Also recognize that expenses inevitably will change during your retirement years. Inflation will erode the purchasing power of your savings. We cannot know whether it will continue at the present level or rise to some extent. We can be confident, however, that the Federal Reserve Board will fight tooth and nail to prevent a return of the double-digit rates of 1946, 1974, 1979 and 1980.

Countering the effect of inflation, some costs are likely to drop during retirement. You're more likely to travel the world at age 65 than at age 80. Elderly dependents eventually pass away. The need for two homes declines. You may no longer need to carry life insurance or maintain a car.

Of course, if you'll eventually need to enter an assisted living or skilled nursing facility, these savings may go out the window.

Running the numbers

Although it's not possible to project future expenses with precision, it's well worth it to make your best estimate now. That way you'll know if you're on track to the kind of retirement that you're looking forward to.

An idea of the income that you'll need is the necessary starting point in the rather complex calculation of how much you need to save now. There are several resources available to help with the process. Calculators are available online and in many of the books on retirement planning.

Basically, all these calculators will work from your anticipated retirement income needs. They'll ask how much income you can expect from Social Security and any pensions for which you may be eligible.

You should be receiving updated estimates of your future Social Security benefit each year. If you are not satisfied with the projected future earnings used to figure your benefit, you can calculate it yourself at the Social Security Web site (www.ssa.gov/planners/calculators.htm), where you also will find a helpful retirement income estimator. The employee benefits office at your present employer and any former workplaces can provide you with an estimate of the pension benefit that you'll have at the date that you expect to retire.

From the resulting income gap, the time remaining until retirement, the expected length of your retirement, your current savings and any other capital that you anticipate (an inheritance, for example), the calculator will tell you how much you need to save now.

Because the various retirement calculators use different assumptions, it's wise to use more than one and compare the results.

Getting into gear

If your calculation shows that you're already saving enough, it's bound to be a big load off your mind. If there's a shortfall, however, there's probably no reason for panic.

When the shortfall is moderate, or there's plenty of time remaining to retirement, you can make it up in either or both of two ways:

1. You can increase your retirement plan contributions. If you are maxed out on your 401(k) at work, consider opening a Roth IRA, which allows for tax-free withdrawals in retirement.

2. You can invest for higher returns by increasing the percentage of stocks in your investment portfolio. Although stock funds do carry more risk than bond funds or money market funds, in the long run they've produced significantly higher returns.

Even when your shortfall is large, and the time is short, you need not despair. Perhaps you can revise your retirement plans. You may choose to work a few years longer to increase your savings, pension and Social Security benefit. It might pay to sell your present home and move to a lower-cost community, investing the excess equity. Or you could set your sights on less costly pursuits during retirement—domestic rather than foreign travel, public rather than private golf clubs, running the old car rather than buying a new one and so on.

Finally, you might choose to work during retirement. A contradiction? Not necessarily. You may well find a job, part-time or full-time, that you like better than the one you retired from, perhaps something you've always been interested in or something with much less pressure.

So why stumble blindly toward retirement when, with a little work, you can find out where you stand and set a sure course?

Any developments occurring after January 15, 2007, are not reflected in this article.