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Accurately Estimating Retirement Expenses

Make Sure You're Saving Enough to Support Your Desired Lifestyle

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Just how much are your golden years likely to cost? Sure, it's easy to find rules of thumb that attempt to estimate this. For instance, some models state that most retirees will need 60% to 70% of their current income.

While these generic guidelines are fine as a starting point, most Americans could benefit from a little more precision as they try to make sure they'll have enough to see them through retirement. Underestimating yearly expenses by even a few percentage points can have a significant impact over a 20-or 30-year retirement time frame.

Start from scratch

Coming up with a reasonably accurate expense forecast typically requires projecting each expense individually, taking into account how it might change in retirement. On the bright side, some current expenses should drop.

You probably won't need to spend as much on job-related costs such as commuting and work clothes. If you plan to pay off your mortgage before you retire, you won't have that expense either. And, once you're fully retired, you'll no longer need to put away money for retirement (though you still may need to save some money each year).

Some retirees may also be able to reduce the amount of life insurance they carry. After all, they no longer need it to replace the income they were earning while they were employed.

Child-rearing expenses also tend to wind down. Most parents hope that, by the time they retire, their children will be out of the house and supporting themselves.

Expenses likely to rise

While it's tempting to assume that most expenses will drop in retirement, that's not always accurate. A few are more apt to increase — some significantly.

One of the most important expenses is health care. According to Fidelity Benefits Consulting, a couple that retires at age 65 can expect to spend an estimated $220,000 on health care costs during retirement. What's more, this is *after* accounting for expenses covered by Medicare. The estimate assumes that the husband will live to age 82 and the wife to age 85, which means their costs will average $11,000 annually.

Moreover, some housing-related expenses likely will increase:

> Property taxes tend to head in only one direction . . . up. Even modest annual increases can be significant over time. A tax bill of $1,000 will jump to nearly $1,500 over 20 years with an annual increase of just 2%. You may need to hire others to take over chores that can become difficult to handle as you age, such as shoveling snow or mowing the lawn — or even cooking and cleaning. You may find it necessary to modify your home to make it easier to navigate or maintain. Even if you downsize, you may need to do some renovations at your new home or condominium. You also might need to pay association fees.

Also keep in mind that, even though you're no longer working for a living, you still may have to pay income taxes. Some IRA withdrawals and Social Security benefits can be taxable, and of course income from assets held in nonretirement accounts is also generally taxable. Yet you may lose some tax deductions. For example, if you pay off your mortgage before retirement (which typically is a wise move), you no longer will have mortgage interest payments to deduct on your tax returns.

Finally, although having more time to travel and become involved in hobbies and other pastimes is a true benefit of retirement, these activities almost always require some money. So, make sure you include an allocation in your budget.

Projecting (and protecting) your future

Carefully projecting retirement expenses offers several benefits. Most important, it can help you determine how much you need to save *now* to ensure a comfortable retirement. The exercise also can help you think through just how you'd like to spend your time, once you're no longer on the job 40+ hours per week.

Your financial advisor can help you develop reasonable projections of your expenses in retirement. He or she also can help you determine the amount you need to be saving for retirement, and suggest ways to help you achieve this. •

Don't let "surprises" drain your coffer

When it comes to expenses that are unpredictable such as the inevitable car and appliance repairs it makes sense to budget an annual allowance. To start the process, total up the money you've spent on such repairs over the past few years to arrive at an average. Then you may want to increase the number over time, given that repairs tend to become more frequent as products age.

Also be aware of the potential for more significant surprises. For instance, if you would want to help an adult child who needs financial support due to a divorce or job loss, make sure you consider this in your planning.

Most critical, consider the "bite" that inflation can take on your budget. A monthly food budget of $400 jumps to nearly $600 in 10 years, given a 4% annual inflation rate.
