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DEPARTMENTS

On Retirement

Planning for Retirement Spending

With the leading edge of the 77 million-strong baby boomer generation now within three years of Social Security eligibility and six years of Medicare eligibility, the press has been paying noticeably more attention to retirement issues. Thanks to the resulting awareness of retirement matters, people are beginning to take their pre-retirement planning more seriously.

One important retirement planning topic frequently overlooked by popular press reports is planning for retirement spending. Predicted retirement spending is a powerful assumption in any retirement plan. It is tempting to take the planning shortcut suggested by some retirement planning books, the one called the "spending replacement ratio." Just plan to spend some percentage-perhaps 75 percent-of your current income to maintain today's lifestyle during retirement.

Instead of this shortcut, professional retirement planners suggest doing a thoughtful retirement budget. True, retirement spending cannot be exactly predicted, but the deliberation that goes into a retirement budget is the best foundation for your plan.

The most helpful retirement budgeting distinguishes between spending needs and spending wants, to find retirement spending flexibility. This approach shows which expenses can be reduced if times get rough. The best retirement plan has enough income to cover the needs budget from secure lifetime sources, such as defined-benefit pension payments, Social Security, and perhaps an annuity. The wants budget covers such extras as eating out, travel, and entertainment, or those expenses best covered by occasional withdrawals from invested retirement accounts.

Underestimating health care costs and cost increases is a serious planning error. Retiree health care costs are regularly misjudged in retirement budgets, especially for those who retire before they are eligible for Medicare, at age 65, and who lack employer-provided health care support for retirees. Too little attention has been paid to the financial plight of Medicare. Problematic future

Medicare benefits, escalating costs, and more health care use as we age, taken together, mean that we must expect rapidly escalating out-of-pocket health care costs.

Thoughtful retirement budget planning helps us prepare for the financial consequences of getting older. Retirement planners observe three typical stages of retirement spending as we age. Early years of retirement are the most active with spending for travel and other leisure activities. Spending too much during these years will threaten later financial independence.

In the middle retirement years, retirees may be content to stay closer to home and spend less than they did in their more active years. And in the final years, spending may increase, as health declines and long-term care costs arise. Good planning means having adequate reserves for these later years, to maintain financial independence.

Finally, a sound retirement spending plan considers the inevitable. However emotionally difficult, financial planning for widowhood is part of retirement. Decisions that a couple makes when they retire will have consequences for the eventual survivor. Sound planning can even help the survivor avoid falling into financial dependence. It will help select an irrevocable pension payment option. Anticipating the financial consequences of widowhood early on can lead to decisions that will reduce money worries at what will inevitably be an extremely stressful time.

Whether you are a boomer or just starting your career, planning for retirement spending should be part of your overall strategy.

—Joan McCallen
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