

# Planning for a Long and Comfortable Retirement



Preparing for retirement will likely require the most significant financial decisions most people make during their lifetimes. Good spending and investing habits are essential to your long-term success. Your CPA can assist you in estimating your retirement income needs, determining the most effective ways to invest for retirement, and prioritizing your withdrawals from retirement and other investment accounts once you are retired.

The best strategy for retirement saving is to begin at the earliest possible age. Someone who is 27 years old needs to invest about \$5,000 per year to accumulate \$1 million by age 67, assuming an average annual investment return of 7 percent. Starting the annual investments at later ages increases the annual funding amounts to reach the same million-dollar goal: \$10,600 for a 37-year-old, \$24,400 for a 47-year-old, and \$72,400 for a 57-year-old (see chart on back page).

Retirement savings can be invested through tax-deferred retirement plans, such as 401(k) and IRA accounts. Contributions can be made from pretax or after-tax earnings. If contributions are made from pretax earnings, the individual receives an income tax benefit that can be significant over time. Generally, if you expect your personal income tax rate to decrease during retirement, then saving on a pretax basis might be advisable.

When planning for a comfortable retirement, both financial and nonfinancial matters need to be considered. Some nonfinancial matters include good health, keeping purpose and meaning in your life, and maintaining strong personal relationships. Many people with more money than they need are very unhappy in life, so the nonfinancial considerations are very important.

Building a strong financial position, though, remains an important piece to a happy retirement. When you save and invest, beginning at a young age, you are buying your way to a sound financial position during retirement. The sooner you begin to save and invest for retirement, the easier it is.

Most people will need about 80 percent to 85 percent of their preretirement earned income to fund retirement expenses. A CPA can assist you in determining a realistic retirement income budget and guide you on choices of funding and meeting your retirement income needs.

## How do I define my financial needs during retirement?

It's best to think through how you want to live in retirement and develop a budget. The most significant expenses for retirees include housing, transportation, food and beverage, and health care. These four categories can consume about 80 percent

of after-tax retirement income. Other expenses to consider, which are generally more discretionary, are entertainment, travel, apparel, education, and charitable contributions.

For most people, the key to spending less than they make in retirement is to carefully manage housing, transportation, and food and beverage costs. Will you sell your house and upgrade or downgrade to a new one? Will you move to another geographic region? Will you buy or lease cars? Will you eat out more or less during retirement?

Once you've estimated all of your expenses, add some for unexpected needs and contingencies. Recent studies have shown that health care expenses do increase in retirement. Most other expenses stay the same or decrease.

## How do I estimate the amount I need to have invested before I retire?

Most individuals will receive Social Security benefits. Generally, it is best to delay taking your benefits until the latest possible date up until age 70. Social Security benefits grow with each year you defer and include cost-of-living increases.

Some individuals receive defined benefit pension income. Many private employers have changed retirement plans to providing annual contribu-

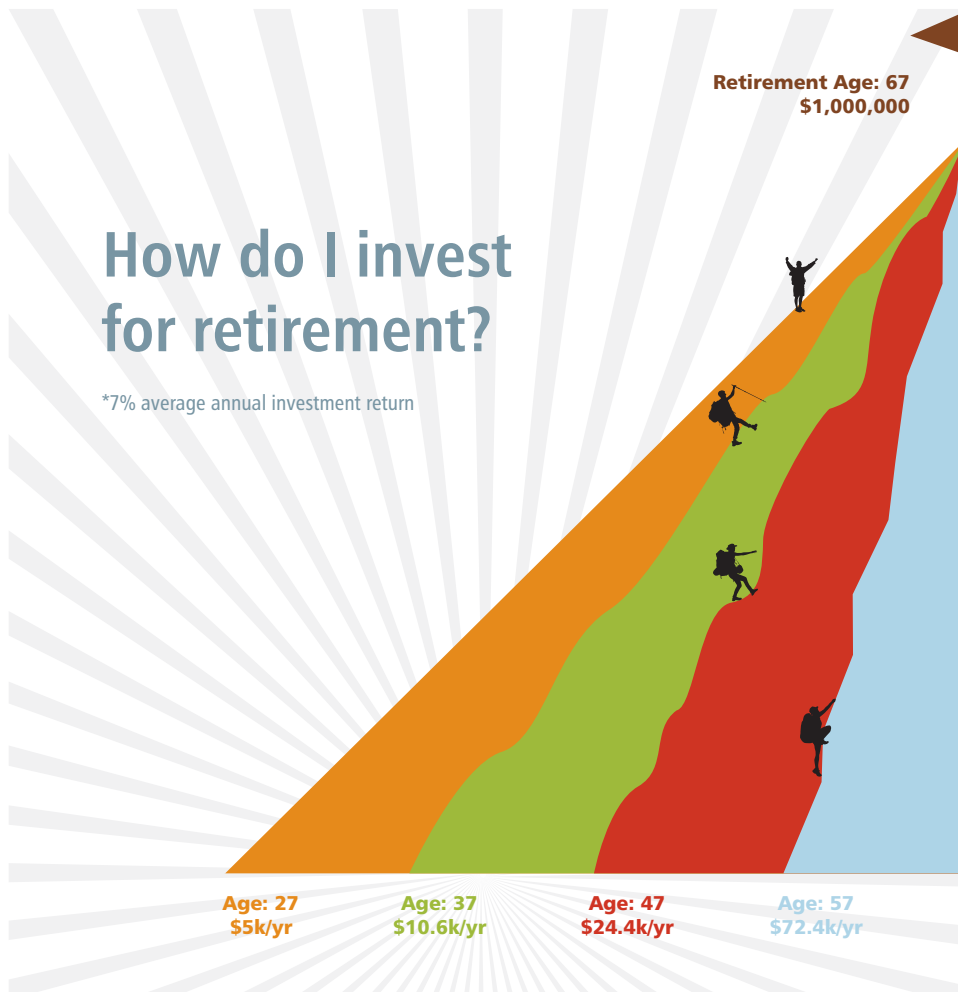
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tions that are invested in employee retirement accounts, such as 401(k) plans and others. These plans do not guarantee a minimum amount of income. Individuals who have retirement savings plans that require them to choose investments need to make sure they are properly informed or advised so they make appropriate and prudent investment decisions.

Add the income you will receive in retirement from all sources – Social Security, pensions, and other sources such as rental properties or businesses – and subtract that from your estimated retirement expenses. The remainder is the amount you will need to provide from your savings and investments.

A prudent rule to follow when withdrawing from your investment accounts is to limit your withdrawals the first year to 4 percent of your prior year-end invested balance. Subsequent annual withdrawals can be increased to offset the effects of inflation. Following such a rule should give you 25 times your first year planned withdrawals invested upon retirement

**Example:** Your earned income prior to retirement is \$80,000 per year and you've been deferring 10 percent of that into your employer-sponsored retirement plan. You plan to fully retire. Once you retire, you will no longer be deferring amounts into your retirement savings, and you will not be subject to Social Security or Medicare taxes. That reduces your income requirement to \$65,880 (82.35 percent of your pretax preretirement earned income). You've determined that this amount is sufficient for you to live comfortably. You checked with the Social Security office and determined that your Social Security benefits will be \$1,900 per month, producing annual income of \$22,800. You are not entitled to any other retirement income benefits. Subtracting Social Security benefits of \$22,800 from your planned income need of \$65,880 results in a remainder of \$43,080. You would need to have \$1,077,000 invested upon retirement to provide for this amount of income. Twenty-five times \$43,080 equals \$1,077,000.



## The PICPA offers resources for a variety of financial topics.

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