Retirement Planning Guide

How much money do you need to retire? Find out about retirement planning, saving and how to use a retirement calculator in this comprehensive retirement guide.

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Whether you are just starting your career, winding down toward retirement, or somewhere in between, there are positive steps you can take toward financial security.

Retirement planning is not a single step but a continuous series of actions. You plan, you work toward your plan, and then you adjust your plan and keep working toward it. The most productive steps can be taken very early in your career, yet the work is never done not even once you retire.

How Much Money Do I Need to Retire?

If the basic retirement planning question is "how much money do I need to retire," a retirement savings calculator can give you a pretty straightforward answer. It can help you figure out how much money it will take to see you through retirement, and how much you need to save each year between now and then to reach your target.

Retirement Savings Calculator

The answers you get from a retirement calculator are just the starting point. This guide will help you understand how to work with a retirement savings calculator, but the information those calculations give you is by no means a final answer.

Those calculations are based on assumptions about how long you will work, what inflation will be like in the years ahead, and how much your investments will earn. All of those things might turn out to be different than you expect, which is why you have to revisit those calculations from time to time so you can adjust to how things are actually playing out.

Also, your retirement savings calculator might give you a target you can't afford to meet right now. That's not the end of the world, because you still have options. You can either reduce your retirement lifestyle expectations, or you can plan to raise your savings rate over time as your career progresses and your earning power increases.

Putting Retirement Planning Into Action

Even though your retirement plan will always be a work in progress, you need to take steps to put that plan into action. Think about getting your spending habits retirement ready now.

This means saving and investing.

- Use a retirement calculator to come up with a budget that allows for setting aside money out of each paycheck for retirement saving.
- Learn some basic investment concepts that will help you put those savings to productive use.

As with creating a retirement plan, the implementation of that plan is a continuous process rather than a single step. Your investment needs change as your career progresses. Investment results and market conditions also change and require you to adapt.

Perhaps most importantly, you'll find that there's always more to learn about investing. As you learn, you can put what you've learned to use by adjusting your investment approach.

Stay the course and adjust as needed

Once you start saving and investing for retirement, don't expect everything to fall into place automatically. Investment results may disappoint, your lifestyle goals might change, or you might have fallen behind on some of your savings targets.

This is why you regularly need to review your plan and your progress toward it and make adjustments from time to time. Resetting the plan and taking steps to implement your revised plan will help keep you on track over the decades it takes to save for retirement.

So when is the right time for retirement planning? This process of constant adjustment means that the answer is always "now."

Setting Up Your Retirement Plan

There are two main parts to setting up a retirement plan: figuring out how much money you will need to retire, and planning how to come up with that money.

Setting your target

Figuring out how much money you need in retirement involves examining what it will cost to support the lifestyle you plan and projecting that cost out over the total number of years you expect to be in retirement.

A retirement calculator can crunch the numbers for you, but the results you get are only as good as the information you put into the calculator. So, using a retirement calculator effectively depends on coming up with good assumptions about a variety of things that will affect your financial needs in retirement.

Coming up with good assumptions can be more difficult than it sounds, because you don't know in advance how long you will live nor how inflation will raise the cost of living by the time you retire. However, the more you know about the variables the better you will be able to base your retirement plan on informed estimates of those variables.

Retirement Lifestyle Calculator

Figure out your retirement expenses

There's a simplistic rule of thumb that says you should shoot for living on 80% of your working income during retirement. While this is good in theory, there are many variables.

Trying to base the amount of retirement income you'll need on how much you earn during you career can be a flawed approach for several reasons. Some people earn much more than they need to support their lifestyle, while others rely on borrowing to support their standard of living. In each case, income is not a very accurate indicator of living expenses.

Therefore, the best place to start when calculating retirement expenses is by taking a look at how much you spend each year. Identify how much you spend and what you spend it on.

Look at your list of expenditures and figure out how that list might change when you retire. There are certain expenses, like those associated with raising children, that should no longer be necessary by the time you reach retirement age. Also, you might have paid off your mortgage by then and thus have much lower housing costs or decide to downsize to a smaller place.

Just as some expenses might drop, others might increase. Health care expenditures for people in their seventies can be several times what they are for people in their twenties. With time on your hands in retirement you may want to travel more or take part in other leisure activities that cost money.

By itemizing your expenses you can start to pick and choose which of those expenses will be part of your retirement lifestyle. Add up the total and you will have an estimate of the retirement budget that would be necessary to support that lifestyle.

The next step is figuring out how much money it would take to sustain that lifestyle throughout the length of your retirement years.

How Long Will You Live After Retirement?

Here's one of the odd things about retirement plan: a long life is normally thought of as a blessing, but when it comes to retirement planning the possibility of living a long life adds to the risk that you will outlive your money.

Naturally, there is bound to be some uncertainty about how long you will live. It's especially hard to predict when you are young and just starting to save for retirement. However, there are some ways you can make an estimate that is good enough for long-term planning purposes, and you can also take steps to cushion against the risk of relying on a lifespan estimate.

How Does Life Expectancy Affect Retirement Planning?

Start by considering the question of life expectancy. According to the Centers for Disease Control, the average life expectancy for a newborn baby boy in the United States is about 76 years. For a newborn girl, it's about 81 years.

It might seem logical to use those averages to estimate your lifespan for retirement planning purposes, but there are a couple of problems with that.

For one thing, those averages are impacted by the portion of the population that dies young. Of course, you'll only reach retirement age if that doesn't happen to you. That means that a person reaching retirement age can now be expected to live beyond those overall average lifespans of 76 years for men and 81 years for women.

In fact, the Social Security Administration (SSA) projects that at age 65, the average man can expect to live for nearly 18 more years. That would extend his total life expectancy at retirement age to about 83 years. The average woman at age 65 can expect to live just over 20 years, so her total life expectancy at retirement age is a little past 85 years.

Using life expectancy at retirement age rather than overall averages gives you a better estimate of how many years of retirement you will have to fund, but this still can leave a substantial risk of outliving your money. After all, those life expectancy figures are averages, meaning that roughly half the population lives longer than those averages.

Thus, counting on an average life expectancy at retirement means you will have roughly a 50/50 chance of outliving your money. If this represents an unacceptable level of risk to you, think about pushing the lifespan assumption in your retirement calculations well beyond the average.

Of course, if you do that it will mean needing to fund more years of retirement, which will require a higher level of savings while you are working. Try running a few different longevity assumptions through your retirement calculator. This will help you come to terms with the trade-off between reducing your risk by using a longer lifespan assumption and the extra cost it would take to fund your retirement on that basis.

How Will Inflation Impact Your Retirement Money?

When you go through the exercise of looking at your current expenditures to estimate what your retirement budget should be, remember that everything in that budget is likely to cost more in the future due to inflation.

Retirement calculators will often adjust future dollar amounts for inflation, but this relies on an assumption of what the inflation rate will be.

Over the past 50 years, inflation based on the [Consumer Price Index] has averaged 3.9% a year. However, inflation can be quite variable. Over the first half of that 50-year period inflation averaged 5.73% per year. Over the second half, it averaged just 2.19%.

How much does a difference of just a few percent a year make? Projected over a long period of time, a seemingly small difference in your inflation assumption can have a huge impact.

For example, if you are 30 years from retirement and you use an inflation assumption of 2% you would come to the conclusion that it would take $18,113.62 at retirement to fund the equivalent of $10,000 in today's dollars. However, if you use a 5% inflation assumption you would calculate that it would take $43,219.42.

As with the lifespan assumption, choosing an inflation assumption involves a trade off. A higher inflation assumption reduces the risk that your savings target will not be enough to afford the cost of living when you retire, but it will also require you to save more money to meet a higher retirement savings target.

Work with a retirement calculator to find the sweet spot between an inflation assumption that is too low to be realistic and one that is so high it sets a retirement saving target you can't afford.

Featured Experts Answer Your Retirement Questions

Jill Fopiano, CEO of O'Brien Wealth Partners

Bernadette Girvin, CEO and Registered Representative at Gambin Financial Group

Annette Harris, Financial Coach & Owner at Harris Financial Coaching

Mario Hernandez, Principal & Director of Operations at Gemmer Asset Management

Brandon Renfro, Professor/Financial Planner at Brandon Renfro, PhD

Lyle Solomon, Principal Attorney at Oak View Law Group

Q: How much money should you have when you retire? How much money should you have saved up, and how much should you plan on needing every month?

Fopiano: The amount of money that you will need to have socked away to fund your retirement will vary according to the lifestyle you want to have during your during your retirement. People tend to assume that expenses will decline when they retire, when many times they actually just shift in nature. For instance, money that was once spent on commuting or work attire can easily shift to recreation, leisure, or travel. If you can sort out your necessary expenses – food, shelter, healthcare – from your “nice to haves”, it will give you a bare minimum on what you will need to support yourself.

Girvin: The amount of money you need when you retire can vary greatly from individual to individual. A few things you should take into consideration when determining how much retirement will cost is inflation, taxes and how much money you have in qualified plans vs tax-free plans, guaranteed income streams like pensions, social security and other passive income sources, cost of health care and cost of a potential long term care event to name a few.

To determine how much you will need each month, we suggest thinking in terms of today’s dollars and letting your advisors planning software extrapolate for inflation. So if you spend $10,000 per month but you know in retirement the mortgage will be paid off and kids will be out of the house, then you could probably live on $6,000-$7,000 a month we would calculate based on that number.

We also plan retirement in phases – Active Retirement, the first 5-10 years, Passive Retirement, the next 3-5 years and Supported Retirement, the final years. In Active Retirement we need to plan for increased spending. You have more free time and are still young and healthy enough to take vacations, visit and spoil grandkids, buy a new car, etc. In Passive Retirement, we see a decrease in spending on goods and services as people become less active. In Supported Retirement we often see spending increase again as people transition to assisted living facilities or need long term care.

Harris: When planning for retirement, the amount you have will depend on your future debt and expected standard of living. If your mortgage is paid and you have no other debt, you can plan for living expenses and travel. To maintain a resemblance of your current financial situation, plan to have 80% of your current annual income. If you will be retired for 30 years and earn $80,000 annually, your retirement savings goal would be $1,920,000.

Hernandez: How much money someone needs for retirement depends on their spending level. I advise clients that the one thing that they can control that helps determine how much they need to accumulate is their spending level. I tell clients about the 4% rule which refers to the percentage of a client's assets that they can expect to live on annually. In studies, the 4% rule is a conservative measure of how much someone can withdraw from their assets annually and have their assets last for their lifetime. For example, if someone has $1 million of assets, they can withdraw $40,000 annually (increased for inflation). This rule of thumb can help determine how much someone needs to accumulate for retirement.

Renfro: The amount you should have saved will be different for everyone, but should be based on the amount of income you need to replace after accounting for things like Social Security or other pensions. Think of it as a percentage of your current income. For example, you may need to replace 60% of your income from distributions from your savings. From there, do some research to figure out a withdrawal rate you are comfortable with. Your target savings then is the amount you'd need to have to make your distributions based on that withdrawal rate.

Solomon: The ideal figure is 80% of your pre-retirement income. When your annual income is $100,000, you will need at least $80,000 to run your family. That would help you to lead a comfortable life after leaving your job.

You can use a retirement calculator to determine the amount you need after retirement.

Usually, the amount you want to save for retirement depends upon two factors:

- Your present age.
- How long you intend to work before retirement.

It is best to determine the amount you need to save for retirement based on how much you expect to spend every month. Much depends on your lifestyle also. If you are a guy who loves to travel, you need to set aside money for that also. As soon as you get that magic number, you can start saving money accordingly.

Q: What are some of the main financial concerns of retired people or those nearing retirement? What can they do to plan for these concerns?

Fopiano: One of the key concerns for retirees is running out of money during their retirement due to unforeseen events. These events are usually not related to the market. While market declines are not pleasant for most of us, a well-structured portfolio will usually ride though market cycles and should not require major changes in retirees' plans. On the other hand, life happenings like health events requiring expensive long-term care, unanticipated family support, or extensive home repairs may draw on assets in a compromising way. The best way to plan for these events is to ensure that extreme and expensive risks are in some way insured and that your retirement savings includes some wiggle room for unplanned events.

Girvin: The number one concern we hear from clients approaching retirement is do I have enough to never run out of money? While there is no guaranteed way to know for sure, have your advisor stress test your plan under multiple economic conditions – high taxes, high inflation, market down turns. If your probability for success lies at 70% or greater, you should feel good about finally making that decision to retire!

Have a purpose for each of your money buckets – if you want to buy a car, have an account specifically earmarked for that purpose. If you want a rainy-day fund, have a bucket of money that is very conservatively allocated and don't mess with it. Ensuring that your asset allocation is in alignment with your risk tolerance will help you sleep better at night.

Harris: One of the financial concerns of retired people nearing retirement is medical care. As we age, we tend to require more medical attention. To prepare for medical concerns, evaluate the medical plans offered by your employer after retirement. Preparing should include prescription plan offerings. Understanding how you can be medically covered until you are eligible for Medicare can prepare you financially in the future.

Hernandez: Most clients who are nearing retirement or are in retirement, their number one concern is having enough money to last their lifetime. I advise them to control their spending and to review any signficiant purchases or changes in their lifestyle with me before making the decision. That is when we run a retirement plan to make sure that they are still in good shape if they go forward with the desired purchased or additional expense.

Renfro: Running out of money is the number one fear of retirees. Conscious planning can help alleviate that fear by maximizing guaranteed sources of income and incorporating strategies to reduce that risk. Following a variable withdrawal strategy is one of the easiest ways you can do that. When your investments take a hit reduce your withdrawal amount to alleviate some strain on your savings.

Solomon: The biggest financial concern of the retired people or those on the verge of retirement is healthcare costs. The medical expenses in the US are too high. Most retired people can't afford them. Medicare and Medicaid provide some relief to some extent. But that is not enough.

Here are a few simple steps retired people can take to protect their financial health.

1. Save enough money in your emergency funds to cover your unforeseen medical expenses.
2. Compare the available drug plans and determine your monthly cost when you have a medical condition.
3. Get yourself adequately covered with your health insurance plan. Automatic payments in your bank account to pay your insurance premium on time.
4. If you have not retired yet, opt for the employer-sponsored health plan. It gives you coverage at a low premium rate.
5. Explore the health insurance plans that are available through the Affordable Care Act in your state.

Q: What is your best retirement financial tip for people who don't expect to be wealthy when they retire?

Fopiano: For those who don’t expect to be wealthy when they retire, my best tip would be the same as for when they are working – try not to live above your means. This becomes especially important in retirement as the potential to earn income – and save money – becomes more limited as well.

Girvin: Get as crystal clear on your budget as possible and then check it each month. Knowing exactly what your burn rate each month is can significantly increase your chances of successfully retiring. Similarly, know exactly what streams of income you can expect. Go to ssa.gov and create your account to know and understand exactly what your benefit will look like in retirement.

Harris: It's important to save early, invest, and plan ahead. The earlier you start saving increases the likelihood of you having a financially secure retirement.

Hernandez: For clients with modest means, it is very important that they control their expense level. Having additional sources of income during retirement can have a significant effect of how long their nest egg can last since they do not have to access very much of it and it can be left to grow over time.

Renfro: Be very deliberate about your Social Security decision. Take the time to learn and make sure you understand all of your options and how your choice will affect you long-term. For many, Social Security provides the vast majority of income in retirement so it's worth taking the time to get it right.

Solomon: The best financial tip for people who don't expect to be wealthy when they retire is to lead a frugal and healthy lifestyle. A frugal lifestyle helps a person to live within his means. And a healthy lifestyle will help to keep the doctor and costly medical bills away.

Health and wealth are interrelated. Poor health and hygiene will lead to medical issues and frequent doctor visits. Healthcare cost is a significant concern in the US. Medicare and Medicaid are not enough to cover the health care costs. That is why it is important to stay healthy, physically and mentally, as long as you can.