Your Financial Action Plan *for Retirement*

The cornerstone of retirement planning is financial planning. Planning allows you more satisfaction and security in retirement.

Many people avoid thinking seriously about retirement until it is only a few years away. Yet starting to make and implement plans for retirement as early as you can—before you are 40 years old—is preferable. Early preretirement planning allows you to gain a sense of control over the changes retirement may bring.

Early plans should not be carved in stone, and a good plan allows flexibility. Changes in economics, family structure, etc., are inevitable. You'll need to review your plans periodically to take into account changes in your circumstances.

Following are some actions to help you begin to plan for those later years.

Set goals

The first action to take in financial planning is to determine what is important to you and your family. Goals will guide you and give purpose to your actions 10, 20, or 30 years from now. Begin by listing on paper all the things you really want to do in your retirement. Your list might look something like this:

- ✓ Retire at age 67
- ✓ Move to a different location
- ✓ Sell present home
- ✓ Purchase a condominium or townhouse
- ✓ Remain financially independent as long as possible
- ✓ Travel extensively
- ✓ Maintain present lifestyle
- ✓ Continue to be employed on a part-time basis
- ✓ Develop special hobbies and interests (identify them)
- ✓ Provide protection from catastrophic medical expenses
- ✓ Provide financial support for my spouse after my death
- ✓ Leave substantial assets to my children or family or to a charity
- ✓ Maintain membership in civic, social, and religious groups and organizations

As you think about each of your goals, try to assess its financial cost. If your anticipated income is less than your anticipated expenses, you may have to select the most important goals to accomplish and postpone others until a later date. Hold on to your list and use it as a management tool.

Estimate how long you will be retired

You and your spouse (if you are married) will need to decide at what age you plan to retire. Then you will need to estimate how long you expect to live. You can make an estimate using life expectancy averages (table 1).

Many people don't realize their retirement could be as long as 20 to 25 years. For example, a 65-year-old male can expect to live to be 80 years old. A 65-year-old female can expect to live to be almost 84 years old.

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Table 1. Life expectancy: Years remaining at a given age.

Age	Male	Female
30	44.7	50.6
35	40.1	45.8
40	35.6	41.0
45	31.1	36.2
50	26.7	31.6
55	22.5	27.2
60	18.7	23.0
65	15.2	19.1
70	12.1	15.4
75	9.4	12.0
80	7.1	9.0
85 and over	5.2	6.4

Source: U.S. National Center for Health Statistics. Vital statistics of the United States, annual, 1990.

You will need to adjust these averages to fit your circumstances. Consider the longevity of family members, especially your mother and father. If you are in good health and keep yourself physically fit, you might expect to live longer than the average.

Planning for retirement means planning for the many years after you retire. Keep this in mind when you think about finances and other elements of your retirement plan.

Estimate your income needs

The amount of money you will need for retirement living expenses depends on your lifestyle and your goals. The rule of thumb is that you will need an annual retirement income amounting to 70 to 80 percent of your preretirement earnings, 60 percent if you have no mortgage or outstanding debt.

Depending on your income level, you could maintain a constant level of living with 50 to 80 percent of your preretirement income. This is possible because taxes, work-related expenses, and savings commitments are reduced in retirement.

Say you are a married couple with a gross income of $30,000. Assume you pay $7,238 in taxes, $1,157 in work-related expenses, and $2,315 in savings. This leaves about $19,290 in spendable income or 64 percent of the $30,000.

Some financial planners recommend that you strive for a 100 percent replacement of your preretirement income if you want to maintain your current lifestyle. Of course, if you don't have that much retirement income you will have to make special efforts to reduce your living expenses.

Consider changes in your expenses

Some expenses in retirement will be lower than before retirement, while others will stay nearly the same. Housing expenses will depend on whether your mortgage is paid up or whether you decide to change your residence and acquire a new mortgage.

Work-related expenses are likely to decrease. Some of these expenses are transportation costs, license fees, meals away from home, gifts for coworkers, clothing, etc. You also will not be contributing to a retirement plan. A portion of Social Security benefits will be taxed if your income is over a certain threshold.

Payout for life insurance coverage can generally be reduced by at least 50 percent or even eliminated if your spouse is fully provided for under a pension plan.

Some expenses may continue at their preretirement levels. Food; utilities; gifts; contributions; and auto, liability, and property insurance expenses will probably stay fairly constant.

Some expenses will increase once you retire. Health expenses are the most likely to increase. Expenditures for leisure, entertainment, recreation, and transportation may also take a larger share of your budget, depending on your goals.

The amount of money you spend on food, clothing, housing, recreation, transportation, and other expenses should reflect your values and meet your goals. However, you may want guidelines to use in determining how much to allow for various expenditures. *The Bureau of Labor Statistics Report, Fourth Quarter 1989* provides the spending patterns of households of retired couples age 65 and over. The percentages are of total expenditures of $19,715 with an after-tax annual income of $20,335 (fig. 1). These percentages are based on a nationwide average and will vary depending on the state where you live.

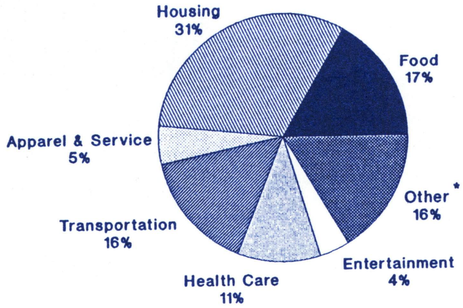

Fig. 1. Estimated annual expenditures for a retired couple.

Note: Other includes insurance and pension, personal care, alcohol, tobacco, cash, contributions, education, miscellaneous.

You also can calculate your estimated future expenditures. Probably the easiest method is to determine your current expenses (use your checkbook and charge receipts if you do not have a written record of expenses). Then estimate your expenditures in retirement based on today's prices.

Record your calculations on worksheets 1 and 2.

Worksheet 1, "Estimated Monthly Living Expenses," can help you calculate your expenses on a monthly basis. The first column on worksheet 2, "Estimated Annual Living Expenses in Retirement," provides a summary of your expected retirement expenses on a yearly basis.

Consider the inflation factor

The expenses you calculated for retirement on worksheets 1 and 2 were figured at today's prices. Unfortunately a dollar today may not be worth as much when you retire 10 or 20 years from now. Loss of buying power due to inflation is what makes planning ahead so important.

To estimate more accurately your income needs at retirement you need to predict what inflation will be, which is not an easy task. You also need to know how long it will be before you retire. Use table 2 and the following steps to estimate the effect inflation will have on your income needs.

Step 1: Choose the number of years until your retirement starts from the left-hand column in table 2 (subtract your age now from the age at which you plan to retire).

Step 2: Choose an assumed rate of inflation. Inflation cannot be predicted accurately, and

Table 2. The inflation factor: Average annual rate of inflation.

Years until retirement	Annual inflation rate (%)				
	3	5	7	9	11
5	1.16	1.28	1.40	1.54	1.69
10	1.34	1.63	1.97	2.37	2.84
15	1.56	2.08	2.76	3.64	4.78
20	1.81	2.65	3.87	5.60	8.06
25	2.09	3.39	5.43	8.62	13.58
30	2.43	4.32	7.61	13.27	22.89
35	2.81	5.52	10.68	20.41	38.57

it will vary from year to year. Since the early 1980s the annual rate has been about 4 percent.

Step 3: Find the inflation factor corresponding to your assumed rate of inflation and number of years to retirement. (Example: 20 years to retirement and 5 percent inflation gives a factor of 2.65.)

Step 4: Multiply your estimated total retirement expenses (worksheet 2) by the inflation factor to get your inflated retirement expenses. (Example: $18,000 x 2.65 = $47,700.) That means living costs would be about 265 percent higher when you retire than they are now.

You can also enter different inflation factors for different categories on worksheet 2. For example, medical prices may continue to rise more rapidly than food prices so you may want to use a higher inflation rate for medical and health expenses than for food. Estimate your future expenses by multiplying today's dollar figures (column 1) by the inflation factors (column 2) and filling in column 3.

You may want to make several projections at various inflation rates. If these figures seem depressing, don't despair. Through the years, income more or less keeps up with prices. Also, with time on your side, you have the opportunity to plan for a level of retirement income that will keep up with inflation or stay ahead of it.

Calculate your net worth

As you are approaching retirement you should also know your net worth—the difference between what you own and what you owe. Worksheet 3, "Personal Financial Statement," will help you take a reading of your financial pulse. The worksheet has columns for calculating your own, your spouse's, and your combined net worth. It is a good idea to look at your overall situation annually. Here are some guidelines for calculating assets:

- ✓ Ask a real estate agent to estimate the value of your house. Don't use the price you paid for it.
- ✓ Check a used car price guide for the value of your car.
- ✓ Make a conservative estimate of the value of household items. Anyone who has had a garage sale knows that even televisions and stereo equipment often don't bring what you think they are worth.
- ✓ Use the appraised value for antiques and art.
- ✓ Check the newspaper for the market value of stocks and mutual funds.
- ✓ Check your policy to find the cash surrender value of whole or straight life insurance policies.
- ✓ Use as the current value of your pension the amount you would receive if you quit your job today.

Here are some guidelines for calculating debts:

- ✓ Use the mortgage balance that appears on your monthly statement. If none appears, ask the lender for an amortization schedule of your mortgage.
- ✓ List the balance due on all charge accounts, installment accounts, and loans.
- ✓ Under current bills, include the dentist's bill, this month's water bill, telephone charges, etc.

Now, subtract total assets from total debts. That's your *net worth* and an idea of the "nest egg" you have saved.

Now that you have taken action in financial planning for your later years, your next step will be to determine the sources of income you can expect in retirement. See EXT 762, *Your Income Sources After Retirement*.

Worksheet 1. Estimated monthly living expenses.

Expense category	Current cost	Retirement cost
Housing		
Rent/mortgage payments	$ ________	$ ________
Real estate taxes	________	________
Insurance	________	________
Household operation and maintenance		
Home repair, yard care	________	________
Water, electric, gas, fuel oil	________	________
Telephone	________	________
TV antenna/cable	________	________
Waste disposal, other	________	________
Home improvement and upkeep		
Furniture, fixtures	________	________
Floor coverings	________	________
Kitchen equipment	________	________
Garden, yard equipment, supplies	________	________
Automobile and transportation		
Car payment	________	________
Repairs	________	________
Gasoline and oil	________	________
License, registration	________	________
Insurance	________	________
Other transportation	________	________
Food		
Food at home	________	________
Food away from home	________	________
Entertaining expenses	________	________
Clothing		
New clothing	________	________
Laundry not done at home	________	________
Dry cleaning	________	________
Shoe repair	________	________
Personal		
Cosmetics and toiletries	________	________
Barber and beauty shops	________	________
Stationery, postage	________	________
Medical and health		
Medicine and drugs	________	________
Physician, dentist	________	________
Eyeglasses, hearing aids	________	________
Health insurance	________	________
Recreation, education, and other		
Books, newspapers, magazines	________	________
Club memberships, dues	________	________

Worksheet 1 continued on next page.

Worksheet 1 cont. Estimated monthly living expenses.

Expense category	Current cost	Retirement cost
(Recreation, education, cont.)		
Movies, sports events, concerts	$ ________	$ ________
Sports and hobby equipment and supplies	________	________
Vacations, celebrations,	________	________
weekend trips	________	________
Adult continuing education	________	________
Pets: Care, food, license	________	________
Contributions	________	________
Gifts	________	________
Other	________	________
Taxes, debt repayment, insurance		
Federal and state income taxes, local taxes	________	________
Social security	________	________
Credit cards and due bills	________	________
Life insurance	________	________
Property insurance (not homeowner's)	________	________
Savings, investments		
Banks, savings and loan	________	________
Company pension, profit-sharing plan	________	________
Stocks, bonds, real estate		
Retirement: Keogh, IRA, SEP	________	________
Miscellaneous expenses		
Domestic help, day care	________	________
Alimony, child support	________	________
Professional and business expenses	________	________
Total	________	________

For further reading—

EXT 762	Your Income Sources After Retirement	$1.50
CIS 973	Where to Live After Retirement	50¢
CIS 958	A Letter of Last Instruction: Everybody Needs One	75¢

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Worksheet 2. Estimated annual living expenses in retirement.

Multiply by 12 the total retirement cost for each category in worksheet 1 to estimate your annual living expenses in retirement. Enter these amounts in column 1.

	(1) Estimated annual living expenses in today's dollars	x	(2) Inflation factor	=	(3) Adjusted annual expenses
Housing	$ ________		$ ________		$ ________
Household operation and maintenance	________		________		________
Home improvement and upkeep	________		________		________
Automobile and transportation	________		________		________
Food	________		________		________
Clothing	________		________		________
Personal	________		________		________
Medical and health	________		________		________
Recreation, education, and other	________		________		________
Taxes, debt repayment, insurance	________		________		________
Savings, investments	________		________		________
Miscellaneous expenses	________		________		________
Future irregular expenses	________		________		________
(new roof, new car, new furnace)	________		________		________
Total	________		________		________

Worksheet 3. Personal financial statement.

	Self	Spouse	With spouse
Assets—What we own			
Cash			
Cash on hand	$ ________	$ ________	$ ________
Checking accounts	________	________	________
Savings accounts	________	________	________
Certificates of deposit	________	________	________
Investments			
Government bonds and instruments	________	________	________
Mutual funds	________	________	________
Bonds—corporate/municipal	________	________	________
Stocks	________	________	________
Affiliated business interests	________	________	________
Life insurance and annuities			
Cash value, accumulated dividends	________	________	________
Annuities	________	________	________
Vested retirement fund benefits	________	________	________
Accrued pension or retirement benefit	________	________	________
Real estate			
Home (current market value)	________	________	________
Other real estate	________	________	________

Worksheet 3 continued on back page

Worksheet 3 cont. Personal financial statement.

	Self	Spouse	With spouse
Property			
Household furnishings	______	______	______
Jewelry and furs	______	______	______
Art and antiques	______	______	______
Vehicles	______	______	______
Other valuables	______	______	______
Other			
Notes receivable (owed you)	______	______	______
Total assets	______	______	______
Liabilities—What we owe			
Unpaid bills			
Charge accounts	______	______	______
Credit card accounts	______	______	______
Taxes	______	______	______
Insurance premiums	______	______	______
Other	______	______	______
Balances due on			
Installment contract	______	______	______
Loans (from banks, savings and loan associations, insurance companies, etc.)	______	______	______
Other	______	______	______
Real estate mortgage			
Total amount owed	______	______	______
Total liabilities	______	______	______
Summary			
Assets	______	______	______
Liabilities	______	______	______
Net worth	______	______	______

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Acknowledgments—The author extends her appreciation to the following University of Idaho Cooperative Extension System faculty who reviewed this publication: G. Ray Prigge, director, University of Idaho Cooperative Extension System, District IV; Darlene Moss, Extension home economist, Caribou County; Marilyn Cross Shinn, Extension home economist, Ada County; and Diane Schmerbauch, Extension home economist, Minidoka County.

Issued in furtherance of cooperative extension work in agriculture and home economics, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, LeRoy D. Luft, Director of Cooperative Extension System, University of Idaho, Moscow, Idaho 83844. The University of Idaho provides equal opportunity in education and employment on the basis of race, color, religion, national origin, age, disability, or status as a Vietnam-era veteran, as required by state and federal laws.

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Produced by Agricultural Communications Center

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