Independent Investor

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How Much Do You Need to Retire?

Picturing yourself as a retiree may be hard, if not impossible. But if you could envision those future years, you'd probably see a life full of activity and decades of health, happiness and prosperity. The problem with this picture is that the pleasure and comfort of your later years depend, to an ever-increasing degree, on the actions you take today.

Americans used to count on a pension plus Social Security to get them through their "golden years." But times have changed. Today defined benefit pension plans are becoming much less common, people change jobs more often and most manage their own retirement funds through defined contribution plans.

Today's Planning Variables

Over the years Social Security has become a less significant component of retirement income for most Americans, and now represents a little more than a third of the aggregate income of Americans aged 65 and older.[1] Not only are Social Security benefits less significant, but the sums are diminishing and the age at which you can begin to receive benefits is higher. You can contact Social Security at 1-800-772-1213 to learn what you can expect in benefits, and when. Benefits are calculated on your earnings, with certain variable factors.

As you begin thinking about how much you'll need for a comfortable retirement--and how you will fund your later years--you may be startled to learn the impact of inflation. At an average inflation rate of 3%, your cost of living would double every 24 years. Your annual income will need to increase each year even during retirement in order to keep up with the gradual rise in prices of everyday goods.

You'll also have to consider the likelihood of increased medical costs and health insurance as you grow older. Consider, for instance, that the average nursing home stay now costs more than $87,000 a year[2]--a figure that is likely to continue increasing when you factor in annual inflation.

With these variables comes the realization that the responsibility for providing the bulk of your retirement income rests with you.

Gaining an Edge

Including "extras" in your package may help woo top-notch workers. Employer-paid life insurance is a relatively inexpensive benefit that is appreciated by employees with dependents as well as older workers. It also sends the implicit message that you care about employees' families.

An aging workforce, as well as uncertainty over the projected Social Security shortfall, should accelerate demand for retirement plans.

If interested in sponsoring a retirement plan, first pinpoint your goals.

Personal Saving Is the Key

Now that you better understand the situation, the importance of saving and taking charge of your own financial future becomes clear. How much will you need to save to live comfortably in retirement? That depends on a number of factors, but experts estimate that most of us will need about 60% to 100% of our annual preretirement income to live on each year after we retire. Find out how close you are to meeting this goal by completing the exercise below.

1. Estimate your last working year's salary. Multiply your current salary by the inflation factor from Table 1 below, based on the number of years you have until retirement. This represents the future value of your salary, assuming 3% annual inflation.

Example: If you are currently making $40,000 and have 20 years until retirement, your formula is $40,000 x 1.81 = $72,400.

2. Determine what percentage of your current income you expect to need after retirement. If 100% seems high, consider that while you may be able to stop paying some expenses, like mortgage payments, other expenses will likely increase, such as health and travel expenses. Multiply that percentage by the amount in #1 above.

Example: $72,400 x .80 = $57,920.

3. Estimate your future Social Security and retirement benefits. The best source for Social Security benefit projections is the Social Security Retirement Estimator at www.ssa.gov/estimator/. (If you cannot readily access the official calculator, you can get a very rough estimate of your benefit from Table 2 below.)

   a. If you are using the calculator, multiply the monthly amount listed under "At full retirement (age 66 and 8 months)" by 12, then multiply that figure by the inflation factor from Table 1 below.

   Example: If the calculator shows an estimated monthly benefit of $1,153, your formula is $1,153 x 12 x 1.81 = $25,043.

   b. If you are using Table 2, take the number corresponding to your annual salary and years to retirement.

   Example: If you currently earn $40,000 and have 20 years to retirement, your estimated benefit would be $25,000.

   c. Subtract your Social Security benefits and other retirement benefits from the annual amount calculated in #1. This will give you an estimate of how much of your own savings you will have to use each year in retirement.

   Example: $57,920 - $25,000 = $32,920.

4. Estimate the total amount you will have to put aside in retirement accounts such as 401(k) plans, IRAs and personal savings. To determine how much you will need, multiply 19.3 by the annual amount you calculated in #3. This represents how much savings you would need to last 28 years at 3% inflation and earning a 6% annual return.

Example: $32,920 x 19.3 = $635,356.

5. Enter the amount of your current savings and investments and multiply it by the growth factor from the accompanying table. This is what your savings would be worth by the time you reach retirement, assuming an 8% return compounded annually.

Example: $30,000 x 4.66 = $139,800.

6. If line 5 is larger than line 4, congratulations! You are on your way to meeting your retirement goal. Keep saving! If line 4 is larger than line 5, subtract line 5 from line 4. Enter that amount here. This is the additional amount you'll need.

Example: $635,356 - $139,800 = $495,556.

7. Divide #6 by the multiplier in the table below for the number of years until your retirement. The multiplier represents how large your savings would grow based on your annual contribution, assuming an 8% annual return. The result is the approximate amount you may want to set aside each year.

Example: $495,556 ÷ 49.42 = $10,027.

Table 1 -- Factors*			
Years	Inflation	Growth	Multiplier
5	1.16	1.47	6.34
10	1.34	2.16	15.65
15	1.56	3.17	29.32
20	1.81	4.66	49.42
25	2.09	6.85	78.95
30	2.43	10.06	122.35
35	2.81	14.79	186.10
40	3.26	21.72	279.78

**Assumes 3% annual inflation and a 5% annual return.*

Table 2 -- Social Security Income**								
	Years to Retirement							
Current Salary	40	35	30	25	20	15	10	5
$20,000	29,500	27,000	25,000	22,500	20,500	19,000	17,500	16,000
30,000	32,500	30,000	27,500	25,000	22,500	21,000	19,000	17,500
40,000	35,500	32,500	30,000	27,000	25,000	23,000	21,000	19,000
50,000	38,500	35,500	32,500	29,500	27,000	25,000	22,500	21,000
60,000	41,500	38,000	35,000	32,000	29,000	26,500	24,500	22,500
70,000	44,500	41,000	37,500	34,000	31,000	28,500	26,000	24,000
80,000	47,500	43,500	40,000	36,500	33,500	30,500	28,000	25,500
90,000	50,500	46,500	42,500	39,000	35,500	32,500	29,500	27,500
97,500 +	53,000	48,500	44,500	40,500	37,000	34,000	31,000	28,500

***Assumes 3% annual inflation.*

Today's Planning Variables

If you are concerned about being behind in your retirement accumulation goals, take heart. You have some powerful allies on your side. First is the power of compounding, which takes advantage of time. Tax deferral is another ally. Using investment vehicles such as 401(k) plans or individual retirement accounts (IRAs), you can put off paying taxes on your earnings until you are retired and potentially in a lower tax bracket. Meanwhile, your contributions may be pretax or tax deductible, helping reduce current tax bills.

The more time you have until retirement, the more fortunate you may be. Delaying just months--never mind years--may or could significantly reduce your results. Consider this example: Jane begins investing $100 a month in her employer-sponsored 401(k) plan when she's 25. Mark does the same--beginning when he's 35. Assuming a 7.5% annual rate of return compounded monthly, when Mark retires at 65, he'll have $135,587. Jane will have $304,272.

While this is only a hypothetical example and there are no guarantees any investment will provide the same results, you can see the remarkable difference starting early can potentially make. By starting early, investing systematically, and benefiting from the potential of compounding and tax deferral, you may pack a lot more punch into your retirement portfolio.

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[1]Social Security Administration, 2014 (using 2012 data). This report is designed to give you a snapshot of your current retirement savings surplus or shortfall. It is not a guarantee of future performance or outcomes. Assumed rates of return are hypothetical which do not reflect the deduction of fees and charges inherent to investing in securities, and are not representative of any specific securities. Inaccurate or unreasonable assumptions may materially impact the results. It is important to note that actual results may differ due to any number of events. Some events are within your control, such as your spending habits, while other events, such as market performance, interest rates and tax policies, are not.

[2]Genworth 2014 Cost of Care Survey, March 25, 2014. Median rates nationwide; based on the daily rate of $240 for a private room.