3 STEPS To Know When You Are Financially Ready to Retire

FINTEGRITY®

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Whether you are voluntarily choosing to retire or are thrust into it from factors beyond your control, it's important to understand how your financial resources will sustainably support your living expenses once you stop working. This high-level guide will help you:

- ***Know when you can retire comfortably***
- ***Assess if you can spend more money for those who are already retired***
- ***Put your mind at ease***

To find out if you are financially ready for retirement, use this 3-step process:

Step 1

Estimate Your Spending Needs

The amount you need to retire depends on your annual expenses. As a result, it's essential to begin the process by estimating your total annual expenses during retirement. At a high level, you can take your current total annual spending and adjust for any significant changes to your expenses during retirement.

If you don't know your current annual spending, sum the amount paid from your checking account and/or bill-pay service for the most recent 12-month period. Scan your payments for any unusual non-recurring expenses, such as a home renovation, a major medical event, or paying for a wedding. If there is a different unusual expense in most years, you may want to include the average cost in your desired annual retirement spending. Alternatively, you can build a detailed budget for greater precision.

Once you have a sense of your current spending, think about major changes during retirement. For example:

- Will some spending increase because you plan to travel more frequently?
- Will your housing expenses decline because you are planning to relocate from a high cost area to a lower cost area?
- How will your health insurance and healthcare costs change?

Take your current spending, then add and subtract your anticipated changes for an estimated annual cost of living during your retirement years. We will work through an example in Step 3. For that purpose, let's say your estimated retirement spending is $120,000 a year or $10,000 per month.

Step 2

Estimate Your Income

Retirement income will help you cover your expenses. Retirement income sources include social security, interest, dividends, pension, and other continuous income. Add the total amount of income you expect from all of these sources:

- **Social Security**. The amount you receive depends on the amount you paid in social security taxes, when you paid it, and your age (between 62 and 70) when you begin collecting it. You can obtain your projected social security income from the **Social Security Administration** at **www.SSA.gov.** For our example, let's say your projected social security income will be the maximum amount for 2020 at age 70 or $45,480 a year.

- **Interest and dividend income**. Review your tax return to see the amount you earned from last year. If that amount will continue, add it to your retirement income. For our exercise, let's assume it is $10,000.

- **Pension**. Although not as common as in the past, you may have pension income from your employer.

- **Compensation**. For work you do, such as serving on a Board, as a trustee, an employee, freelancer, or other activity.

- **Trust income**. If you are the beneficiary of a trust and receive income from it.

- **Other income**. We will use $20,000 of other income as part of our example.

The sum of our total income is $75,480 for use in our Step 3 example.

To determine the amount you can spend, subtract income taxes from $75,480 of total pre-tax income. In this example, we used the 2020 married filing jointly federal tax table and assumed no state income tax (as is the case in Texas, Florida, Washington, Nevada, New Hampshire, South Dakota, Alaska, and Wyoming). Our estimated income tax is $14,613, leaving us with $60,867 in after-tax income to cover our expenses.

Step 3

Calculate the Savings You Need

How much savings do you need? Your savings amount will need to cover the difference between your total expenses (Step 1) and your total income from all sources (Step 2) for every year of your retirement. In our example, we expect income to be $60,867 and our spending to be $120,000. That means we will need to withdraw from our savings enough to cover the difference of $59,133 each year.

A rule of thumb is to withdraw 4% from your savings for a reasonably good chance to have your money last 25 years, provided it is invested 60% in stocks and 40% in bonds in average market conditions. That means you need 25 times (1/0.04) the amount you will be withdrawing annually, provided the savings are in after-tax accounts. In our example, $59,133 times 25 equals $1,478,315. For retirements longer than 25 years, a lower withdrawal rate or higher savings amount is advisable.

If your savings are in pre-tax retirement accounts, you need to adjust for income taxes that will need to be paid on pre-tax retirement account withdrawals. In this example, the marginal tax rate for our retired married couple filing jointly is 22%. To have $59,133 for spending, we need to withdraw that amount plus enough to pay the tax on the withdrawal. The pre-tax withdrawal amount needed is calculated as $59,133 / (1-22% tax) = $75,811. Therefore, the amount of savings needed in a **pre-tax** retirement account to support this income and spending scenario is $75,811 * 25 = $1,895,275. Paying income tax makes quite a difference!

Most people have a combination of after-tax and pre-tax savings. Compare the amount of your savings with the amount you need.

Income	
Social Security	$45,480
Interest and dividends	$10,000
Pension / other	$20,000
Total income	**$75,480**
Less: income tax	$14,613
After-tax income	**$60,867**
Expenses	
Living expenses	$120,000
Funded from Savings	($59,133)
After-Tax Savings Needed @ 25x	**$1,478,315**
Pre-Tax w/d Required @ 22% tax	($75,811)
Pre-Tax Savings Needed @ 25x	**$1,895,275**

Conclusion

If your estimate indicates a surplus, you are likely in good shape and may be able to spend more money each year than expected. If your estimate indicates a deficit, you can a) reduce your spending to match your financial resources, b) increase your saving to meet your desired retirement lifestyle expenses, or c) some combination of both. Whether you calculated a surplus or deficit, you may want to confirm your results with a financial adviser.

This method provides a rough estimate with a variety of assumptions. To get a retirement plan tailored to your unique circumstances, such as varying income or expenses, time horizon, risk preference, health condition, tax rate, and other needs, contact Jeffrey Barnett, a fiduciary financial adviser, at jb@fintegrity.biz or 201-266-6829. Jeffrey will listen to what you want, then invest and plan with you so you can focus on doing what you enjoy most and not worry about your money.

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Jeffrey Barnett

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