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How Will You Spend Retirement? A Spending Plan Can Provide Answers

The golden rule for managing personal finances applies to just about everyone, young, old and in between: Spend within your means.

But a key distinction surfaces in planning for how to spend your money in retirement, says New York City-based Certified Financial Planner™ Larry Luxenberg of Lexington Avenue Capital Management. “What's different [in retirement] is your income is fixed, not your spending, and the consequences of overspending are different. If you overspend in retirement, you may need to go back to work or [you will] run out of money.”

The best way to keep from overspending and to maintain control of your financial destiny throughout retirement is to establish a spending plan, says Robert Braglia, a Certified Financial Planner™ who heads American Financial & Tax Strategies in New York City. “A spending plan is vital to provide you with a view of what the future holds and to give you a path to live the best life possible during retirement.”

The process of devising and implementing a spending plan is relatively simple once you understand the steps involved, including:

STEP: Check your mindset. Think you’ll be spending considerably less during retirement than you spent before? Think again, says Braglia. “Face it, you’re not slowing down and you can’t let your money slow down either.” That means positioning your assets to continue growing during retirement and avoiding the temptation to get too conservative with those assets. “The main trap retirees must not fall into is the old thinking that you must be very conservative at this time…A healthy 65-year-old today must plan for a retirement that will last decades.”

STEP: Get clear on how you want your retirement to unfold. “When developing a spending plan for my clients, we talk about retirement lifestyle. How they want to live, what they want to do,” says Certified Financial Planner™ Niv Persaud, managing director at Transition Planning & Guidance in Atlanta, GA.

STEP: Identify income sources. Among the first steps in devising a spending plan is to establish how much money you will have coming in, from which sources. Those sources may include Social Security, retirement accounts, pensions and investments, plus other income, such as from a job, if continuing to work is part of your retirement plan, a rental property, an annuity, etc.

STEP: Get a grasp of what you spend. Track expenses to determine how much you need to live on each month, not only to cover hard expenses like food, transportation and housing, but also discretionary spending to maintain the lifestyle you want to lead during retirement.

STEP: Use online tools to make it easier on yourself. No need to reinvent the wheel when it comes to tracking expenses and income. Apps available at sites like Mint.com and Mvelopes.com provide a ready-made framework to turn a chore into a quick, easy process.

STEP: Decide how to manage income streams. Be sure you have a good handle on which income streams will be available, when, and plan accordingly. When will Social Security benefits begin to flow? How about income from a pension or an annuity? “You want to make sure your cash flow [during retirement] is consistent and secure through market cycles,” explains Braglia. He suggests setting aside a cash pool equal to one year’s cash flow. “Draw the monthly income from there. In times the [stock] market is up, replenish that pool; when markets are all down, do nothing and let the drawdown continue. Be patient and replenish only with profits” from the investment portfolio. This cash reserve also can serve as an emergency fund to cover unexpected expenses.

STEP: Eliminate (or drastically reduce) debt. Because debt (and associated interest payments) can be difficult to manage on a static retirement income, Braglia urges people to shed as much debt as possible before retirement. “Aside from your mortgage, it’s a good idea to be debt-free when retirement hits,” he says.

STEP: Account for inflation. Some of the sources you’ll be relying upon for retirement income will provide fixed payments (like a pension) and others, like Social Security, may be indexed to inflation. The goal, says Braglia, is to create an income stream that will increase in step with inflation, so if consumer prices for goods and services rise, so, too, will your income. Stock market investments provide good inflation protection because they tend to track with inflation, he notes. Be sure to account for a higher rate of inflation with medical and healthcare costs as well. “The cost of healthcare is going to rise faster than anything else,” says Braglia, “so the slice of income to cover medical care is going to get bigger.”

STEP: Build well-informed assumptions into the plan. As part of the planning process, you’ll need to make projections in a few key areas, including an annual inflation rate (inflation has averaged about 3% over the long haul) and an annual growth rate for your investment assets (market watchers say 4% to 5% average yearly growth is a solid projection going forward).

STEP: Crunch the numbers. Time to take out the calculator or your favorite budgeting app (see the online tools step above) to see where you stand — how total income stacks up compared to total expenses, while factoring in a projected inflation rate, discretionary spending, projected investment growth rate and more. If projected spending outpaces estimated income, you’ll need to find ways to bridge that gap.

STEP: Get guidance. Did you overlook something that could make a major difference in the plan, either positively or negatively? What are some proven ways to make up a projected income shortfall? Given the time, energy and know-how it takes to coordinate all the aforementioned steps and answer questions such as these, it makes sense to enlist a financial professional to guide you through the process of drafting and implementing a spending plan, says Braglia. “It’s important to find a professional to help you, someone who does this stuff everyday who can design and quarterback a plan for not a lot of money.”

STEP: Revisit the plan periodically and revise it as necessary. “We like to set up a spending plan and then revisit it three to six months into retirement,” says Steve Brenton, a Certified Financial Planner™ in San Francisco, CA. After that initial check-in, says Braglia, be sure to “retest the plan every couple years and recalibrate it to stay on track.” Because in all likelihood, things will change. Your plan should adjust accordingly.

This Month's Webinar

Planning for Retirement: It's More Than Just the Numbers

The advertising you see about retirement all seem to emphasize money. While money is very important, it's not the only thing. Join us for a broad look at what you can do now for a satisfying retirement. We'll explore the new world of semi-retirement, emotional issues around leaving work, the money of course, and more.

Log-in any time this month to watch the webinar!