

## **New Views on Retirement Income Planning**

*By Kevin R. Worthley*

A recent article in the *Journal of Financial Planning* discussed a relatively new take on planning for one's income during retirement years. Its theme is based upon the notion that retirees actually spend less during retirement (on an inflation-adjusted basis), than they do during the years prior to retirement. If this is so, then retirees may not need quite so much of a so-called "nest egg" of liquid retirement assets, (IRA's, annuities, other investments, etc), to finance their desired retirement standard of living. Essentially, the article suggests that perhaps retirees are being asked to save and sacrifice *too much* during their working years.

In a typical financial plan, many planners use an estimated average inflation rate (usually 3%) to account for rising costs of living over a 20-25 year retirement period. The resulting increase of dollars needed to maintain an established standard of living usually means that more money must be withdrawn from IRA's or other investment savings accounts each year. If the investment returns on these accounts do not keep pace with the additional outflows, then more principal may need to be withdrawn, thereby depleting the account further. If this occurs too frequently, the investor may end up depleting the account entirely toward the later years of their life.

The new study, however, suggests that retirees historically spend less as they grow older, especially after age 75, thereby negating the inflationary effect on required income over time. Simply put, if a retiree's income needs decrease as fast as (or faster than) inflation, the "nest egg" could theoretically last longer and therefore, perhaps not as much of a nest egg is needed initially to last the retiree's lifetime. If so, then perhaps traditional planning calculations of savings and investment needed could be too conservative and tomorrow's retirees may not need to save and invest quite as much as traditionally thought.

The evidence for this new perspective was taken from the US Dept of Labor's Consumer Expenditure Survey in 2002 spanning the past 20 years. While the data seems to support the conclusions, it could be dangerous to read too much into this theory, in my view. For one, many pre-retirees are not saving nearly enough for retirement as it is, even at lower expected income needs. Second, the survey does not seem to take the rapidly rising costs of healthcare over the past few years or the impact of possible long-term care costs later in life; certainly a significant factor and concern for seniors. Next, although inflation is currently modest and historically averages about 3%, it has not always been so. If inflation should rise significantly in the future, the impact on income needs could be significant. Finally and most importantly, everyone's situation could be markedly different, so applying a broad-based planning standard, even with its insights, can be detrimental to an individual financial plan.

Financial and retirement income planning is still a very personal process. With all the variables to consider, including income needs, desired goals, plans and objectives, pensions benefits and varying degrees of investment risk tolerance, changing economic factors and the all-encompassing "life happens", it is difficult for a static theory to account for all of these, even with sophisticated planning tools, such as so-called Monte Carlo probability software. While this new line of thought is useful to incorporate into planning, it should not be a complete excuse to overspend one's income or not to conserve and save for the future. In any case, the need to formulate *and regularly monitor* a financial plan is still very important. If you are unsure about how to create a retirement income analysis, consult with a qualified financial professional.

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