

How Much Do You Need to Retire?

Key Points

- [Sources of Retirement Income](#)
- [Saving Is the Key Component of Retirement Income](#)
- [Meeting Your Goals](#)
- [How Much Do You Need to Retire in Style?](#)
- [Pensions, Social Security, and Other Allies](#)
- [Points to Remember](#)

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. No rocking chairs and lap shawls need apply.

The reality, however, is probably somewhere in between. The problem with the picture is that the pleasure and comfort of your later years depend, to an ever-increasing degree, on the actions you take today.

So many changing facets of the American workplace have made it more important than ever to take control of your financial future. By investing now with a long-term focus, you can greatly improve your chances of having a fulfilling retirement.

Americans used to count on a pension plus Social Security to get them through those "golden years." These days, people change jobs more often, rely on dual incomes, and manage their own retirement funds through defined contribution plans. By most estimates, you'll need between 60% and 100% of your final working years' income to maintain your lifestyle after retiring.

Sources of Retirement Income



This chart represents a breakdown of income sources for all retirees (aged 65 and over).

Source: Social Security Administration, 2010 (using 2008 data, most recent available).

Saving Is the Key Component of Retirement Income

The accompanying pie chart shows the importance of saving now toward a retirement fund. 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.

Alas, the responsibility for the bulk of your nest egg rests with you. Social Security represents approximately 36% of the aggregate income of Americans aged 65 and older, according to the Social Security Administration.

Also, as you begin thinking about how much you'll need for a comfortable retirement, 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. The average nursing home stay, for instance, now costs more than \$83,000 a year and could rise to over \$150,000 per year by 2030, assuming an annual inflation rate of 3%.¹

Meeting Your Goals

Now that you have an idea how much you'll need to finance your retirement years, of which there can easily be 25 or more, you may better understand the urgency to build your assets.

How Much Do You Need to Retire in Style?

Financial 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 the table 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 $\$40,000 \times 1.81 = \$72,400$

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.

Example: $\$72,400 \times .80 = \$57,920$

3. Estimate your future Social Security and retirement benefits. The best source for Social Security benefit projections is your annual Social Security statement (or one of the calculators from www.ssa.gov). If you don't have that, you can get a very rough estimate of your benefit from Table 2 below.
 - a. If you have your Social Security Benefit Statement, multiply the monthly amount listed under "If you continue working until full retirement age" by 12, then multiply that figure by the inflation factor from Table 1 below.

Example: If your benefit statement shows an estimated monthly benefit of \$1,153, your formula is $\$1,153 \times 12 \times 1.81 = \$25,043$

- 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: $\$57,920 - \$25,000 = \$32,920$

- Estimate the total amount that 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 to save, multiply 19.3 by the annual amount you calculated in #3. This multiplier represents how much savings you would need to last 28 years at 3% inflation and earning a 6% annual return. A healthy, 65-year-old male has a 10% chance of living longer than 28 years.

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

- 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

- 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

- Divide #6 by the multiplier in the table below for the number of years until your retirement. The multiplier represents how large your savings will 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

Table 2 -- Social Security Income

Current Salary	Years to Retirement							
	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 and a 5% annual return.

Pensions, Social Security, and Other Allies

Traditional pensions (private and government) are estimated to supply about 17% of the aggregate income of today's retirees, while Social Security is estimated to supply 36%, although nearly two-thirds of retirees rely on Social Security for 50% or more of their income, according to the Social Security Administration (2010; using 2008 data, most recent available). Still, you'll probably fall far short of your goal. A radically reduced standard of living for a quarter century or more is hardly the stuff "golden age" dreams are made of.

Fortunately, you have some allies. 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.

For example, an investment of \$10,000 would grow to more than \$100,000 after 30 years, at an annual return of 8%, if all the returns were reinvested and the account grew tax deferred. As with all hypotheticals, this example does not represent the performance of any specific investment and the earnings would be subject to taxation upon withdrawal at then-current rates and subject to penalties for early withdrawal.

The more time you have until retirement, the more fortunate you may be. Delaying just months -- never mind years -- can 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 9% annual rate of return compounded monthly, when Mark retires at 65, he'll have \$183,074. Jane will have \$468,132.

While this is only a hypothetical 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 portfolio.

Another advantage of today's retirement planning options is that you can control how your money is invested.

Investment plans need to be customized because different people have different degrees of risk they will accept as well as varying time frames they intend to hold their investments. Keep in mind, all investments involve risk including the possible loss of principal. A tailor-made portfolio can be diversified to take these factors into account. It's a wise idea to consult a professional financial advisor for complete information.

Points to Remember

1. The rising cost of living means you need to plan on an annual retirement income that could be substantially higher than what you spend now.
2. You may have higher expenses in some things such as medical care, but lower expenses in others. You can estimate your "personal inflation rate" by looking at your expected living costs in retirement.
3. You may need between 60% and 100% of your final working years' salary.
4. Retirement income may be made up of pension benefits, Social Security benefits, personal savings and investments, and income from part-time work.
5. Your financial advisor can help you develop an estimate of your needs and a plan to help you accumulate a retirement fund to provide income you'll need.

¹Sources: MetLife Market Survey of Nursing Home and Assisted Living Costs, *October 2010*; *Standard & Poor's, 2010*.

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