

RETIREMENT PLANNING BASICS

PART ONE

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Retiring may be one of the biggest decisions you will ever make. Think of it as planning a 25-year road trip. One of the first questions you need to ask yourself is where am I going?

The “where” in retirement does not necessarily have to be a different physical place but rather a different internal place. For most of your life, you woke up every morning to go to work, except on your days off. You had a purpose. For many, it is a forced purpose, but at least it gave you a direction of what you needed to do.

When you retire, there will not be an external force telling you where and what to do. You will have to create a new purpose(s) to keep you going day after day for the next 15–30 years.

The purpose you create has to have meaning to you. It could be perfecting your golf game, which might take a few lifetimes, or volunteering at your local church. Whatever the purpose, make sure it is something that will keep your mind and body active. Planning ahead can make your golden years more meaningful.

How Much Will Retirement Cost?

The next thing you need to determine for your retirement road trip is how much it will cost. Many retirement decisions are made based on affordability. It doesn't make much sense to retire and then have to go back to work a few years later at a much lower-paying and/or stressful job because you realized too late that retirement cost more than you expected.



Step 1. CURRENT SPENDING

One of the first steps in determining the cost of retirement is to get a snapshot of what you are currently spending. Let's suppose that figure is \$40,000 a year. The general rule during retirement is that you will spend 80% of your current living expenses. In this example, it would be $\$40,000 \times 80\% = \$32,000$.

If you are 50 years old and want to retire when you are 65, it would be nice to say that the \$32,000 you need today is the same amount you will need 15 years from now. Unfortunately, inflation needs to be factored into this equation. Inflation has averaged around 3% a year for the last half-century. Thus, factoring in inflation, 15 years from now you will need \$ 49,855 to purchase \$32,000 in today's dollars. The following chart shows the impact of inflation for different amounts at different time intervals.

Future Amounts Needed with 3% Inflation Factor

Current Amount	Years Until Retirement				
	10	15	20	25	30
\$ 15,000	\$20,159	\$23,370	\$27,092	\$31,407	\$36,409
\$ 20,000	\$26,878	\$31,159	\$36,122	\$41,876	\$48,546
\$ 25,000	\$33,598	\$38,949	\$45,153	\$52,344	\$60,682
\$ 30,000	\$40,317	\$46,739	\$54,183	\$62,813	\$72,818
\$ 32,000	\$43,005	\$49,855	\$57,796	\$67,001	\$77,672
\$ 35,000	\$47,037	\$54,529	\$63,214	\$73,282	\$84,954
\$ 40,000	\$53,757	\$62,319	\$72,244	\$83,751	\$97,090
\$ 45,000	\$60,476	\$70,109	\$81,275	\$94,220	\$109,227

RETIREMENT FUNDING FOR 65 YEAR OLD

Needing \$32,000 in today's dollars

Inflation adjusted amount needed in first year of retirement: \$49,855

Rates of Return

Living to age:	3%	4%	5%	6%	7%	8%	9%
70	\$249,275	\$242,176	\$235,387	\$228,892	\$222,674	\$216,718	\$211,010
75	\$498,550	\$472,930	\$449,195	\$427,176	\$406,724	\$387,704	\$369,994
80	\$747,825	\$692,802	\$643,401	\$598,945	\$558,850	\$522,610	\$489,781
85	\$997,100	\$902,305	\$819,802	\$747,744	\$684,590	\$629,048	\$580,035
90	\$1,246,375	\$1,101,927	\$980,031	\$876,646	\$788,519	\$713,025	\$648,036
95	\$1,495,650	\$1,292,135	\$1,125,571	\$988,310	\$874,421	\$779,282	\$699,271
100	\$1,744,925	\$1,473,372	\$1,257,768	\$1,085,042	\$945,424	\$831,558	\$737,875

Step 2. SAVINGS NEEDED

After determining how much you will need in your first year of retirement (using the above information) the next step is to determine the savings you will need to fund your retirement years. The tenure of your retirement is anybody's guess. When I help someone with their retirement planning, I usually plan for a person to live until at least age 90. I will adjust this figure depending on the health and lifestyle of the client.

To continue with the example above, the chart above shows the savings needed for a 50-year-old retiring at age 65 and living to different ages earning different rates of return on their portfolio. The rates of return include a 3% inflation factor.

For example, a 65-year-old living to age 90, earning 3% on their investments will need \$1,246,375 to fund their retirement. If he/she can accept a little more volatility in the investment allocation and plan for a 7% rate-of-return on the investments, he/she will need \$788,519 to fund their retirement.

In this market environment, where stock investments have

dropped to historic lows, many people have flocked to less volatile investments, such as certificates of deposits (CD's) issued by banks. The average rate of return on these types of investments has been around 3-4%.


Thus, as you can see from the table, if you have chosen low-yielding investments and plan to continue with them, be prepared to save a lot more for retirement. In the example, the difference between a 3% and 7% rate-of-return for a 65-year-old living to age 90 is \$457,856.

Even though the table shows a lump sum needed for retirement, which may seem daunting for most people, this figure could be significantly reduced by other revenue sources such as pension


plans, social security, and home-equity options. In my next article, I will go over some of these different funding options for your retirement plan

In closing, remember to keep a long-term perspective when planning for retirement. Don't let the current fog of fear over our economy be your guiding principle. As Franklin D. Roosevelt once said, "The only thing we have to fear is fear itself—nameless, unreasoning, unjustified terror, which paralyzes needed efforts to convert retreat into advance." ■

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