COOPERATIVE EXTENSION SERVICE

VIRGINIA POLYTECHNIC INSTITUTE AND STATE UNIVERSITY

Blacksburg, Virginia 24061

MID-LIFE PLANNING FOR RETIREMENT

Letter 4

Dear Pre-retiree:

To this point we have looked at sources of income and the management of savings, investments, the value of assets and life insurance. Hopefully, you are taking the opportunity to do your homework as you receive each letter. By keeping your planning up to date as each letter is received you will receive more benefit and the job will be easier.

At the same time, there really doesn't seem to be a way to organize all of these steps for planning retirement into a neat 1-2-3-4 system. Somehow, they all seem to depend one on the other. For example, how much will it cost to live? It will cost whatever you have to spend. But, the answer isn't as much of a riddle as that.

How Much Will Retirement Living Cost?

When retirement is more than 3-5 years away, it is difficult to know exactly how much income you will have. However, a rough estimate is helpful in making decisions. When retirement is only two or three years away you need to sharpen your pencil and do some close calculations.

There may be three types of income within our current pay checks. We have income before taxes, after taxes, and take home pay. How will each of these change at retirement? Your pay check may now follow the pattern as given below but you can adapt these suggestions to your own situation.

How will each deduction from your present pay check change at retirement?

Social Security and pension fund payments of course will cease.

Tax withholdings will change.

Savings plans as credit union or stock purchase plan will cease.

Health and/or life insurances may continue as a retirement benefit or you may have to pay these bills.

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The reference books were listed only for the purpose of information and the VPI & SU extension service does not recommend any one of the reference books to the exclusion of others which might be available.

An example plan: monthly basis

Current Gross Income $1,250.00		Gross income after Ret.	$850.00
Income after tax deduct - 1,150.00		Income after taxes $800.00	
Social Security	62.50		
Union Dues	5.00		
Employees share of life insurance	10.00		
Total deductions (97.50)	$97.50		
Income after deductions $1,052.50		Retirement income $800.00	800.00

(Pay premium on life insurance $200 annually)

In this example the retiree will continue to receive health insurance as a retirement benefit from the company. He can continue in the company's group life insurance plan but he must pay the entire premium.

At this point you should have a fairly accurate picture of the income you will receive from pensions and social security, and the employee benefits that will or can be continued into retirement. The next step is to calculate the cost for you to live after retirement.

The most practical way to figure the cost of retirement living is to list current expenses using annual figures.Estimates are not of much value here, you need true figures. Lucky are those who have kept home accounts or complete records. In the case of missing home accounts use income tax records, check stubs, or similar records. By the way - now is the time in life that family accounts can be invaluable.

Don't be concerned about an average budget for people in your stage of life. Make your own plan. It will be tailor-made, especially for you.

A suggested form is given below, but you probably will need to delete or add items to personalize it. Before you write in each anticipated amount for "after retirement" read the descriptions of each category listed below the form.

Expenditure category	This Year	Year Before Retirement	After Retirement
Housing			
For present house	______	______	______
For new place	______	______	______
Gas	______	______	______
Electricity	______	______	______
Telephone	______	______	______
Household costs	______	______	______
Food-edibles and beverages only	______	______	______

Expenditure category	This Year	Year Before Retirement	After Retirement
(con't.)			
Clothing	________	________	________
Insurance - life	________	________	________
Insurance - health, medical bills	________	________	________
Recreation	________	________	________
Gifts	________	________	________
Church and charity	________	________	________
Working expenses	________	________	________
Personal items	________	________	________
Income taxes	________	________	________
Transportation	________	________	________
Deductions from present income (that will not apply after retirement)	________	________	________
Savings	________	________	________
Debts	________	________	________

Housing includes mortgage, rent, property insurance, taxes and upkeep. Housing costs may be reduced by living in a more moderate climate. Expenses of housing could change if you have less space and less yard. Being closer to business centers can save on transportation, over your present cost.

Utilities: gas, electricity, water. See housing.

Household costs: laundry, supplies, equipment, replacement, and repairs.

Food: Eating habits may change, but probably the biggest change will be in cost of lunches if lunch was eaten "out" before retirement. On the other hand, more meals may be eaten out as a form of recreation.

Clothing: Clothing expenditures usually are less after retirement. A smaller wardrobe, less expensive type of clothes, longer wear and less use that reduces upkeep all help reduce cleaning expenditures.

Insurance - Life: Your life insurance program should receive a thorough evaluation before retirement. You may wish to keep some coverage in effect. You also may wish to stop paying premiums in order to have more money for other expenditures. For policies that have accumulated cash value you can use the cash value to pay up for life (at a reduced amount of coverage), take cash, invest it to provide income through interest or dividends, or purchase an annuity to guarantee income for a specific number of years.

(See section on life insurance, LETTER 3)

Insurance - Health: Will your health insurance coverage through your job continue after retirement? How much will it cost? Will you need to purchase an individual policy? Be sure to buy adequate coverage, as medical expenses generally increase with age. Medical care is one expense that most often increases as we approach retirement age.

Recreation: While recreation expenditures are quite flexible, it is important to be able financially to pursue your interests.

Gifts: The amount one spends on gifts is flexible. Using more time to make gifts and shop carefully can reduce this expenditure.

Church and Charity: Your financial contributions may need to be reduced, but you may want to contribute more time & talents that help organizations stretch money. You will still have the satisfaction of having contributed.

Working expenses: Of course working expenses will drop to zero, unless you take another job. They are listed in the plan to emphasize that people can live on less income during retirement without reducing your level of living. In listing expenses for food, clothing, transportation, gifts, etc. there will be some overlap with job expenses. Don't deduct the same expense under both listings.

Personal items: Coffee breaks, cigarettes, haircuts, cosmetics, etc. Some of these expenditures will be different after retirement.

Income taxes: Use your last income return to figure how your tax would have been different had you been retired. Figure both income and deductions. However, tax laws seem to change each year.

Savings: Normally there is no need to save any longer, after retirement. This is the time to reap the benefits of your previous savings. This is one of the most difficult changes for most people to accept in their financial habits.

Debts: It is not necessarily true that we should try to reach retirement debt free. It may be a goal you wish to attain. Should you toy with the idea of paying off a mortgage be sure to compare the rate of interest your mortgage carries with the rate of interest your money could earn in an investment. Why pay off a 20-year mortgage with dollars that have lost value since you borrowed them. Why pay off a 6½ percent mortgage with money that can be in certificates of deposit that return 7½%. Other investments could produce an even higher return.

Next, compare the amount of income with the amount of expenditures you expect to have. I expect my income to be $___________. My expenditures will probably be $___________.

If income is more--great retirement!

If income is less, how can you re-arrange your resources to increase income? Don't over-look any asset. If there still isn't enough income, what can you do to earn some income during retirement? Or, you may wish to reduce expenditures rather than increase income. You may be better able to make some of these decisions as you read additional issues in this series and do further study on your own.

You may even give retirement income a trial run. Some people have gone so far as to "practice retirement." They reported that the last year before retirement they lived on the amount of income they would have in retirement. The experiment not only tested how they could live on this amount, when retirement came they had one less adjustment to make.

Good Management for Now and for Retirement

There are some "tools" for managing living expenses that have been successful for many people. You may wish to give these a chance to work for you. They work just as well now as they will in retirement and they may help to reach that financial retirement goal easier.

Tool #1 Emergency Fund - a must -

We all have unexpected expenses. The common ones are such expenses as car repair, appliance repairs, regular medical expenses, maybe a trip, etc. In our mobile society, often there are emergency trips because of illness or death of relatives. Too, there are good emergencies as an unexpected opportunity to go to Hawaii!

What amount would be an emergency so big that you couldn't handle it from current pay check? For some this may be $10.00, for others it may be $100.00. What kind of emergencies do you need to be prepared to pay? Decide on the types of emergencies that you need to cover and the amount of money you need in an emergency fund. When you have decided on the amount, then decide how much you will put into that fund each pay day. Of course, you probably will have emergencies before you reach your goal. This fund is then used to pay as much as you have saved at the time of the emergency. Even though there may not be enough money to pay all the costs you are further ahead than if you had not saved anything.

After you reach your emergency fund goal, why not use the emergency fund payment the next pay day for something special. You need to reward yourself for being successful.

Tool #2 A Revolving Fund

A revolving fund is great for simplifying money matters. Its purpose is to have money available when those big irregular bills come due throughout the year. The more common bills of this type are property taxes, car and property insurance and quarterly or annual life insurance premiums. Some families may wish to decide on a specific amount for Christmas and vacation, to be included. Put a monthly amount in the fund for these expenditures. Other expenses such as car licenses or school clothes could be included if it is a real struggle to pay these.

List all of the items to be included in this fund and the amount of money added for each one. Add the amounts to get the total for the year. Divide this total by 12, or the number of pay days you have. Each pay day, put back this amount. This is a very good way to get rid of all anxiety of having the money to pay the taxes, or insurance or whatever. One person who does this has it deducted from the pay check and never thinks about it until the tax and insurance bills come. Then he breathes a sigh of relief. The money is ready. Another advantage of this system allows us to buy extras without jeopardizing funds for necessary bills. The month before a big bill is due you may find that you have a few extra dollars left over from your pay check. You can afford to splurge for something special because the money "is in the bank" for those big expenses coming up.

Both of the emergency and the revolving funds can be kept in credit union shares or pass book savings. Interest is paid on the money and it is available quickly when it is needed. The easiest way to save these monies is through payroll deduction to a credit union. Or, most banks will automatically draw the amount you indicate from your checking account and put it into a savings account. Both of these funds could be in one account and notes written on the passbook as to the amount in each fund.

Summary

How well will your retirement income measure up to your retirement living costs? To answer this question, determine the amount of retirement income and the expected living expenses. The best basis for planning living expenses is a written record of present expenditures. This record can be used to analyze the expenses that will change after retirement. A methodical system for handling common emergencies and the big irregular bills eases many financial pressures. If income is not adequate how can you increase income or reduce living expenses? Begin examining your own situation and look for some possible answers in the next letter.

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