Missed it by That Much

By: Robert Margetic

Many of us watched Maxwell Smart in the *Get Smart* television series. Among his antics he would repel through a doorway or to the top of a nearby building. Inevitably, he would crash into the door jam or hit the side of the building and would comment, holding his thumb and forefinger about an inch apart, he missed it by that much.

Similar things can happen in our retirement plan when we over or under estimate how much it costs for us to live each month. We build our plan around our monthly income estimate. We feel a sense of accomplishment and security with this critical element decided and our plan in place. But, what if this number is wrong? What if we need more money than we estimated?

There are two critical parts to our income estimate; the base level, what we are spending today, and the projected level what we will spend in the future.

BASE LEVEL

A number of surveys conducted by the financial services industry show fifty-five percent of people fear running out of money in retirement. Additionally, seventy-five percent feel they are not adequately prepared for twenty to thirty years in retirement. We never placate these fears if we do not know how much money we need to maintain our lifestyle.

Quick, how much money do you need to live on? Does this figure include federal and state income taxes, annual home and car insurance or property taxes? Does it include gifts and donations? If we do not start with the right number, our retirement plan becomes like a road map to Toledo when we want to go to Phoenix.

Many of us resist tallying what we spend for a variety of reasons. But, if we are to rid ourselves of the fear gnomes, we must be brave enough to confront our spending habits. We may find out our actual expenses may be higher than we thought. If we underestimate our expenses by $300 per month this could leave us short over $100,000 by the time we are in our eighties. We just slammed into the door jam.

PROJECTED LEVEL

The projected level comes in two parts: changes to our base level and inflation. What we spend while we work will be different than what we spend once retired. To adjust our base level we need to figure out our work related expenses like social gatherings, clothes, education, tools and equipment to subtract from our base level. Then we add the new things we will be doing like traveling, hobbies and leisure activities. This becomes our new base level.

However, we cannot simply project from this new base level as our expenditure level for the rest of our retirement. For example, we may have included skiing expenses as our die hard activity. While we may be avid skiers in our sixties, we may not be able to buckle our ski boots in our eighties. At some point the ski expenses must be reduced or eliminated from our projected expenses.

Next, many of us misapply an inflation estimate. We simply take some number, like 3%, and apply it to all of our expenses to get an idea of how much it will cost us to live in the future. But, what if we have a fixed mortgage? We cannot apply an inflation rate to this. What if our largest expense is health care? Health care costs have increased at a much faster rate than 3%.

In the first example we overestimated our expenses and the second we underestimated them. If we overestimate our expenses we think we cannot afford to achieve our dreams. If we underestimate them we face the loss of dignity as we lower our lifestyle. Now we missed the roof and slammed into the building.

To prepare for the future we need to understand where we are today and to imagine likely outcomes. This lets us know what we need to do to complete our plan. To better capture our current expenses we can keep a journal for a month or so to see where we spend money. We can go through last year's bank and credit card statements to see how much was spent. This brings a reality test to the living expense number we keep in our head.

As we project our expenses into the future it is helpful to think of how we are likely to spend money using age bands. We can imagine the things we will do in our sixties and estimate how much they will cost. Next, determine how our activities will change when we are in our seventies and our eighties. If we change our activities we change our spending.

A realistic expense level launches our retirement plan. The success of our leap into retirement is highly dependent on where we start. If we start from the right spot we will repel through door openings and clear building ledges to land on the roof. We made it by that much.

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