SPENDING MATTERS

BY SAM MARTIN, MBA (TAX), CFP®, CPA

Imagine my reaction, a backwater Registered Investment Advisor, recently coming across this headline in a financial magazine, "Major brokerage firm executive discovers retirement income success is determined more by retirement spending than return on investments[1]." Wow, that is what we refer to in our office as a BFO, a "Blinding Flash of the Obvious." Who would have thought controlling spending to a predetermined amount could be the key to our long-term retirement success? Yikes!

ADAMANT ABOUT PLANNING

For those of you who read this column in *Catalyst*, you know I am adamant about planning and typically, most of my emphasis is on becoming a better saver. No matter how good we become at saving, it will not make up for bad spending practices; particularly in retirement.

WHAT PLANNING CAN DO

Let's look at what planning can do for us. It can:

1. Help get our most important goals and concerns in writing, a step that all by itself, can start a positive chain reaction.
2. Bring spouses into alignment, if not immediately, over time.
3. Help us develop steps, if followed, greatly enhance the likelihood for long-term financial success.
4. Bring discipline to current and future spending and saving.
5. Make us much better savers.

GOOD PLANNING BREATHES

Planning isn't just the plan. Good planning lives and breathes. Systematic monitoring, follow-up, and discussion are also keys to long-term success. The monitoring process helps to get you into shape and keeps you on the straight and narrow. It leads to being ready for retirement. The monitoring process also helps give us confidence in the retirement income or cash flow plan we've developed.

KNOW WHAT YOU SPEND NOW

The first step in preparing a retirement income plan—is to know how much you spend now. It helps to use an online tool or software such as Quicken, but it can also be accomplished manually by capturing three months of your credit card spending and checking account and then adding in expenses that are paid less frequently—such as semi-annual or annual expenses. In particular, identify those items that won't (or shouldn't) be there in retirement:

1. Mortgage
2. Children's education
3. Other debts
4. Certain types of insurance—disability, overhead, life (in some cases)
5. Other work-related expenses—perhaps professional wardrobe and commuting
6. Savings and investing
7. Income and FICA taxes[2]

Most of our clients are shocked to realize how little they actually live on! By the time you deduct the items above, it is clear most mid-career dentists' lifestyles are probably a quarter of what their tax return might otherwise suggest.

TRANSLATING CURRENT INCOME TO RETIREMENT INCOME

Once you isolate your current "real" income, it reveals a comfortable retirement income estimate. Of course, additional things will be added, travel is a common example—as is recreation, and perhaps dining out. For some, slight adjustments may be the answer, estimating a similar standard of living for retirement—to what they are currently used to. For others, there may be more work to develop the retirement spending plan.

PLAN TO SPEND MORE THE FIRST TEN YEARS

A common approach is to model the first 10 years of retirement at a slightly higher level of spending than presumed, and estimating the balance of retirement - at a lower level. Studies have shown, when the average retirement is broken into three periods, the first tends to be at the highest spending level; the second, at the lowest level; and the final, at the second highest spending level. Increased primarily by health care costs.

BENEFITS OF WORKING PART-TIME

Once the desired retirement spending goal is determined, we work backward to identify how much additional saving will be required between now and your desired retirement age, to achieve that income goal. We can then work together toward that goal. There are many alternatives to consider in this process. For example, I find more and more clients expect and plan to continue working part-time for a period of years. This can be very beneficial financially and emotionally; even though retirement is no longer being funded, it also prevents retirement assets from being tapped.

PRACTICE ANTICIPATED LEVEL OF RETIREMENT SPENDING

As you get closer to retirement, you should begin "practicing" this level of spending and monitoring your results. How well will this work for you? You need to conclude it will work well for you. If you overspend what is feasible to spend, the latter years of your retirement could be quite difficult financially.

SET YOURSELF UP FOR SUCCESS

Putting goals in writing and establishing a plan that includes a predetermined level of retirement spending you are confident with will go a long way toward setting yourself up for a financially successful retirement. Practicing and monitoring spending, particularly as retirement approaches, can be extremely valuable and provides the confidence to live comfortably—and enjoy life.

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[1] This is a paraphrase of the original quote.

[2] Income tax does not go to zero in retirement (although it may for certain dentists in certain years); however, income tax for most dentists will be substantially less than during their careers. For retirement income planning purposes, we use an inflation adjusted "after tax" annual/monthly spending plan—so our clients do not need to plan for income taxes out of their monthly spending, which helps keep life simpler.