



How Much is Enough?

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How much income is enough? Will it last? Will you be okay? How do you know?

A challenging question for people entering retirement is determining how much income is necessary to last a lifetime. You don't want to run out of money at 83 if you're going to live to age 93.

I'm often asked, "How much income will I need?" and "How long will it last?" At a minimum, you'll need enough income to cover your annual expenses. The amount of income required is driven, in large part, by how much money you spend.

Your annual expenses probably won't change much in retirement. The dollar amount may stay the same, but the categories will differ. For example, rather than spending money on college tuition, you'll spend it on travel.

Do you need a budget?

A budget is necessary for a successful retirement, and the best way to budget for retirement is to review your past spending patterns. What financial footprints have you left behind? A deep dive into your past will help guide your future expenses. Identifying how you've spent your money will make it easier to adjust your retirement spending. After your review, can you reduce or eliminate any expenses?

I recommend increasing your budget by 5% or 10% to give yourself some wiggle room before retiring due to unexpected expenses. As you get closer to retirement, reviewing your budget quarterly makes sense so you can adjust or modify it as needed. It's common to see a spike in spending before retirement because of several factors, like buying a new car or remodeling your home, so don't be surprised by the increase.

In retirement, housing can account for most of your annual expenses. According to the Consumer Expenditure Survey,¹ housing accounted for 32% of a person's budget for those 65 and older. Transportation came in second at 15.6%, healthcare was third at 12.5%, and food items were fourth at 11.9%. Housing is a considerable expense in retirement, even if you don't have a mortgage. Utilities, property taxes, and repairs are ongoing expenses that can disrupt your budget.

A quick calculation.

Let's revisit the original question, "How much money is enough?" If your annual expenses are \$100,000, you may need \$2,500,000 in assets. How did I arrive at \$2,500,000? The magic

¹ <http://www.bls.gov/cex/22015/midyear/age.pdf>

number is 4%. To get \$2,500,000, divide your expenses by 4% (\$100,000 divided by 4% = \$2,500,000). You can multiply \$100,000 by 25, the inverse of 4%, to get the same result. Why 4%? A former Registered Investment Advisor, Bill Bengen,² created the 4% rule. I won't go into his analysis, but he calculated that you shouldn't run out of money if you withdraw 4% of your assets yearly.

Let's look at a few examples. Again, assume your annual expenses are \$100,000. At \$100,000, you'll need an investment portfolio of \$2,500,000, earning 4% (\$2,500,000 x 4% = \$100,000). This calculation assumes you only spend income and not principal.

Adding Social Security lowers the amount of assets needed in retirement. If your Social Security income is \$30,000, deduct it from \$100,000 to get \$70,000. Applying the 4% rule to \$70,000 gives us \$1,750,000 (\$70,000 divided by 4%).

If you receive a pension, the income required from your investment portfolio falls further. Let's say your annual pension is \$20,000, which reduces your income to \$50,000 after subtracting Social Security and your pension benefit (\$100,000 - \$30,000 - \$20,000 = \$50,000). The assets needed are \$1,250,000 (\$50,000 divided by 4%).

As you can see, the more passive income you receive, the fewer assets you need. We started with no passive income, requiring assets of \$2,500,000, and after subtracting Social Security and a pension payment, it lowered your asset level to \$1,250,000, a 50% reduction.

The three-minute financial plan calculates the amount of assets needed for retirement. You can compare it to your current level of assets to see if you have enough money to retire. If you have enough assets to cover your expenses, you can retire anytime - on your terms.

Will it last?

How long will your money last? If you're withdrawing less than your accounts earn, you should never run out of money. An account earning 5%, withdrawing 4%, will grow at 1%.

However, if you withdraw more money than your account generates, you run the risk of running out of money. For example, if you retire with \$1,000,000 and withdraw 10% a year or \$100,000 from an account earning 5%, your retirement nest egg will only last 15 years.

I've included a table to help you calculate the level of assets needed to cover your expenses. A 40-year-old who spends \$50,000 will need \$2.3 million at retirement. An inflation rate of 2.5% will increase the yearly spending from \$50,000 to \$92,697 at age 65. If we apply the 4% rule to the inflation-adjusted expense number (divide by 4% or multiply by 25), we get \$2.3 million (\$92,697 x 25).

² <http://www.retailinvestor.org/pdf/Bengen1.pdf>

Use the inflation factor nearest your age to calculate your future expenses. Once you have this number, multiply it by 25 to give you the asset level needed in retirement.

Age (A)	Inflation Factor (B)	Expenses Today (C)	Future Value Calculation (B x C = D)	Multiple (E)	Assets Needed (D x E)
40	1.85	\$50,000	\$92,500	25	\$2,312,500
45	1.64			25	
50	1.45			25	
55	1.28			25	
60	1.13			25	
65	1			25	

How much is enough, and how long will it last? You can answer these questions with a few calculator or Excel spreadsheet inputs. Once you know the answer to these questions, you can adjust accordingly. The three-minute financial plan is your quick guide to getting your retirement on track.

Next Steps.

If you want to learn more about your financial future, please email bill@parrottwealth.com.

Our financial plan includes reviewing your investments, risk tolerance, fees, budget, goals, estate plan, insurance, Social Security, debt, and more.

Happy Retirement!

Sincerely,

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Note: Investments are not guaranteed and do involve risk. Your returns may differ from those posted in this blog.