Do You Plan to Retire?

# Key Issues to Consider

Retirement is a time to relax and enjoy life. Unfortunately, not all of us will be assured a plush retirement home, lots of free time, and world travel. Here are some important things you should know:

- Start saving for retirement early. If you hope to have a comfortable retirement, starting now can help to ensure that you will likely save enough for retirement. Retirement is approaching more quickly than you realize, so it is important to plan and save for retirement to have the quality of life you want to maintain. The younger you are when you begin to save for retirement, the less money you will have to save each month over the course of your lifetime! Also, your investments will have more time to grow.
- Make a plan. Knowing that you have prepared for retirement can ease some of your fears and give you a clearer picture of your future. The earlier you begin to plan, the sooner you will reach your retirement savings goal. If you have not started to plan yet, keep in mind that you are never too old to invest in your future, so start now.
- Know how you will achieve your goals. Retirement planning allows you to identify and establish your retirement goals and create a plan to achieve your goals.

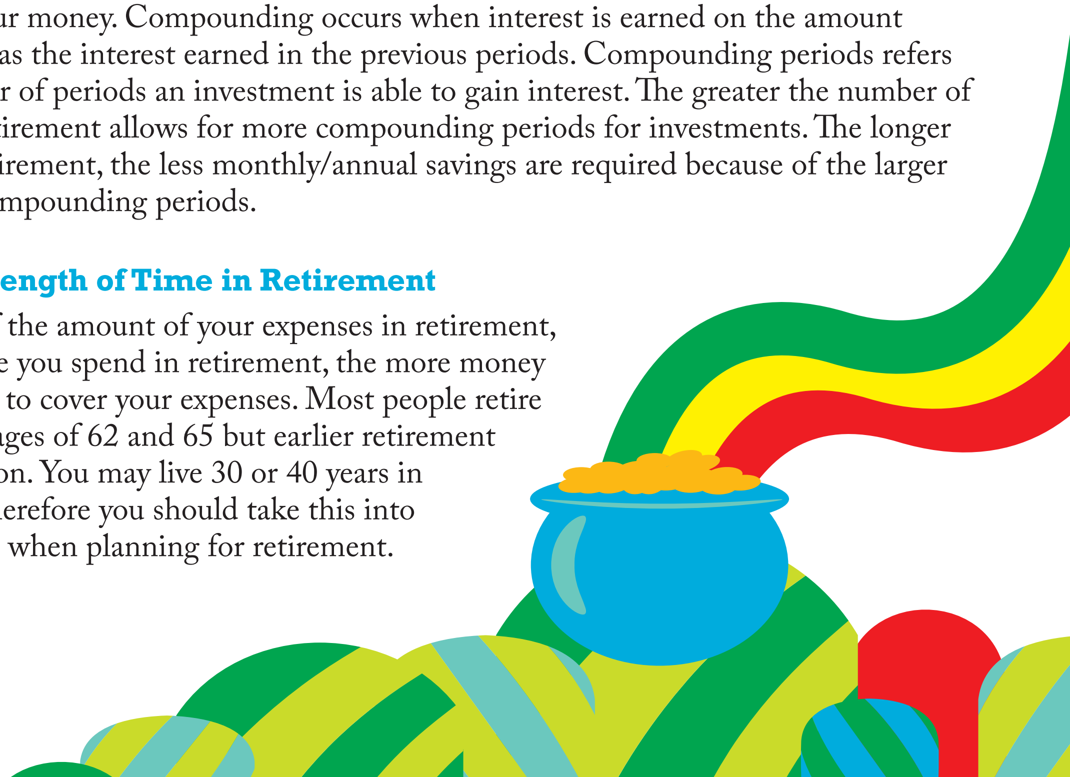
## Factors Affecting the Amount of Income Needed in Retirement

### Length of Time until Retirement

The amount of time you have left until retirement directly affects the amount of interest earned on your money. Compounding occurs when interest is earned on the amount saved as well as the interest earned in the previous periods. Compounding periods refers to the number of periods an investment is able to gain interest. The greater the number of years until retirement allows for more compounding periods for investments. The longer time until retirement, the less monthly/annual savings are required because of the larger number of compounding periods.

### Expected Length of Time in Retirement

Regardless of the amount of your expenses in retirement, the more time you spend in retirement, the more money you will need to cover your expenses. Most people retire between the ages of 62 and 65 but earlier retirement is also common. You may live 30 or 40 years in retirement, therefore you should take this into consideration when planning for retirement.



### Amount of Current Savings

The larger the amounts of current savings, the less future savings are required. If you opened a bank account today with the minimum deposit of $500, it would take longer to reach $2,000 than if your initial deposit was $750. Your retirement savings are similar; the more money you have saved already, the less you will have to save in the future.

### Annual Living Expenses

It is important to predict the future costs associated with retirement. During retirement, your lifestyle will change. The amount of money you spend during your working years may be vastly different than the amount you will spend in retirement. Most retirement income projections state that individuals will spend about 70 to 80 percent of their current income once they stop working, but these projections are only a starting point. Many people want a better lifestyle in retirement than they had during their working years which will require more than the average suggestions for savings. Some expenses may increase while others may decrease or stay the same. For example, you may not have the necessary business expenses like dry-cleaning or purchasing professional attire. Your medical costs are likely to increase with age. With more free time, you may spend more money on travel.

### Investment Returns

The returns on investments affect retirement planning. One of the main ways to determine how much you will save for retirement is the level of risk involved in your investments. Your retirement savings will grow very slowly if you choose to place it in a regular savings account or money market account or fund. If you have a low risk tolerance, you might choose more low-risk investments than high-risk investments. Low risk investments tend to have fewer earnings over time than high-risk investments. Therefore, the amount of risk you are willing to take directly impacts your retirement savings, but it is important to note that returns are not guaranteed on any investments and all investments have some type of risk. Earning low rates of return on your investments will require you to save more to reach your retirement goals and/or save for a longer period of time before retirement.

### Inflation

Over time the price of food, clothes, and entertainment has risen steadily; this effect is referred to as inflation. Inflation is the increase in prices of goods and services. Inflation is important to consider in retirement planning because inflation decreases the purchasing power of money. An increase in the price of products and services will have an impact on how far your retirement savings will stretch, and as a result, how much you should be saving for retirement. Historically, inflation has averaged around 3 percent. To compare the purchasing power of the dollar for different years, the Bureau of Labor Statistics' web site has an inflation calculator that allows you to compare the value of a dollar today to the past up to 1913. The web address is http://www.bls.gov/data/inflation_calculator.htm.

## Sources of Retirement Income

Retirement income can come from a variety of sources. One source you may have access to is an employer-sponsored retirement plan at work. It is also good idea to save additional money outside of your employer-sponsored plans at work. Social Security retirement benefits are another source of income, as well as income from employment after retirement.

### Employer-Sponsored Retirement Plans

Not all employers offer a retirement plan, but if your employer offers one, you can benefit greatly by participating in the plan. These plans allow you to save for retirement with pre-tax dollars (money is deducted from your paycheck before it is taxed). In many cases, the employer also contributes to the plan for you. Employer-sponsored retirement plans are usually a part of employees' benefit packages, but are often an overlooked savings tool. It's important to take advantage of these retirement savings vehicles. This source of income is a significant source of income during retirement. These plans are either defined benefit or defined contribution plans. See the section on Retirement Plans below for more information.

### Personal Savings

While employer-sponsored retirement plans are an important way to start saving for retirement, your own personal savings will probably fund a large portion of your retirement as well. Personal savings include money held in regular and retirement accounts outside your place of employment. Money in savings accounts, money market accounts or funds, stocks, bonds, and mutual funds are sources for your personal savings. Individual retirement accounts (IRAs), both traditional and Roth (after-tax), are non-employer sponsored accounts that offer tax advantages when saving for retirement.

### Social Security Retirement Benefits

Social Security retirement benefits will not replace your pre-retirement income. However, it is the largest source of retirement income for many Americans. Deciding when to take Social Security benefits is an important decision. If you qualify for Social Security retirement benefits, you can claim them as early as age 62. If you choose to receive benefits early (before your full retirement age), your benefit amount will be lower than the benefit amount you would receive at full retirement age. The annual reduction in Social Security benefits for early retirement decreases as you get closer to your full retirement age. Full Social Security benefits can be claimed when you reach your full retirement age. Your full retirement age is based on the year of your birth. You can find information at http://www.ssa.gov.

### Continued Employment

Some people love their careers and continue to work part-time after they retire, but some retirees have to work in retirement because their retirement savings are not enough to cover their living expenses. If you continue to work after you have officially retired, your Social Security benefits may be reduced if your earnings exceed a certain limit.

## Retirement Plans

In the past, many employers offered defined benefit pension plans to their employees. Over the past few decades, employers have shifted to offering defined contribution plans to employees. With this shift, it is more important than ever to save for retirement.

*Defined benefit plans* are employer-sponsored retirement plans that provide a guaranteed monthly benefit in retirement. The monthly benefit is not determined by the contributions and investment earnings, but a formula used by the employer to calculate the benefit. *Defined contribution plans* don't promise a guaranteed monthly benefit. The benefit in retirement is based on the amount of money contributed to the plan and the investment earnings. There are several types of defined contribution plans. The characteristics of these plans can vary slightly across employers. These plans include 401(k) plans, profit sharing plans, stock bonus plans, 403(b) plans, and 457 plans. Individual retirement accounts (IRAs) are not associated with an individual employer; these are personal investment accounts that allow you to save a certain amount each year for retirement.

## Amount of Money Needed in Retirement

Currently, most retirement accounts offer tax advantages that make them attractive choices for your savings goals. Now you are probably wondering how much money you will need to meet your *retirement* savings goals. There are several ways to find the amount of money you will need each year in retirement. One method is the wage replacement ratio. This ratio is the percent of your current annual income you will need to live on in retirement. It is suggested that most people need between 70 to 80 percent of their current annual income to live comfortably in retirement. However, this will depend on your future expected expenses. It is a good idea to estimate your annual expenses by creating a retirement budget. Once you have decided how much you need annually in retirement, then time value of money calculations can be used to determine how much you need to save on a regular basis to reach your retirement savings goals.

Now that you know some of the basics, here's how to get started building your savings. Estimate the amount of money you will need in retirement. Set goals that will help you get in the habit of saving. If you are not doing so already, begin saving in your employer's retirement plan, especially if the employer contributes to the plan on your behalf. You may also want to open either a traditional or a Roth IRA. Workers that are closer to retirement (age 50 and over) are allowed to put more into tax-advantaged retirement accounts. If you are having difficulty finding the money to save in a retirement account, consider using some of your tax refund. IRAs can be opened at any major bank or investment firm. When the time comes for you to retire, you will be glad you took the extra time to consider all of your retirement savings options. Today's sacrifice will become your retirement benefit.

## Sources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