

# Should You Plan to Retire on 80% of Your Income?

*Examining a long-held retirement planning assumption.*

Provided by Hatcher Financial, P.C.

A classic retirement planning rule states that you should retire on 80% of the income you earned in your last year of work. Is this old axiom still true, or does it need reconsidering?

Some new research suggests that retirees may not need that much annual income to keep up their standard of living.

**The 80% rule is really just a guideline.** It refers to 80% of a retiree's final yearly gross income, rather than his or her net pay. The difference between gross income and wages after withholdings and taxes is significant to say the least.<sup>1</sup>

The major financial challenge for the new retiree is how to replace his or her paycheck, not his or her gross income.

So concluded Texas Tech University professor Michael Finke, who analyzed the 80% rule last year and published his conclusions in *Research*, a magazine for financial services industry professionals. Finke noted four factors that the 80% rule does not recognize. One, retirees no longer need to direct part of their incomes into retirement accounts. Two, they no longer involuntarily contribute to Social Security and Medicare, as they did while working. Three, most retirees do not have a daily commute, nor the daily expenses that accompany it. Four, people often retire into a lower income tax bracket.<sup>1</sup>

Given all these factors, Finke concluded that the typical retiree could probably sustain their lifestyle with no more than 77% of an end salary, or 60% of his or her average annual lifetime income.<sup>1</sup>

**Retirees need to determine the expenses that will diminish in retirement.** That determination, rather than a simple rule of thumb, will help them realize the level of income they need.

Imagine two 60-year-old workers, both earning identical salaries at the same firm. One currently directs 25% of her pay into a workplace retirement plan. The other directs just 5% of her pay into that plan. The worker deferring 25% of her salary into retirement savings needs to replace a lower percentage of their pay in retirement than the worker deferring only 5% of hers. Relatively speaking, the more avid retirement saver is already used to living on less.

**New retirees may not necessarily find themselves living on less.** The retirement experience differs for everyone, and so does retiree personal spending.

As a recent Employee Benefit Research Institute study noted, household spending typically declines 6% in the first two years of retirement, with additional declines thereafter. This is not the story for all retirees; EBRI also found that almost 46% of retiree households *increased* their spending in the initial two years of retirement. On the other side of the scale, nearly 40% of the retiree households EBRI studied saw their expenses fall by at least 20% within two years of retiring.<sup>2</sup>

**A timeline of typical retiree spending resembles a “smile.”** A 2013 study from investment research firm Morningstar noted that a retiree household’s inflation-adjusted spending usually dips at the start of retirement, bottoms out in the middle of the retirement experience, and then increases toward the very end.<sup>2</sup>

**A retirement budget is a very good idea.** There will be some out-of-budget costs, of course, ranging from the pleasant to the unpleasant. Those financial exceptions aside, abiding by a monthly budget (with or without the use of free online tools) may help you to rein in any questionable spending.

**Any retirement income strategy should be personalized.** Your own strategy should be based on an accurate, detailed assessment of your income needs and your available income resources. That information will help you discern just how much income you will need when retired.

«representativename» may be reached at «representativephone» or «representativeemail».  
«representativewebsite»

This material was prepared by MarketingPro, Inc., and does not necessarily represent the views of the presenting party, nor their affiliates. This information has been derived from sources believed to be accurate. Please note - investing involves risk, and past performance is no guarantee of future results. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional. This information should not be construed as investment, tax or legal advice and may not be relied on for the purpose of avoiding any Federal tax penalty. This is neither a solicitation nor recommendation to purchase or sell any investment or insurance product or service, and should not be relied upon as such. All indices are unmanaged and are not illustrative of any particular investment.

**Citations.**

- 1 - [marketwatch.com/story/you-may-need-less-retirement-income-than-you-think-2015-11-30](http://marketwatch.com/story/you-may-need-less-retirement-income-than-you-think-2015-11-30) [12/24/15]
- 2 - [money.cnn.com/2015/12/02/retirement/retirement-income/](http://money.cnn.com/2015/12/02/retirement/retirement-income/) [12/2/15]