

How Do You Know When You Have Enough to Retire?

There is no simple answer, but consider some factors.

You save for retirement with the expectation that at some point, you will have enough savings to walk confidently away from the office and into the next phase of life. So how do you know if you have reached that point?

Retirement calculators are useful – but only to a point. The dilemma is that they can't predict your retirement lifestyle. You may retire on 65% of your end salary only to find that you really need 90% of your end salary to do the things you would like to do.

That said, once you estimate your income need you can get more specific thanks to some simple calculations.

Let's say you are 10 years from your envisioned retirement date and your current income is \$70,000. You presume that you can retire on 65% of that, which is \$45,500 – but leaving things at \$45,500 is too simple, because we need to factor in inflation. You won't need \$45,500; you will need its inflation-adjusted equivalent. Turning to a Bankrate.com calculator, we plug that \$45,500 in as the base amount along with 3% annual interest compounded (i.e., moderate inflation) over 10 years ... and we get \$61,148.¹

Now we start to look at where this \$61,148 might come from. How much of it will come from Social Security? If you haven't saved one of those mailers that projects your expected retirement benefits if you retire at 62, 66, or 70, you can find that out via the Social Security website. On the safe side, you may want to estimate your Social Security benefits as slightly lower than projected – after all, they could someday be reduced given the long-run challenges Social Security faces. If you are in line for pension income, we will work with you and your employer's HR people to get an estimate of what your annual pension payments could be.

Let's say Social Security + pension = \$25,000. If you anticipate no other regular income sources in retirement, this means you need investment and savings accounts large enough to generate \$36,148 a year for you if you go by the 4% rule (i.e., you draw down your investment principal by 4% annually). This means you need to amass \$903,700 in portfolio and savings assets.

Of course, there are many other variables to consider – your need or want to live on more or less than 4%, a gradual inflation adjustment to the 4% initial withdrawal rate, Social Security COLAs, varying annual portfolio returns and inflation rates, and so forth. Calculations can't foretell everything.

The same can be said for "retirement studies". For example, Aon Hewitt now projects that the average "full-career" employee at a large company needs to have 15.9 times their salary saved up at age 65 in addition to Social Security income to sustain their standard of living into

retirement. It also notes that the average long-term employee contributing consistently to an employer-sponsored retirement plan will accumulate retirement resources of 8.8 times their salary by age 65. That's a big gap, but Aon Hewitt doesn't factor in resources like IRAs, savings accounts, investment portfolios, home equity, rental payments and other retirement assets or income sources.²

For the record, the latest Fidelity estimate shows the average 401(k) balance amassed by a worker 55 or older at \$150,300; the Employee Benefit Research Institute just released a report showing that the average IRA owner has an aggregate IRA balance of \$87,668.²

Retiring later might make a substantial difference. If you retire at 70 rather than at 65, you are giving presumably significant retirement savings that may have compounded for decades five additional years of compounding and growth. That could be huge. Think of what that could do for you if your retirement nest egg is well into six figures. You will also have five fewer years of retirement to fund and five more years to tap employer health insurance. If your health, occupation, or employer let you work longer, why not try it? If you are married or in a relationship, your spouse's retirement savings and salary can also help.

Can anyone save too much for retirement? The short answer is "no", but occasionally you notice some "good savers" or "millionaires next door" who keep working even though they have accumulated enough of a nest egg to retire. Sometimes executives make a "golden handshake" with a company and can't fathom walking away from an opportunity to greatly boost their retirement savings. Other savers fall into a "just one more year" mindset – they dislike their jobs, but the boredom is comforting and familiar to them in ways that retirement is not. They can't live forever; do they really want to work forever, especially in a high-pressure or stultifying job? That choice might harm their health or worldview and make their futures less rewarding.

So how close are you to retiring? A chat with a financial professional on this topic might be very illuminating. In discussing your current retirement potential, an answer to that question may start to emerge.

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Citations.

1 - bankrate.com/calculators/savings/simple-savings-calculator.aspx [5/30/13]

2 - marketwatch.com/story/how-to-know-if-you-have-enough-to-retire-2013-05-25 [5/25/13]