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Thinking About Spending in Retirement: Findings From SOA and EBRI Research

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The Society of Actuaries (SOA) has been studying the management and understanding of post-retirement risk for more than 15 years. These studies have consistently found that a key method of risk management used by retirees is managing their expenses. The Employee Benefit Research Institute (EBRI) has analyzed household spending by older Americans using data from the Health and Retirement Study (HRS) and the Consumption and Activities Mail Survey (CAMS). This article includes some highlights from the EBRI published reports linked to some of the findings from the SOA research.

The SOA research consists of eight biennial surveys of the U.S. public about post-retirement risk and several sets of focus groups. The 2015 SOA focus groups interviewed middle-income individuals in the United States and Canada who had been retired for at least 15 years.

OVERALL SPENDING

The SOA surveys and focus groups consistently have shown "reducing spending" as the primary risk management strategy. The 2015 focus groups indicated a willingness to reduce spending and discussion of moving from spending on "wants" to focusing on "needs." Those surveyed expressed pride about frugality. The EBRI reports provide insight into types of spending by age and how spending changes by age, but they did not deal with shocks and unexpected expenses. Note that the SOA research tells us what people say they expect and how they describe what they do.[1] The EBRI research, on the other hand, looks at data and tells us what people have actually done as reported in the HRS.

Several EBRI reports provide different view on overall spending. Issue Brief 368, February 2012[2]—**Expenditure Patterns of Older Americans, 2001–2009,** EBRI Notes, September 2014[3]—**How Does Household Expenditure Change with Age for Older Americans?** and Issue Brief 420, November 2015[4]—**Changes in Household Spending After Retirement.**
Additional research focuses on Health Care Spending and Utilization: Issue Brief 411, February 2015[5]—**Utilization Patterns and Out-of-Pocket Expenses for Different Health Care Services Among American Retirees.**

KEY CONCLUSIONS FROM THE EBRI RESEARCH INCLUDE:

- Household spending drops after retirement by age within retired cohorts.
- Housing is the largest area of expenditure by far.
- Health care is the one area of spending that does not decrease by age; mean spending increases both as a dollar amount and a percentage of total. Recurring health care costs—doctor and dentist visits and prescription drugs—remain stable throughout retirement. Non-recurring health services—nursing home stays, home health care usage and overnight hospital stays—increase with age and are much higher in the period before death. The percentage of total spending devoted to health care increases by age group.[6]
- Not surprisingly, spending on transportation, entertainment and clothing decreases more rapidly by age group than housing and food expenses.
- Some categories show a lot more variability than others.

Table 1
Mean and Median Household Spending in 2011 Adjusted to 2013$ by Age Group

	Age 65-74		Age 75-84		Age 85+	
	Mean	Median	Mean	Median	Mean	Median
Home	$18,720	$12,642	$14,732	$10,805	$13,111	$8,781
Food	4,526	3,982	3,994	3,228	2,520	2,152
Health	4,383	3,104	4,624	3,109	6,603	2,814
Transport.	5,169	4,025	3,666	2,794	1,972	1,241
Clothing	1,311	724	950	569	888	434
Entertain.	4,300	2,380	3,277	1,655	1,609	714
Other	3,583	1,148	3,565	1,034	3,188	734
Total	$42,805	$34,036	$35,315	$29,884	$30,610	$22,263

Source: Figure 2 from EBRI Notes, September 2014—**How Does Household Expenditure Change with Age for Older Americans?**

HOW DOES SPENDING CHANGE AT RETIREMENT?

The 2015 SOA survey explored expectations and experiences with regard to spending. Personal choices, shocks and unexpected expenses will lead to differences in expenses before, after and throughout retirement. Some of the bigger choices that influence increases and decreases in expenses include travel, downsizing housing or moving to a less expensive area, adding a second home, remodeling housing, and expenses on hobbies. Day-by-day choices, such as eating out and going to the theater and movies, also influence expenses. It appears that most people are planning for lower expenses after retirement. Retirees in the focus groups indicated that they value frugality.

The SOA survey showed that many pre-retirees (people nearing retirement) expect retirement to be less expensive than pre-retirement. Pre-retirees were more than twice as likely to predict lower rather than higher expenses in early retirement (43 percent vs. 17 percent). More than one-third said they think their expenses will stay about the same.

The SOA survey also asked retirees how their expenses compared to what they expected when they first retired. The surprise for many retirees was that their retirement expenses were often higher than what they expected when they first retired. In fact, nearly two-fifths of the retirees (38 percent) said they had found their expenses in retirement to be higher than expected. Retired widows were especially likely to report this situation (44 percent). And only a few—12 percent each of retirees and retired widows—said their expenses were lower than they anticipated. Based on comments made in the focus groups, I would expect many retirees to have higher expenses than anticipated. It seems that many of the retirees plan for cash flows based on regular repeating expenses but do not consider the unexpected.

The SOA survey found that retirees often decrease their spending—at least, their voluntary spending—during their retirement years rather than increase it.

In the SOA survey, half of retirees (49 percent) reported decreasing their spending in retirement, including 20 percent who reported decreasing their spending by a lot. Just 2 in 10 (18 percent) said their level of spending increased since they first retired. The retirees who responded to the SOA survey included people who had experienced different periods of time since retiring.

EBRI did an analysis of changes in spending after retirement published in Issue Brief 420, November 2015—**Changes in Household Spending After Retirement.** The EBRI study showed that some households spent more and some less, but average household spending dropped in the first few years after retirement. The study showed that although average spending in retirement fell, many households experienced higher spending following retirement. In the first two years of retirement, 45.9 percent of households spent more than what they had spent just before retirement.

Spending changes varied by type of spending with the biggest drop at time of retirement in transportation spending. Commuting is a big part of pre-retirement transportation for many households. In this study, the median household had a mortgage payment before retirement but none after retirement. As discussed above, in other studies, spending by age shows different patterns by type of expenditure with declines in most categories and big declines in transportation and entertainment.

The EBRI study of spending after retirement shows that in the first two years of retirement, median household spending dropped by 5.5 percent from pre-retirement spending levels, and by 12.5 percent by the third or fourth year of retirement. But the spending reduction slowed down after the fourth year.

The EBRI study also showed some households increase spending. In the first two years of retirement, 28.0 percent of households spent more than 120 percent of their pre-retirement spending. By the sixth year of retirement 23.4 percent of households still did so.

SHOCKS AND UNEXPECTED EXPENSES AND THEIR IMPACT ON SPENDING

The SOA research focused on the impact of shocks and unexpected spending. Choices made about routine expenditures are very important, but so are unexpected expenses and shocks. A review of the SOA survey data indicates that expenses were much more likely to be higher than planned for those who had experienced multiple shocks. As shown below, the percentage of surveyed retirees who experienced expenses higher than planned increased with number of shocks experienced.

Table 2

The Impact of Multiple Shock Events in Retirement

Number of Shocks Experienced in Retirement	Percentage Reporting Much Higher Expenses Than Planned	Percentage Reporting Somewhat Higher Expenses Than Planned
No shocks	4%	21%
One or two shock events	6	32
Three or more shock events	16	34

Source: SOA 2015 Risks and Process of Retirement Survey

FOCUS GROUPS PROVIDE SOME INSIGHT INTO SPENDING RATIONALE

The SOA focus groups provided insights into how people think about spending. Frugality and expense management were a big theme. It should be noted that the focus groups were conducted with middle-income Americans and Canadians who had been retired for 15 years or more. There was little evidence of lavish spending. Here are a few quotes about spending from the focus groups.

Focus Group Quotes

- *"We don't have a lot of money, but we never needed it. We never lived above our needs I guess. I take a couple of trips every year and my wife goes up and visits her brothers. We do basically what we want. We are happy."—Male, Health Decline Group in Dallas, Texas*
- *"When we retired, we spent/wanted. Now I am spending a greater percentage on needing and not as high a percentage on wanting."—Female, Marital Change in Chicago, Illinois*
- *"My spending has gone down terrifically, because I don't go on vacation very … well, I haven't been on vacation now for a couple of years. I'm older. I don't know, I just don't need stuff anymore."—Female, Marital Change Group in Chicago, Illinois*
- *"When I was working and making a considerable amount of money every year, I didn't shop. If I needed something, I would go buy it. I never thought about shopping. I will tell you something, my wife and I have made shopping and coupon clipping, of course using the internet, a hobby."—Male, Low Asset Group in Baltimore, Maryland*
- *"Now today, I am basically on a fixed income, from investments to Social Security to my pension. Well, when you are the average housewife, I'm speaking for myself and a lot of my neighbors, you can have a couple pair of jeans and t-shirts and you get along just fine. You don't have to go out and spend a lot of money."—Female, Health Decline Group in Chicago, Illinois*
- *"But I watch what I buy and a lot of things I don't even buy anymore because it's too expensive. When I go to the grocery store, [I think] 'I don't really need that.' Whereas back in the good old days, you bought what you wanted. It didn't seem to be that expensive."—Female, Health Decline Group in Edmonton, Alberta*
- *"We buy what we want, but if there is not enough money there, I am going to watch what I got there. I don't want to spend, so I am basically the same, because I haven't changed in my thinking of how I buy and what I don't buy and how I spend and how I don't spend and govern accordingly."—Male, Health Decline Group in Kitchener, Ontario*

- *"I've always kept a record of my expenses and income and tried to live within my income. And what's left over, if there is anything left over, then you put it aside for whatever, vacation or whatever."—Female, Low Asset Group in Dallas, Texas*

SPENDING VS. INCOME AND ASSETS

The EBRI Issue Brief 368, February 2012—**Expenditure Patterns of Older Americans, 2001–2009,** looks at spending, income and wealth by age group. As shown in Tables 3 and 4 below, this research demonstrates that the lower half of the income distribution are spending more than their annual income (and using up part of their wealth, or borrowing to support that spending), whereas the top half are spending less than their income, so that they can continue to save. As shown in Table 5 below, married couples are much better off than single-person households.

Table 3
Year 2007 Median Household Income, Household Spending,
Household Nonhousing Wealth, Household Total Wealth by Age Group.
In 2010$ for the Lower Half of the Income Distribution

Age Group	Income	Spending	Income Gap	Nonhousing Wealth	Total Wealth
50–64	$29,854	$31,094	-$1,240	$18,465	$84,975
65–74	22,080	25,973	-3,893	21,740	119,778
75–84	18,837	22,360	-3,523	31,367	136,238
85+	14,082	18,629	-4,547	15,969	47,108

Source: Figure 6A from Issue Brief 368, February 2012—Expenditure Patterns of Older Americans, 2001–2009

Table 4
Year 2007 Median Household Income, Household Spending,
Household Nonhousing Wealth, Household Total Wealth by Age Group.
In 2010$ for the Upper Half of the Income Distribution

Age Group	Income	Spending	Income Gap	Nonhousing Wealth	Total Wealth
50–64	$113,123	$64,945	$48,178	$200,288	$432,863
65–74	70,776	47,838	22,938	239,919	475,332
75–84	53,227	43,066	10,161	326,774	554,358
85+	39,620	34,377	5,243	175,600	365,644

Source: Figure 6B from Issue Brief 368, February 2012—Expenditure Patterns of Older Americans, 2001–2009

Table 5
Year 2007 Median Household Income, Household Spending,
Household Nonhousing Wealth, Household Total Wealth by Age Group.
In 2010$ by Marital Status

Age Group	Income	Spending	Income Gap	Nonhousing Wealth	Total Wealth
Couple	$54,970	$44,378	$10,592	$216,149	$418,733
Single	21,749	24,065	-2,316	22,927	72,837
Widowed	22,649	26,050	-3,401	44,243	184,515

Source: Figure 7 from Issue Brief 368, February 2012—Expenditure Patterns of Older Americans, 2001–2009

The SOA survey found that most retirees say they keep their spending level at about what they can afford. The majority of retirees indicated they generally find that, at the end of the year, they have spent about what they can afford. Nearly 20 percent said they generally spend less than they can afford, while 10 percent admitted to spending more than they can afford.

However, as shown below in Table 6, retirees who have experienced multiple shocks are more likely to report that they are spending more than they can afford.

Table 6

Spending Levels of Retirees by Number of Shocks

Number of Shock Events Experienced in Retirement	Percentage Reporting Spending Level Exceeds Affordable Range
0	5%
1-2	8
3+	21

Source: SOA 2015 Risks and Process of Retirement Survey

It appears that unexpected and unplanned-for expenses can contribute to retirees spending more than can be afforded.

FAMILY TRANSFERS, SHOCKS AND UNEXPECTED EXPENSES

In the 2015 SOA post-retirement risk research, one of the major shocks and unexpected expenses experienced by the members of the focus groups and survey respondents was transfers of assets to children (and presumably grandchildren). The focus groups indicate that the shocks were primarily in response to some sort of a "problem"—child had a major illness, lost their job, got a divorce, etc. These payments were one of the shocks that had a lasting impact and were often not dealt with well. My impression is that the parents seemed to feel it was very important to help children when they needed to even if they could not really afford it.

EBRI discusses family transfers in **Intra-Family Cash Transfers in Older American Households,** Issue Brief 415—June 2015. The EBRI report shows that 38 to 45 percent of older households make cash transfers to younger family members vs. 4 to 5 percent of older households that receive transfers from younger family members. The cause of the transfers is not identified. The older households are age 50 and older and analysis covers 1998 to 2010. In 2010, the percentage of households making transfers to children and grandchildren and the amount of transfers by age group was as follows:

Table 7

Intra-Family Cash Transfers by Older American Households

Age Group	% Making Transfers	Average Amount	Average—2nd Income Quartile	Average—Top Income Quartile
50-64	51%	$16,272	$7,411	$27,378
65-74	39%	$13,639	$7,784	$21,072
75-84	33%	$14,704	$9,849	$22,864
85 - over	28%	$16,836	$13,474	$24,601

Note: Average Amount is average transfer in last two years by households making transfers in 2014 dollars. Averages are shown for all households, and for second and top income quartile.

Transfers are more likely in higher asset and income families, and the amounts are larger.

MINIMUM NEEDS MEASURES

A different approach to thinking about spending for older persons is to develop a measure based not on maintaining the pre-retirement standard of living, but on ensuring that resources are sufficient to meet some minimum level of needs. Wider Opportunities for Women (WOW), through its Elder Economic Security Initiative, worked with Brandeis University to establish a "minimum baseline" for what is required for an elder person to live at a reasonable level.[7]

The index includes a variety of monthly expenses and is developed for both couples and single persons and for renters as well as homeowners. In addition to national averages, indexes were developed separately at the community level in a number of states. Table 8 summarizes key expense items and the Elder Index national average for several elder family types.

Household spending drops after retirement by age within retired cohorts.

Table 8
The Elder Economic Security Standard Index
U.S. Average Monthly Expenses for Selected Household Types, 2010

	Elder Person	Elder Person	Elder Couple	Elder Couple
Monthly Expenses	**Owner w/o Mortgage**	Renter	**Owner w/o Mortgage**	**Renter**
Housing	**$372**	**$698**	**$372**	**$698**
Food	**231**	**231**	**424**	**424**
Transportation (private auto)	**283**	**283**	**346**	**346**
Health care	**254**	**254**	**508**	**508**
Miscellaneous	**228**	**228**	**330**	**330**
Elder Index Per Month	**$1,368**	**$1,694**	**$1,979**	**$2,305**
Elder Index Per Year	**$16,415**	**$20,328**	**$23,751**	**$27,773**

Source: National Economic Security Initiative January 2012 Fact Sheet, citing Conahan, et al. (2006). Values inflated to 2010 using the Consumer Price Index.
Note: The federal poverty level in 2010 was $10,380, which can be compared to the indexes for a single person.

I believe that the WOW Elder Index is a much more sound measure of minimum retirement income needs than the poverty level. It is based on actual spending and is calculated by subgroup with different spending needs. The index information was made available by local area. Financial planners and individuals may want to use minimum retirement standards, such as the Elder Index, to establish a baseline, and make a very rough estimate about whether or not there is the potential for significant reductions in an individual's expenditures. Note that many households in the bottom half of the income distribution probably have spending that is not very far from the Elder Economic Sufficiency Index that applies in their geographic area.

SPENDING AND BENEFIT ADEQUACY

Retirement benefit adequacy is a key concern of pre-retirees, and adequacy relates to having enough money to meet spending requirements. Conceptually, spending requirements may be defined in very different ways. Conceptual approaches to adequacy include definitions of spending based on some of the following criteria:

- Equivalence of post-retirement income to pre-retirement standard of living income based on a replacement ratio relationship;
- Sufficiency to cover all forecasted future living expenses; and
- Minimum needs as defined by the poverty or other minimum needs threshold.

The best method for personal planning at retirement age is to be able to forecast expenses, but not everyone can do that. Absent the ability to forecast expenses, then one is left with the question: What is the appropriate goal and approach for making an approximation?

BIG QUESTIONS

As we think about this research data, there is a big question that confronts actuaries and many people concerned with retirement planning. What is the appropriate level of spending to plan for in retirement? Traditional thinking is that retirees need 70 to 80 percent of pre-retirement income adjusted for inflation to maintain their pre-retirement standard of living, but post-retirement spending seems to follow a different pattern. Minimum needs definitions do not differ by person, but income differs a great deal. And some people will be very comfortable within the minimum needs spending definition, while others would have a great deal of trouble managing expenditures at that level.

As we think about the questions related to benefit adequacy, different stakeholders have different questions to think about. Individuals need to think about what to save, when they can afford to retire, and what they can spend. If they do not have enough money, they probably need to think about how to reduce spending during retirement years. Employers who sponsor benefit plans need to decide what support they will provide to employees and their retirees. Policymakers need to decide what Social

Security benefits and social supports to provide. They need to decide how to structure the tax systems.

SUMMARY AND CONCLUSIONS

Spending is a big part of the financial picture for most households. For many households who are 65 and older, available resources put constraints on spending. Others are able to spend what they wish and continue to save. SOA focus groups provide insights into the choices that middle income households are making.

EBRI and other research give us insights into what older people are spending and what they are spending for. The research tells us that:

- Household spending drops at time of retirement and by age during the period after age 65. This is true on average, but there is a great deal of variation by individual household. Some households spend more and others spend less.
- The pattern of household spending by age varies by type of spending.
- Most types of household spending decline from age 65–74 to 75–84 and again to age 85 and up, and seniors spend less than the households nearing retirement.
- Health care needs are greater for seniors than for younger persons.
- Many seniors are frugal and careful about how they spend and are remarkably resilient.
- More than one-third of senior households are making transfers to children and grandchildren.
- Shocks are very important.

We still have a great deal more to learn about how much spending is shock-driven and about how significant the problems are that it causes. Future research should help shed more light on the issue. ■

ENDNOTES

1 Sudipto Banerjee, Ph.D., is the EBRI researcher and author of the EBRI Issue Briefs and Notes articles. There is an interview with him in this issue of the Pension Section News.

2 https://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=4992

3 https://www.ebri.org/pdf/notespdf/EBRI_Notes_09_Sept-14_OldrAms-WBS.pdf

4 https://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=3291

5 https://www.ebri.org/pdf/briefspdf/EBRI_IB_411_Feb15_HlthExpds.pdf

6 See EBRI Issue Brief No. 411, Utilization Patterns and Out-of-Pocket Expenses for Different Health Care Services Among American Retirees.

7 Note that WOW is discontinuing operations during 2016 and the Elder Economic Security Standard research is being transitioned to the University of Massachusetts and the National Council on Aging.

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