



A Spending Plan for Retirement

Estimating Expenses





How you envision retirement...

When you think of retirement, what comes to mind? Is it suntan lotion and white sandy beaches, or perhaps a table full of kids and grandkids? Maybe it includes serving in your community, or kicking back and watching an occasional baseball game. There are all kinds of retirement lifestyles, and the type of lifestyle you live—and how long you live it—can make a big difference in what retirement costs you.

...will have a big impact on its cost.

Most retirement expenses will fit into one of four categories:

- ▶ Living expenses
- ▶ Lifestyle expenses
- ▶ Healthcare expenses
- ▶ Income taxes

Some expenses, like housing, utilities, and food, remain relatively constant and can be budgeted, while others, like recreation and medical care, fluctuate over time. Having a basic understanding of the different kinds of expenses is essential to helping someone determine how much they may need to save for retirement.

This guide is a resource to help you understand what types of retirement expenses you may have in your first year of retirement, how long you may have them, and how they may change over time.

Did You Know?

- 63% of pre-retirees expect to spend less in retirement, but only 35% of retirees say they actually do.¹
- 31% of pre-retirees say they have given little or no thought to how well their savings will meet their expense needs during retirement.¹

Drill down on costs:

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Living Expenses: The Essentials

Living expenses are those that are essential to maintaining a reasonable standard of living. They include things like food, clothing, and shelter, but can also include things like utilities, insurance, and transportation. It is important to determine the affordability of such things, and to make changes when necessary.

For example, a home may be an asset for retirees who can afford the mortgage payments and upkeep, but a liability for retirees who struggle to make payments or maintain it because of limited income or unexpected repairs. Consider the affordability of your situation, and if you cannot afford your rent or mortgage payments and upkeep, consider downsizing, and possibly relocating, to reduce the cost of housing. If you own a home, be sure to plan and budget for the costs of maintenance and repairs (see [Helpful Resources](#) for guidance).

WHAT CAN YOU DO NOW

Start by examining how much you spend currently on these types of expenses, and ask yourself whether you expect these expenses to go up, go down, or remain the same in retirement. Areas to focus on include:



Housing

Costs include mortgage or rent payments, maintenance, repairs and remodeling, condo special assessments, association dues, utilities, taxes, and insurance, some of which may depend on your home's current size, value, and location.



Transportation

Modes of transportation may include public transit, taxi, UBER, or owning your own vehicle. Costs may include loan or lease payments, fuel, insurance, registration fees, and maintenance, which can vary by the age and value of your vehicle, along with average annual miles driven.



Insurance

In addition to auto and homeowners' insurance, retirees may carry life, health, and long-term care insurance. These costs often increase with age and level of coverage.



Food

The cost of food includes groceries and dining out. Review your current level of spending and decide whether you expect it to increase, decrease, or stay the same.



Did You Know?

The average retiree household spends \$459 per month on food and \$1,294 per month on housing.²

Planning Tip #1

Three in 10 (28%) middle-income Boomers say they devote more than 40% of their monthly income to debt.³ Make it a priority to pay off your debt prior to retirement.

Lifestyle Expenses: The Good Stuff

Lifestyle expenses are those that go above and beyond our living expenses, and tend to be unique to the individual. They may include travel and recreational activity, community involvement, charitable giving, and family dynamics.

Your retirement lifestyle is a matter of choice, but may be influenced by what you value, where you live, and what you can afford. For example, do you prefer to stay in luxury hotels, or roughing it in the great outdoors? Do you like to play golf three days a week, or play bridge with your three best friends? Discretionary expenses like these vary greatly, and often depend on how much you can save during your working years and your capabilities as you go through retirement.

WHAT CAN YOU DO NOW

Begin to imagine life as a retiree. What would you like to be doing? How often would you like to do it? How will your choices change over time? Here are some areas on which to focus:



Travel

Imagine the places you would like to visit, your frequency of travel, and the types of accommodations you would prefer. Estimate the cost and use this information to develop a travel budget.



Recreation & Hobbies

Some activities cost more than others, and some cost nothing at all. Make a list of the things you like to do for recreation, how often you like to do them, and how much they cost. Use this information to develop a recreation budget.



Volunteering

Volunteers may work for no cost to others, but there is a cost to volunteer. This may be as simple as gas to get across town, or as involved as travel arrangements to a third-world country. Contact causes you would like to support to determine your level of involvement.



Family

If your goal is to be actively involved with children and grandchildren, decide what that looks like and consider the cost. For example, how much do you plan to spend on gifts, family vacations, holiday meals, kids' activities, and education?



Did You Know?

70% of retirees say being generous provides a significant source of happiness.⁴

Planning Tip #2

Use defined income from sources like Social Security, pensions, and annuities to pay for essential living expenses, while using variable income from sources like retirement plans and part-time work to pay for lifestyle expenses.



Healthcare Expenses: A Rising Cost

Healthcare expenses are those that help you maintain your mental and physical health. They include, but are not limited to, health insurance premiums, deductibles and copayments, medication, vision and dental care, long-term care, and other out-of-pocket medical expenses.

Prior to age 65, retirees may have access to health insurance through COBRA, a spouse, retiree medical benefits, a healthcare exchange, or military/VA benefits. Starting at age 65, most Americans will also be eligible for Medicare, but Medicare is not free and does not cover everything such as basic hearing, dental, and vision care.¹ You should know how much Medicare costs, as well as your options for Medicare Supplement plans. Because most long-term care is not covered by Medicare, you will also want to plan for possible long-term care needs. This can include purchasing long-term care insurance, planning on help from family members, or determining whether you qualify for long-term care benefits through Medicaid.

A Health Savings Account (HSA) may also provide a source of healthcare funding for qualified medical expenses. With so many things to consider, now is the time to start learning more about your options.

WHAT CAN YOU DO NOW

Look at your family's health history to gauge the level of health care you may need in retirement, adjusting for personal differences (e.g., nonsmoker, exercise) in maintaining your health. Pay attention to these focus areas:



Medicare

Medicare provides coverage for hospital stays (Part A) and doctor visits (Part B). Costs and plans will vary, so visit the Medicare website to learn more.



Prescription Drugs

Prescription drug coverage is available through Medicare Part D, or as part of a Medicare Advantage Plan (Medicare Part C). Costs will vary by plan type and income.



Medigap

Medicare Supplement Insurance (Medigap) policies help pay for things not covered by Medicare, such as copayments, deductibles, and coinsurance.



Long-Term Care

Long-term custodial care is needed when you are unable to perform certain activities of daily living, such as eating, bathing, or getting dressed. Costs can vary greatly depending on the level of care (e.g., home, assisted living, nursing home).



HSA

Health Savings Accounts (HSA) provide tax-free money for qualified medical expenses such as deductibles, copayments, and Medicare and long-term care insurance premiums.

Did You Know?

70% of people turning age 65 can expect to use some form of long-term care during their lives.⁵

Planning Tip #3

Some healthcare needs require travel to another city for specialized care (e.g., cancer and heart conditions), or require accepting services not covered by insurance or Medicare. If eligible, make annual contributions to a Health Savings Account to help pay for medically-necessary travel, and other qualified medical expenses not covered by insurance or Medicare.



Income Taxes: What to Expect

You may have heard that your income taxes will be lower in retirement, and for some that may be true, but not all sources of retirement income are taxed the same. Knowing how your different income sources are taxed can help keep income taxes under control.

Tax-deferred accounts, like a traditional IRA or 401(k), are generally subject to ordinary income tax, as are pensions and a portion of Social Security benefits. Tax-free accounts, like a Roth IRA or Health Savings Account (HSA), are generally not taxable when qualified withdrawals are made. The sale of certain assets, like stock, may be subject to capital gains tax treatment, while the sale of other assets, like a primary residence, may receive exemptions that reduce or eliminate the capital gains tax altogether. Retirees who have different assets that are taxed differently will want to consider tax rules when deciding which assets to spend first. Having a variety of retirement income sources, and an understanding of how they are taxed, can potentially save you money.

WHAT CAN YOU DO NOW

Learn how each of your retirement income sources is taxed, and develop a retirement tax strategy. Here are some common areas on which to focus:



Retirement Accounts

Traditional retirement account withdrawals are taxable at the federal level, and may be taxed at the state level. Withdrawals made prior to age 59½ may be subject to a 10% early withdrawal tax penalty. Qualified Roth and HSA withdrawals are tax free.



Social Security

Up to 85% of your Social Security benefit is taxable at the federal level, depending on how much other taxable income you have. Some states also tax Social Security income.



Sale of a Home

Homeowners may exclude up to \$500,000 in capital gains (\$250,000 if a single tax filer) from the sale of a primary residence when they have lived in the home for two of the previous five years.



Taxable Investments

If you own stocks, bonds, mutual funds, or other types of investments outside of a retirement account, you'll want to know how each is treated from a tax perspective.

Did You Know?

Health Savings Account distributions used for non-medical expenses are taxable, and may be subject to a 20% tax penalty if taken before age 65⁶

Planning Tip #4

When it comes to taxes, individual circumstances may vary. It is always best to consult with a tax professional when preparing a retirement tax strategy.

The Challenges

HOW LONG DO I NEED TO PLAN FOR?

Many Americans fail to realize just how long they may be retired. For this reason, it is important to understand both the potential length of retirement, as well as the potential expenses incurred during retirement. The American Academy of Actuaries and the Society of Actuaries have teamed up to create the Longevity Illustrator (see [Helpful Resources](#)) to help Americans estimate their chances of living to certain ages. You can use this illustrator to determine how many years of expenses you may need to plan for.

WHAT MAY CHANGE EXPENSES OVER TIME?

There are several factors that could cause expenses to change over time. Some we choose, such as changes in where we live and what kind of lifestyle we enjoy, while others are not by choice, such as changes in health or financial shocks. Before making changes in lifestyle and living arrangements, consider the affordability of such changes. Plan for unexpected changes in expenses by saving more for retirement, and by purchasing (and maintaining) adequate levels of auto, homeowners, life, health, and long-term care insurance.

HOW FAR WILL MY MONEY GO IN THE FUTURE?

The average inflation rate is around 2.5%, but that can change over time. This means that the cost of retirement today is probably much lower than what it will be when you actually retire, depending on how close you are to retirement. This is one reason why pinpointing how much money you will need to save is so difficult. Use a financial calculator that includes inflation (see [Helpful Resources](#)) to estimate how far your money may go in the future.

WHAT ELSE MIGHT HAPPEN?

While we can count on paying for things like taxes, utilities, food, home repairs, etc., there are other costs we will likely incur that we can't imagine right now. Costs of catastrophic events like fire and flood are often not covered by insurance. Our children and grandchildren may fall on hard times and reach out for assistance. Sometimes these situations make it very hard to say "no." Having a built-in cushion when planning for retirement will help avoid stress that comes from these types of unexpected events.

WILL MY TAX RATE BE THE SAME?

Changes in the tax code—and your personal situation—may affect how much you will have to pay the IRS in retirement. You will need to revisit your tax planning as these changes occur.



Did You Know?

Women are now expected to live 5 years longer than men.⁷

Did You Know?

An item costing \$100 today would cost \$128 in 10 years at 2.5% inflation.⁸

Helpful Resources

LIVING EXPENSES

- ▶ Actuaries Longevity Illustrator: www.longevityillustrator.org/
- ▶ Estimate the cost of owning a vehicle: <https://www.edmunds.com/tco.html>
- ▶ Society of Actuaries Decision Brief on housing: www.soa.org/Files/Research/research-pen-housing.pdf
- ▶ IRS Publication 523 - Selling Your Home: <https://www.irs.gov/publications/p523>
- ▶ Estimate how much to budget annually for home maintenance: www.thebalance.com/home-maintenance-budget-453820

LIFESTYLE EXPENSES

- ▶ Estimate the cost to travel: <http://www.budgetyourtrip.com/>
- ▶ The cost of being a grandparent: <https://www.aarp.org/home-family/friends-family/info-2017/2017-grandkids-cost-how-much.html>
- ▶ Find your cause: <https://www.volunteermatch.org/>
- ▶ How long will your savings last?: https://ffcalcs.com/how_long

HEALTHCARE EXPENSES

- ▶ Information on Medicare & Medicaid: www.medicare.gov & www.medicaid.gov
- ▶ Society of Actuaries Decision Brief on long-term care: www.soa.org/Files/Research/research-pen-long-term-care.pdf
- ▶ A Shopper's Guide to Long-Term Care Insurance: http://www.naic.org/documents/prod_serv_consumer_ltc_lp.pdf
- ▶ Estimate the cost of insurance: <https://www.insurance.com/>
- ▶ Society of Actuaries Decision Brief on health insurance for retirees: www.soa.org/Files/Research/research-pen-securing-health-insurance.pdf
- ▶ Health Savings Accounts (HSA): www.healthcare.gov/glossary/health-savings-account-hsa/

INCOME TAXES

- ▶ Roth IRA Withdrawal Rules: www.rothira.com/roth-ira-withdrawal-rules
- ▶ How Investments are Taxed: www.investorguide.com/article/11730/tax-implications-of-different-types-of-investments-igu/
- ▶ Income Taxes and Social Security: <https://www.ssa.gov/planners/taxes.html>
- ▶ Internal Revenue Service: <https://www.irs.gov/>
- ▶ Taxation of Retirement Income: <https://www.finra.org/investors/taxation-retirement-income>



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- ³ "Paying For The New Retirement: Responsibilities And Challenges For Middle-Income Boomers". 2016. Centerforsecure retirement.Com. <http://www.centerforsecure retirement.com/archive-study/2016/paying-for-the-new-retirement-responsibilities-and-challenges-for-middle-income-boomers/>
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- ⁵ U.S. Department of Health & Human Services. 2017. "How Much Care Will You Need? – Long-Term Care Information". LongTermCare.gov. <https://longtermcare.acl.gov/the-basics/how-much-care-will-you-need.html>
- ⁶ "Publication 969: Health Savings Accounts and Other Tax-Favored Health Plans." 2018. Internal Revenue Service. <https://www.irs.gov/pub/irs-pdf/p969.pdf>
- ⁷ Tinker, Ben. 2017. "US Life Expectancy Drops For Second Year In A Row". CNN. <https://www.cnn.com/2017/12/21/health/us-life-expectancy-study/index.html>
- ⁸ Online Inflation Calculator". 2018. Vertex42.Com. Accessed June 1. <https://www.vertex42.com/Calculators/inflation-calculator.html>

End Notes

- ⁱ Medicare and other forms of insurance have rules on what is covered. Some specialized treatments and extremely long hospital stays may not be covered. Some physicians do not contract with Medicare, and must be paid out-of-pocket. With most insurance policies, out-of-network care is generally covered at higher cost than in-network care. Some insurance covers only approved providers. Be sure to know the level of coverage and limitations before purchasing insurance.



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