Pencil & Paper Retirement Planning

For those already retired.

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Many retirees are adverse to using a computer, particularly for something that can be as confusing as determining how much they can spend next year without exhausting savings too early. This pamphlet solves that problem. Further, many computer programs leave out some of the important factors that are included here.

Make a new calculation each year on about the same date. So if you were near January of 2016, you would get out the chart below and make a calculation about how much you can safely spend in 2016. It is based on a method that comes from the Federal Government described in IRS Publication 590. That method is mandatory for those who reach age 70 ½ and have qualified accounts like a 401(k), 403(b), or IRA. However, the information can be used voluntarily by those who are much younger or older for any kind of account such as savings in taxable mutual funds or tax-exempt funds like a Roth IRA.

Just before January of 2017, you would make a new calculation in the next column for how much you could safely spend in 2017. And before you would reach 2018, you would enter your calculation in the next column. You should not try to make a forecast by getting ahead of yourself and making calculations for future years beyond the coming year. That's because we can't forecast how your savings balances will actually come out.

There is a real plus to this method for non-computer users, both because of the simplicity and the written record it keeps. It can also be used as a check on the assumptions and results from your professional planner.

There are some underlying assumptions that you should know.

The first assumption is that the method assumes that you will be able to invest with an after-tax return equal to or greater than inflation in the majority of future years. This assumption is described in some detail in an article from *The Wall Street Journal's Market Watch* section: **Save Like a Squirrel** http://www.marketwatch.com/story/save-like-a-squirrel-2013-01-24

Assuming returns equal inflation is very practical for retirees because their portfolios are usually more conservative or get so as they age. Optimistic planning is disastrous for retirees and does not give consideration to all of the uncertainties that come during retirement. Not only do retirees encounter difficult financial events during the many years of retirement such as very expensive repairs, uninsured health problems or relatives needing money, they also experience years with severe stock market declines which lead to overspending in lean years and a phenomenon called reverse-dollar-cost-averaging. Regular savers gain from dollar-cost-averaging because they buy more shares when stock prices are low and fewer when stock prices are high. That's what we all are supposed to do. Unfortunately, retirees regularly withdraw money with debilitating draws during bad market years.

Another major assumption is that withdrawals from savings are dictated by the same rules as for Required Minimum Distributions (RMDs) from IRS Publication 590. There is a mandatory requirement to use these rules after age 70 ½ for qualified accounts like 401(k)s, 403(b)s and IRAs. However, the same rules can be used for people who are much younger. RMD factors are equivalent to life-expectancies. For example, the factor for age 70 is 27.4 meaning that one of two spouses has a good chance of living to age 70 + 27.4 which would be 97.4. These values were chosen to be conservative—another reason to use the RMD method in this simplified calculation. Of course if the spouse of the owner is much younger female, say 65, the corresponding life-expectancy for her at his age of 97.4 would be 92.4 which is no longer very conservative for a female.

There is another advantage of using a conservative withdrawal rule. That is it has a better chance of preserving some funds for the higher medical costs incurred by the elderly and for long-term-care. Those who have very little savings left, and pensions destroyed by inflation, will have to get their care using Medicaid and Medicaid supported facilities. This is not the image younger people have for their elderly care.

One other key assumption for those that subtract their debt from investments is that this assumes the interest rate on the debt equals their return on investments. Debt interest can be much larger than returns, but the error incurred is largely offset by entering the actual interest in the debt payment in Row 16.

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Affordable Inflation-Adjusted Spending for Life of Retirees

Row	Item Description	Example	Make entries only as approach your next year. Do not try to use for forecasting.			
1	Year	2015				
2	Age (of younger spouse if married)	70				
Annual Safe Withdrawals from Savings						
3	End of previous year's savings. (See note)	200,000				
4	Emergency funds (See note)	20,000				
	Debt balances (See note)	30,000				
	Future large one-time expenses (See note)	20,000				
5	Net savings for annual expenses: Row 3 - sum of Row 4 items	130,000				
6	RMD factor from IRS Publication 590. (Table below)	27.4				
7	Safe withdrawals from savings = Row 5 / Row 6	4,745				
Income from Pensions and Social Security						
8	Annual gross income from fixed pensions or annuity payment	10,000				
9	(Row 8 x Row 2) / 100	7,000				
10	Annual gross income from COLA pensions and Social Security (See note)	20,000				
		10,000				
11	Adjusted annual income Row 9 + sum of items in Row 10	37,000				

Monthly Affordable Spending

12	Monthly Resources = (Row 7 + Row 11) / 12	3,479				
13	Monthly Medicare & Insurance payments & Home Owners Association Dues	100				
		100				
		500				
14	(Annual Taxes) / 12 (See note)	400				
15	Net = Row 12 - Row 14 - sum of items in Row 13	2,379				
16	Monthly debt payments <u>if</u> Debt Balance entered in Row 4. Otherwise enter 0. (See note)	400				
17	Affordable monthly spending = Row 15 + Row16 (See note)	2,779				
18	Affordable One-Time Large Expense <u>if</u> part of Row 4 entry. Otherwise enter 0. (See note)	5,000				

In one of the months, you can spend the amount in Row 18 in addition to the regular amount in Row 17.

RMD Factors from IRS Publication 590

See Publication 590 if more than 10 years difference in spouses' ages

Age	Factor	Age	Factor	Age	Factor	Age	Factor	Age	Factor	Age	Factor	Age	Factor	Age	Factor	Age	Factor
50	44.2	56	38.7	62	33.5	68	28.6	74	23.8	80	18.7	86	14.1	92	10.2	98	7.1
51	43.3	57	37.9	63	32.7	69	27.8	75	22.9	81	17.9	87	13.4	93	9.6	99	6.7
52	42.3	58	37.0	64	31.8	70	27.4	76	22.0	82	17.1	88	12.7	94	9.1	100	6.3
53	41.4	59	36.1	65	31.0	71	26.5	77	21.2	83	16.3	89	12.0	95	8.6	101	5.9
54	40.5	60	35.2	66	30.2	72	25.6	78	20.3	84	15.5	90	11.4	96	8.1	102	5.5
55	39.6	61	34.4	67	29.4	73	24.7	79	19.5	85	14.8	91	10.8	97	7.6	Bless you!	

Note: Using RMD factors for planning calculations does not relieve users from using RMD factors to meet minimum withdrawals from qualified accounts. In the few cases where the RMD factor would dictate a larger withdrawal than determined by the analysis above, the excess should be saved.

Notes:

Row 3 could include a part of your home equity if you are seriously considering downsizing. If you will have **part time work** for a while, add the total take-home pay for that period to Row 3 savings.

Row 4 includes the addition of emergency funds, debts and future large purchases. **Emergency funds** might be the larger of 10% of savings or a half-year of retirement spending. **Debts** should include the current balance of a mortgage, other loans and unpaid credit card obligations. **Future large purchases** can be things like funds for a kitchen remodel, replacing a roof, car(s), long-term-care for several years or anticipated help for an elderly parent or adult child seeking support. **If purchases to be paid with qualified funds like a 401(k) or IRA, include the extra income taxes on that withdrawal as part of their cost.**

If the sum of Row 4 reduces Row 5 to a minus amount, then you **should not enter the Debts here** and may have to reduce the amount of Large Future Expenses. If the remaining Emergency Funds still make Row 5 a minus number, it would be wise to seek professional financial help.

Row 9 makes an important adjustment to spending from a fixed-payment pension. This simple formula does a good job of helping to compensate for the ever decreasing value of fixed payments in an inflationary environment. For more information on this adjustment, see *The Wall Street Journal* article http://www.marketwatch.com/story/why-fixed-income-is-not-fixed-2015-02-25.

Row 10: If you have **not yet started social security** or a pension, subtract the amount of savings you will use for support in the years until you do start from Row 3, but still make an entry in Row 10 for the amount you will get. You can get the amount to enter in Row 10 from www.ssa.gov. Do not adjust that future Social Security payment for inflation, but for the Row 3 adjustment only, reduce Social Security for Medicare Part B & D payments. The amount to subtract from Row 3 is (Net monthly payment from delayed Social Security or pension) times (Number of months until you begin the payments).

Row 14 might use taxes from last year's 1040 tax return.

Row 16 is only payments for interest and principal and should not include property taxes, Home Owners Association (HOA) dues or insurance. Property taxes are part of Row 14. Mortgage insurance should be part of Row 13 as should HOA dues. If you did NOT enter Debt Balance in Row 4, then enter zero here and debt payments then are part of the expenses in Row 17.

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