Planner: You may be overestimating retirement needs

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Business

NEW YORK — If you're tired of all the talk that you're not saving enough for retirement, you'll be happy to hear the latest: People may be overestimating what they need in their Golden Years.

People generally spend less in retirement as they age, regardless of income, according to a recently published research paper. It's one of those things that "everyone kind of knows" but that isn't reflected in traditional retirement-planning strategies, says Ty Bernicke, a financial planner with Bernicke & Associates in Eau Claire, Wis., who supports his theory with data from the Bureau of Labor Statistics.

Traditional financial-planning strategies often assume retirement spending rises over time due to inflation. In reality, spending goes down with age and inflation pulls it back up, leaving most people with retirement spending that remains fairly constant from the start of retirement until death, Bernicke said.

In his paper, which was published by the Journal of Financial Planning this month, Bernicke illustrates how traditional calculation methods can distort what people think they need to save for retirement. Under a traditional planning method, a married couple who retire at 55 years old and spend roughly $60,000 a year would see their spending needs rise to $145,635 a year by the time they reach age 85. The reason for the rise: An inflation rate assumption of 3 percent a year on top of expenditures that start out at $60,000 a year.

If this couple's nest egg equals just $800,000 plus Social Security payments of $12,000 a year, they would be told that they could run out of money by age 81. They would probably also be told that they need to work a few more years to boost their savings or risk living off Social Security in their later years.

That $800,000 nest egg goes a lot further, however, when the assumption is that spending drops with age. Under Bernicke's model, the same couple would spend only $67,963 by age 85 with inflation, a rise of just $7,963 compared with a rise of $85,635 under the traditional model. The $800,000 nest egg would, therefore, not only last past age 81, it would grow, allowing the couple to live without fear of running out of money.

Bernicke's first hint that people tend to overestimate their retirement spending came from his father, Barry, the founder of Bernicke & Associates. "When I first got into the business he had mentioned this to me and it made a lot of sense," said Bernicke.

After several years of watching his father's predictions come true, Bernicke decided to support the theory with numbers. By reviewing the U.S. Bureau of Labor's Consumer Expenditure Survey, he found that people ages 75 and older tend to spend half of what they spent between the ages of 45 and 55.

Health care costs are the only costs to rise as people age, according to Bernicke's data. Everything else — including entertainment, housing costs, food and transportation — falls, resulting in an overall decline in spending.

Bernicke doesn't believe this decline is due to a generational phenomenon. He looked at data from as far back as 1984 and found a consistent decrease in spending by age from 20 years ago.

The one wild card is the cost that might be required for long-term care, like a nursing home, said Bernicke. People in nursing homes are unlikely to be represented in the data set because they are unlikely to participate in the Bureau of Labor Statistic's survey, Bernicke said.

Consultancy Aon Corp. has been looking at the same Consumer Expenditure Survey data for several years and has found similar results, said Mike Schachet, an Aon senior vice president. Aon's message has been a bit different, however, in that it has focused on how people's retirement spending needs are changing over the years. Someone who needed 67 percent of his or her pre-retirement income to retire several years ago may need 75 percent today, according to Aon's research.

Bernicke's message is that the financial-planning community should be aware that they may be pumping up the numbers due to erroneous assumptions about spending and inflation.

Bernicke's research has struck a chord with financial planners who have long felt that traditional retirement-spending calculations are misleading.

"It's an absolute fact that as people get older they spend less money," said Rick Ferri, president of money-management firm Portfolio Solutions in Troy, Mich.