Chapter 3

TRACKING DOWN FUTURE EXPENSES

This chapter will start you on the road toward a realistic look at your expenses in retirement and how they will be affected by inflation. These numbers are important clues to your retirement mystery.

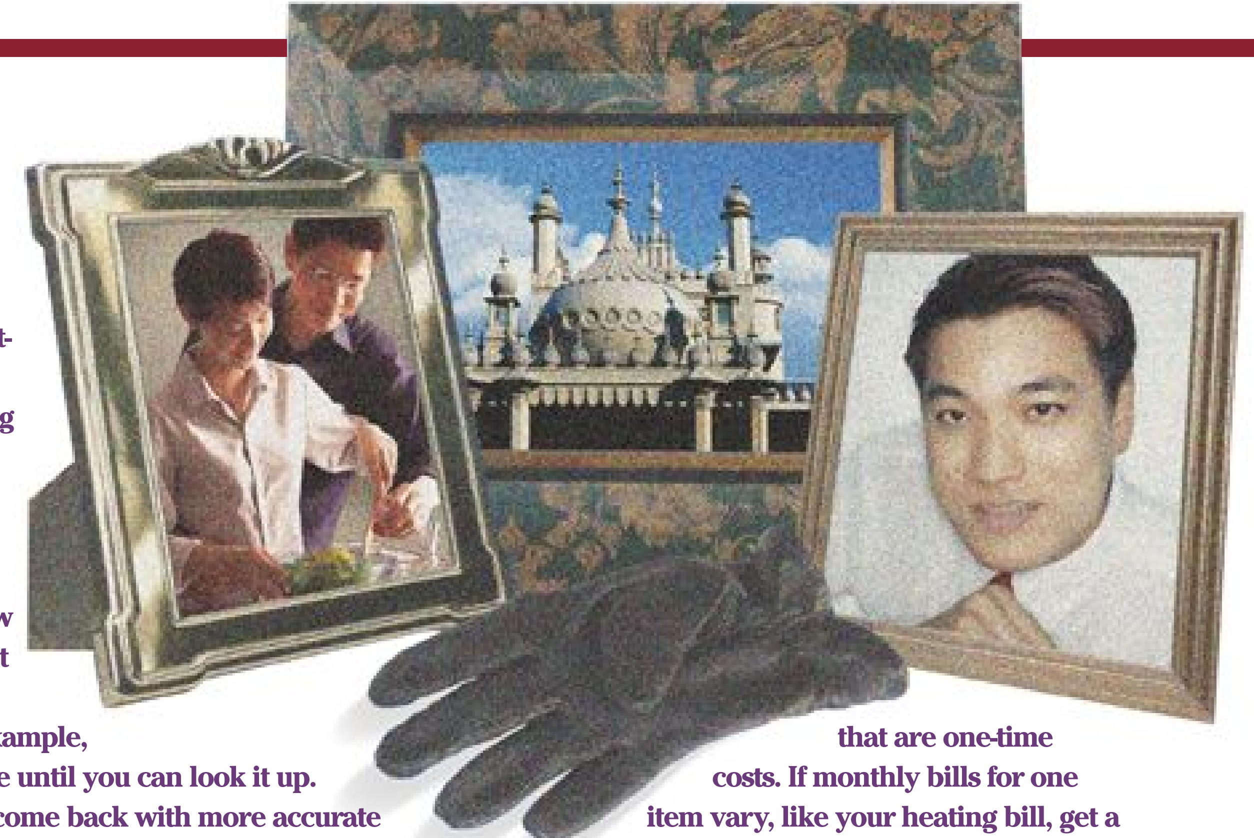
You will be looking at your expenses today and estimating how they will change over time and, specifically, during two other time periods: the day you retire 10 years from now and over the approximate 30-year span of your retirement. In doing so, you will have some idea of whether the money you have saved will be enough to last. You will also have a chance to look at your spending patterns and decide how they could change over time. After all, you can't control inflation over this stretch of time, but you certainly can control what you spend.

Your expenses will likely change as you grow older. Early on, you will spend less on work-related things like transportation and clothing. Maybe you'll spend more on traveling, hobbies, or other things you have always wanted to do. As you age, it is likely that more of your budget will go toward medical expenses, which you will read about soon. Retired people may find that recording their expenses will alter future spending patterns.

ABOUT WORKSHEET E (PAGE 19):

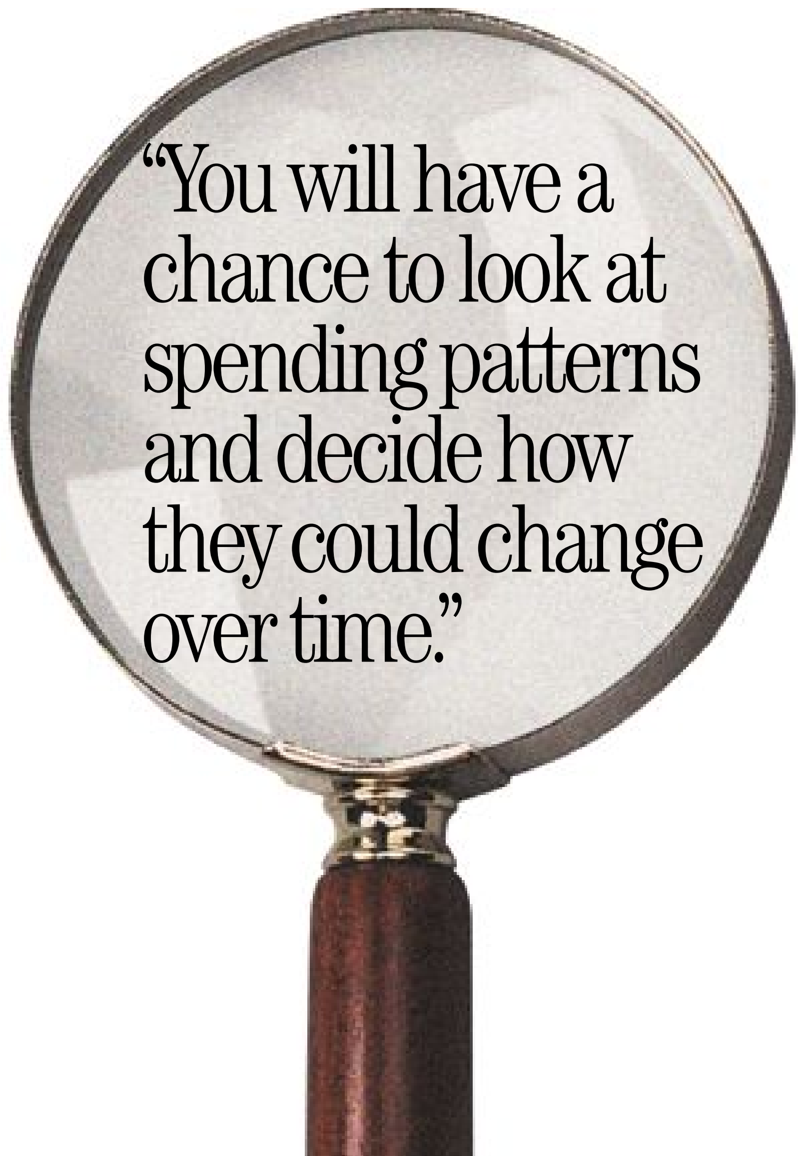
MONTHLY EXPENSES TODAY

First add up current monthly expenses in Worksheet E (*Monthly Expenses Today*). Then in Worksheet F, *Monthly Expenses in 10 Years,* take those totals and adjust them for inflation to estimate your expenses during your first year of retirement. Chapter 4 will look at those expenses over a 30-year retirement and how you will be spending the income you just calculated. If you want a quick estimate of how much monthly income you'll need to cover expenses in retirement, figure on at least 70 percent of your preretirement income. Many experts are now increasing that figure to 80 or 90 percent.



Avoid getting stuck on the details and giving up because you don't have exact records of your spending.
If you don't know the exact amount you pay for car insurance, for example, use a guesstimate until you can look it up. You can always come back with more accurate numbers.

Don't include things like college tuition that are one-time costs. If monthly bills for one item vary, like your heating bill, get a year's worth, add them up, and divide that total by 12 for an average monthly expense. If you get a bill four times a year, add up a year's worth and divide by 12 for an average monthly cost. Remember to include your spouse's expenses if you're married and the expenses of anyone financially dependent on you.



"You will have a chance to look at spending patterns and decide how they could change over time."

Inflation and Your Future

Inflation, in its simplest terms, means that dollar-for-dollar your money will not buy as much next year as it does this year. This means inflation is a major factor in determining how much money you will need in retirement since, to cover inflation's impact, you will need more money every year. In other words, if your money is not earning more than the rate of inflation, you will lose part of your nest egg's buying power.

You can't know and can't control future inflation. The only accurate inflation rates are from the past, and they vary widely. In 1980, overall prices went up a whopping 13.5 percent; in 2002, they went up only 1.6 percent. Looking at the past shows how rates may vary widely. Worksheet F uses the factor for a 3.5 percent rise in prices for the next 10 years. But these are estimates, and remember we've gotten used to low inflation overall—with a few glaring exceptions—over the last decade.

Facing Down Rising Costs

One exception to low inflation rates is medical costs, which have risen faster than inflation over the last 20 years, and some experts think will rise about 7 percent a year over the coming years. If you have, or your family history includes, a serious medical condition like heart

WORKSHEET E

MONTHLY EXPENSES TODAY

	[1] Monthly Amount
Housing	
Mortgage (Including condo fees)	
Rent	
Maintenance	
Food (at home)	
Utilities	
Electricity	
Heat	
Internet/cable	
Phones	
Water/sewer	
Clothing	
Taxes	
Real estate	
Income (state and federal)	
Other property taxes	
Insurance	
House	
Life	
Car	
Disability	
Long-term care	

	[1] Monthly Amount
Loans	
Car	
Credit card	
Other	
Workplace retirement and personal savings	
Personal Care	
Hair cut	
Dry cleaning	
Gym	
Other	
Transportation	
Car repairs and maintenance	
Gas	
Parking	
Public transportation	
Health Care	
Health insurance	
Doctor visits	
Hospital	
Medicine	
Over-the-counter medicine	

	[1] Monthly Amount
Health Care (continued)	
Dental	
Vision	
Noncovered items	
Travel/vacations	
Entertainment	
Eating out	
Hobbies	
Movies/theatre	
Charitable contributions	
Other	
Gifts	
Membership dues	
Pet-related costs	
TOTAL ESTIMATED MONTHLY EXPENSES (other than health)	
TOTAL ESTIMATED MONTHLY EXPENSES (health)	

disease, you will probably spend more on health care than you ever imagined. In fact, the consulting firm of Hewitt Associates estimates that, on average, 20 percent of retiree income will be spent on health care.

While Medicare is a great benefit to persons 65 and older, it does not cover all medical costs – deductibles, copayments, and long-term care, for example. Medicare Part A covers hospital care only. Medicare Part B, an additional insurance you will be offered when you become 65, covers doctors' services, outpatient hospital care, and things like physical and occupational therapy and some home health care. The current cost of Medicare Part B is about $78.20 per month, and it goes up every year. In addition to Medicare Parts A and B, many retirees buy Medigap policies for uncovered services like dental and vision care and drugs. Depending upon where you live and the policy you choose, you can pay $55 to $300 a month. In 1999, Medicare, private insurance, and/or Medicaid paid for only about 65 percent of retirees' overall health care expenses.

An additional feature that will be available starting in 2006 is the Medicare prescription drug program (Medicare Part D). Those eligible for Medicare Part A and/or Part B will be able to join a prescription drug plan offered in their area. By paying a small premium – around $37 a month in 2006 – those who join will be able to get prescription drugs at a lower cost. (The *Resources* section on page 42 includes publications about this new program.)

If you are thinking about retiring early, you may have to buy health insurance until Medicare kicks in at age 65 if your employer does not cover health care for retirees. And you should know that employer-provided health benefits for retirees might not be guaranteed, and could be reduced or eliminated by your former employer under some circumstances.

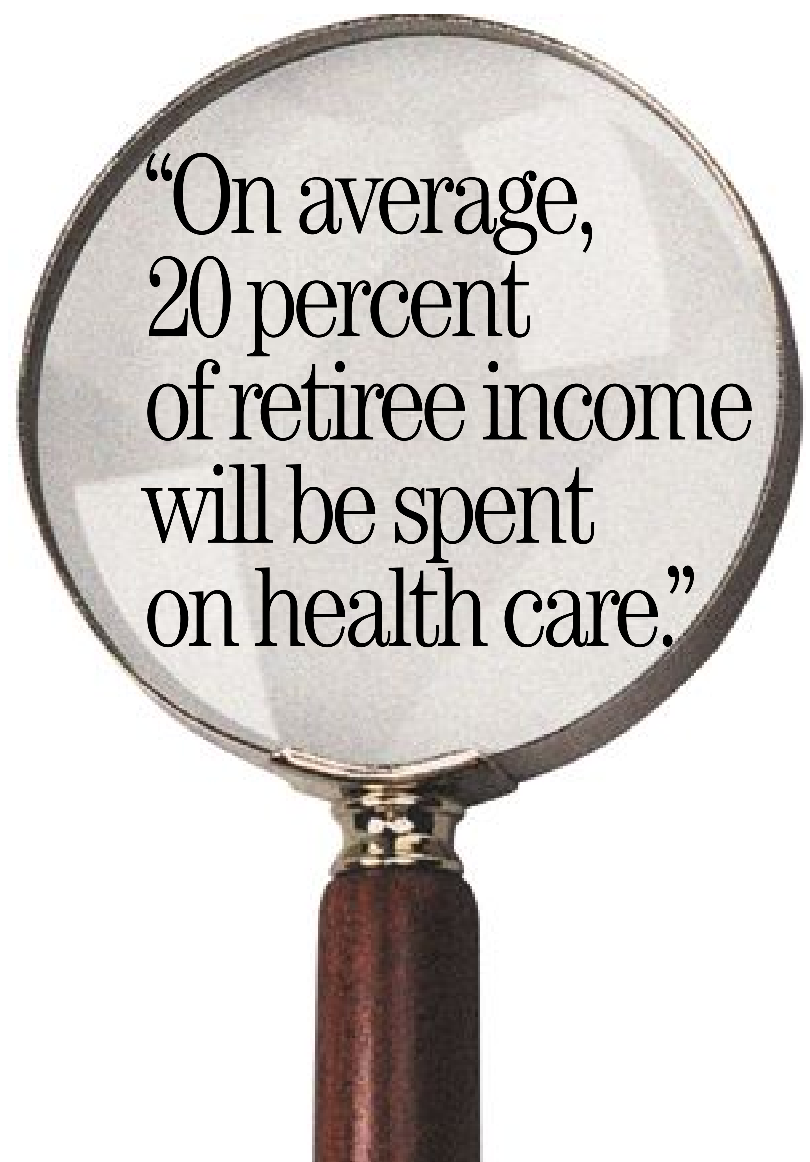
Where Will You Live When You Retire?

Make planning for your future housing needs one of your first priorities since where you live in retirement affects not only your income, but also your emotional, social, and physical well being. It is an important part of your overall retirement strategy. While the cost of owning a home hasn't gone up as much as health care, it is high in many regions. Home heating and cooling costs are rising fast too. Maintenance, condo fees, real estate taxes, and insurance are other costs affected by inflation.

As you age, you may want to look into other types of housing. Independent living facilities, designed for reasonably healthy older people, often require a hefty down payment, say $200,000, and then a monthly fee of about $2,000. Saving for nursing home care, which in 2004 averaged $192 a day, also might make you feel more financially secure, given that at least 40 percent of today's 65-year-old Americans will spend some time in the future in a nursing home.

With medical and housing costs such a big part of a retirement budget, it's no surprise that products and services have been developed to help plan for and manage these costs. Rising health care costs, in particular, could consume all the money saved for retirement. One of the more recent products developed is long-term care insurance, which can protect retirees' assets by paying for medical care in a nursing home and sometimes in your

own home. Premiums vary by the features you choose, such as the amount of the daily benefit paid and protection against inflation. The typical annual premiums for a 60-year old can be as high as $2,500 a year. Buying such a policy at a later age means higher premiums. If you're considering a policy, get some advice, because long-term care insurance is a new product and some policyholders may find the coverage isn't what they need.



To cope with these future expenses, some preretirees are starting special health care savings funds at work, separate from their retirement savings. One example is a new type of account, a health savings account (HSA), which is designed to help certain employees save for future qualified medical and retiree health expenses on a tax-free basis. Essentially, an HSA is a savings account into which you can deposit money for future use. If you belong to a health plan with a deductible of at least $1,000 (for individual coverage) or $2,000 (for family coverage), you may be able to set up an HSA. Individuals who don't belong to a workplace health plan can sign up for HSAs with some banks, insurance companies, and other approved entities.

These accounts can receive contributions from you, your employer, or even a family member on your behalf. You can use the funds from an HSA to help offset future medical costs, and the money in your account can be carried over from year to year. In addition, this type of account is portable; it stays with you as you move from one employer to another or if you leave the work force. To learn more about health savings account criteria, see the *Resources* section.

WORKSHEET F

MONTHLY EXPENSES IN 10 YEARS

(First year of retirement)

	1 Total monthly expenses now (from monthly expenses column in Worksheet E)	2 10-year inflation factor of 1.4106 (3.5%) (except for health care)	3 Total expenses in 10 years adjusted for inflation (Columns 1x2)
Housing			
Mortgage (Including condo fees)			
Rent			
Maintenance			
Food (at home)			
Utilities			
Electricity			
Heat			
Internet/cable			
Phones			
Water/sewer			
Clothing			
Taxes			
Real estate			
Income (state and federal)			
Other property taxes			
Insurance			
House			
Life			
Car			
Disability			
Long-term care			

	1 Total monthly expenses now (from monthly expenses column in Worksheet E)	2 10-year inflation factor of 1.4106 (3.5%) (except for health care)	3 Total expenses in 10 years adjusted for inflation (Columns 1x2)
Loans			
Car			
Credit card			
Other			
Workplace retirement and personal savings			
Personal Care			
Hair cut			
Dry cleaning			
Gym			
Other			
Transportation			
Car repairs and maintenance			
Gas			
Parking			
Public transportation			
Health Care	For a	7% inflation factor, use	1.9672
Health insurance			
Medicare Part B			
Medigap			
Doctor visits			
Hospital			
Medicine			
Over-the-counter medicine			

WORKSHEET F CONTINUED

MONTHLY EXPENSES IN 10 YEARS

(First year of retirement)

	1 Total monthly expenses now (from monthly expenses column in Worksheet E)	2 10-year inflation factor of 1.4106 (3.5%) (except for health care)	3 Total expenses in 10 years adjusted for inflation (Columns 1x2)
Health Care (continued)			
Dental Vision Noncovered items			
Travel/vacations			
Entertainment			
Eating out Hobbies Movies/theatre			
Charitable contributions			
Other			
Gifts Membership dues Pet-related costs			
TOTAL MONTHLY EXPENSES ADJUSTED FOR 10 YEARS INFLATION (other than health)			
TOTAL MONTHLY EXPENSES ADJUSTED FOR 10 YEARS INFLATION (health)			

ABOUT WORKSHEET F (PAGE 23):

MONTHLY EXPENSES IN 10 YEARS

This worksheet will show you how inflation can increase your total expenses in your first year of retirement.

You will notice that Worksheet F has room for some new types of health-related expenses many retirees are likely to incur in retirement. Since your home mortgage will be paid at some point, this may be one place where money will be freed up. You may want to use that money (or other funds) as savings during retirement, whether to add to your nest egg for unexpected retirement emergencies or to plan for inflated expenses later in your retirement.

Here is an example of the calculations you will do in Worksheet F:

$200.00 (amount spent on food each month today)
x 1.4106 (inflation factor of 3.5%)
$282.12 (cost of the same food basket in 10 years)

Note that for many mortgages and some loans, your payments have taken into account the rate of inflation. If you have a fixed mortgage or loan you will not need to do the calculation for this item.