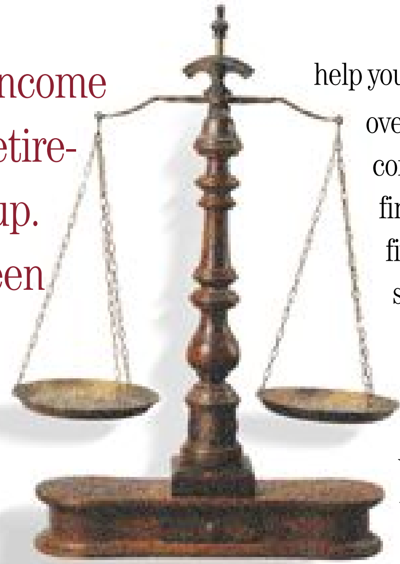
Chapter 4

COMPARING INCOME AND EXPENSES



Now you will compare your income with your expenses during retirement and see if they match up. This is the number you've been working toward as you've investigated your assets and income, then expenses, and finally, figured the effects of time on your money. By the end of Chapter 4, you will discover whether you need to save more for retirement and, if so, how much more...and you will learn how to grow your savings over time.

Few people will have exactly the amount of money they will need in retirement. Most will get a negative figure – a gap – when they do the math. If this is your situation, this chapter can help you figure how much more to save each month over the next 10 years until you retire. After you come up with your totals, be sure to read on to find out the difference a year can make and the five ways to close the gap and boost your savings. Where will you find additional savings? Here are some suggestions for active workers and retirees alike.

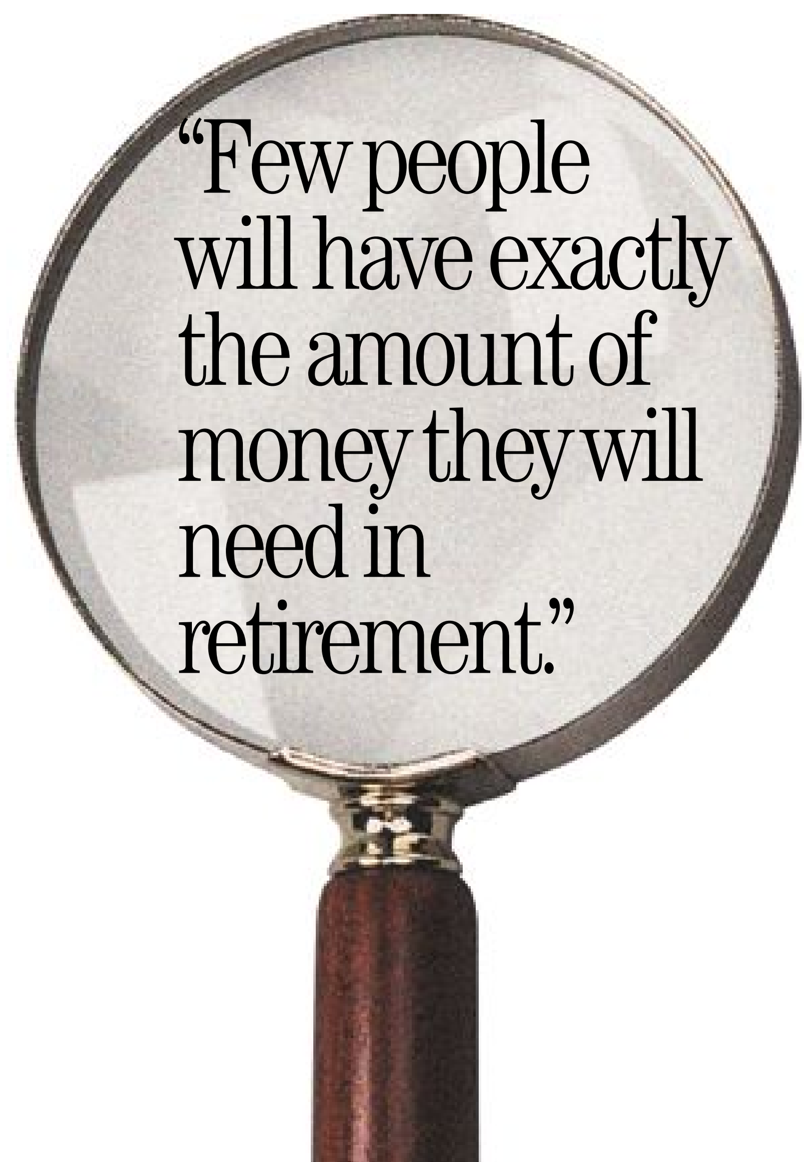
You probably know by now the easiest way to watch your nest egg grow is to make the maximum contribution to your workplace savings plan through payroll deductions. If you are 50 or over, you will have the chance to add even more to your savings through catch-up contributions, ranging from $500 to $5,000, depending on the type of retirement plan you have. And you are reducing your taxes. If there's no retirement plan at work, you can add annual contributions to any IRA accounts you have.

Join the Club

Most people haven't thought about how long their savings will last in retirement or how much inflation will increase over time.

Worksheet G is where all your prior work comes together. Building on the clues uncovered in the earlier worksheets, Worksheet G compares your anticipated income and expenses over the 30 years of your retirement. Making the comparison in dollars valued at the time of your retirement, this worksheet takes into account that while you will have a fixed monthly income, your expenses will increase due to inflation.

At the beginning of retirement, most people's monthly income likely will exceed their expenses; but after a decade or so, expenses begin to exceed the monthly income. Realizing this now will allow you to save and invest any extra income in the early years of retirement so that it will grow and can be used to cover increased expenses later in retirement. Especially if you have a shortfall, this worksheet will allow to see how much you may need to add to your savings. When doing this comparison of your projected income and expenses, keep in mind that the value of a dollar tomorrow is less than a dollar today. The goal is to stay ahead of inflation. For example, a dollar today is worth more than a dollar in 30 years if the rate of return, say 5 percent, is greater than the inflation rate, say 3.5 percent. The worksheet addresses the impact of inflation by converting your anticipated cash flows into a constant dollar value – at the time of your retirement.



ABOUT WORKSHEET G (PAGE 29):

COMPARING PROJECTED INCOME AND EXPENSES

Start Worksheet G by taking the total monthly income calculated in Worksheet D and multiply it by a value adjustment factor you select from Clue 3 (page 31). Select the rate of return with a 0 percent inflation rate. Then multiply this result by 360 – the number of months in a 30-year retirement. Enter that amount in Column 4 of Worksheet G.

WORKSHEET G

COMPARING PROJECTED INCOME AND EXPENSES– ARE YOU PREPARED?

	1 At retirement	2 Inflation adjusted value factor (see Clue 3)	3 Value in dollars at retirement for one month (Column 1 x Column 2)	4 Total value of in dollars at retirement (Column 3 x 360 months)
Total projected income Worksheet D, col 3 total, page 16				
Total projected expenses Worksheet F, col 3 total, page 25 Health Other than health				
Projected value of income less expenses Subtract line 2 from line 1				

Next move on to expenses in row 2, taking the total monthly expenses calculated in Worksheet F. For expenses other than health, go to Clue 3 (page 31) to select an inflation adjustment value factor. Use the 3.5 percent inflation rate (used in Worksheet F) or select another that you believe will reflect inflation over the 30 years of your retirement. For health, use the 7 percent inflation rate used previously or select another rate. Multiply this result by 360 and enter it in column 4. Subtract the total value of projected expenses ("other than health" and "health") over 30 years of retirement in Column 4 from the corresponding total value of your projected income (Column 4).

Here is an example of how this works:

Projected value of income:

$1,400.00 /month
x 0.5174 (5% rate of return, 0% inflation)
x 360 (months in 30 years)

$260,769.60

Projected value of expenses:

Health expenses
$200.00 /month
x 1.3691 (5% rate of return, 7% inflation)
x 360 (months in 30 years)

$98,575.20

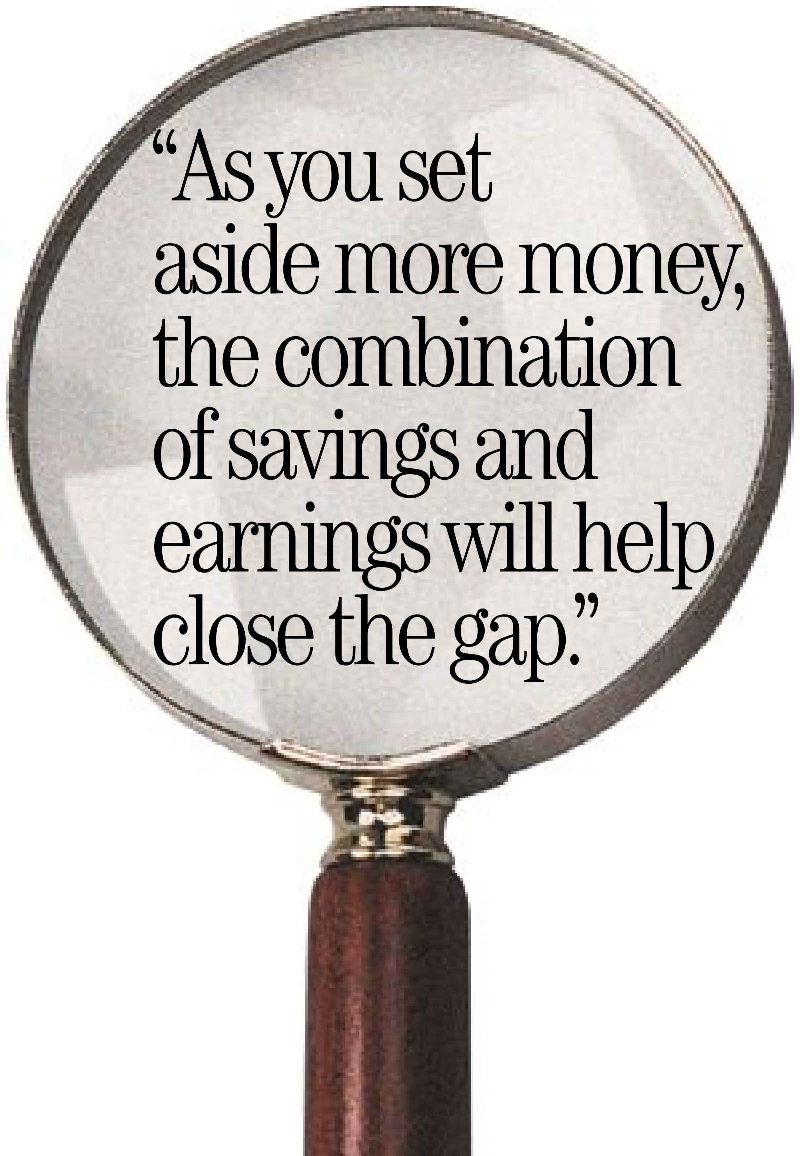
Other than health expenses
$700.00 /month
x 0.8054 (5% rate of return, 3.5% inflation)
x 360 (months in 30 years)

$202,960.80

Total projected value of expenses:
$301,536.00

$260,769.60 (value of income over 30 years)
-$301,536.00 (value of expenses over 30 years)

-$ 40,766.60 (shortfall)



CLUE 3

Value Adjustment Factors

INFLATION RATE	ASSUMED RATE OF RETURN 3%	5%	7%
0%	0.6589	0.5174	0.4175
1%	0.7517	0.5821	0.4636
2%	0.8638	0.6593	0.5179
3%	1.0000	0.7520	0.5825
3.5%	1.0789	0.8054	0.6194
4%	1.1661	0.8640	0.6597
5%	1.3698	1.0000	0.7524
6%	1.6207	1.1658	0.8642
7%	1.9309	1.3691	1.0000
8%	2.3161	1.6193	1.1655
9%	2.7962	1.9286	1.3683
10%	3.3968	2.3125	1.6179

If the result is negative, don't worry. Just about everyone will need to make up a shortfall in savings. Remember also, that it is difficult to project inflation rates, especially for health care, that far in the future. It is better, however, to have a rough idea of where you stand than have no guesstimate at all.

The good news is that time is on your side. Remember the effect of interest compounding and how it can work to make your money grow in 10 years. Each year, as you set aside more money, the combination of savings and earnings will help close the gap. Worksheet H lets you figure out how much you need to start to save today to make up the gap between projected income and expenses. Multiply the gap from Worksheet G by an additional savings factor you select from the top of Worksheet H, based on the rate of return you think you will earn.

For example:

$40,766.40 (gap from Worksheet G example above)
x 0.00644 (5% rate of return)
$262.54 /month to close the gap

Socking away that amount of money over the next 10 years, while getting a rate of return you're comfortable with, should go a long way toward matching up income and expenses over 30 years of retirement.

The good news is that you don't have to save the total amount of any gap between what you have and what you need. Each year the amount you invest will grow, and the growth of your savings lessens the amount you need to save.

WORKSHEET H

ADDITIONAL SAVINGS NEEDED BEFORE RETIREMENT (IN 10 YEARS)

Additional savings factors:

0.00716 for 3% 0.00644 for 5% 0.00578 for 7%

Gap between projected total value of expenses and projected total value of income (from Worksheet G)	1 $
Additional savings factor	2
Additional monthly savings needed (multiply line 1 x line 2)	3 $

Five Ways to Close the Gap

Where will you find additional savings? Here are some suggestions for active workers and retirees alike.

Number 1 - Work your contributions at work

Without exception, retirement planners advise contributing the maximum to your retirement plan, especially if your employer contributes too. If your contributions are made by salary deduction, saving is easier to do and may seem almost painless. And contributing more means postponing, or "deferring," taxes until you withdraw the money at retirement. Then you may be in a lower tax bracket.

Catch-up provisions for some retirement plans allow you to contribute extra amounts if you're over 50. Information about 401(k) catch-up contributions is available from your retirement plan administrator or on the Internet. If your plan has a catch-up provision, act on it now.

Number 2 - Work longer, retire later

Staying employed as long as possible benefits your retirement finances in several ways. Having an income gives your retirement savings more time to grow. A regular income could mean more regular savings. If you work for a company that provides health insurance, you won't have to fully pay for a policy yourself.

You don't have to stay at your same job if there are other opportunities. Maybe you want a new career, one that ties in to your personal interests. Longer life spans and better

CLUE 4

Saving: A Little Goes A Long Way

EXTRAS TO CONSIDER DOING WITHOUT	MONTHLY COST	SAVINGS OVER 10 YEARS AT A 5% RATE OF RETURN WITH ALL EARNINGS REINVESTED
Weekly dinner for two @ $50	$200	**$31,186**
Premium cable TV subscription	$80	**$12,474**
Movie and popcorn for two @ $32 twice a month	$64	**$9,998**
Daily lottery ticket	$30	**$4,678**

health mean many older people have the energy and enthusiasm employers are looking for, not to mention the skills and experience. Many people find the social benefits of working as important as the financial ones.

Number 3 - Cut expenses, big and little

Moving to a region with lower housing and living costs or moving to a smaller home can help narrow the savings gap. Another option is staying in your community but downsizing to a smaller place like a condo or apartment. The same factors that drove up the value of your current house, however, will also have driven up overall housing costs, including real estate taxes. Housing is a major part of everyone's budget so think carefully about where you want to be and whether you can afford it. Keep in mind, however, that moving includes its own financial expenses and means leaving friends, and your community.

Financial planners say that preretirement years are the wrong time to take on large debts, including home equity loans and high interest credit card debt. Buying a new car, boat, or vacation home is not wise if you need to save. Investing that $400 a month (on average 5-year car loan payment) and getting a 5 percent return would put more than $27,000 in your retirement account. Consider keeping your old car or buying a used one.

Preretirement is also the wrong time to give or "loan" large sums of money to your children and grandchildren. Their earning power is usually far better than yours. Now is the time to take care of your finances so you don't have to ask others to bear the financial burden for your care later on.

Number 4 - Social Security, now or later?

The amount of your monthly Social Security benefit goes up the older you are when you start receiving it. For example, a 61 year old man earning $60,000 in 2004 and eligible for his early Social Security benefit at 62 would receive an additional $1,000 a year by waiting 1 year, until he is 63, to collect his benefits. On the other hand, retirees who are seriously ill, who need the money immediately, or who feel comfortable investing their monthly checks may choose not to wait.

For example, a worker turning 62 in 2005 would have a full retirement age of 66 under Social Security. At full retirement, that person's benefit will be $1,281. If, however, that person starts to receive benefits at age 62, his/her monthly benefit would be reduced to $960. By waiting until age 70, that same worker's monthly benefit would be $1,690.

As a general rule, early retirement will give you about the same total Social Security benefits over your lifetime, but in smaller amounts to take into account the longer period you will be receiving them.

If you delay retirement beyond the full Social Security retirement age, you can earn retirement credits, increasing Social Security by a certain percentage (depending on date of birth) until you reach age 70.

Regardless of the age you start receiving Social Security benefits, remember to sign up for Medicare at age 65.

Number 5 - Put your money where the returns are

Educate yourself about investing and consider paying a professional to help you choose the right place for your money. Financial experts say too many people keep too much money in the wrong kinds of accounts, for example checking accounts, savings accounts, and money market funds, which typically have low interest or return rates. Review the discussion in Chapter 2 about asset allocation and diversification of investments.

Adding $200 a month, or $2,400 a year over 10 years to a starting retirement savings balance of $40,000 would more than double your money, assuming a 5 percent rate of return and all earnings reinvested.

CLUE 5

Closing The Gap

With $200/Month Additional Savings At 5% Per Year Over 10 Years

YEAR	START	ADD	RATE	YEAR END
1	$40,000.00	$200/month	0.05	**$44,512.50**
2	$44,512.50	$200/month	0.05	**$49,255.80**
3	$49,255.80	$200/month	0.05	**$54,241.90**
4	$54,241.90	$200/month	0.05	**$59,483.00**
5	$59,483.00	$200/month	0.05	**$64,992.30**
6	$64,992.30	$200/month	0.05	**$70,783.40**
7	$70,783.40	$200/month	0.05	**$76,870.80**
8	$76,870.80	$200/month	0.05	**$83,269.70**
9	$83,269.70	$200/month	0.05	**$89,995.90**
10	$89,995.90	$200/month	0.05	**$97,066.20**