KEEN ON
RETIREMENT

Controlling the Controllable: Planning Your Retirement Spending

Welcome to Keen on Retirement
With Bill Keen and Steve Sanduski

Steve Sanduski: Hey everybody. Welcome back to another episode of Keen on retirement. I'm your co-host, Steve Sanduski. And with me today, as always, Bill Keen and Matt Wilson. Guys, today we are gonna talk about something that I think everybody loves to do. And that is spend money.

Bill Keen: Of all the episodes that we've discussed in the past and topics that we talk about, whether it's taxes, inflation, investments, Social Security, Medicare. You think about all the work that goes in to the planning and accumulation phase of getting yours ready to be able to retire. And this time we wanted to focus on, someday being able to spend the money that we've worked so diligently and planned so diligently to have and to be there.

Matt Wilson: When we sit down with clients and we talk about what do they want to achieve in retirement and, essentially it is what are the goals? What do we want to spend money on? And that's a lot of fun. People really enjoy going through that process. Now, occasionally we have to reign some people in because they can get a little out of hand on the things they want to start spending money on so we gotta be a little realistic too in some of these situations.

Bill Keen: We want to help people find the middle ground, don't we?

Matt Wilson: That's right.

Bill Keen: We have both sides of the equation. We have folks that could be spending quite a bit more than they are. And we encourage them to know that and to understand that if they have some things they want to be doing that they're able to. And to enjoy their resources because, as we said to someone recently who was in our office you don't take it with you. At least as far as I'm aware. But then on the other side we have folks that, like Matt said, are potentially compromising their later years.

You know, it's interesting to say I don't care about having money when I'm in my 80s. But I know a lot of people that are in their 80s that have their health and they have their minds and they care about having money. I'm just here to go on record with that. So we have to plan for all aspects of this equation and make sure that we help people find the middle ground as best we can.

Steve Sanduski: And speaking of equation, Bill, I think we want to start out here talking about the retirement equation. What do you mean by that?

Matt Wilson: Yeah, there's three pieces to the retirement equation and we break it down into what do you have control over? And there's things that you have total control over, things you have some control over and things that you have no control over. How does this fit in with retirement spending? Well, spending is one of the items that you have complete control over. That's a focus of a lot of our planning because when we look at someone's retirement plan, the spending is one of the biggest components of it. It's how much do you have saved and how much do you want to spend. Other factors to it also are how do you have your accounts titled? How have you saved money? Whether it's in IRAs, Roth IRAs or after tax funds. Those things you have control over as well.

Now, the items that you have some control over are how long you work. So that's always an option, is do you retire sooner or do you work longer? And then also your life expectancy. We say there's some control over that because no one knows for certain how long you're gonna live and you can't control that. Especially when it comes to genetics. But you can control your lifestyle and whether you take care of yourself and avoid some of the bad habits that lead to shorter life expectancies.

And then the items we have no control over are market returns and then also what the government does regarding taxation of our investments. Those things we can vote, but essentially we have no control over when those decisions happen and what impact that has. So we want to focus on the things that we have the most control over. So today we're gonna talk about that spending portion of it.

Bill Keen: Goes with our theme of control the controllable. It speaks throughout all of the process here.

Matt Wilson: We looked at a study that JP Morgan put out and they broke out different categories that people over age 65 spend money on. And then they also came up with the percent of their budget that goes toward these categories. There's some interesting data in this. One of the biggest categories that people spend money on is healthcare, which ends up being about 12% of their budget. Very little on education. Most folks age 65 and over aren't spending much on education. Transportation's a large piece of it. That's about 14% of their budget. Then you've got food and beverage, which is another 12%. But one thing I thought was very interesting was the housing costs. And housing costs excluding the mortgage payments? That was a significant sum of individuals' budgets. And it was 30%.

Steve Sanduski: What is that, Matt? What kind of spending is housing, excluding the mortgage?

Bill Keen: This was a surprising fact that a lot of our attendees at our live events saw was that the housing was 30%, exclusive of mortgage. Mortgage was only 7%. So this concept of thinking, well, I'll get my house paid off and then that expense goes out the window ... that's not right, is it, Matt?

Matt Wilson: That's right. The biggest factors that went into this 30% budget category is taxes, utilities, maintenance. You think about all those things that go into just living at your house. You can have it paid for but what does it cost just to live there? And if you go through your budget and you start looking at that it does add up over time. Insurance costs. So just being conscious of that number makes a big difference. Because when we look at it ... and we talk to individuals, especially when we sit down with them before they retire, and we talk to them about budgeting and spending that's one thing. Have you considered that as a factor that you've factored in, is this housing cost. Because you're gonna have maintenance on your house, there's just no way around it. Roof's gonna have to be replaced. Air conditioners have to be replaced. Furnace ... or at least have to be serviced from time to time and sometimes those aren't cheap expenses.

Bill Keen: We actually have clients now, today, that are looking to rent, based on some of the things Matt just mentioned, not to mention mowing the yard and other things, they're renting condos. And really enjoying their lives there. Now on the other side of it we have clients that are buying second and third homes as well. Which, again, if they have the resources that's one thing. But now if you have to replace three roofs ... these are things that you have to consider. They shouldn't be a surprise. That's the purpose of our episode today. We want to make sure that some of these things aren't surprises.

Matt Wilson: What was interesting too about this study was they also factored in travel in this budget. It's about 5% of the spending categories for people over age 65. So I was surprised by that as well. I thought that would have been a bigger portion of a retiree’s budget. But transportation is factored in at 14% on this study, so maybe some of that is getting picked up in the transportation category as well.

Bill Keen: Matt, you mentioned JP Morgan did these studies and they looked at all their consumer banking accounts or a good swath of them. Last episode we talked about data breaches, I think JP Morgan was one of the folks that had a massive data breach. Was this part of that or did they have the authority to look at all those accounts and put this report out?

Matt Wilson: If they're public with it I'm sure they have the authority. Or maybe they stole this data from Equifax.

Bill Keen: Okay. All right. Excellent. Well, as long as it's right for our show today that's all we care about at this point.

Steve Sanduski: Hey, in addition to the spending we also have to think about inflation. Now, in recent years, inflation's been relatively mild. But a lot of the people listening to this will remember the 1970s and early 1980s when we had really high inflation. So what do your numbers show in terms of what we should be thinking about or what we've seen in inflation, perhaps in some of the different categories that people spend their money on?

Matt Wilson: Preserving purchasing power, is what we see as the number one risk that people face in retirement. They want to maintain their standard of living and their lifestyle for the rest of their life. And, essentially, you need to have an asset base that outpaces the rate of inflation, or at least keeps up with it. So looking at that, these categories all inflate at different levels. Now the long-term average for inflation, going back to 1926, is 2.9%. So when we compare these inflation numbers to that we put them in context compared to what a basket of goods has been over the long-term. One of the highest is healthcare.

Healthcare has been inflating at about 4.9%, according to JP Morgan. Now they're using a long-term average on the healthcare expense. We use here at Keen Wealth, when we factor in healthcare spending, we actually break that out as one of the spending categories, one of the goals that we're trying to accomplish, and we inflate that anywhere from 5-6.5%. So it kind of depends on the situation with the client, how old they are and what other factors are placed into it. But we look at healthcare inflating at a higher rate of inflation than long-term average. And even a little bit higher than what JP Morgan's stating here in their study.

Other categories that are high are education, which isn't necessarily surprising to anyone. 5.1% is what education's been inflating at. But again, education isn't a big expense for most retirees unless they're funding a college account for a grandchild or another family member. Everything else, all the other major categories, food and beverage, housing, transportation, entertainment. All of those are less than the long-term average of 2.9%. So food and beverage, housing, those two have been running at about 2.8%. Transportation and entertainment, those have all been just over 2% and below, those are all essentially running at lower than the long-term rate.

That's probably to your point there, Steve, it's been slow here on the inflation front for the last decade. And the projections are for the next decade, too, probably aren't gonna be very high either.

Steve Sanduski: Yeah, and it's interesting with unemployment really low right now. We're just starting to see some pressure on wages coming up so we may ... we've got the federal reserve is on an interest rate increase cycle right now. So we'll see what happens with that here over the next year or two. But let's also talk about when people retire and what are some of the reasons why people retire early. And, if you do retire early and it's unexpected, that may affect what you might be able to spend in retirement. What does some of your data show, guys?

Matt Wilson: Part of this study is they surveyed some of these consumers and they said, "When do you expect to retire?" The median response was age 65, which is pretty common. We see that a lot when sitting down with individuals. They sit down, especially when it's maybe one of the first meetings we're having with them and we talk about retirement. 65 is a very common number. Then they looked at actually retirement and the actual retirement age was age 62. And so that tells us right there that most people are retiring sooner than they expected. And why is that? The reasons for retiring early, the number one reason is the health issue. 60% of the respondents who retired early said it was because of a health reason. But the number two reason for retiring early was they were able to afford retirement.

Steve Sanduski: We like that one, don't we? As a reason, at least.

Matt Wilson: That's right. This does confirm what we see here at Keen Wealth. That expected retirement at age 65, we don't see people sticking it out that long. Especially when we do the planning and if they're able to afford it, we do tend to see people choosing to retire sooner than when they expected when we do run through that analysis.

But 60% of the people that did retire early said it was because of health problem. So this does tell us that you may be forced into retirement sooner than you expected. That's the power of these plans that we talk about all the time, is putting a plan in place because you never know when that happens. And you want to get conscious of this stuff before you retire, not after. Or not have to figure it out the last-minute right before you might be forced into retirement situation.

Bill Keen: A couple of others here were there was a change at the company. So we've seen companies that have voluntary reduction in forces or the involuntary reduction in forces. That was one of the other categories. 27%. Other work-related reason, 22%. I'm not sure what that was. I've had a few people not get along so well with their direct supervisor, that's happened a couple of times.

Matt Wilson: I think that would fall on the other.

Bill Keen: Right. 22% was care for a spouse or family, though. So not necessarily your own health, but the caring for a family member. So, again, things some that are moderately in your control and some that simply are not in your control. So having a plan upfront and vetting for worst case, best case scenarios is so powerful when contemplating this.

Steve Sanduski: Well, guys I notice those numbers add up to more than 100. So it looks like in the study from JP Morgan that people could give more than one reason why they retired early. Am I reading that right?

Matt Wilson: That's right. It could have been a combination of factors that went into their decision making, so ...

Steve Sanduski: Well, the next thing we need to be thinking about here is we've made the decision to retire, now how are we gonna replace our income? And, of course, we want to know how we're gonna replace our income before we make that decision to retire. So what do some of the numbers show in terms of how people are replacing their income? What percentage of their income do they need to replace in retirement? How does that all work?

Matt Wilson: We're very familiar with this process because that's a key component into planning for someone's retirement. Is, okay, we're used to a certain lifestyle pre-retirement. Now, if we maintain that post-retirement, what does that take? One, from an asset base. How much do we have to have saved up? But then, two, the equivalent dollar amount to replace that. Most people, they think or are just not familiar with it, let's say they make 150,000 in pre-retirement income.

Bill Keen: Pre-tax.

Matt Wilson: Pre-tax. That's right. That's a gross income. That's your salary before you're retired. That same amount of pre-tax income is not needed when you retire to generate the same amount of after tax income. The way to think about that is, okay, if you're making 150,000 pre-tax you might only be clearing 8 or 9,000 a month after taxes. We talk to people a lot about what are you clearing, because here's the things that go away when you retire. You don't need to save for retirement anymore. And that, on average, is about 9% of someone's pre-tax income, goes towards pre-retirement savings. So that goes away. So there's 9% right off the top of your expenses that you don't need to replace.

The other big category is taxes. Most people see about a 14% drop in taxes from pre-retirement income to post-retirement income. And there's a few reasons for that as to why their taxes go down. And then the other factor is people spend a little bit less. This is on a national level, so this is on JP Morgan, they say about 5% less of what people spend in retirement than what they did pre-retirement. So if you add those three categories up that is 28% of your pre-retirement income that you don't need to replace. You only need to replace about 72% of it to equate to the same after-tax income.

Bill Keen: That's important to understand because if someone listens to that on a cursory level they might just think he's saying, hey, you need to reduce your lifestyle by a third. No, what he's saying is to have the same standard of living you need less pre-tax income. That's important to make that distinction.

Matt Wilson: That's right. We also look at then how do you make up for that? Where does that come from? There's a portion that will come from Social Security. And for a married couple it's about 27% of their post retirement income will come from Social Security with the rest coming from your investment assets. So, you're only having to replace 72% of your income. 27% is from Social Security, 45% is from your savings. And then you have the change in taxes of pre-retirement savings and expenses of 28%. You add all those together and that gives you 100% of your pre-retirement income in retirement.

Bill Keen: Not that we need to go real deep here on the taxes, but just to give you an idea, Steve, part of Social Security is not taxable depending on your income. You also don't pay FICA tax when you're retired. So on your Social Security income, your pension income if you have a pension, your IRA distributions. You no longer pay the 6.2% going into FICA for Social Security on the first 127,000 or the 1.45% for Medicare that's actually on an unlimited amount of income. That goes away in retirement. On top of being in typically lower levels in the brackets as well. And we'll see how that plays out here for tax brackets going forward.

Steve Sanduski: Well, let's talk about some of these spending categories here in retirement. Particularly the unexpected scenario. So, good, competent fiduciary financial advisors can help you plan for the expected expenses but what are some of these unexpected scenarios that you guys have seen in working with your clients?

Bill Keen: We sat down and we brainstormed a list of things that we see come up in the firm here. One is an illness or disability. Two is nursing home or in-home healthcare. The third was the death of a spouse and, as tragic as that is on a lot of levels, just the loss of that spouse's pension or their portion of Social Security actually does make a financial difference. We talked about victimizations by frauds and scams. Unfortunately, we're seeing more of this, where someone gets involved in something that looks like a too good to be true investment that truly is and they lose all or a portion of their investment. That's something that we see hit. We also see illiquid or non-performing investment. We'll sit down with folks at times and they think they have a pool of assets they can draw from and they realize they were sold something that has a surrender charge or something that's completely illiquid for 10 years or more.

We also see people getting into a lawsuit situation. So we always recommend folks have at least that umbrella policy. Steve, do you carry an umbrella policy with your property and casualty insurer?

Steve Sanduski: I do.

Bill Keen: Yeah, could you imagine someone falling down walking their dog in your yard and it compromising your retirement? That's an unexpected situation or scenario. Family emergencies. Long-term support for parents or children. We know that if something happened and your daughter or son got into a bad marriage and that spouse ran off, and you hate to talk about it and it's not fun, but they ran off and took the resources. Those are things that, most of our clients at least, would step up and would help those kids or grandkids. These are things that we see regularly that come up that maybe aren't thought about. Also weddings. Travel to funerals or weddings unexpectedly. And the weddings themselves. Those things you kind of see coming. But I'll tell you this, when I see folks having 10,000 set aside for a wedding, in my experience that's barely covers the dress anymore, Steve.

Steve Sanduski: I hear that.

Matt Wilson: Of course, you can go to the courthouse. I hear it's about $75. So there's a wide range of wedding expenses there.

Bill Keen: We could maybe advise our clients on that as well.

Matt Wilson: Yeah.

Bill Keen: So other things. Holidays. You might think, "How are the holidays an unexpected expense?" Well, invariably we sit down with folks come January and they talk about, "Uh, yeah. We need to clean up some of the money we have on credit cards from an unexpected expense over the holiday season." Again, divorce. Unfortunately. We've written about this in prior blogs. That's more common these days. Unfortunately, with folks that are retired. Matt mentioned home repairs. Also other things, such as natural disasters, which we've been talking about lately in the news, unfortunately. Where insurance doesn't cover something or deductibles are high. These are all things that we talk about being unexpected scenarios that, yeah, can you plan for all of them? No. You can't have money set aside for all of them. But I think being aware of that these issues could come along, and having some assets set aside, does make sense in the planning process.

Steve Sanduski: And I think one thing that is important for us to chat about here, is you talk about these unexpected expenses is okay, let's say one of these happens? What are some of the levers that you can pull, so to speak. Meaning, okay, if I do have an unexpected expense, what are some of the ways that I can actually pay for that expense. I know there are a few levers out there. What do you guys typically work on in situations like that?

Matt Wilson: One of the common levers is working longer. Okay, we were gonna retire at 62. What if we work till 65? We've got three years there where instead of spending money we've actually saved money. We've pushed off Social Security. You know, those types of aspects. The money doesn't have to last as long because we're projecting in a end of plan, we call it. We don't know the date of death for sure but we can come up with some ranges there.

The other levers are could we save more money between now and retirement? What impact does that have? What if we adjust our Social Security strategy? You can take it as early as age 62, you can delay it up to age 70. There's a lot of combinations in between there so we can look at different Social Security strategies and see what impact they have. What if we spend less money in retirement? That's probably the biggest one of all of them that we look at, is just reduced spending over the life of the plan. Because that has a big impact.

Bill Keen: Especially when you're at retirement age and you don't have a whole lot of time to save a whole lot more.

Matt Wilson: That's right. Some of it's just, here's what's possible. And then we talk about what impact does overspending have? And then lastly, people do ask us from time to time, "Well, what if you just increase the investment risk." When we have more investment risk we also have increased the likelihood of an adverse event happening. So that actually ends up, in most cases, decreasing the probability of success at our plans. Increasing the investment risk. Sounds kind of intuitive but that's not a lever that we like to pull. And we'll show it to people, we display it to them.

Bill Keen: That's right. And I think the power to the process, at least that we walk people through at Keen Wealth, is we are able to adjust all of these levers live. With our clients at the conference table. On the big screen. And just simply see the effects of each of these levers on their outcome or their probabilities of success over time. It makes it very interactive and understandable.

The other thing that we didn't talk about yet is just, everybody is different about how much they want to leave at the end of plan. And that makes a difference. We probably could add that as ... it's not really a lever, it's a goal. But if someone doesn't care about leaving some big estate to their next generation, that does make a difference. But again, as Matt mentioned, we don't know the date of death. So that whole strategy. Make your last check bounce. We don't promote that strategy at all as a concept. But it does make a difference, what your desire is to leave to the next generation. But we wouldn't want to push it that close.

Steve Sanduski: Well, guys, great. Let me just briefly summarize what we've talked about here today. The first is, as it relates to spending, we really want to make the most of what we can control. So there's certain things we can control, there's certain things we have some control over and other things that we really have zero control. So we really want to make the most of those things that we can control. And then, also, we really want to be intentional about how we're spending our money. And evaluating are we spending our money in ways that really brings us the most happiness and we're really conscious about spending money in ways that help improve our life.

Another thing we need to consider, we talked about, is inflation. And while inflation historically might have averaged 2.9% or so since 1926, different subcategories within that maybe higher or lower. And some of the areas, like housing for example, I think you showed, was actually higher than the 2.9%. So we have to consider that. Also, income replacement. That the math actually works in your favor to some extent when you're in retirement. And that $150,000 pre-tax income while you're working, you need, maybe, roughly 108,000 or so I think was the number you mentioned there, Matt.

Matt Wilson: Mm-hmm (affirmative).

Steve Sanduski: In pre-tax income after you retire. Just because of changes in spending and taxes. So we have to really think about where's the income gonna come from. And then we talked about some of the unexpected expenses in retirement. And we have to understand that, yeah, there's probably gonna be some of those. And then you really finished here talking about some of these levers to pull and that there are a number of ways to handle a situation if there's some unexpected expenses in retirement. Or for some reason you need to reduce your expenses or find a way to pay for unexpected things, there's a lot of levers to pull there. So lots of great ideas in our conversation here today.

Bill Keen: This part of the process should be fun. It should be exciting. And if you've listened closely to our episode today ... it might be perceived that we're talking about restriction and cutting back and things not working. The reality is it's about getting out ahead of these issues so that you can design the next half of life that is fun. That is exciting. And something that will work, though. That's the key to it. So, yeah, if you have to work a couple more years and you want to make that decision so that you can go into that next phase fun and exciting and not feeling restricted, and having a plan that may not work long-term, that's the purpose of this. And so I wanted to leave it with that. This should be something that you look forward to in designing the next half of life.

And, finally, and I know, Matt, we talked offline about this. This is something that we say get figured out before you retire. Do not get retired six months into it and say, "Oh my goodness. We needed 7,000 a month, not five." Or, "We needed six." Because at that point it's going to be very difficult to go back and obtain that good job that you may have had for 30 or 40 years. So please do the work up front. Take the time to look at what the spending is. And take it and run it by somebody, a competent fiduciary advisor. We do this regularly for our clients, after they've done the homework, though. Because we can't do that homework for folks. They have to do the homework. And that's looking at their budget and really getting thoughtful about it. And run it by us and we'll tell them if we see holes and we share our wisdom on what we've seen over the last

25 years and make sure that we have a plan in place that will work and that folks can be excited about.

Steve Sanduski: Excellent. Well, hey, thanks guys. Another great show. And, Bill, I'm glad you mentioned that last point there about this should be a fun part of the process. To really think about how you're gonna be spending your money in retirement. How you're gonna be spending your time in retirement. It should be something you look forward to, have fun with and so I think that's a great way to wrap up today's show.

So, Bill. Matt. As always, thank you. Appreciate all the great work that you guys are doing and look forward to the next conversation.

Bill Keen: All right. Thank you, Steve. And thanks a lot, Matt.

Matt Wilson: Yep. You're welcome.