5 Ways Spending Changes in Retirement

Prepare to change your spending mindset as you go from saving for retirement to living in retirement.

As you near retirement, you face many challenges preparing to transition from working to enjoying the fruits of your labor. You're not alone—on average, more than 10,000 baby boomers retire each day[1].

One thing you need to understand is your spending habits. Since you're no longer receiving income from employment or contributing to your retirement plan, you will now begin drawing down your savings to pay for your expenses.

By fully understanding your habits and expenses, you can position yourself for retirement spending success.

1. Your essential and discretionary expenses evolve

Your life throughout retirement is likely to change over the years. Many new retirees focus on activities such as travel, hobbies and time with family—that means higher expenses in discretionary spending than when you were working. However, as you age into your 80s and older, there is typically a shift in your expenses from discretionary to essential, as things like healthcare become more important. There is no way to know exactly how your individual essential and discretionary expenses will change over the course of a 30 or 35-year retirement, but you can be sure that they will change and evolve during that period.

2. Your risk tolerance changes

Risk tolerance indicates the amount of risk you are comfortable taking in order to achieve a specific investment return. Typically, more aggressive risk tolerance involves investing a higher percentage of assets in the stock market, while a more conservative posture may involve a higher allocation to fixed income products like bonds.

Prior to retirement, risk tolerance is a more flexible concept because you're trying to grow your assets, you have time to recoup losses and you may be actively contributing to your company retirement plan. You can afford to be more aggressive because time is on your side.

However, in retirement, your risk tolerance may change. You may be inclined to take on less risk with your investments because that money has to last through your entire life. As you move into retirement, take the time to re-examine your ideas around risk and investment as they may change.

3. Your taxes are triggered upon withdrawal

If you are like the vast majority of retirees, much of your retirement savings is in tax-deferred savings accounts. That means that when you withdraw those assets to cover expenses in retirement, they will be taxed at your ordinary income rate. As you develop your income strategy you should analyze your entire portfolio from a tax viewpoint. This will give you a better sense of how much money is available to spend and how much you will have to put aside for taxes.

How much retirement income you will have after taxes depends on your federal tax bracket and where you live. For example, people in the 25 percent federal tax bracket that live in Pennsylvania, which has a 6 percent state tax rate, would be paying 31% on their retirement plan distributions, excluding local taxes. So, if they withdrew $30,000 from their tax-deferred IRA or 401(k), they would have $20,700 after paying $9,300 in taxes.

4. Your healthcare expenses increase

Research reveals that healthcare expenses rise in retirement as you age. HealthView Services, in it's 2017 Retirement Health Care Costs Data Report, projects that total projected lifetime healthcare premiums, deductibles, copays, hearing, vision, and dental expenses for a healthy 65-year-old couple retiring in 2017 add up to $404,253 in today's dollars.[2]

Since healthcare is one of the largest expenses in retirement, consider reserving a portion of your annual budget to your own health saving fund. If you have some savings in a Roth IRA, for example, you could dedicate those funds to cover healthcare spending. In addition, if you have a health savings account, any funds left from when you worked can be used to cover health care expenses in retirement.

5. Your guaranteed income matters more

Retirement means big changes, not just in your lifestyle, but in your cash flow and your spending patterns. To help make things more predictable, consider annuities as another source of consistent income during retirement. Annuities provide regular, pension-like payments that can help smooth out your income stream throughout a long retirement. Some annuities offer riders that provide a guaranteed income stream for life.

Getting ahead of the changes in retirement

Consulting with a financial advisor before you retire can help you position your savings appropriately based on the options available. Seek an advisor who is familiar with retirement spending patterns and can help you create a spending plan that will securely carry you through retirement.

Ideally, you should create a retirement savings plan as early as possible to benefit from the power of compounding. It's never too late, however, to take steps to improve your retirement security.

[1] The Washington Post, "Do 10,000 Baby Boomers Retire Every Day?" July 24, 2014, https://www.washingtonpost.com/news/fact-checker/wp/2014/07/24/do-10000-baby-boomers-retire-every-day/?utm_term=.633833980f65

[2] HVS Financial, 2017 Retirement Health Care Costs Data Report, http://www.hvsfinancial.com/2017/06/12/2017-retirement-health-care-costs-data-report/

Annuities are designed for long-term retirement saving. Early withdrawals may be subject to withdrawal charges. Partial withdrawals may reduce benefits available under the contract, as well as the amount available upon a full surrender. Withdrawals of taxable amounts are subject to ordinary income tax and, if taken prior to age 59½, an additional 10% federal tax may apply.

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