

RETIREMENT

How to Know When You Can Retire

You've scrimped and saved, but are you really ready to retire? Here are some helpful calculations that could help you decide whether you can actually take the plunge.



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See if you can relate to this ... You have contributed to a 401(k), 403(b) or other employer-sponsored account at work, maybe you're paying extra on the mortgage or have already paid it off, you keep cash on hand for those unexpected expenses or upcoming big-ticket purchases and you often wish there was a way to pay less in taxes.

You have worked for 30 or 40 years and are at or approaching Social Security eligibility and are now looking at when to take Social Security to maximize your benefits.

Sound familiar? Now, here's what often comes next ... You look at the account statements and begin to wonder whether the investments you have are the right ones to own for where you are in life. You begin weighing your options for making withdrawals from your retirement accounts. You aren't sure exactly how this is done, and you're nervous about the risk of a stock market pullback and the possibility of running out of money. And then it happens, you begin searching the internet for answers. (That may even be how you ended up here!) After a lot of searching and reading you realize that there are just too many opinions to choose from, and you resort to simply eliminating options that you're not as familiar with or have heard negative things about. Then you take what's left and try to put together a coherent strategy while continuing a search to find information that supports what you have contrived.

This is an all-too-common situation. Maybe this is exactly where you are or perhaps it describes something similar, but either way, you wouldn't be reading this far into the article without some truth to what I am describing.

Regardless of the details, what you do next is critical to your long-term success. The decisions you make will determine the trajectory of your financial future, and it's imperative to have a good plan to follow.

What to Do and How to Know When You Can Retire

There is a lot to this if done correctly, and at some point you're probably going to want some professional help, but there are a few things you can do to get moving in the right direction.

Calculate Your Income Need

Before you jump in and begin picking from the assorted list of investments that you found on the internet or that a broker recommended, you should understand that this is the very last step in the process. You would be well advised to set all of that aside for now and begin with your income needs. You cannot sidestep this, because you have to know this figure before you can do anything else.

To do this right, sort through and total up all your bank payments, then your insurance payments, then your tax payments, then your monthly living expenses, and don't forget the irregular expenses throughout the year, like gifts and travel. You want to know how much money you spend over the course of a year.

Another point to make here, realize that this spending amount will be for when you are retired – not while you're working. Things are going to look different for you in retirement, so be sure to think about how you will be spending your time in retirement. You'll have a lot of time to fill!

Calculate Your Income Gap

Once you have this figure, subtract from it your Social Security or pension benefits. Any fixed income you have coming is already solved for, so we have to figure out what your "income gap" is between what you need and what income you already have coming in.

Identify the Return You Will Need from Your Investments

So, the amount you have determined as your income gap needs to be annualized and divided by the amount of retirement assets you have designated for retirement. This calculation will tell you what yield you need from your investments. This figure shouldn't be more than between 4%-5% at the most. If it is higher, then you may not be ready for retirement just yet.

For example, say you have an income gap of \$70,000 per year and retirement savings of \$2 million. Divide \$70,000 by \$2 million, and you find that you will need an investment return of 3.5% to support your living expenses. That's well within an acceptable range.

Remember that you stretch your resources too far right out of the gate, you're just setting yourself up for failure. This is no time to be overly optimistic with your calculations and will want to lean on the side of caution.

Hedge For Inflation

Unfortunately, there is inflation in your future that you will need to account for on top of market volatility. The income gap amount you came up with a moment ago will need to be hedged due to the future effects of inflation. The amount of money you need today will be greater in the future simply due to the price of goods and services increasing over time.

By using a historical figure for inflation of 3.5%, we can estimate that in 15 years your income need will increase by 68%! So, you have to consider this headwind in your calculations and realize that you need two pools of retirement assets, one to generate the income you need now and another designated for income in the future. One portfolio would be allocated using income producing assets while the other allocated for long term growth.

Find Income-Producing Assets

When you're looking to fill your income gap, the obvious solution is to generate more income to fill it. How this is done can vary from person to person, but the primary outcome you're looking for is income regardless of how you go about it.

If you're wanting to remain active, you can consider taking on a part-time job, start or buy a business, acquire some rental properties or work another full-time job that you enjoy.

If you prefer not to work and want passive income, then you're going to have to rely on income-oriented investments. This would be through specific types of income annuities or select alternative investments that are designed specifically for income.

When doing this, be sure you are working with a qualified professional who is properly licensed and who can education you on your options.

Get A Checklist

It is always a good idea to work off of a checklist, and regardless of where you are in this process, there are likely a few tweaks that can help increase your probability for a successful retirement. I encourage you to formulate a plan that articulates where you are, where you're going and what needs to be done to start receiving the income you need.

You can download a retirement checklist for free and use it as a guide as you prepare for your retirement. In addition, taking a retirement readiness quiz can be a good idea, too. A quiz is a useful tool to measure your level of understanding about a topic or your readiness for progressing toward something.

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Brian Skrobonja is an author, blogger, podcaster and speaker. He is the founder of St. Louis Mo.-based wealth management firm Skrobonja Financial Group LLC. His goal is to help his audience discover the root of their beliefs about money and challenge them to think differently. Brian is the author of three books, and his Common Sense podcast was named one of the Top 10 by Forbes. In 2017, 2019 and 2020 Brian was awarded Best Wealth Manager and the Future 50 in 2018 from St. Louis Small Business.

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