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How to Build Your Budget in Retirement

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Look at your lifestyle today. What does it cost? What expenses will stay in retirement, and what will go away? (Getty Images)

Shifting from your income-earning years to retirement can be an adjustment as you go from a lifetime accumulating assets to a time when you will be withdrawing to fund your lifestyle.

The earlier you look at how much you will need during retirement, the more time you will have to adjust your current routine.

Conventional wisdom is your spending will go down in retirement. That may or may not be true. For most, spending stays the same or increases, especially at the start of retirement, says Thomas J. O'Connell, president of International Financial Advisory Group in Parsippany, New Jersey.

"Every day becomes a Saturday in retirement, so getting used to that takes time," O'Connell says. "Plus, it's simply human nature to live in a lifestyle we become accustomed to. Typically when we end one expense like a home mortgage payment, we pick up another like vacations, health care, long-term care coverage."

There is nothing conventional about retirement, says Nancy L. Skeans, partner and managing director of personal financial services at Schneider Downs Wealth Management Advisors in Pittsburgh.

"Your retirement will be unique to you," she says. "I encourage my clients to define what they want their retirement to look like, and then we can start putting projected dollar amounts to that scenario."

Some individuals do not own two homes now but want a second home in a warmer climate, or they many want a second place closer to their children and grandchildren, Skeans says.

"Some want to start traveling in retirement to all of the places they were not able to go while working," she says. "These examples could mean that retirement is more expensive, not less."

One of the first steps is to estimate how much money you will need for retirement. There are plenty of "rules of thumb" on what you need to save. One states you should aim to replace 80 percent of your preretirement income. Another suggests saving 10 times your income at the age of 67.

However, you might need to throw these rules out the window.

O'Connell points to the rule that states you need 10 times your last year's salary to provide retirement income.

"If my last year's salary was $75,000, does anybody really think $750,000 is enough to retire with?" O'Connell says. "If you use the old 4 percent rule that means you can take $30,000 a year, but you can't touch principal."

Rules of thumb are not a good method of determining what your retirement might cost unless you are relatively young, Skeans says.

"For the young audience, my No. 1 rule of thumb is to save as much as you can for retirement starting as early as you are able," she says. "This does not mean you have to become a hermit or a penny pincher. It means don't wait until you are 40 to start saving for retirement. The earlier you pay attention to this lifetime goal, the more flexibility you will have."

To start building an actual line-item budget, the first step is to look at your lifestyle today. What does it cost? What expenses will stay, and what will go away?

"Many individuals do not really understand where their dollars go today thanks to ATM cash withdrawals and credit cards," Skeans says.

As you create a retirement budget, remember to include line items for housing expenses. Even if you've paid off your mortgage there will be on-going property taxes, maintenance costs and upkeep. Think new roof and new hot water heaters. Other basic line items include general living expenses such as food, utilities, cellphone and internet. From there you can start looking realistically at your vision for retirement and how that could impact your budget.

Want a second home? Create a line item in your budget.

"If you are 50 years old today and you want a second home in Florida at age 65, with the help of the internet, think Zillow, and historical inflation," Skeans says. "The purchase price of a home in the future can be estimated and planned for."

There are a number of items that people commonly forget when planning a retirement budget. One of the most common is their automobile, Skeans says.

"If a person purchases a new car now every six years, then the retirement budget should reflect this behavior," she says.

Another item, though it does not apply to everyone, is a wedding for a child.

"Today many adults are seeing their children marry while the parents are in retirement," Skeans says. "If that happy event is going to occur during retirement, perhaps one needs to capture it in the retirement budget."

Inflation is a factor many people don't account for when thinking about retirement. A dinner out today will likely cost a lot more 20 years from now, and the same goes for just about everything else.

"Even though the government has been telling people for a number of years there is no inflation or low inflation, anyone who shops at the grocery store or pays for health care or college tuition knows that that is just not true," O'Connell says.

"If inflation were only 3 percent per year that means your needed income doubles every 24 years," he says. "So if you are 41 now and need $100,000 to retire on by the time you're 64, you will need $200,000 just to stay the same, and by 88 you will need $400,000."

Long-term care is another expense people tend to ignore.

"A recent statistic came out and said that there is a 75 percent chance that someone who is at least age 65 will have some need for a nurse in the home or a nursing home at some point," O'Connell says. "In New Jersey, the average cost for a private nursing home is between $9,000 to $10,000 per month. You could be financially wiped out rather quickly if unprepared."

Last but not least, any estimated retirement budget needs to have flexibility.

"The people who retired in December of 2007 probably did not plan for the financial crisis of 2008," Skearns says. "But those who understood their financial needs and developed a plan in advance for retirement expenses were definitely better able to cope with the unexpected."