

Budgeting in Retirement

Creating a formal budget is an effective tool for managing retirement expenses and incomes.

Projecting retirement expenses is a critical step in planning for a successful retirement. However, only 28% of those in or near retirement have a written budget in place.¹ Creating a written budget will not only help in more accurately assessing a family's retirement readiness, but can also provide guidance for what possible adjustments can be made during retirement if the need arises.

The Budgeting Process

Budgeting is the process for tracking, planning, and controlling cash flow. The process begins by gathering data on your incomes and expenses. This information will then be used to create a cash flow statement, which will consolidate all of your incomes and expenses in a single location. This document will be the basis for a cash flow analysis, with the ultimate goal of creating a spending plan to follow during retirement.

Creating a Budget

The end goal of the budgeting process is to create a detailed list of the sources and uses of income over a period of time. The below steps will walk you through the budget creation process:

1. **Gather financial statements** – The first step is to gather all information that will show any expenses you incur or income you receive. These items might include tax returns, check stubs, bank statements, investment accounts, recent bills (utilities, data services, credit cards, etc.), insurance policies, and any other information regarding where your income comes from or where it goes.
2. **Document all of your sources of income** – By sorting the documents gathered in Step 1, you can find all your sources of income during the year. Relevant documents would include a recent pay stub or your most recent W-2. If you are self-employed or your pay is reported on a 1099, you will want to include those sources, as well as income from investments, Social Security, pensions and retirement accounts.
3. **Create a list of monthly expenses** – In this step, it is important to not only review your actual spending history over the past few months, but to also consider expenses you expect to incur in the future. Write down a list of all the expenses you incur over the course of a month. This list might include food, clothing, housing, debt payments (mortgage, auto, credit card), insurance premiums (life, disability, long term care, medical, home, auto, umbrella, etc.), utilities, cable/internet/wireless, gifting, taxes (federal, state, property, etc.), and on and on. This list should be as detailed as reasonably possible, without becoming a record-keeping burden. Then, identify any other known future expenses along with irregular expenses, such as car maintenance, home repairs, etc.

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4. **Designate expenses as “essential” and “discretionary”** – Dividing expenses into categories can help you identify where you have choices in what you spend. Essential expenses are those that are required to maintain a basic standard of living. They tend to be your most important expenses and are usually recurring and relatively stable. Examples of essential expenses include food, clothing, housing, transportation, taxes, etc. Discretionary expenses tend to be items that are not deemed as “necessary for survival”, but increase the quality of your lifestyle and add enjoyment above and beyond your daily routine. These types of expenses might include entertainment, vacations, hobbies, dining out, etc. Discretionary expenses typically vary year-to-year and can be adjusted as needed. In other words, essential expenses tend to be needs, while discretionary expenses tend to be wants. Finally, as you list your expenses, don’t forget about the “future” expenses you identified in the prior step. Include those goals as expenses, and contribute savings toward them regularly.
5. **Total your incomes and expenses** – Comparing your total income to your total expenses allows you to evaluate whether or not you are living within your means. Leading up to retirement, your goal should be to spend less than you earn so that the additional income can be saved for retirement. Once retired, you will need to rely on your investment accounts to produce income. By determining how much you will need from your savings, you can determine what your account withdrawal rate is and whether or not your savings can support those withdrawals.
6. **Make adjustments to expenses** – It is important that your spending plan fits with your resources and objectives. In situations where expenses are higher than income or an income source becomes less certain, you should examine your discretionary expenses to determine where reductions can be made. In retirement, these reductions may be temporary, perhaps due to uncertain market conditions, or they may be permanent if your current spending level is determined to be unsustainable. In contrast, there may be circumstances where you can increase your income and, therefore spend more. For example, if your investments outperform their target return or you receive additional capital (for example, an inheritance), your accounts may be able to generate more income. In all cases, analysis of your income and expenses should be an ongoing process, and adjustments may need to be made throughout retirement.

Create a Spending Plan and Appropriate Asset Allocation

Once you know where you stand financially and have a good understanding of the spending goals you wish to meet, you are in a position to design a plan that will move you in a direction to help you meet these goals. You will begin to understand how aggressively your investments need to be positioned in order to achieve the objectives you set, and can then design a plan that fits both your resources and objectives. Keeping your spending goals aligned with your investment objectives is a critical part of the process and essential to budgeting successfully. You may need to prioritize financial goals, if you do not have sufficient resources to fully fund each goal.



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Monitor and Adjust Your Budget

Over time, changes to tax laws, estate laws, market environments, and your personal circumstances will occur and may require changes to your plan. Having a budget and adjusting your budget accordingly will allow you to better react to these changes as they occur.

Budgeting Tools

Baird has several tools available that can make the budgeting process easier and assist in creating a cash flow statement. The level of income and expense detail desired will help determine which resources might be appropriate for a given situation.

- ***Income and Expenses Budget Worksheets*** – For those just starting the process, Baird offers budgeting worksheets that can help you compile a list of your incomes and expenses. These worksheets provide both summarized and detailed categories to prompt thought on just where your income comes from – and where it goes.
- ***Comprehensive Financial Plan*** – Completing a financial plan is the best way to create a comprehensive cash flow analysis and evaluate its sustainability. A financial plan will incorporate expense needs with fixed income sources, investment accounts and income, taxes, and estate and insurance needs. In addition, a probability analysis can be incorporated to more accurately simulate market fluctuations that you are likely to experience during retirement. A financial plan is also easily updated as time passes to ensure that you remain on track to meet your spending and other financial goals.
- ***Baird Cash Management*** – Adding Baird’s Cash Management services to your account can allow you to more easily track your expenses. The expense monitoring feature on your checks will report expense types on your monthly statement. This information can be imported into Quicken, to take advantage of that program’s advanced budgeting features. The eBill Management service available as part of Cash Management can also enhance the expense tracking capabilities on your Baird account.
- ***Microsoft Excel Templates*** – Most versions of Microsoft Excel offer a variety of built-in budget templates. To access these templates within Excel, click the office button located at the top left corner of the screen, and choose “New”. In the left-hand menu of the window that appears, choose budgets from the Microsoft Office Online section of the menu. Choosing “Home Budgets” will then display the numerous personal budget templates available within Excel.

¹ 2008 Wachovia Retirement Survey of 2,100 respondents age 55-70 with household assets of \$75,000 excluding real estate holdings.