

Episode 22: How to Get Those Unknown Expenses in Retirement Right, Pt 2

Bob French 00:00

The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. Let's see. Wade prefers to budget one way, and Alex prefers another. I think I'll stick with the guy who wrote the book on this.

Alex Murguia 00:48

Hi, everyone, and welcome to Retire with Style. I'm Alex

Wade Pfau 00:53

And I'm Wade.

Alex Murguia 00:55

And today we're going to continue our series on budgeting for retirement. And last episode, we sort of set the groundwork with regards to budgeting and what issues you may face and what are the building blocks you want to think about. Effectively, we're quantifying your goals for retirement, or quantifying what risk you want to take off the table. And we spoke about one method, which was the replacement rate. And we got into a concept that Wade wrote about that we think blends very well, which is a safe savings rate. Today, Wade, what are we going to be tackling in terms of budgeting? Next approach?

Wade Pfau 01:35

Yeah, so today, what we want to get into is actually, if you're more like me, unless like Alex, and you want to actually budget. That's everyone that's doing that. How do you think about actually like defining the categories, collecting past expenses, looking at average expenditures over time, and then also thinking about how to translate that for retirement as well. So that's the objective for today.

Alex Murguia 02:02

Okay, and one of the things that we just want to, I want to make a point, when we're talking about the replacement rates, and if you missed that, you can just feel free to catch our previous episode where we get into that, one of the, you know, part science part art kind of thing, you know, part witchcraft. But one of the things that is actually tough when it comes to this is, how do you account for changes in retirement. And one of the best ways to do that is just to get us an actual sense from an itemized standpoint of where those changes could be coming from. And so to do that, and to adjust for these numbers, I think Wade is right, that a bottoms up approach makes sense. And so that requires breaking

down your expenses by categories. And Wade, you want to talk about perhaps the usual suspects. And and I'll chime in there when it comes to what retirement what what retirement budgeting categories, makes sense for you to start trying to itemize.

Wade Pfau 03:06

Yeah, and just before starting to talk about that, and Alex was even debating whether we should name the ball, but I think it's important. But to be clear, you can have much fewer categories, and emerge things together, you could expand out categories, some of these categories, we'll talk about subcategories. And so it's really the sky's the limit, whether you want to reduce what we're going to talk about into five general categories, or whether you want to have 30 different categories. That's up to you. But at least what we're going to talk about now, I hope we'll at least hint at or, like mention, will type of an expense someone Yeah, so consider for retirement. So

Alex Murguia 03:47

so we're getting at is we're gonna go into a little bit of an exhaustive list of items you want to think about. So for those of you that, like the collapse categories, I suggest you go to your podcast settings, and where it says 1.0 1.5 or 2.0. In terms of playback speed, let's go with the what do you think, Wait 1.5 playback speed.

Wade Pfau 04:08

You're trying to get through this faster?

Alex Murguia 04:10

Yeah, if you'd like to collapse the categories. If you want to just listen in and immerse yourself in it, leave it at one, right Wade.

Wade Pfau 04:18

That's right, that these general categories are in alphabetical order. So there's no specific ordering preference here. But also that like mentioning how you can merge categories, I do use a general all my expenses category that actually probably combines at least about 10 of what we're about to talk about. I don't try to make that refined of a distinction between some of these. But I think that's all the caveats before we get into the actual list of things.

Alex Murguia 04:47

Fire away, man.

Wade Pfau 04:48

Let's let's begin. And so again, in alphabetic order, we've got charitable contributions. That's part of your budgeting, so charitable giving. Next would be clothing expenses, and And like I said, I do put a lot of things together into just a general home expense category. So clothing is something I don't keep separate, I just put it into a big home category, but clothing expenses, credit card rewards, which if you like to play around with some of those opportunities with credit cards, this is a negative expense. But I liked, include it to just be able to keep track of especially something like travel, if you're able to say, get a flight ticket with points, I would like to add in the estimated expense so that so that I could increase

my travel budget by that amount for the purposes of future projections, I not want to know how much I'm spending on travel, but then my overall spending for that year would then be offset by the negative value of that expense that I put into this credit card rewards category. So either cashback type rewards from credit cards, or using the points to cover expenses, and then estimating those expenses and offsetting them with a negative expense. And this credit card reward category.

Alex Murguia 06:08

So Wade, what's in your wallet.

Wade Pfau 06:12

I liked the

Alex Murguia 06:17

I just wanted to see if you picked up on a commercial I don't, don't worry

Wade Pfau 06:22

I've got one I'm quite happy with but I wanted to see like basically like a 2.6 to 5% cashback on everything except travel, which is actually a three and a half percent cashback.

Alex Murguia 06:36

And another thing people realize it's Wade's is a bit of a point snob, when it comes to his his hotels and airlines, he loves to rack them up, don't you Wade.

Wade Pfau 06:48

I do love to rack up the airline points especially because with my family, when we are able to make a trip to Japan, that's a very valuable use. And I do have a ton of hotel points that I really don't find that much use for. So I'm not so happy about racking those up necessarily. They can be a lot of value there.

Alex Murguia 07:11

It just to continue it. There's also I'll take the baton Wade. There's debt repayments that comes in the form of mortgage, mortgages. And when we spoke about the last episode, these are mortgages, something that most likely will be changing as you retire. But it's still a line item in the budget. Car Loans. Another thing that could change and there's also car payments that we'll get into later. educational loans, credit card and just other general types of loans you may have. That's something you definitely want to have, you know have items out because those are things that aren't as constant pre retirement as post retirement and you want to know potentially where that where the change is going to come from. Entertainment. Go on, sorry, Wade.

Wade Pfau 07:57

Some of the comments there too. Like with credit card payments, that's going to be something that you kind of have to back out of if you're downloading all your expenses through some website or through the credit card statements. Paying the credit card bill isn't really an expense if you counted the actual spending as the expense.

Alex Murguia 08:14

It's like the more loans where maybe you didn't pay in full and so you have some payments.

Wade Pfau 08:20

right interest on credit cards would be something you'd want to specifically tease out and include in the budgeting potentially to know pass expenses. And then also something like mortgage payments. You want to be careful because if you're putting money into escrow to pay the taxes or homeowners insurance, that might be an expense you forget to actually include in your budget so that when you finish your mortgage payments, that mortgage payment doesn't simply just dropped to zero for you, you now have to pay for the property taxes and homeowners insurance and you want to make sure that is you could accidentally hide those payments and your mortgage payments and forget to include them. When we talk about how things might change in retirement, forget to include property taxes in your retirement budget, which could potentially big mistake if you're under than than under estimating your spending needs.

Alex Murguia 09:13

You have entertainment, hobbies, leisure activities, those kinds of items and this is something that right you're retired you're not dead you want to enjoy your retirement and there's things that you should be budgeting in for. It goes back to the four hours this is the lifestyle category and there's things you want to be doing there's you want to avoid the cree divorce right? He needs some quality time with you with your spouse if you will. And you make time for you know entertainment, food, a line item for food, you have groceries, restaurants, gifts,

Wade Pfau 09:48

You can do like I do keep those separate actually I consolidate a lot of categories but I do have separate categories for like groceries and then for restaurants. I

Alex Murguia 09:59

Restaurants could go we could put that under entertainment really, as well.

Wade Pfau 10:03

There's a lot of flexibility here this is we just want to touch upon everything, but how you then you have quite a bit of flexibility for that.

Alex Murguia 10:11

Gifts. Gifts is not just a gift. It's not just tangible gifts that you know, you're giving something to somebody, but it's also comes in the form of family support. So educational expenses, family support, those fall into the category of gifts, Wade, something there?

Wade Pfau 10:28

it never gets to you. I mean, just the, it could

Alex Murguia 10:31

be an iPhone, too, but it's beyond, it's beyond just that tangible if you have health care expenses, and this is a doozy. And you're gonna have, you know, we'll have podcasts just on this alone, a whole arcs on this. But effectively, that's insurance, Medicare premiums, out of pocket expenses, dental vision, just trying to think that I get them all away to do anything I could be missing. They're just all sorts of health care expenses.

Wade Pfau 10:59

Well, it's Yeah, insurance premiums. And then out of pocket type expenses not covered by the insurance. But this is something that might change quite a bit in retirement, anytime somebody changes their health insurance, you might see big changes, but particularly at age 65, when you switch over to Medicare, your past, it's good to keep track of this, but you might need to make adjustments. And depending on how subsidized your health insurance is, it's possible you will either be spending more or less after switching to Medicare.

Alex Murguia 11:33

And for the joys of homeownership, you have home maintenance, right? Landscaping, snow removal, depending on where you live pool cleaner, depending on where you live, home security, age vac, etc. By the way, we were getting a new air conditioning tomorrow delivered. And I had to say this thing everyone can relate. There were only three of these air conditioners available in the city. It's like my wife said, We'll take it just because it was with the way things are going. But home maintenance is an issue. I mean, what would you say Wade?

Wade Pfau 12:10

Yeah, yeah, and also like home, I mean, pest control, that sort of thing. But this is another area to where, maybe an early retirement, everyone's different, like, perhaps you're paying for a house cleaner while working. If you're gonna then clean the house yourself, you could lower that potential expense. But then later in retirement, maybe you're doing your own lawn mowing, and so forth. But at some point, you might need to outsource that as it becomes increasingly difficult to do.

Alex Murguia 12:38

Today, my father was taking a different track, my father loves things doing more and more home repairs, as he gets older,

Wade Pfau 12:45

that could be a way to save, you have more than the way to use your time. You might be able to take care of some of the things that you out prior to retiring,

Alex Murguia 12:54

although that may cause a spike in healthcare expenses. If if the ladder wobbles the wrong way.

Wade Pfau 13:03

That's true.

Alex Murguia 13:05

Okay, take care with now do you would you do you personally collapse home expenses like rent it were HOA dues repairs? Versus home maintenance, because this could be overlapping? They're a little bit right.

Wade Pfau 13:21

I do. Yeah, generally keep those separate, because these are specific categories where if you know about a move in retirement, like rent, you can be more specific of okay, I will allocate X number of dollars per month for rent in apartment. So you and that's if you if you own a home now, but you're thinking of rent in retirement, it might be this category that you call property taxes slash rent, because pre retirement, it's property taxes, post retirement, that can be where you keep track of the rent. Also, HOA dues if you're thinking to move money, so just keep that separate. So you can put in a specific estimate on any HOA dues it might be and then home repairs, you could count in home maintenance. But that's I think a lot of the home maintenance expenses are more fixed. Like if you're paying for this service every month, you know that those are somewhat fixed, whereas home repairs does have that element of suddenly zero. Yeah, yeah. But you're getting the new H back tomorrow. That's probably something I would fit more in the it's not a

Alex Murguia 14:28

It's not an HVAC tune up. It's not like we're changing the filters and it's a monthly kind of time to change the filter or whatnot. This is a completely new system.

Wade Pfau 14:38

Yeah, so that's something I might repair wouldn't be the right name there, but that's the kind of...Yeah, yeah. potentially large one off types of expenses. Yeah, go into that separate.

Alex Murguia 14:51

You also have insurance premiums. Insurance premiums, home life, auto umbrella, disability, long term care.

Bob French 15:02

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Alex Murguia 15:29

You have that now Wade, what do you think about long term care? And we're splitting hairs. I know that but I just want to answer questions that people could be asking as they're listening. And so you see insurance premium and all of a sudden they see long term care, you know, hey, do I put that into insurance premiums or to put that into health care?

Wade Pfau 15:48

Oh, well, it's, if you just have one insurance category, they go together. But yeah, that's true. Well, yeah. I mean, that's a good point, you could bundle long term care related expenses into health care. But this long term care is the area where, well, if you have insurance, you know, there is a fixed expense every so often. But if there could be more volatility, I think it might be easier to keep long term care separate from health care, which may surprise people that a lot of times when you see annual estimates of say this is how much retirees can expect to spend on health expenses in retirement. That doesn't include long term care. Long Term Care is usually treated as a separate category. And so my, I would approach this as treating health care and long term care. It's separate categories, though, like yes, there is flexibility to find a system that works for you. And if you want to combine them, I will not object

Alex Murguia 16:47

well but the beauty of Retire with Rstyle podcasts with Wade and Alex is that it's by Wade and Alex and so a Wade once it in the insurance premium. It goes in the insurance premium. Yeah, good to be the king. Memberships, you hear it's you know, this is where you have your SilverSneakers right, fitness civic organizations warehouse, season tickets. And who knows, nowadays, it's your your pickleball, club, membership dues, right?

Wade Pfau 17:20

country clubs to you got to fit somewhere if that's part of the budget, but yeah, anything where it's kind of a fixed ongoing expense, and warehouse clubs. Don't forget to put the annual however much a Costco membership is these days, you definitely want to account for that in the budget somewhere. But anything where you, you know, it's a membership in the organization that has a fixed monthly seasonal annual type of an expense. That's what I have in mind with that memberships category, that as I mentioned, that is something that I just dumped into my general home expense category as well, I don't keep that separate.

Alex Murguia 17:57

Then we move into miscellaneous household expenses, you got cleaning supplies on this bad boy

Wade Pfau 18:04

Well, right. And that's where with the miscellaneous household expenses, that is part of my household expense category, but a couple of things I had thought of that just need to be can't forget about them cleaning supplies, I do have appliances there. But that's like we're just talking about the H back type situation, you might want to since the appliances can be these large, durable goods that are expensive, but that you only have to purchase every so many years, you might want to keep them in a separate category. But then again, if yours and electronics could go

Alex Murguia 18:36

if you're listening in and you're kind of writing these down, like these are kind of normal things we're not coming up with like cold fusion as a line item that no one's ever thought of before. But remember that this is also we're taking this from Wade's book, chapter three of his retirement planning guide book. And so it's all there as well if you if you want to take a look, you know, in a more organized manner. So

pet paths personal care, where we have phones, and electronics kind of stuff. This is cellular landline, although I don't know if we're gonna have landline in the new edition anymore.

Wade Pfau 19:13

Right, but that would be the monthly expenses. And then if you want to put actually buying a new cell phone, you have to decide where to put that you could also I mean, do you have a landline here?

Alex Murguia 19:23

Wade, do you have a landline?

Wade Pfau 19:24

No, I do not have a landline myself. I have one.

Alex Murguia 19:28

We kept it. It's through Comcast, I think and we just have it. But if anyone calls that number, no one's answering. It's almost like if you're calling the landline you're like not in the united in our inner circle at this point. I think we get it for blackouts just in case there's you know, for whatever reason, there's a dial tone, but there's no electricity, although I don't think they would go hand in hand so maybe I should cancel it at this point, yeah, right subject eruptions. I mean, don't discount subscriptions. There's a company called truebill. That is doing spectacularly well. And its job is just to look at your monthly statements and tease out subscriptions that you may not want anymore.

Wade Pfau 20:18

Yeah, and this can be like, don't forget about newspapers, magazines, software. And that could be things like, if you're paying for Microsoft Office now, through the cloud, so that it's a monthly bill, instead of just paying for the software, other types of software, what website memberships, music, like the whole issue of Amazon, what the various services they have, and so forth. At cloud storage, if you use a service like Dropbox or iCloud or whatever other options are all out there. Just those kinds of ongoing bills that you face is what I had in mind with the subscriptions category.

Alex Murguia 20:58

And what's under taxes, taxes and more taxes way.

Wade Pfau 21:01

Yeah, yeah, taxes, you got federal income taxes, you've got any payroll related taxes, Medicare, this would be pre retirement, I'm thinking of Medicare premiums is going with healthcare, but pre retirement, Medicare, that part of that FICA tax, state income taxes, property taxes, and then any other local taxes as well.

Alex Murguia 21:25

As you know, the government sure do take a bite

Wade Pfau 21:28

if they want their share of the pie.

Alex Murguia 21:31

And you know, and again, we put phone out there and just looking at this just shows you how different strokes for different folks, right? But even we even have a line item for television internet, which is internet cable TV streaming services, you can easily say But isn't that a subscription? Yes. But that's one of those things.

Wade Pfau 21:52

That's, I do have the the separate internet category as well as a separate television category, which I know some people still may have cable TV, but for those who have cut the cord, it's just the various streaming services that you may keep up with. That could go there.

Alex Murguia 22:08

What have you done Wade? I'm just curious. Have you cut the use of cable?

Wade Pfau 22:12

No cable? Yeah, just different streaming services. A couple different ones.

Alex Murguia 22:19

I think I have cable. I have Apple TV. I have Hulu. I have Amazon TV. I have Netflix.

Wade Pfau 22:26

It's like cut some expenses or somewhere.

Alex Murguia 22:28

It's a mess. you're onto something. I even have like Crunchyroll I even have Crunchyroll so my kids, I can see the enemies. It's crazy.

Wade Pfau 22:40

Yeah, I can't hardly watch commercials anymore. I'm so accustomed to no commercials. So cable TV. It just doesn't do it for me.

Alex Murguia 22:46

Yeah. You don't watch 90 Day fiance.

Wade Pfau 22:50

No,

Alex Murguia 22:51

Come on. Yeah,

Wade Pfau 22:52

I think that fun discovery plus probably

Alex Murguia 22:55

what you know what TV channel? It's on.

Wade Pfau 23:00

one of the things they pop up on? Yeah,

Alex Murguia 23:02

of course it is. Of course it is. Transportation, what do you got into transportation?

Wade Pfau 23:11

Well, you've got like auto maintenance taken in for the annual checkup, that sort of thing. Or other repair bills related to the automobile, fuel. Parking, if you have like parking at your apartment, that sort of thing? Or if you specifically have to pay for parking at various times. Insurance I do have in there but you might we already listed auto insurance. I don't know what exactly I had in mind with that particular insurance. And then roadside assistance if you're a member of AAA or something like that.

Alex Murguia 23:46

That's very comforting Wade. No, but you can see here and we're gonna get to this after we detailed the we're going to talk about some issues. And as you see us even detailing it we're realizing and Wade wrote this, I mean, he wrote a book on it, but we're realizing there's easy opportunities for crossovers here. And you know, budgets are like a snowflake, right? There's millions of them, no two are alike, etc. So make it your own, but we're just highlighting some broad strokes in which where there's opportunity for you know, line itemization travel what what could go into travel?

Wade Pfau 24:32

Well, you might want to separate it by season that you might have your summer travel, your fall travel, winter travel, but you also make sure your

Alex Murguia 24:40

First world problem Wade. Wow.

Wade Pfau 24:45

Flights, hotel bills, travel insurance, that would be one like if you're adding in a supplemental travel insurance for a trip. Local transportation if you're like renting a car or using counting up all like goobers and things like that. And then I mean, do you want to count things like admissions tickets? If you're going to theme parks or other like Broadway shows? Where would you budget that? You might count that as part of your travel budget unless you live in New York City and go,

Alex Murguia 25:15

or it's gonna be straight up payment.

Wade Pfau 25:18

Yeah, that could also be part of entertainment. Now your food when you travel, you can decide like if you're going to more expensive restaurants as part of the travel Do you want to count in as travel or do

you just want to throw that into your your restaurant budget, but definitely any kind of transportation related to the flight, local transportation, hotels, in Amtrak, all those kinds of bills tend to go into the travel budget.

Alex Murguia 25:47

Wade I can tell you spend time in the mid atlantic because I don't think anyone would say Amtrak unless they were taking that corridor,

Wade Pfau 25:53

say from Boston or DC.

Alex Murguia 25:58

They hit you know, DC Baltimore, Delaware, Philly. excetera New York pretty much

Wade Pfau 26:03

anytime the SL Express. Exactly.

Alex Murguia 26:07

I don't think I've been flying to New York anymore. I can't remember the last time I flew into New York. Utilities. What do we got there?

Wade Pfau 26:17

Yes, so water bills, electric bills, gas bills, if you have home oil related bills like propane, so forth, waste disposal, sewage. Just anything that you know is a monthly type utility bill that you need to pay.

Alex Murguia 26:36

Man, if you have a line item for propane, you'd like to grill propane or invite Wade and I to a barbecue. In the next available weekend, we'll be there

Wade Pfau 26:47

Alex reveals he has not been in the Midwest, very? A lot of people.

Alex Murguia 26:56

Alright, and then special large expenditures here we got the bar mitzvahs, huh Wade?

Wade Pfau 27:01

Yeah, this is something a category like if there's just specific either one off or occasional type of expenses that you just want to keep separate. So if you are planning to pay for a child's wedding, you might just treat that as a separate one time expense. Automobile purchases is something you want to think about, like budgeting, how frequently and how much do you want to budget for those types of every however many years that you purchase a new car, major home renovations, so that could be replacing the roof, that could be Alex's new H fac, if he wants to just keep that somewhere in a separate category where this is, a lot of years, these might be zero in this category. But then you might have a year where you have a \$20,000 expense there or even more for like a car and so forth. But I'm

trying to keep that separate. And also if you have any unique trips in mind that go beyond just the regular travel budget, but if it's a special one time around the world trip or something like that, I think what's actually more expensive than your usual travel, you might put that into a separate category.

Alex Murguia 28:05

I think what helps with this Wade though, is for the special categories, even something like travel and things like that is this is where mental accounting, at least for me works very well. And that's where you create, like an envelope system around these things. You know, like you, you build up to it, like you put \$20 a month, or whatever the number is \$200 a month, or whatever your number is, you know, let's say especially the wedding is 10,000 bucks, right? You know, you suspect no weddings more, more, more unpredictable. But let's say there's a special trip that you want to take in five years to Bali or whatnot, right? That's where you can start putting away a certain amount per month. So by the time that time comes around, you have the money there. You know, from a budgeting standpoint, that kind of works. Work for me when you know my wife and I are we're in our formative years just trying to save up for special trips, just having an envelope system around that. Thank you Wade. Great idea Alex. Think so! Really? Thanks, man.

Wade Pfau 29:13

cutting edge stuff. We can also just talk about like just how you can simplify some of this as well. And so I mentioned this at whenever retirement income challenges once that like I know when I go to Costco or when someone from my household goes to Costco, you buy things besides groceries there as well. But as a way to simplify life, I just see any expense from Costco that shows up I'm going to count 100% as groceries, and that's wrong. But it's going to be wrong in a consistent way that okay, I'm over estimating my groceries but I'm under estimating other categories by an equal amount and over time. Really what I want to know is what's the total expenditures and so you can this is true Do for any kind of store where you're buying, like one receipt includes different types of expenses? What do you do with that? Well, that's where either I call it all groceries or I call it all general home expenses, and don't really worry about any sort of precise way to break that down. And somebody at that retirement income challenge mentioned that, oh, yes, I do that as well. And that's, like, it's just a matter of how detailed you want your budget to be. If you are trying to use your budget as a way to reduce expenses, the more refined you make it, the better it can be. For me, I really just want to know how much I'm spending. And that's where, even though Alex is gonna say I'm have too many categories, and I'm spending too much time budgeting. I don't try to break down a receipt into different categories, I'm just gonna throw it into one category.

Alex Murguia 30:52

Wade I would never say that about you know, that's, that's on you, man that's on you.

Wade Pfau 30:59

And the other issue is cash. When you go to the ATM and you take a withdrawal at an ATM? How do you account for that? Now these days, I use a little cash that I just simply don't worry, I will I count any ATM withdrawal account is my general home expense category at the time, I took those funds out of the ATM, and then I'm done with it. I don't worry about saving any sort of receipt or anything, whatever I do with the cash, I already accounted for it in my budget as okay, I took \$200 out of the ATM on this

day. That's the expense. So that's another way you can potentially simplify some of this. Because the other big issue is if you use credit or debit cards for most of your spending, you get all these details. And then it's just a matter of classifying into the categories you want. For the each individual building that's built into that particular card.

Alex Murguia 31:58

What's your take on the big ticket items? Like you this big one year amount. Do you do you kind of like spread that out? Or are you just take the hit that one year from the budget, even though you enjoy it for like the next five years.

Wade Pfau 32:14

That's like suppose you spend \$25,000 on a car and you buy a car of yours. Your options are every fifth year, you have a \$25,000 expense and zero for the other four years. Or if you amortize it, that would be okay, I'm gonna divide that and put \$5,000 each year for the five years, I prefer to just keep it as the one expense. So I'd have the \$25,000 in one year, and then zeros for the next four years. But the important point coming out of this is in big ticket items is a great example. But it's true for all these other categories too. If you do this kind of budgeting, you're probably going to notice your expenses fluctuate quite a bit from year to year. And so it's not really just the spending in one year that ultimately matters. It's more what is your average spending over five or six years. And that way, you can then count for these one off expenses. And so either way, if I like if I looked at my spending over five years, it doesn't matter if I put that \$25,000 car bill in one year and zero and the other years, or if I spread it out 5000 Each year, I'm still gonna have the same average spending \$5,000 a year. And that's how I would account for that. And also with the inflation issue. If you just put it all in one year, then you can more easily adjust that amount for future inflation. Whereas if you're amortizing it over time, you get into trickier questions about what that means for your inflation adjustments.

Alex Murguia 33:48

I couldn't agree more Wade. I mean this, this comes up with clients when we're you know, when when you're doing these cash flow based plans, and it's just a nightmare to try to make these budgets quote unquote GAAP compliant, if you will, it's like, who cares, man, we're just trying to, you know, get a good sense of it. And you're right. It's, you know, this rolling average is actually more important. But you're you're speaking of something that there's a variability in the in the in the budget that that's inherent to what to the exercise. But what are some potential line items that we mentioned that could increase and what are some that could decrease?

Wade Pfau 34:27

Yeah, yes. So when you retire, for expenses that might decrease. We actually did cover these in the previous episodes, but it's worth just mentioning again. So child rearing expenses will likely decrease once your children have grown. If you've paid off the mortgage, the mortgage payment or the the interest on your mortgage and so forth, will go away from the budget. If you're not paying payroll taxes once you leave the labor force, and though there's some question about what your overall impact on income taxes could be For a lot of people, probably they'll be paying less income taxes as well after retiring and not having that labor income as part of their adjusted gross income, you don't have those other work related expenses. Now there's the whole housing issue. If you move if you're downsizing,

you might be able to cut a lot of expenses related to housing. And then also, if you are doing more home maintenance after retiring, or if you're downsizing your property taxes may decline your other home maintenance bills could potentially decline, at least in the early retirement years. So those are the main expenses that might decrease. What what do you see going up? Yeah, so with increasing expenses, the one particular issue is just an early retirement, this is where every day becomes a Saturday. And so you might have all this built up energy to have leisure. So you could have a lot of leisure expenses early in retirement much more than pre retirement, you also have to assess the health care situation. And depending on how much your health insurance was pre retirement, Medicare could lower your health care expenses overall, at least in early retirement, might increase it in some cases. But then also healthcare inflation tends to be higher than average inflation. So that is an expense that can increase at retirement, any other health care insurance premiums? Well, as part of your budget, thinking about long term care, you may not include that in your budget, but that is definitely an expense that you would want to account for somewhere with the potential for later in retirement having that, and extent that you might outsource more home maintenance or other things. That is something that where you might consider higher expense for some of those types of categories.

Alex Murguia 36:56

And to be clear, I mean, a lot of these we're giving them quick, quick treatment right now. But I can envision us right way, we'll have an episode specifically on health I episode arc on healthcare, an episode arc on housing, an episode arc on taxes in retirement. But these are items, these are called sort of three horsemen kind of items that you want to you want to make sure that you begin to consider them. Now, in a way, it's something that, that I think you Okay, so you get a number, right, you're doing a budget, you get a number, and here it is. But you want to maybe talk about how you can kind of maybe do some sensitivity analysis around this. I'm scenario analysis around this specifically to the foils, and bringing it back to the four hours, I'm thinking, lifestyle and longevity, you know, how you get a baseline number? And then how do you play with it to account for what happens if you live to this age versus what happens if you live longer?

Wade Pfau 37:56

Yeah, there's that L. I mentioned this inflation issue. And now, like, we know that inflation is these days. So if inflation is 10%, in a particular year, when I'm trying to figure it out my return, whatever I spent last year, I might want to increase by 10%, to get my real spending in today's dollars. And so that can be a part of this budgeting process. But then yeah, then you Well, the next step is making these adjustments. And especially with something like health care, you do probably want to assume whatever you figured out as appropriate in early retirement years, you might increase that. And so like maybe the best way to explain this, since the 1990s, there's been this idea of the go go slow, go and no go years of retirement, where the age is typically used for that there's, of course, everyone's different. But go goes usually like 65 to seven before that this is when you've got all this pent up energy, early retirement, you really want to enjoy those years, you might spend a lot more slow go is more ages 75 to 84, where you're not spending as much on leisure, you're not going out as much traveling as much, and your overall expenses tend to go down. And then the no go years, you could say ages 85 and older. And that's where your leisure or discretionary expenses might get quite low. But that's also where other health care expenses or long term care expenses could start to accelerate. And so accounting for that when you're budgeting becomes important. Now in the examples I provide in in the retirement planning

guide book, I didn't use the three different age categories. Just I wanted to explain the concept without getting too in the weeds there. So I talked about both couple, they're spending between ages 65 and 79. And then they're spending for ages 18 and older, and I made some adjustments that aging doubled their real inflation adjusted health care spending after a JD But I also reduced some of the leisure and other types of categories after age 80, as well, to provide some sort of sense of how spending might evolve over retirement. And because there's so much uncertainty about that, want to err to the side of caution of not assuming your spending would decrease too much. But you can still build in something like that. The 4% rule concept assumes you increase your spending for inflation throughout retirement. That's a pretty conservative assumption, most people will tend to not have their spending keep up with inflation over time. And so that's where we'll what can I factor in that might be a realistic way to say reduce some of my expenses, but increase the health care expenses. And then that can lead naturally into this kind of retirement spending smile, that David Blanchard's talked about when he looked at household spending data, where spending tends to decrease not between 160s and 80s. But then the smile is spending starts to come up in inflation adjusted terms after one's mid 80s. Never necessarily getting higher than where it wasn't the 60s, but catching up to where it was in 160s. And that spending smile. Yeah, it's it's going to reduce the overall cost of retirement compared to assuming inflation adjusted spending throughout the entire retirement horizon. Is that what you were asking me, Alex? Or did I go on a tangent there?

Alex Murguia 41:36

No, no. Well, I had points, but you kind of touched on, I'm just making sure that we touch upon all these potential talking points. And I mean, the only thing I would say to that is where did saying something interesting, and I'm gonna talk about travel and healthcare expenses. So again, it depends on your style, right? We're talking about a total return approach. But you know, you have different concerns. If you've done an income protected approach. And you have, if you've already have your essential expenses covered, you're you're thinking about, you know, there's a different set of, of items, you're you're pondering if you will, but for the most part, let's say, you've retired, you're you're you're looking at your budget, and you created a travel budget, and you don't really touch your travel budget, or you do you're doing the 4% inflation adjusted no matter what year to year. I mean, effectively, wait, what happens sometimes is things become a wash, right? You overestimate in one category only to underestimate in another. And then you know, when they kind of net out even right, I mean, I kind of see that with health care a lot, where people, they don't really realize they're not going to be spending as much for leisure just simply because you're not going to be moving around. Or you don't want to anymore a there's only so many times you can whatever see old faithful, you don't want to at a certain point, and that kind of starts to offset the increase of health expenses, at least anecdotally, that's what we've seen with clients.

Wade Pfau 43:06

Yeah, and something like so there's a scary estimates about the average price of a nursing home is \$100,000 a year. And what can make that scarier is the inflation on that it's expected to be a lot higher than the overall inflation. So if you're maybe in a nursing home 30 years from now, that can look pretty nasty, with a five or 6% inflation rate attached to it. But nonetheless, at least some offsetting item is when an individual does move to a nursing home, a lot of their other expenses would go away, there's no travel budget anymore, they're the food well, but the nursing home provides food, so you don't have

that sort of food budget anymore, and so forth. And so the inflation is still a big issue, but at least the full 100 It's not that if you move to a nursing home, whatever you budgeted has to increase by the \$100,000 nursing home expense, a lot of the other expenses will be offset in that type of scenario. And so that can provide a least a little bit of comfort with that type of long term budgeting.

Alex Murguia 44:09

And if you've done your sensitivity analysis, you know where you're thinking about it if you live long, live shorter, etc, etc. This is where you can determine if you need to reduce a certain amount, you're kind of reducing it by the amount that you could still enjoy retirement. Sure, you may not travel as much or sure there may be some leisure stuff you don't do as much, but it's still there's unacceptable. There's an acceptable floor around that, that that you know what it is and that that can help you sort of horse trade a little bit with regard to unexpected contingencies. But, you know, from this episode Wade, I think we've covered all the bullet points and just to be clear, we started with last episode, the main issues regarding budgeting for retirement, how to budget how to think about the basic moving parts we got Add into a replacement rate, which is that quick and dirty, you take your salary, you know a bit whether an average or whatever, let's just say you take your salary and you apply a replacement rate to it, like I'm gonna spend 80% of that, which is kind of a go to number for I don't even know how that number came about Wade other than that study used it. And it worked for them. We talked about safe savings rate as you accumulate, which is the inverse of the 4% rule. To some extent, it focuses on savings amounts of time you retire, you're kind of golden in terms of your distribution. Here, we took another approach to budgeting, which is really lie on line, itemizing that you want to perhaps Wade, just give a quick summary of that. And as we lead to the next phase of this art.

Wade Pfau 45:47

Well, yeah, we I mean, our focus today was really on on the budgeting piece, the longevity and lifestyle. There is also the legacy and liquidity that we didn't spend as much time on. But that's kind of the the next step of that process of is there a specific legacy goal? Or is it just whatever's left over? And then also that with the liquidity, that's where, specifically, how much do I want to set aside for long term care or other types of potential spending shocks on my retirement budget? But first, you want to think about that retirement budget. So hopefully, this discussion does help to think some of those issues clear with how to be thinking about the kind of options and flexibility people have, and how to think about what have you been spending and how might that change after you retire?

Alex Murguia 46:40

And then the upcoming episodes, we're going to talk about the now that you have the budget, you know, what you're working with? Remember, it's what's your retirement income style? What What strategies resonate with, will you resonate with then? Okay, once you have those strategies, how do you assess the economic feasibility? Step one is just let's get your budget in order, right. And then once you have your budget in order, let's assess your preparedness for retirement. And so how do you assess this preparedness? And that's what we're gonna go into in upcoming episodes. That's right. All right. Well, thank you for joining us on retirement style. Wade.

Wade Pfau 47:16

Yeah, we'll catch you next time. Thanks, everyone.

Alex Murguia 47:19

All right bye now.

Bob French 47:23

Wade and Alex are both principals in McLean Asset Management and Retirement Researcher. Both are SEC registered investment advisors located in Tyson's Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with the risk including risk of loss. Past performance does not guarantee future results.