

HOW LONG WILL MY RETIREMENT SAVINGS LAST?

Generally the first question most retirees ask when discussing their retirement is: "How long will my retirement savings last?" People naturally want to be confident that their income streams and investment portfolios will provide adequate income for their life expectancy.

For individuals planning their retirement, lifestyle should be considered in the long-term wealth creation process. The sum of money that retirees accumulate during their working lives will drive their total retirement income and therefore influence their lifestyle choices. Once in retirement it becomes more unlikely that individuals will be able to 'top up' their capital base.

Changes in medicine have ensured that life expectancies are longer and all the evidence suggests that this trend will continue. The proposition that some of us will outlive our savings is not at all unrealistic. While there are many uncertainties associated with retirement, it is possible to draw some broad rules of thumb in terms of how long retirement savings will last.

Table 1 – Life Expectancy Rates

The following table shows the life expectancy rates for men and women between the ages of 55 and 70 years.

Age	Male	Female	Age	Male	Female
55	25.92	29.91	63	19.24	22.85
56	25.05	29.00	64	18.46	22.00
57	24.19	28.10	65	17.70	21.15
58	23.34	27.21	66	16.95	20.32
59	22.49	26.32	67	16.21	19.49
60	21.66	25.44	68	15.48	18.67
61	20.84	24.57	69	14.78	17.87
62	20.04	23.71	70	14.08	17.08

Source. Australian Life Tables 2000 - 2002

Table 2 – How long before my savings run out ?

The table below illustrates, for any particular amount of retirement savings, how long this amount will last assuming a constant annual drawdown amount (left hand axis) and a constant annual effective earning rate net of taxes and fees (top axis).

Effective Earning Rate %	1	2	3	4	5	6	7	8	9	10
Drawdown %										
5	22.43	25.80	31.00	41.04						
6	18.32	20.48	23.45	28.01	36.72					
7	15.49	16.99	18.93	21.60	25.68	33.40				
8	13.42	14.53	15.90	17.67	20.10	23.79	30.73			
9	11.84	12.69	13.72	14.99	16.62	18.85	22.23	28.55		
10	10.59	11.27	12.07	13.02	14.21	15.73	17.79	20.91	26.72	
11	9.58	10.13	10.77	11.52	12.42	13.53	14.95	16.88	19.78	25.16
12	8.74	9.21	9.73	10.34	11.05	11.90	12.94	14.27	16.09	18.80

13	8.04	8.44	8.88	9.38	9.95	10.62	11.43	12.42	13.68	15.38
14	7.45	7.78	8.16	8.58	9.06	9.60	10.24	11.01	11.95	13.14
15	6.93	7.23	7.55	7.91	8.31	8.77	9.29	9.90	10.63	11.53
16	6.49	6.74	7.02	7.33	7.68	8.07	8.50	9.01	9.59	10.29
17	6.09	6.32	6.57	6.84	7.14	7.47	7.84	8.26	8.75	9.31
18	5.74	5.95	6.17	6.41	6.67	6.96	7.28	7.64	8.04	8.51
19	5.43	5.62	5.81	6.03	6.26	6.51	6.79	7.10	7.45	7.84
20	5.15	5.32	5.50	5.69	5.90	6.12	6.37	6.64	6.94	7.27

For example, let's assume that Bill has an accumulated retirement amount of \$200,000 when he retires at age 65. If he starts withdrawing 10% (\$20,000) per year, assuming his withdrawals remain constant and he earns 4% (effective) constantly on his money, he will run out of money early in the 13th year. Even if Bill earns 6%, the money will be fully depleted during the 15th year.

This means that a 65 year male who has a life expectancy of 17.70 years (refer to Table 1), will require an effective earning rate of at least 7 percent to have sufficient funds for his life expectancy.

The above table does not take into account price inflation nor does it take into account indexation of annual drawdown amounts. If price inflation and indexation of drawdowns are included, the money runs out even faster.

If we return to Bill and assume that instead of \$200,000 he has \$400,000 and his lifestyle can be accommodated by a constant drawdown of 5%, which equates with \$20,000, the table indicates that even at very low earning rates, Bill will have enough money to last as long as his life expectancy even if he increases the constant draw down amount to 6% or even 7% (assuming an earnings rate of at least 3% in that case).

Clearly, having more money to start with is the desirable retirement strategy.

How does asset allocation affect things?

The above analysis assumes effective earning rates ranging from 1% - 10%. This does not address the returns associated with different asset allocations and the different marginal tax rates that apply for individuals. Instead of saying that over your retirement period you would hope for a return of 5% – 6% per annum, one could also ask what particular asset allocation which will determine an earnings rate. This asset allocation will also reflect the retiree's tolerance for risk.

However, even if this approach is adopted there will still be occasions when an investment mix may not be able to satisfy a retiree's expectation of income for their life expectancy (and beyond). For instance, it may be that even if all investments were in growth assets the expected rate of return may not be sufficient to provide the desired income for the person's life expectancy, notwithstanding the level of risk that would have been assumed. It is also important to remember that the life expectancy is an average for a group of people – there is a significant chance that a particular person will outlive their life expectancy. For instance for a 60 year old male it is nearly 51%.

Once again, the moral of the story is the more money you start with, the more likely you will be able to fund your retirement throughout your life expectancy.

The above information is, of course, general in nature and demonstrates the need to seek specific retirement planning advice in order to comprehensively address issues of risk and return.

Notes on using Table 2

Because the table values are independent of the initial investment it is necessary to work out what gross level of income would meet lifestyle needs. Thus if someone has \$400,000 and can live on a constant amount of \$20,000, they need only draw down at the 5% rate. If their income needs were higher they would need to use a higher drawdown rate.

The values reflect all fees and taxes so that by choosing an appropriate rate of earnings it is possible to model both taxed and tax-exempt income streams (the latter would have a higher effective earning rate).

A drawdown rate of 5% effectively equates to the minimum annual payment from an allocated pension at age 55. A drawdown rate of 10% equates with the minimum annual payment from an allocated pension at age 78.