Calculating retirement: Add up your numbers

Some basic math skills can help you determine when you're financially ready to hang up the white coat -- and how much money you'll need afterward.

By Katherine Vogt, *AMNews* staff. Nov. 28, 2005.

Some physicians do it at 65. Others make it happen at 50. Some don't do it all.

For each, the number is different. But for nearly all, choosing when to retire depends on a lot more than age alone.

Most physicians will attest that in order to retire, they need to reach a monetary goal that will enable them to live comfortably after their working years. Picking just the right number could impact everything from health care to housing, whether they play golf or watch it on television.

To find the magic number, many financial advisers use a series of calculations. Depending on the method used, they may factor in a survey of assets, projected expenses and predictions about variables such as investment returns and interest rates. Some even use special calculators to determine when a person it likely to die.

Whatever method is used, physicians have a special interest in making sure it is as comprehensive -- and potentially accurate -- as possible. Physicians tend to have shorter careers and more school debt than do other professionals, leaving them at a disadvantage in retirement planning.

"They're very much like athletes, who have a short-term career. In medicine, by the time they really get going and make any money, they're well into their 40s," said John E. Sestina, a fee-only financial planner and president of Columbus, Ohio-based John E. Sestina and Co.

Make an assessment

The first steps in calculating a physician's retirement age often include an assessment of assets and debts -- a have and have-not check list that might count everything from investment portfolios, bank accounts and loans on houses, boats, artwork and more.

"Before we figure out where you want to go, we need to know where you are," said Peter Mallouk, a financial adviser and principal of Creative Planning in Overland Park, Kan.

He said the net worth assessment must be very detailed and should take into account what the assets might be worth in retirement. Just because a practice is worth $400,000 doesn't mean it still will be worth that after the doctor associated with it steps down, he said.

Getting an accurate figure from the assessment is not only critical in determining the right value to plug into the calculations but also might serve as a wake-up call to people who haven't been saving adequately.

"It really forces a reality check. It's one thing to say my business is worth a million dollars, but it's another thing to say I'm going to rely on this," Mallouk said.

The assessment also could specify when certain assets will be available. Mary Lou Zangerle, first vice president of investments with Merrill Lynch in Dearborn, Mich., said she often advises drawing on non-retirement assets first so tax-advantaged retirement accounts can grow longer.

Under tax law, most retirement accounts can be tapped without penalty after age 59.5, she said. By age 70.5, it may be required that some money is withdrawn from them.

As part of the assessment, most advisers also will make a list of debts. But deciding whether they should be paid down before retirement depends on the situation and the adviser.

If a person can earn more using money for an investment than what would be saved in interest by paying off a loan, Zangerle said, it might be reasonable to hang on to some of the debt.

But in most cases, Mallouk said, people want to pay off their debts before they quit working. "People want to know things are paid for in retirement," he said.

Know your expenses

The next step typically involves cataloguing expenses to find out how much money a person uses each month. Some financial advisers use a detailed cash flow worksheet to track everything from loan payments to gasoline, pet care, country club dues and insurance.

"You have to determine your lifestyle expenses," Sestina said. "Once I have that information, the next step is to consider, 'When I retire, what will be different?' "

Expenses in retirement could be radically different from expenses during working years. Perhaps there is no longer a need for disability insurance. Maybe the mortgage has been paid off. Physicians also might face new expenses, such as tail liability insurance or increased health costs.

Ultimately, the lifestyle could be so different that it affects spending. "So the real question of how much you need in retirement is what are you going to do in retirement," Mallouk said.

He believes it is a common misconception that most people only need 70% of the income they made in their working years to maintain their lifestyle in retirement.

That might work for people who plan "to sit around and watch ESPN all day," he said. But for many physicians, "when they retire, they're spending some serious money. Some of them might want to do world travel." Others may want to golf every day or lavish their grandchildren with gifts. Those retirees actually might need more income than they pulled in while working.

The calculations also should take into account variable influences such as interest rates and expected investment returns.

Financial advisers say interest rates historically average out at about 3%, so that number is commonly used in equations. That means a retiree who needs $90,000 the first year will need $92,700 the second year and so on.

As for investment returns, expert recommendations vary with each adviser. Mallouk said the stock market's average historical return over 10 years is a little more than 10%, but he uses an estimate of 7% to be on the safe side. Karen Cunningham, a financial planner with Oklahoma Financial Center in Oklahoma City, said she projects no more than 8%.

Figure out how long

Another variable is how long the retirement income will be needed, or in more blunt terms, how long the retiree is expected to live. Any financial adviser who could accurately predict this would have to be endowed with special powers, so many simply choose a conservative estimate.

Cunningham assumes her clients will live to be 100. "It's a more conservative point of view, but it is safer that way. I'd rather they die rich than poor," she said.

Zangerle uses a model that allows her to pick an expected age of death. In "most cases," she picks 90. "I want to be out there as far as we think is really feasible," she said.

Other advisers might steer their clients toward "longevity calculators," many of which are easily found on the Internet in varying degrees of credibility and often ask questions about family medical history, body mass index, and alcohol or tobacco use.

Once all these considerations are made, advisers can take the information and put it into a computer program or get out their calculators to come up with a final figure specifying not only how much money will be needed to retire, but how much must be saved each month to reach that goal.

The end figure is different for everyone, though financial advisers questioned by *AMNews* said many of their physician clients typically aim for a total value ranging from $1.5 million to $4 million. That might sound like a lot, but that money has to be spread over 30 or 40 years and might not buy as much later in life as it does now.

In a simplified example, Cunningham said a $1.5 million pot would produce income of $75,000 per year assuming a 5% rate of return. Some of the money likely would be taxed, so actual income would be less.

She doesn't expect her younger clients to get any additional income in the form of Social Security payments because of the program's uncertain future. Physicians who are already 52 or older might be able to expect an additional $1,500 per month before taxes, she said.

But other additional income may stream in for physicians who continue to do some work in retirement. Estimates of what this income might be should be factored in to the overall assessment of assets. The extra money can make a big difference.

Thomas R. Skaggs, MD, a pediatrician from Mahomet, Ill., retired last July but plans to spend time doing *locum tenens* work in the coming years. He said it will help him keep his hand in with a profession that he has enjoyed for 44 years.

The 72-year-old said he was forced to retire abruptly when circumstances changed and he could no longer get anyone to cover his independent practice on days he needed to be off. Fortunately, he had enough money saved that he could survive without the income.

"I'm OK. I can't go out and buy a million-dollar resort home in some place, but I don't want to anyway," Dr. Skaggs said.

He never went through a detailed worksheet to calculate what nest egg he would need. But he did "converse several times a year" with his financial adviser to make sure his investments were being properly allocated.

Indeed, financial advisers say all the calculating, modeling and projecting in the world means nothing if it isn't regularly updated and adjusted to reflect any significant changes in a person's financial affairs, such as a home sale or even an expensive vacation.

At a minimum, most experts recommend checking in with an adviser at least once a year to recalculate the figures. Physicians who are in their final years of work might want to check in more frequently to make sure they are on track.

Sestina said it makes sense to know the pool of money well. "It's not how much money you make that makes the difference, it's how much you keep. Sooner or later the doctor will lose their ability to make income. So they better have this big bag of money," he said.

ADDITIONAL INFORMATION:

Calculate it

This downloadable worksheet in pdf format helps you calculate your costs, intake, and worth by listing some common items that determine monthly or annual income and expenses, and typical factors used in assessing net worth. Spaces are provided for amounts and totals.

Get worksheet

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