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## Retirement Basics: For the Individual Lawyer

By James D. Cotterman

First, what are the economics of retiring? Statistically, today's adults will live on average until age 82. Retirement planners, however, routinely urge more conservative (longer life expectation) planning. Some data indicate that the average life span of at least one member of a retired couple is 93. One might consider it prudent to plan for a life span of 90 to 95 years, if not for oneself, then for one's spouse. We are a much healthier nation today than just a decade ago (at the least, we are *capable* of being healthier). Medical advances continue and the prospects of life spans exceeding 100 years are certainly a consideration in this century. So, to be prudent, let's consider living to age 95 as an appropriate planning assumption.

How much money will one need during retirement years? The general rules of thumb suggest two-thirds to three quarters of your pre-retirement annual income. Research data indicate that *outlays* (excluding income taxes and savings) are close to three quarters of pre-retirement levels. Many categories of expense decrease, but healthcare becomes more expensive.

Again, let's assume a conservative posture with 75% of pre-retirement outlays as a prudent planning assumption. Notice that we are not talking about income at the moment. Lawyers are generally in the top five percent of wage earners and, accordingly, there should be considerable excess disposable income in the final years before retirement going towards savings and not outlays. Those final years should portray a healthy balance sheet — no debt. Cash flow should be free of education and support outlays for children and parents (if they are still living). Clearly personal circumstances and situation will dictate adjustments to our analysis. For our projections we will use \$75,000 in annual outlays. That is just below the social security wage base for income and nearly 2.5 times above the average level of outlays for a retired husband and wife.

Seventy-five thousand dollars in outlays (or after-tax income) is likely to be approximately \$100,000 in pre-tax income (assuming that social security is \$1,500 per month of that and the rest is unearned income; that tax exempt income is not material to the portfolio; current federal tax rates are used; and that a combined state/local income tax rate of 6% is provided for). Let's assume the partner is currently 35 years old. To provide for that taxable income from age 65 to age 95 — a full 30 years, or just short of one-third of his entire lifetime — the retiree needs an investment portfolio at retirement (excluding personal property and personal realty) of approximately \$4,100,000 if having any estate remaining at age 95 is not important, or approximately \$7,500,000 if preservation of capital is a goal.

Additional assumptions used in this model are an estimate that pre- and post-retirement inflation will average 3.15 percent annually (the average over the past 76 years). To maintain constant buying power of today's dollars, the retirement income required at age 65 is adjusted for inflation, and the then annual retirement income is adjusted each year for inflation during the retirement period. The partner expects to earn a real (inflation adjusted) return of 5.05 percent on pre-retirement assets. A more conservative 2.85 percent real return is expected post-retirement.

The savings required for that amount of money at different ages is shown in Tables 1 and 2. Clearly the earlier one starts saving for retirement, the easier it is. The dramatic difference among the examples reflects the power of compounded returns on the principal over the years. For example, if you set aside \$250 each month from age 25 to age 65, you will contribute \$120,000 of your own money and accumulate approximately \$840,000 at an average 8% annual return. Forego saving \$3,000 at age 25 and it is not \$3,000 that you keep from your retirement, but rather \$62,000. You lose the increase in your final year of savings.

Table 1 depicts the cost of delay in dealing with retirement planning. A key assumption for

*"Remember that as a retiree, one-third of your life lies ahead of you. How will you finance those years?"*

TABLE 1 — Cost of Delayed Retirement Savings

Description	Age 35	Age 45	Age 55
Single lump sum today to provide benefits	\$383,000	\$841,000	\$1,850,000
Annual level of contributions required	32,000	80,400	257,100
Amount of first contribution if graduated with contributions rising 3.15% annually	23,500	63,800	227,200

TABLE 2 — Qualified versus Nonqualified Plans

Savings Description	Qualified Plan	Nonqualified Plan
Sum available	\$ 40,000	\$ 40,000
Income taxes at 41%*	0	16,400
Net amount invested	40,000	23,600
Earnings of 8% on investment	3,200	1,888
Income taxes at 37% on earnings	0	774
Net accumulated first year	43,200	24,714
Approximate at end of ten years	625,800	306,800

\* Federal income tax rate of 35%, plus estimated state/local income taxes of 6%.

this table is that there are no assets being accumulated for retirement — either in qualified retirement plans or in personal savings. The partner described here delayed saving for retirement for ten years while he accumulated possessions, raised children and enjoyed the higher income. Notice how much the burden increased in just ten short years. This partner's children then went to college, and unfortunately, the partner earned too much to qualify for financial aid. So another ten years went by while college was funded and loans were repaid. Now at age 55, the potential burden to accumulate retirement assets is so massive as to suggest that this partner may work many years beyond initial expectations.

*How one saves can be just as important as how much.* The use of a qualified retirement plan as the foundation of a retirement savings program offers significant benefits. The assets are secured in a separate trust that is protected from creditors. Contributions to the plan and earnings within the plan receive tax advantages that would not occur if you simply were paid additional compensation. The power of compounded earnings matched with a deferral of income taxes creates a very persuasive argument for utilizing this tool.

Table 2 examines the result of saving \$40,000 per year for ten years,

under a qualified plan and in personal savings. It is clear that the qualified plan provides for a significantly higher accumulation that, upon distribution, is subject to tax. Favorable income tax rules, however, may lower or defer the effective tax rate that would otherwise be applied.

Retirement is a stage in one's life that deserves the same attention, energy and forethought that was given to one's professional career. Remember that as a retiree, one-third of your life lies ahead of you. How will you use what you have

learned and acquired over the preceding years? What activities will capture your interest? How will you finance those years? The best retirement program is one that is considered early, rigorously followed and regularly reviewed for adjustment. ♦

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