Money and You: Retirement savings guidelines should resonate with boomers

by Lynn O'Shaughnessy

How much do I need to save for retirement?

Some variation of these words has been uttered by millions of Americans. People keep asking the question because the answers have been about as satisfying as an empty bag of potato chips. Investors have heard it all. Some experts advise people to save 10 percent of their paychecks, while even bigger naggers insist that older procrastinators need to set aside 15 percent or 20 percent or more. Others suggest that people save at least enough to capture a match in their 401(k) retirement plans. Unfortunately, all this advice is overly generic and hardly applies to everyone.

A 40-year-old who has been faithfully saving since her days as a baby sitter, for instance, isn't going to need to save as aggressively as someone who keeps QVC on her speed dial. A person who drives a 10-year-old Volvo and lives in a two-bedroom bungalow isn't going to require as much in retirement as someone who tools around in late-model luxury cars and lives in a five-bedroom house that generates property taxes that are almost as obscene as the utility bills.

It's all these variations from the norm that explain why a new study co-written by Roger Ibbotson, a professor at the Yale School of Management and one of the titans in the financial world, should be invaluable to many anxious retirement savers. Five researchers involved with the study developed savings guidelines for retirement that take into account a person's age, the amount that has been saved and his or her income. Individuals can use these guidelines to figure out how much they should be saving or whether they can relax and stop accumulating so many acorns. The study also provides targets on how much we should have stockpiled by the time we reach age 65.

In conducting the study, researchers focused on three areas:

- The cash flow needed in retirement.

- The savings needed to generate this cash flow.

- The annual savings necessary to build up the nest egg that, along with Social Security, will pay the retirement bills.

In developing their methodology, Ibbotson and the others developed an approach that others have failed to use. To calculate realistic savings rates, they didn't peg their numbers on a person's gross income - that is, what an individual takes home every year before taxes or any other deductions eat it up. Instead, they keyed in on what they called the net pre-retirement income. They defined this as a person's gross income minus whatever money he or she plowed into a 401(k), individual retirement account or other retirement plans for the year.

This makes a lot of sense. Why should someone, for example, who makes $60,000 annually and saves 15 percent of that salary focus on replacing $60,000 when a $9,000 expense will vanish upon retirement? In this example, the aim would be to replace some percentage of $51,000.

The section of the study that I found most intriguing recommends savings rates for people as young as 25 and as old as 60. It starts off by looking at their current salaries. The study assumes that individuals will ultimately replace 80 percent of their net income and that they will work until age 65. To pull off that feat, a 25-year-old making $20,000 a year would need to start saving 5.8 percent of his salary. A 35-year-old earning $40,000 would have to begin socking away 12.1 percent.

But what about the numbers for baby boomers? The study certainly does reinforce the notion that saving early is just as critical as brushing one's teeth and eating fruits and vegetables. Researchers note that the savings rate for 25-year-old workers typically more than doubles if they wait until age 45, and it triples for those who dally until age 55. Knowing that, it might not come as quite a shock that the savings goal for a 55-year-old earning $60,000 would be 32.6 percent.

But wait a minute. The numbers won't look so bleak for baby boomers or anyone else if they have been feeding their retirement kitties. One table in the study shows investors how to shrink their savings requirement based on how much they have already invested. An investor of any age can reduce her savings percentage for every $10,000 she has saved. These deductions will vary depending upon a person's age and salary.

Let's look at our hypothetical 55-year-old, who would appear to need to live in a pup tent on a ration of hot dogs to meet his savings requirements. If our baby boomer had saved $200,000, his savings goal would drop to 18.6 percent a year. This calculation is based on a deduction of 0.7 percent per $10,000 saved. The deductions are greater for those making less money. For instance, the 25-year-old, who makes $20,000 and has $10,000 saved, could subtract 1.6 percentage points from her savings rate to make her new savings target of 4.2 percent.

I would urge anybody who worries about his or her retirement prognosis to take a look at the research. You can find the study, "National Savings Rate Guidelines for Individuals," by visiting the Web site of the Financial Planning Association (www.fpanet.org) and clicking on the link for the Journal of Financial Planning.

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