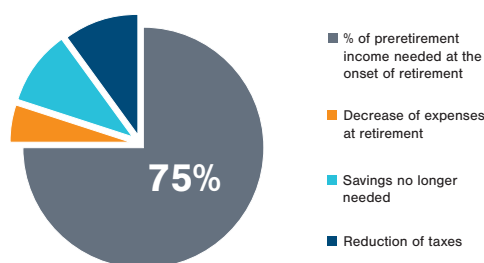




RETIREMENT PERSPECTIVES

INCOME REPLACEMENT IN RETIREMENT

There's more to planning for retirement than just saving money. It's about knowing how that money will fund your expenses when you stop working. It's helpful to have a target for what you might spend in retirement. The challenge is knowing what those expenses might be if you're many years away from retiring. One approach is to estimate your income needs in retirement as a percentage of your preretirement household income. We refer to this as an income replacement rate.



For starters, consider planning to replace around 75% of your gross preretirement income at the onset of retirement in order to maintain your current lifestyle in retirement.

Why 75%? Generally, living expenses do go down in retirement. Taxes will likely be reduced as well, especially payroll taxes when you stop working. And you won't be saving for retirement any longer.

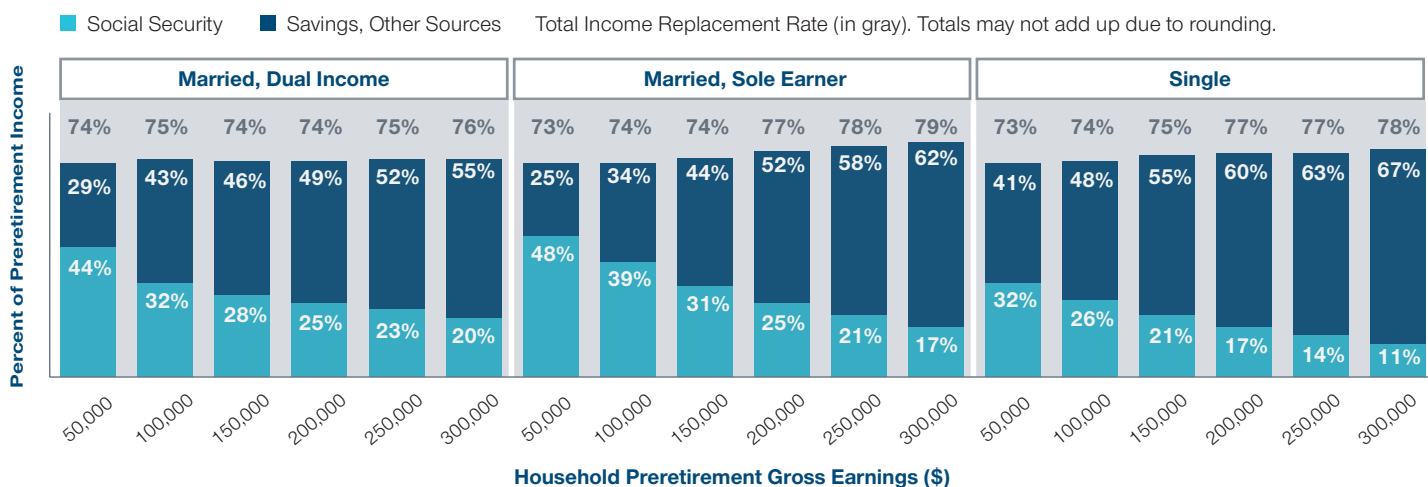
In this example, we assume household income of \$100,000–\$150,000 at retirement and a 5% spending reduction at the onset of retirement. The example also assumes that the household has been saving 8% of gross income (pretax). Keep in mind, while the income replacement rate estimates what you might need in retirement, there is no guarantee that an 8% savings rate will be sufficient to meet that need.

Estimating Your Income Replacement Rate

Many investors will fund their retirement through personal savings and Social Security benefits. Your marital status and household income are two factors that impact the amount of your Social Security benefits, your tax situation, and, therefore, the total income replacement rate. The chart below shows:

- Marital status and income have a modest effect on the total replacement rate.
- However, both have a major impact on how much you will need from sources other than Social Security.
- Social Security makes up a much smaller percentage of total income replacement rate at higher income levels, meaning more savings or other income sources will be needed to fund this gap.

INCOME REPLACEMENT RATE BY SOURCE



Keep in mind, if you claim Social Security before full retirement age, the total replacement rate doesn't go up much, but the percentage you'll need from sources other than Social Security can increase significantly, especially at lower income levels.

Assumptions (unless otherwise noted):

The household's income and spending keep pace with inflation until retirement, and then spending is reduced by 5%. Spouses are the same age, and "dual income" means that the one spouse generates 75% of the income that the other spouse earns. Federal taxes are based on rates as of January 1, 2019. While rates are scheduled to revert to pre-2018 levels after 2025, those rates are not reflected in these calculations. The household uses the standard deduction, files jointly (if married), and is not affected by alternative minimum tax or any tax credits. The household saves 8% of its gross income, all pretax. Federal income tax in retirement assumes all income is taxed at ordinary rates and reflects the phase-in of Social Security benefit taxation. State taxes are a flat 4% of income after pretax savings and are not assessed on Social Security income. Social Security benefits are based on the SSA.gov Quick Calculator (claiming at full retirement age), which includes an assumed earnings history pattern.

(more)



Other Factors Affecting Income Replacement Rate

In addition to income and marital status, there are other factors that may impact your income replacement rate.

What If I Expect My Spending in Retirement to Go Down (Or Up)?

The 75% replacement rate example assumes that spending at the onset of retirement will be reduced by 5% of spending prior to retirement. If you think you will spend less—for example, if your mortgage will be paid off—then you will need less income. Conversely, if you think you may spend more in retirement, you will need a higher replacement rate. Think of the adjustment as nearly a one-to-one ratio.

SPENDING REDUCTION AT RETIREMENT	REPLACEMENT RATE ¹
0%	79%
5%	75%
10%	71%

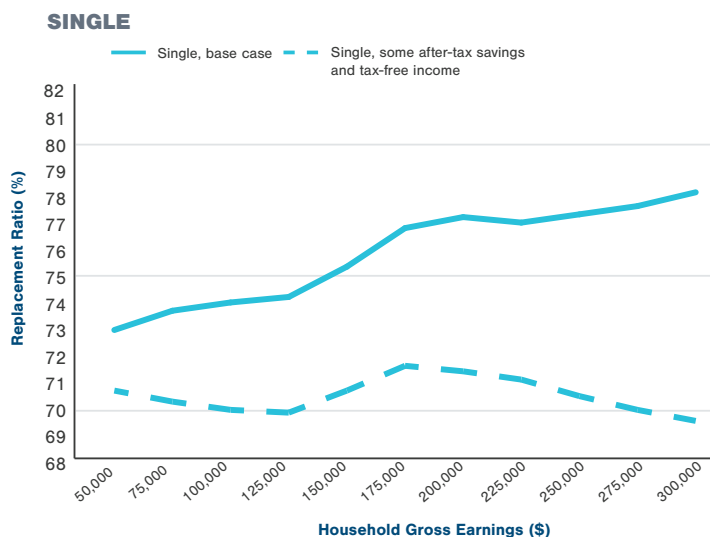
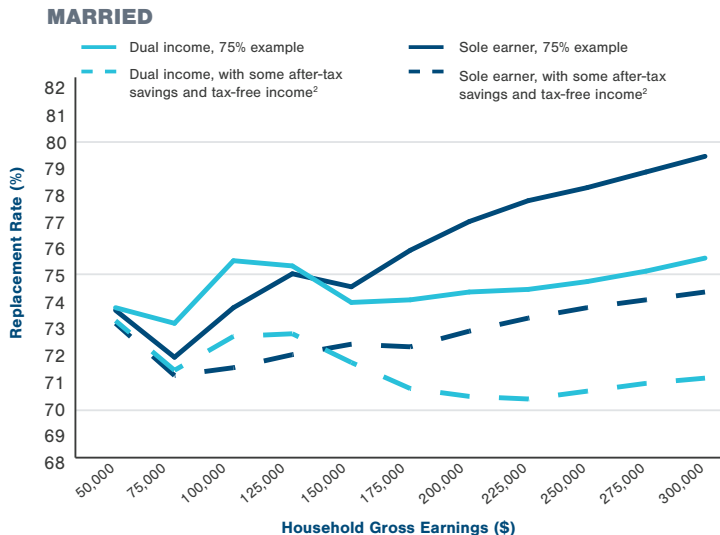
What If I'm Saving Less (Or More) for Retirement?

The 75% replacement rate example assumes that your household is saving 8% of gross household income during your working years. We find that this is about the average that people are saving in their retirement account on a pretax basis. If you're saving less than 8%, that means you are living on more of your current income and may also need that income in retirement. If you're saving more than 8%, then you are living on less of your current income and could possibly need less to live on in retirement. Think of the adjustment as nearly a one-to-one ratio.

HOUSEHOLD SAVINGS RATE	REPLACEMENT RATE ¹
4%	79%
8%	75%
12%	72%

What If I'm Saving After-Tax or Expect Tax-Free Income in Retirement?

For many people, pretax savings are the primary tool for retirement savings. The 75% replacement rate example assumes all savings are pretax. However, if you are saving after-tax in a Roth account, for example, that reduces your current spendable income. Additionally, qualified Roth distributions generate tax-free income in retirement. Both of these factors reduce the replacement rate, especially at higher income levels. This does not necessarily mean you should choose Roth contributions: That decision depends on your expected tax rates and other factors. But if you do have after-tax savings or expect tax-free retirement income, the charts below show that you can maintain your standard of living on a smaller percentage of your current income.



Final Thoughts

Planning for retirement involves many steps. One step is determining what you might spend in retirement. A guideline such as the income replacement rate may be helpful when retirement is many years away. As you get closer to retirement, it will be important to assess your spending needs more carefully. Knowing your destination, you can plan how to get there to achieve your retirement goals.

¹Assumes dual-income married couple with \$125,000 household gross earnings. Other factors held constant.

²Scenario where 20% of the household's savings are after-tax and approximately 20% of non-Social Security retirement income is tax-free.

Charts are shown for illustrative purposes only.

This material is provided for general and educational purposes only and is not intended to provide legal, tax, or investment advice. This material does not provide fiduciary recommendations concerning investments; it is not individualized to the needs of any specific benefit plan or retirement investor, nor is it intended to serve as the primary basis for investment decision-making.

T. Rowe Price Investment Services, Inc.