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Income Replacement in Retirement

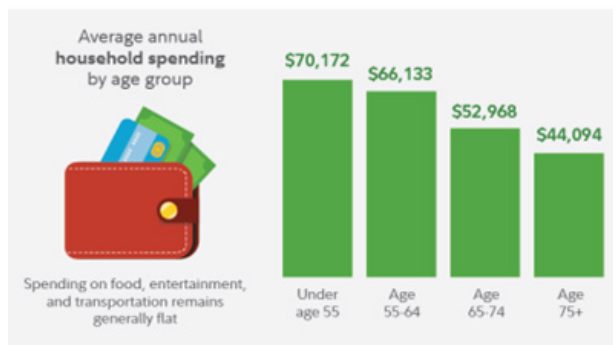
What is the Retirement Income Replacement Rate?

A retirement income replacement rate is the percentage of your income that you will need to have saved to maintain your current lifestyle in retirement.

What Is the Standard Income Replacement Rate?

Experts advise replacing between 70% to 90% of your pre-retirement income to support your retirement. Those percentages assume that you'll need less income in retirement due to numerous factors including:

- **Elimination of retirement savings:** Once you're retired, you will no longer be saving for retirement.
- **Reduction of taxes:** Your taxes will possibly decrease because some of your income may not be taxed or will be taxed at a lower rate.
- **Reduction in everyday spending:** It is common for everyday spending to go down in retirement depending on your desired lifestyle.



Source: CEX database 2022, annual household spending by age group

5 Factors to Determine Your Income Replacement Rate

1. How Much You Earn

The first determining metric is how much you earn. You can use this as a baseline for your projected retirement needs. Those that have higher salaries are more likely to need to plan for a higher percentage of retirement income. This is especially true if they lived proportionally to their income and increased their cost of living with every salary raise.

2. How Much You Save

This is when living within or below your means during your working years comes into play. The more you save now the easier it will be to obtain the desired income replacement rate in the future.

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3. When You Will Retire

The age at which you retire will greatly impact the amount of pre-retirement income you will need to replace. Those that have their eyes set on early retirement will need to keep in mind that the bulk of their retirement income will come strictly from their savings. This is because the earlier you enter retirement, the less you will receive in Social Security benefits and compound interest will have less time to help your savings grow. Delaying retirement until your late 60s or early 70s will allow you to rely less on the funds in your other retirement accounts.

4. Your Tax Rates

Some taxes will be eliminated once you retire such as FICA taxes. FICA or “payroll” taxes, for example, account for 7.65% to 15.3% of your paycheck depending on your employment situation. However, there are a variety of taxes that will continue in retirement and can fluctuate.

5. What Social Security Covers

Social Security will only cover a percentage of your pre-retirement income based on your highest 35 years of earnings. After that, the rate you receive in payouts will be determined by how much you earned during those 35 years and what age you choose to start receiving your benefits.

The Bottom Line:

What retirement planning boils down to is knowing what you will have at your disposal to fund your lifestyle during retirement. That's why it's so important to figure out your ideal retirement income replacement rate. A well-thought-out retirement plan should ideally start early in your career and be consistently adjusted to economic conditions, salary increases, and life changes. Government programs like Social Security are a great way to supplement your retirement income, however, they shouldn't be used as your only source of income.

For beginners looking for a great place to start, or experienced savers wanting to check if they're on the right path, contact your dedicated MCF retirement planning specialist.

For more information, Contact MCF today!

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