Saving $1 Million for Retirement

How can you plan to do it? What kind of financial commitment will it take?

Provided by Ed Grondahl

How many of us will retire with $1 million or more in savings? More of us ought to – in fact, more of us may need to, given inflation and the rising cost of health care.

Sadly, few pre-retirees have accumulated that much. A 2015 Government Accountability Office analysis found that the average American aged 55-64 had just $104,000 in retirement money. A 2016 GoBankingRates survey determined that only 13% of Americans had retirement savings of $300,000 or more.[1,2]

A $100,000 or $300,000 retirement fund might be acceptable if our retirements lasted less than a decade, as was the case for some of our parents. As many of us may live into our eighties and nineties, we may need $1 million or more in savings to avoid financial despair in our old age.

The earlier you begin saving, the more you can take advantage of compound interest. A 25-year-old who directs $405 a month into a tax-advantaged retirement account yielding an average of 7% annually will wind up with $1 million at age 65. Perhaps $405 a month sounds like a lot to devote to this objective, but it only gets harder if you wait. At the same rate of return, a 30-year-old would need to contribute $585 per month to the same retirement account to generate $1 million by age 65.[3]

The Census Bureau says that the median household income in this country is $53,657. A 45-year-old couple earning that much annually would need to hoard every cent they made for 19 years (and pay no income tax) to end up with $1 million at age 64, absent of investments. So, investing may come to be an important part of your retirement plan.[4]

What if you are over 40, what then? You still have a chance to retire with $1 million or more, but you must make a bigger present-day financial commitment to that goal than someone younger.

At age 45, you will need to save around $1,317 per month in a tax-advantaged retirement account yielding 10% annually to have $1 million in 20 years. If the account returns just 6% annually, then you would need to direct approximately $2,164 a month into it.[4]

What if you start trying to build that $1 million retirement fund at age 50? If your retirement account earns a solid 10% per year, you would still need to put around $2,413 a month into it; at a 6% yearly return, the target contribution becomes about $3,439 a month.[4]

This math may be startling, but it is also hard to argue with. If you are between age 55-65 and have about $100,000 in retirement savings, you may be hard-pressed to adequately finance your future. There are three basic ways to respond to this dilemma. You can choose to live on Social Security, plus the principal and yield from your retirement fund, and risk running out of money within several years (or sooner). Alternately, you can cut your expenses way down – share housing, share or forgo a car, etc., which could preserve more of your money. Or, you could try to work longer, giving your invested retirement savings a chance for additional growth, and explore ways to create new income streams.

How long will a million-dollar retirement fund last? If it is completely uninvested, you could draw down about $35,000 a year from it for 28 years. The upside here is that your invested retirement assets could grow and compound notably during your "second act" to help offset the ongoing withdrawals. The downside is that you will have to contend with inflation and, potentially, major healthcare expenses, which could reduce your savings faster than you anticipate.

So, while $1 million may sound like a huge amount of money to amass for retirement, it really is not – certainly not for a retirement beginning twenty or thirty years from now. Having $2 million or $3 million on hand would be preferable.

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Citations.

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