MarketWatch

Are you retirement ready? Take this test at home

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In the coming 60 or so days, you'll become familiar, again, with one of America's shared national rituals. This annual event has no first-run advertisements, no good guacamole, no three-day weekend going for it. Unlike the Super Bowl or Presidents Day, tax season is nearly unanimously described as "painful."

Diving into TurboTax or starting on your accountant's tax organizer, you'll sift through files and will struggle to log in to seldom-used financial websites. All this effort, merely to track down what you made and what you paid. Darn those elusive donation receipts, you'll say. What was that fundraising dinner for, anyhow, and how much of this silent auction donation item can I deduct?

While those flimsy-but-valuable slips of paper may or may not turn up before the April 15 filing deadline, you DO have a golden opportunity to make sense of your bigger financial picture. Each year, step back. Look at the relationship between your earned income (if any), your savings (tax-deferred or not), and your spending (fixed and variable).

Review your assets and your sources of income. In doing so, you can reap insights into what many folks say is their big question: when can I retire? The sassy answer is, any time you want—provided you are ready to live like a monk, and/or you have a tremendous tolerance for uncertainty.

The proper answer will reduce anxiety and improve the quality of your sleep. Gaining confidence in your retirement readiness may be the best way to repurpose the data you must gather for Uncle Sam at this time each year.

Reduce, reuse, recycle

The problem with many popular approaches to retirement readiness is their complexity; the view of the forest is blocked by the trees. Other approaches are simply too basic and don't accommodate your particulars. Planning and conversation in your financial home need to incorporate unique aspects, such as whether you and your spouse have a wide or narrow age gap, a big or slim difference in your earnings history, a modest pension (or not), unknown or contrasting family histories for longevity, adult children with special needs, and so on.

The asset snapshot

The first step to answering this question at home is to reduce the traditional (complicated) math, and jettison the Monte Carlo simulations. Instead, use a snapshot of assets. What do you own or control that can generate income for you now or later? These can be categorized by tax treatment, perhaps a perspective that is fresh for you. Write it down like this:

Section 1: Real-estate values

- Primary home, minus mortgage, if any
- Second property, minus mortgage, if any

- Investment real estate, minus mortgage, if any
- Other

Now, add up the value of the real-estate section.

Section 2:Tax-deferred account balances

- 401(k) or other employer-sponsored plan for each partner
- Rollover IRA for each partner
- Variable annuities (IRA or non-IRA)

Add up the value of the tax-deferred account balances.

Section 3:Taxed-as-earned accounts

- Checking accounts
- Savings accounts
- Brokerage accounts
- Mutual fund accounts

Add up the value of the taxed-as-earned accounts.

Section 4: Tax-free accounts (taxed and not taxed again)

- Roth IRAs for each partner
- 529 college savings accounts (total) (can omit)
- Cash-value life insurance, if any
- Health savings accounts (HSAs), if any

Add up the value of the tax-free accounts.

In this simple asset snapshot, net worth is the sum of these four sections.

Assets to be used for retirement are all of the above, minus the college savings accounts, if any, and subtracting the primary home. Why? If you don't want to use a HELOC (home equity line of credit), a reverse mortgage, or the downsizing approach to free up this equity, then exclude your home value. Note that cars are not included, nor are car loans; student loans are excluded; credit card debt is not found here. Use your judgment if these obligations are significant items for your household before proceeding.

Important timely step: subtract income tax from your Section 2 total. IRAs have an embedded parasite, which is the deferred income tax owed on the account balance. In the absence of a different compelling number, use 25% federal plus your state income-tax rate.

Spendable net worth is what you are left with. As you shift your view from a paperwork frenzy and looming tax obligation to look at all you have to spend, after tax, it's empowering.

Sources of income: work, pensions, annuities, Social Security and your assets

Once you know your spendable net worth, you are one step closer to determining when you can retire with confidence. Now? Soon? Later?

Let's examine your eventual sources of income, whether or not you have begun to receive them. These include:

- Each partner's Social Security benefits (if eligible this year)

- Pension, if any

Add up these sources of retirement income — regardless of whether you are drawing them yet or waiting.

Moving along: list living expenses, including taxes.

A timely shortcut here: everything you made this year minus everything you saved this year equals what you spent this year. At tax time, we have at our fingertips the figures for taxable income, and we have a record of what we saved [in either 401(k)s or in the difference between our opening and closing bank statements (Jan 1 to Dec. 31)]. We also have a record of contributions, additions or net additions to our brokerage accounts; just be careful not to include investment performance!

Next-to-last step: subtract living expenses from retirement income. This income deficit is the amount you need to plug with withdrawals from your portfolio.

Living expenses - retirement income = amount needed from portfolio

Finally, here's the big finish! Divide the amount you need from your portfolio, in dollars, by your spendable net worth, like this:

Amount needed from portfolio / Spendable net worth = %

If this percentage is below 4.8% (some advisers allow 5% and view 5.5% as a maximum upper limit) then congratulations! You have a "superb, excellent, or very good" probability of having your money last your whole life.

Otherwise, you have options. The beauty of reviewing this information during each tax season, while you're working with the dollars and cents of earning, spending, and tax, is that you have a good annual benchmark. Your opportunity now is to keep making progress by saving, investing, working, and/or taking a sharp knife to your expenses.

Get very clear about needs, wants and wishes, whether they are fixed or variable. You may want to delay or suspend that Social Security benefit (if you are under age 70). Take this time to re-examine the role of travel or a second home in your quality of life.

Are there any pockets of money that are not being invested, not working hard for you? What part-time work will you consider as a bridge between traditional employment and full retirement? The mental health benefits often match or exceed the financial benefits, including social engagement, additional peace of mind, and security around spending in retirement.

Want to take a peek at the future? Sharpen your pencil (or plug in your laptop), and return to the spendable net worth nest egg.

Use the spendable net worth figure as line 1 on a new list. Below that, list your annual savings, if any, as line 2. Add to these, the average rate of return on your portfolio (investible assets and rental properties), in dollar terms, for line 3.

Here is an example, using spendable net worth of $500,000 right now. You are committed to maximizing your 401(k) contribution, even though your employer cut the match. If your overall investible assets are mostly invested in a diversified portfolio of stocks, bonds, REITs and a rental apartment or two, then you could use, say, 6%, or $30,000 for line 3. If you mostly have CDs and a large 401(k) in a target retirement date fund, then consider 4% or $20,000, for line 3.

To recap:

Line 1: Dec. 31, 2014 spendable net worth — $500,000

Plus line 2: planned 401(k) savings this year — $24,000

Plus line 3: average investment returns — $30,000

Total: $554,000

Same time next year

As 2015 gets under way, you have a sense of your upcoming earning, spending and saving figures. You also are in the middle of a project that requires you to review the past year (for 2014 tax preparation). The calculation above will allow you to anticipate what impact your 2015 savings plans and potential investment returns (on average) could have. This reveals what your new spendable net worth figure could be, at this same time next year.

Does this figure motivate you to make changes? To retire now with confidence? To begin to move toward the exits at work? To get serious about downsizing or putting that below-market-rent investment property on the market?

At the very least, this exercise is simple enough to engage a loved one with less tolerance for financial news articles, and powerful enough to have an impact on your spending and saving in the years ahead. It reuses income information you have to gather anyway, puts your assets in a new light and illuminates the question: When can I (confidently) retire?

For additional reading, please see the Oct. 2014 Journal of Financial Planning. In particular, Retirement Planning by Targeting Safe Withdrawal Rates by David M. Zolt.

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