RETIREMENT INVESTMENT ADVISORS, INC.

Road Map to RETIREMENT

As we save for retirement, it is important to know whether we are in good financial shape or need to make adjustments to improve the odds of achieving our goals. A good target is to start retirement with no debt and savings worth at least 12 times your salary, which puts you in a position to generate approximately 60 percent of your pre-retirement income from investments.

To plan for your retirement, consider using personal financial ratios.[1]

"Investors commonly use stock ratios such as the price-to-earnings and price-to-book to assess the financial health of a company because the ratios concisely benchmark a company's financial status," according to Charles J. Farrell. "Just as stock ratios are primarily based on a company's earnings, the personal financial ratios are based on an individual's income. There are three ratios: savings-to-income, debt-to-income and savings rate-to-income." Farrell used a series of assumptions including household budgets, post-retirement income replacement, rates of return and retirement distribution rates to create benchmarks for each ratio at different ages (see table).

Our objective is to help individuals move from high debt and low savings at the beginning of their working careers to high savings and no debt at the end of their careers. While the ratios are not meant to substitute for individual advice or account for all of the specific variations in people's financial lives, they can serve as a guideline.

To calculate the ratios, let's assume a 45-year-old female has a household income of $100,000. Her ratios are:

Savings to Income: ($200,000 401(k) + $20,000 savings) / $100,000 = 2.2 (Goal 3.0)

Debt to Income: ($125,000 mortgage + $10,000 auto loan + $4,000 credit card debt)/$100,000 = 1.39 (Goal 1.00)

Savings Rate to Income: ($6,000 401(k) contribution + $3,000 company match) / $100,000 = 9% (Goal 12%)

Compared to the benchmarks, her savings are too low, debt is too high and she needs to increase her savings rate to make up for the low total savings. To be on track with the benchmarks, she would have savings of $300,000 and debt no higher than $100,000. If she considers trading up to a larger home, this information would be helpful. Financially it would be better to increase her retirement savings and pay off debt instead.

There is a fundamental relationship between income, debt levels and savings rates. For example, if a family cannot save 12 percent of pay starting at age 30, the savings rate will need to increase substantially later in life, which could be difficult to achieve.

"The ratios are designed to serve as a road map so that investors can compare their individual ratios against the benchmarks to determine whether they are on track to retire," Farrell said.

Do the math. Are you on track?

Personal Financial Ratios

Assuming 5% Return, 5% Distribution Rates

Age	Savings to Income	Debt to Income	Savings Rate to Income
30	0.1	1.70	12%
35	0.9	1.50	12%
40	1.7	1.25	12%
45	3.0	1.00	12%
50	4.5	0.75	12%
55	6.5	0.50	12%
60	8.8	0.20	12%
65	12.0	0.00	12%

[1] Charles J. Farrell, J.D., LL.M., a partner in the financial consulting firm of Dorman Farrell LLC, in Medina, Ohio, outlined the concept in the January 2006 *Journal of Financial Planning* article, "Personal Financial Ratios: An Elegant Road Map to Financial Health and Retirement."

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Originally published in *Slice* magazine June 2011

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