

# Preparing a Retirement Budget With Beau Kemp

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*Preparing a retirement budget, explained.*

Robert Powell

How might you go about creating a retirement income plan? Where might you start? Well, here to talk with me about that is Beau Kemp from Sensible Money. Beau, welcome.

Beau Kemp

Hey Bob, thanks for having me.

Powell

Pleasure. So this will be the first of several videos that we do on the topic of how to build a retirement income plan. And I think the first place that you want to start is how do you prepare a retirement budget?

Kemp

Yes, think this is, oftentimes with clients, this tends to be one of the spots that we get hung up on. And there's a lot of ways to go about it. And think a lot of times we go about our day-to-day lives with our consistent paychecks. And sometimes we don't realize how much we're spending. And then as you start to go into it, it can feel stressful. One, you might realize you're spending way more than you thought you did. And two, it's like, where do you even begin?

Hopefully by the end of the day, you have a good baseline on how to start and how to go about doing this.

Powell

Yes, so where do you begin? Where's the best place?

Kemp

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What I like to do when, I mean sometimes people are on top of it, right? They're tracking every single penny. You don't really need to be to the penny unless that helps you from a psychology standpoint. know, if it makes you feel comfortable then do that. But when people don't know where to start, I like to start from the top. And how I go about doing this is we really say, okay, well, this is an example, but I know you don't have any credit card debt, so I know we're not spending more than we're making so we start with the paycheck and I like to look at okay I know this consistent paycheck you have is covering your expenses let's see how much is actually going into your checking account every single month and when you do that it always works better with numbers right so let's say let's say you have five thousand dollars coming in per paycheck twice a month we make a nice clean ten thousand dollars a month net and from there then we start to have these discussions of I like to say, well, are you actually spending all of this or have we built up savings throughout the year? Sometimes we'll have people that have consistent transfers, whether it's to a savings account or an investment account. And other times it's just, well, no, but I started the year with say \$50,000. Now I have 75 at the end of the year. And so you can kind of start to work there, right? And see, okay, well, then I start to know how much did I actually spend versus how much did I save? If we follow this logic, I kind of want to use this example throughout today of if we have the \$10,000 coming in, let's assume that we're transferring \$2,000 every single month to a savings account. So now as we're talking, I know you're roughly spending \$8,000 a month.

Powell

And that's sort of the, in a way, it's interesting, right, when we tell people to predict what they might spend in retirement or what they might need. Sometimes we tell them you might need 80 % of your pre-retirement income in retirement. So you just actually just got there, right, by going through the actual math.

Kemp

Exactly, exactly. it's, you know, as you start to work through it, you're like, okay, it's there. We have all these rules of thumb and it's really like, well, this is your situation. This is what you're doing. And from there, I think now we can start to, right, we're doing this top down approach where now we can start to think about how much of these expenses are actually going to my essential living needs versus how much is discretionary. And I don't like it when it's well this is what I truly need and so I'm going to cut out my restaurant budget or go into the spa or the nicer gym, right? There's all these different things that sometimes you want to spend money on. It's not to cut those out, it's more to say, okay, from an ongoing standpoint, this is what I know you need versus how much is in discretionary and really discretionary, a lot of times that's your vacation expense. And so if we're using that

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\$8,000,

Let's just assume we're putting \$1,000 aside for vacations. We'll spend \$12,000 on vacations this year. And so now I know from a planning standpoint of, okay, if we go through a poor sequence of returns, I know you need that \$84,000, the \$7,000 a month, right? We can cut vacations if we truly need it. I don't want to have to do that, but that would be the first item you start to look at. And so that's why separating these two out of non-discretionary and discretionary is important, so then you have that game plan if you were to need to do something like that.

Powell

Yes. As you're building up the essential versus discretionary, are there some items that sometimes people overlook or forget to think about as they're doing this exercise?

Kemp

There are some major ones, right? And so this is, again, this is the good start, but the way, one mistake you can make doing it this way is, well, I've been spending \$7,000 a month on those essential needs and another thousand on vacations. Most of the time we have health insurance premiums being taken out of our paycheck. So I didn't account for that yet. We need to add that back into this number. If you don't, can be surprised. I've seen it happen before and you need to come up with accurate estimates of what you'll be spending. Sometimes our employers will provide retiree health care options. Other times it's where do we even go to find these? If you're pre-65, you're not on Medicare yet, you'll typically go to [healthcare.gov](https://www.healthcare.gov) and you can come up with some good estimates there. Those tend to be more costly. Once you get on a Medicare and you're at age 65 and beyond, now we can go to the AARP website, come up with a good estimate. The Medicare Part B premiums, those are calculated, right? It's based off your income where it was two years previous, but then you also, a lot of times we'll add on a supplemental plan there. And so that's a big one. You also want to think about, so that's just premiums for health care. You'll have dental, you'll have vision, and then there's also out of pocket health care costs. Most of the time you're healthier when you retire than you will be later on. And so we prefer to add a buffer in there of out-of-pocket health care. And the reasoning is, it seems like it's logical, right? You'll probably face more expenses later on for health care needs than you will today when you're say age 60 or 65. And so that's one of the items that can be forgotten is really the whole health care piece of this process and then also your lumpy items that come up periodically. So how have we projected out home repairs? If you don't own a home, how have you typically paid for that? And so maybe you carve out an expense item there for some major home repairs. Sometimes we know, well, yes, I

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need to replace my roof next year, right? Then you can build that in. But those are some major ones. Auto purchases can be forgotten, right? Maybe we have our car paid off and we haven't thought about when are we actually going to replace this vehicle? My favorite expense though, this is the most fun expense to talk about, are your go-go expenses. And this is something that we discuss with clients when you have a strong plan. So after we've already gone through those basic needs of health insurance out of pocket, your discretionary versus non-discretionary, I say, can I add a second discretionary line item to your plan?

Kemp

The reasoning why is, mean, the studies will show this, but also we see this with their clientele as well of when you retire, you want to go enjoy the money that you just worked your whole life for to save for, right? And so we encourage that. want you to go do that. And one of the ways to do that and feel comfortable about it is by adding this line item here.

Powell

So it's interesting when you add that line item, it's one of the things I think about is it's one thing to think about your expenses in the immediate next year. It's a little bit harder to think about them in the immediate three, five, 10 years from now and the effect that inflation might have on some of these expenses.

Kemp

Yes, the inflation is a big one and you'll want to... So I mean if we're using this spreadsheet, even if it's a program you're using for planning, it's essentially a spreadsheet behind the scenes. these are expenses today. We need to make sure we grow those with inflation because that is another mistake that can happen of, I'm going to retire at age 60. I'll start Social Security at age 70. If we have that \$84,000 number in our head, my wife and I, our Social Security, will cover that.

That's today, Social Security will increase with inflation too, but some of our items increase faster than your typical CPI, and that's a lot of the health care. So typically when you're building these, the most common rule with them is health care items grow those at four to six percent. We use five here. So a little bit higher than your typical inflation rate, which is about two to three percent.

Powell

Yes, I know that when I've looked at the Bureau of Labor Statistics data in the past, the Consumer Expenditure Survey, they noted in the past that health care expenses start out

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around like 5 % of someone's budget at age 65, but escalate up to 15 % by the time they're in their 80s. And I think it's due to a couple factors. One is the inflation rate that you just mentioned, the health care costs are inflating at a much higher rate than CPI. But also maybe as you age, you're also needing more health care and incurring more medical expenses for whatever reason. And so all of a sudden what seems like a very small portion of your budget in the go-go years becomes a much larger portion in your slow-go or no-go years.

Kemp

Yes, no, it's definitely true. is. You'll see that increase. see that with, especially as usually around that age 80 is when you'll start to see it the most, feel like. Then part of that too is at that same time when those health care needs have increased, now your go-go expenses have dropped off. And so, you know, there's less expense happening over here. Now our health care is making up a bigger percentage, which that's the unfortunate side. And that's why we encourage people, if we can, if your plan supports it, go enjoy it now.

Like there's, you only have so many decades as you're going into retirement and the decades matter, you know, and your first decade is going to be most likely for most people. your, that's the one where you'll have the most fun. So.

Powell

I'm fond of quoting there, Joe Coughlin is the director of the MIT Agelab, and he's fond of saying that when you get into your mid-60s and when you're going into your retirement years, you only have 8,000 days, on average, only 8,000 days of life left. And then tomorrow will only be 7,999. So spend it wisely and spend it when you can, I guess, right?

Kemp

Yep, exactly. that's where, you know, building this budget and helping it, it brings that peace of mind that you can go enjoy it. You can actually support a little bit extra spending. And so that's part of this whole process, right? When you're building this budget, it's, we want to make sure that we can show you that, yes, you can go do this. And there's that transition period. So we have, we're so used to working and saving money. We don't need to save money now as that comes into your checking account. It's there to spend it all.

Usually if you're at this point of retirement and you have a significant amount of assets, you are not comfortable with spending all the money that just got deposited into that checking account. So there is that transition of the behavioral side of these things.

Powell

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So this is the first of several videos that we plan to do about creating a retirement income plan. What can we expect in the next video?

Kemp

Yes, think so coming up it'll be today was about really your beginning stage, right? Of expenses, then we'll start to dig into the income side. So the cash inflows today, we're talking about the cash outflows. Then from there, it'll be, we'll want to, that'll be really your baseline. And so every time we build a plan, we start with this baseline plan. So these first, really first two sessions will cover how to get those essentials. It's money in, money out. Then from there we can start to dig into how can we make this more efficient, maybe from a tax standpoint, depending on where should we pull money from, which types of accounts. And then at the end we'll discuss how do you piece this all together? I have this big pile of assets, this lump sum of money and all these different accounts, how should I invest them lined up with all these numbers that we started to work through throughout this series.

Powell

Right. All right, well, this has been a great start. I want to thank you for sharing your knowledge and wisdom with us and our listeners and our viewers. Thank you.

Kemp

Yes, thank you, Bob.

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