Lifestyle Inflation and Its Impact

[Editor's Note: This is a republished post from Physician on FIRE, a member of The White Coat Investor Network. The original post ran here, but if you missed it the first time, it's new to you! It's a discussion of just how much of an impact lifestyle inflation can have on retirement dates and lifestyles. Like usual with the PoF "4 Physician" posts, he gets into the nitty gritty of the numbers and shows you just how big of an effect seemingly minor amounts of spending can have.]

In the **Tale of 4 Physicians**, we analyzed the impact of different spending budgets on wealth creation. Each of our 4 physicians was married with 2 kids and had a household income of $300,000. In the second post in this series, we explored the financial impact of Dr. Anderson working after achieving FI. Next up is Dr. Benson.

Dr. B had the second lowest annual spending at $120,000. Dr. B heard that Dr. A was considering an early retirement after 11 years in practice and he promptly scoffed at the idea. With a net savings rate of 44%, Dr. B was already saving way more than most of his peers. And spending less. But Dr. B got an uneasy feeling when he parked his 3-Series Beamer next to the 5-Series and 7-Series performance vehicles in the physician's lot.

Logging into Facebook, he saw his colleagues and their families vacationing in Paris and enjoying new pontoon boats at their lake homes and Dr. B started to feel inadequate. It seemed half the kids in his upscale neighborhood were in private school and how many of their parents were doctors? The insurance salesman / financial advisor next door had three kids in private school, for crying out loud. And a new RV!

Dr. B Opts to Upgrade

Dr. B and his wife decided it was time for a lifestyle upgrade. They've never seen Dr. Dahlgren's balance sheet, but he's obviously doing quite well. I mean, even his kids fly first class when they go skiing in the Alps. So from now on, Dr. B is going to live more like Dr. D.

Let's dig into the numbers. Here is a look at where Dr. B's and Dr. D's $300,000 salary has been going up until now.

	Dr. Anderson	Dr. Benson	Dr. Carlson	Dr. Dahlgren
Salary	$300,000	**$300,000**	$300,000	**$300,000**
Match & Profit Sharing	$20,000	**$20,000**	$20,000	**$16,000**
Compensation	$320,000	**$320,000**	$320,000	**$316,000**
Income Taxes Paid				
Federal Income Tax	$50,000	$48,500	$47,000	$63,000
State Income Tax	$10,000	$9,500	$9,000	$11,000
FICA	$12,000	$12,000	$12,000	$12,000
	$72,000	**$70,000**	$68,000	**$86,000**
Post-Tax Income	$228,000	**$230,000**	$232,000	**$214,000**
Pre-Tax Spending				
Health & Dental Ins.	$5,000	$5,000	$5,000	$5,000
Pre-Tax Investments				
HSA investment	$5,000	$5,000	$5,000	$0
401(k)	$18,000	$18,000	$18,000	$4,000
457(b)	$18,000	$18,000	$18,000	$0
	$41,000	**$41,000**	$41,000	**$4,000**
Take-Home Pay	$182,000	**$184,000**	$186,000	**$205,000**
Post-tax investments				
529 Education Funds	$10,000	$10,000	$10,000	$5,000
Roth IRA (backdoor)	$11,000	$11,000	$11,000	$0
Taxable Investment	$81,000	$43,000	$5,000	$0
	$102,000	**$64,000**	$26,000	**$5,000**
Annual Spending	$80,000	**$120,000**	$160,000	**$200,000**
Saving % Calculation				
All contributions*	$153,000	$115,000	$77,000	$20,000
Monthly Contribution	$12,750	$9,583	$6,417	$1,667
Max Possible Contribution	$243,000	$245,000	$247,000	$225,000
Savings Rate (Net)	63.0%	**46.9%**	31.2%	**8.9%**
Savings Rate (Gross)	47.8%	**35.9%**	24.1%	**6.3%**
Required Nest Egg for FI	$2,000,000	**$3,000,000**	$4,000,000	**$5,000,000**
Years to Goal at 2% Real	11.7	**21.0**	35.7	**89.7**
Years to Goal at 4% Real	10.6	**17.9**	28.2	**60.0**
Years to Goal at 6% Real	9.7	**15.8**	23.6	**46.3**

To keep things fair, we'll assume Dr. B got the same market return that Dr. A saw over the 11 years that it took her to become FI, a return that outpaced inflation by 4%.

His nest egg after those 11 years is worth about **$1.5 million** in today's dollars. By golly, he's rich! Time to start spending like it, so let's assume his spending from this point on will match Dr. D's $200,000 and see how that changes Dr. B's future.

Dr. Benson	Maintains	Spends More
Salary	**$300,000**	**$300,000**
Match & Profit Sharing	**$20,000**	**$16,000**
Compensation	**$320,000**	**$316,000**
Income Taxes Paid		
Federal Income Tax	$48,500	$63,000
State Income Tax	$9,500	$11,000
FICA	$12,000	$12,000
	$70,000	**$86,000**
Post-Tax Income	**$230,000**	**$214,000**
Pre-Tax Spending		
Health & Dental Ins.	$5,000	$5,000
Pre-Tax Investments		
HSA investment	$5,000	$0
401(k)	$18,000	$4,000
457(b)	$18,000	$0
	$41,000	**$4,000**
Take-Home Pay	**$184,000**	**$205,000**
Post-tax investments		
529 Education Funds	$10,000	$5,000
Roth IRA (backdoor)	$11,000	$0
Taxable Investment	$43,000	$0
	$64,000	**$5,000**
Annual Spending	**$120,000**	**$200,000**
Saving % Calculation		
All contributions*	$115,000	$20,000
Monthly Contribution	$9,583	$1,667
Max Possible Contribution	$245,000	$225,000
Savings Rate (Net)	**46.9%**	**8.9%**
Savings Rate (Gross)	**35.9%**	**6.3%**
Required Nest Egg for FI	$3,000,000	$5,000,000
Net Worth at Baseline	$1,590,999	$1,590,999
Additional $ Required	**$1,409,001**	**$3,409,001**
Years to Goal at 2% Real	**8.8**	**42.1**
Years to Goal at 4% Real	**6.9**	**24.3**
Years to Goal at 6% Real	**5.7**	**17.1**

Dr. B was on track to be financially independent in the next 6 to 9 years with a nest egg of $3 million. By upping the spending, he can expect to work another 17 to 42 years with real returns in the 2% to 6% range to attain the larger required nest egg of $5 million.

Keep in mind, we are starting from a baseline of having already been an attending physician for 11 years, which would put him at least in his early forties at the beginning of this exercise. With excellent market returns, he may still be able to retire close to 59.5 when he will have access to the 401(k), but it's best not to rely on 6% real (8% to 9% nominal) returns.

What if Dr. B waited to upgrade his lifestyle until he retired? In other words, how long would it take Dr. B to amass a $5 million dollar net worth if he continued his current spending of $120,000 per year?

The Benefit of Delayed Gratification

You've seen enough spreadsheet for one post, so I'll spare you the math and give you the answer. Spending $120,000 a year, it would take 12, 15 or 20 years at 2%, 4%, and 6% real returns to reach $5,000,000.

In this case, we're no longer relying on stellar returns to have the ability to retire in style at a reasonable age. You could call this a benefit of "**delayed gratification**" although spending $120,000 a year could hardly be considered a life of deprivation, and not everyone will be happier indulging in $200,000 of annual spending. Not all of us are comfortable living the Lifestyles of the Rich & Famous.

Also, remember that Dr. B has two children. If his family is spending $200,000 per year while the kids live at home, those kids will be accustomed to a life of luxury. While some people may want that for their children, I think it can be a setup for disappointment and financial difficulties later on when they are on their own. I think it may be best to wait until the kids are self supporting or at least living away from home before rewarding yourself with a big lifestyle upgrade. That, of course, is a personal decision.

What do you think? Have you upgraded your lifestyle? Was it gradual, or a virtual lifestyle explosion like Dr. B underwent? Is financial independence within reach for you? Comment below!