Early Retirement:

Can You Get Out of Dodge?

By

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When can I retire? This is an oft asked question when meeting with pre-retirees. Sometimes, they are ready to "Get out of Dodge" and want to retire sooner rather than later.

Take the case of Susan. She is 61 years old. She will be receiving a pension and Social Security. Can she retire next year when she turns 62?

A simple assessment starts with determining what I call the retirement income gap. If your wages are $60,000 per year and your retirement income is $40,000 per year, the gap is $20,000. To retire, you must bridge that gap. You can do that one of two ways – increase income or decrease expenses.

Looking at the income side, you may need to rely on personal savings to fund the difference. Many experts recommend spending no more than 4% of your savings to fund retirement. Using this rule of thumb would require $500,000 for a $20,000 annual withdrawal rate. Additionally, this 4% withdrawal rate is affected by interest rates and volatility of the stock market and is in no way guaranteed.

Those wanting to retire from high stress jobs often plan on working part-time for lower wages after retirement. This can be a great way to bridge the income gap and get out of the rat race. Keep in mind that although the economy is recovering from the recession of 2008-2009, it is often challenging for older employees to find jobs.

Another way to bridge that gap is by decreasing expenses. Typically expenses for taxes, transportation, clothing and food will decrease after retirement. On the other side of the coin, payments for travel, entertainment and health care often increase. It's a good idea to draw up a pre and post retirement budget. What are you currently spending each month? What expenses can be eliminated? Can you save money on housing by downsizing?

Before retiring, pay close attention to medical costs – particularly if you retire before that magic Medicare age of 65. Employers often subsidize the healthcare for their employees; but when an employee quits, that subsidy ends. Although you can elect to continue your employer health coverage for 18 months under COBRA, the price for that coverage may be substantially higher than you are currently paying. Some retirees have found that they can get reasonably priced coverage though the health care exchanges. Check out HealthCare.gov to see if this is an affordable option for you.

One unknown factor is inflation. With a 3% inflation rate, expenses will double in 24 years. Will your income keep up? Most pensions are not indexed for inflation. Social Security is currently indexed to the consumer price index, but if that changes, there will be a new meaning to the term "fixed Income." It's vitally important to have some money set aside to offset future inflation.

Another unknown is when "stuff happens". When you are working, that unexpected roof repair, replacement vehicle or emergency dental work is often financed though your savings account or paid for by credit card. When you retire, your personal savings will need to have enough to fund those unexpected emergencies – for the rest of your life!

If you are not sure if you can afford to retire, it's a good idea to institute a "trial retirement" before you actually quit working. Test if you can live on your post retirement income. In the case of Susan above, in the year before she wants to retire, she should try to live on $40,000 per year – and save the rest of her salary. This may prove difficult, but it is better to find out now than later.

Originally appearing in
Lovin' Life After 50
August 2014 Issue

Keep in mind that the longer you wait, the better the numbers look. For instance, delaying retirement to age 65 may save you substantially on health care expenses as you will be eligible for Medicare.

On the income side of the equation, waiting to take Social Security may dramatically increase your benefits. According to SSA.gov, if your full retirement age is 67 and you retire at age 62, your monthly benefit is reduced by 30%. Every year you stick it out increases your retirement income.

Retirement is a big step. Be sure that you tread carefully before turning in that letter of resignation to your boss.

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Teresa Bear specializes in retirement planning and asset preservation for retirees and their loved ones. Teresa works primarily in the Phoenix Metro area and has offices in Mesa and Chandler.

Teresa has been helping families and retirees reach their financial, tax, retirement planning, and estate planning goals for over 25 years. She is legally bound to uphold the highest level of fiduciary standards when providing investment advice to her clients.

Author of the book, S*he Retired Happily Ever After*, Teresa is committed to educating clients and assisting them in reaching their financial goals.

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