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Deciding When to Retire: When Timing Becomes Critical

Deciding when to retire may not be one decision but a series of decisions and calculations. For example, you'll need to estimate not only your anticipated expenses, but also what sources of retirement income you'll have and how long you'll need your retirement savings to last. You'll need to take into account your life expectancy and health as well as when you want to start receiving Social Security or pension benefits, and when you'll start to tap your retirement savings. Each of these factors may affect the others as part of an overall retirement income plan.

Thinking about early retirement?

Retiring early means fewer earning years and less accumulated savings. Also, the earlier you retire, the more years you'll need your retirement savings to produce income. And your retirement could last quite a while. According to a National Vital Statistics Report, people today can expect to live more than 30 years longer than they did a century ago.

Not only will you need your retirement savings to last longer, but inflation will have more time to eat away at your purchasing power. If inflation is 3% a year--its historical average--it will cut the purchasing power of a fixed annual income in half in roughly 23 years. Factoring inflation into the retirement equation, you'll probably need your retirement income to increase each year just to cover the same expenses. Be sure to take this into account when considering how long you expect (or can afford) to be in retirement.

Current Life Expectancy Estimates		
	Men	Women
At birth	75.2	80.4
At age 65	82.2	85

Source: National Vital Statistics Report, Vol. 56, No. 10

There are other considerations as well. For example, if you expect to receive pension payments, early retirement may adversely affect them. Why? Because the greatest accrual of benefits generally occurs during your final years of employment, when your earning power is presumably highest. Early retirement could reduce your monthly benefits. It will affect your Social Security benefits too.

Also, don't forget that if you hope to retire before you turn 59½ and plan to start using your 401(k) or IRA savings right away, you'll generally pay a 10% early withdrawal penalty plus any regular income tax due (with some exceptions, including disability payments and distributions from employer plans such as 401(k)s after age 55).

Finally, you're not eligible for Medicare until you turn 65. Unless you'll be eligible for retiree health benefits through your employer or take a job that offers health insurance, you'll need to calculate the cost of paying for insurance or health care out-of-pocket, at least until you can receive Medicare coverage.

Delaying retirement

Postponing retirement lets you continue to add to your retirement savings. That's especially advantageous if you're saving in tax-deferred accounts, and if you're receiving employer contributions. For example, if you retire at age 65 instead of age 55, and manage to save an additional \$20,000 per year at an 8% rate of return during that time, you can add an extra \$312,909 to your retirement fund. (This is a hypothetical example and is not intended to reflect the actual performance of any specific investment.)

Even if you're no longer adding to your retirement savings, delaying retirement postpones the date that you'll need to start withdrawing from them. That could enhance your nest egg's ability to last throughout your lifetime.

Postponing full retirement also gives you more transition time. If you hope to trade a full-time job for running your own small business or launching a new career after you "retire," you might be able to lay the groundwork for a new life by taking classes at night or trying out your new role part-time. Testing your plans while you're still employed can help you anticipate the challenges of your post-retirement role. Doing a reality check before relying on a new endeavor for retirement income

Retirement: a state of mind

Don't underestimate the psychological issues involved in deciding when to retire. Many people welcome the opportunity to reinvent themselves. Others postpone retirement or return to some form of work so they can continue to feel connected and productive. You'll also need to shift your mental focus from accumulating savings to investing for income and managing income streams from various sources.

can help you see how much income you can realistically expect from it. Also, you'll learn whether it's something you really want to do before you spend what might be a significant portion of your retirement savings on it.

Phased retirement: the best of both worlds

Some employers have begun to offer phased retirement programs, which allow you to receive all or part of your pension benefit once you've reached retirement age, while you continue to work part-time for the same employer.

Phased retirement programs are getting more attention as the baby boomer generation ages. According to the Bureau of Labor Statistics, by 2012 workers age 55+ will represent almost 20% of the U.S. workforce, and many employers are forecasting an eventual shortage of skilled workers. In the past, pension law for private sector employers compounded the problem by actually encouraging workers to retire early. Traditional pension plans generally weren't allowed to pay benefits until an employee either stopped working completely or reached the plan's normal retirement age (typically age 65). This frequently encouraged employees who wanted a reduced workload but hadn't yet reached normal retirement age to take early retirement and go to work elsewhere (often for a competitor), allowing them to collect both a pension from the prior employer and a salary from the new employer.

However, pension plans now are allowed to pay benefits when an employee reaches age 62, even if the employee is still working and hasn't yet reached the plan's normal retirement

Deciding when to retire will have a substantial impact on your Social Security benefits. If you decide to start receiving payments at age 62, they will be lower than if you waited until your full retirement age. Contact the Social Security Administration for more information.

age. Phased retirement can benefit both prospective retirees, who can enjoy a more flexible work schedule and a smoother transition into full retirement; and employers, who are able to retain an experienced worker. Employers aren't required to offer a phased retirement program, but if yours does, it's worth at least a review to see how it might affect your plans.

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Key Decision Points		
	Age	Don't forget...
Eligible to tap tax-deferred savings without early-withdrawal penalty	59½*	Federal income taxes will be due on pretax contributions and earnings
Eligible for early Social Security benefits	62	Taking benefits before full retirement age reduces each monthly payment
Eligible for Medicare	65	Contact Medicare 3 months before your 65th birthday
Full retirement age for Social Security	65 to 67, depending on when you were born	After full retirement age, earned income no longer affects Social Security benefits

*Age 55 for distributions from employer plans upon termination of employment

Check your assumptions

The sooner you start to plan the timing of your retirement, the more time you'll have to make adjustments that can help ensure those years are everything you hope for. If you've already made some tentative assumptions or choices, you may need to revisit them, especially if you're considering taking retirement in stages. And as you move into retirement, you'll want to monitor your retirement income plan to ensure that your initial assumptions are still valid, that new laws and regulations haven't affected your situation, and that your savings and investments are performing as you need them to.