NJMoneyHelp.com
smart advice. every day.

January 15, 2015

Couple's early retirement dreams could be a reality

- Mike, 58, and Amy, 56, want to get far away from corporate America. The couple has raised two children. "When can we retire? How much money do we need?" Mike asked.

  Mike and Amy would like to retire when Mike is 62, and Amy has cut her hours back to half this month. They would consider part-time work if needed, while they also plan to do volunteer work. The couple is also looking for strategies to fund health care until Medicare kicks in at age 65. They've already started their planning by downsizing their home to a smaller one, which they plan to stay in for the rest of their lives.

  Claudia Mott, a certified financial planner with **Epona Financial Solutions** in Basking Ridge, worked with the couple on a plan for their future for NJMoneyHelp.com.Mott said with some adjustments, Mike and Amy should be able to reach their goal of retirement when Mike is 62.

PLANNING FOR EARLY RETIREMENT

Mott says Mike and Amy will find themselves relying heavily on their savings and investment portfolios in the early retirement years. "Although filing for Social Security at age 62 might seem like a wise decision to ease the shortage of income, the loss in lifetime benefits would be significant at almost $470,000 and is not their optimal filing strategy," she said. More on that in a moment. The couple must create as much income as possible from their investments, Mott says, and that's an important part of their long-term retirement success as.

If Mike retires at age 62, the couple would need approximately $98,000 in additional income to meet their needs, Mott says. To ease their cash flow needs, the couple said they are considering using some of the company stock to pay off the mortgage balance when they retire. Before they make that move, Mott says they need to consider the tax implications from the stock sale. She recommends they work with a tax professional to be sure they have the funds available to cover any tax obligation. But even with taxes, paying off the mortgage would reduce their living expenses by $16,440 per year, would have a significant positive effect on the success of their retirement plan. Mott says.

Health care is another important consideration because they'd have to pay for coverage until Medicare kicks in. "Right now on the open marketplace, an insurance plan to cover both Mike and Amy would cost between $17,000 and $19,000 per year," Mott said, noting the plan would include family deductibles ranging from $2,000 to $4,000 a year. "With insurance costs rising at an estimated 6.5 percent per year, this will be well over $20,000 in four years." They need to consider and budget for those costs.

The couple said they anticipate an inheritance of close to $2 million at some point in the future, and that will be essential for financial success. “The earnings that can be generated from this portfolio will contribute significantly towards meeting their living expense needs,” Mott says. “It may also factor into how they wish to claim Social Security and what assets might be used to pay off the mortgage.”

SOCIAL SECURITY OPTIONS

Filing for Social Security benefits at age 62 will cause benefits to be reduced by approximately 25 percent for the life of the filer, Mott says. She says if income and cash flow allow, waiting until at least full retirement is preferred. However, for couples with adequate sources of income, having one spouse hold off until age 70 enables their benefit to grow by 8 percent per year from full retirement age. The couple will need to review their income and cash flow when Mike reaches 65 so they can determine the best strategy for them. Among the items to consider? Their health. If one or both has an illness or other issue that may result in death within 10 to 15 years of reaching age 62, holding off on the benefit may not make sense, Mott says. They should also understand the cash flow needed to cover expenses. If a small amount of income is needed for four or five years, withdrawing from an investment or retirement account may be a wise trade-off in order to allow the benefits to grow, Mott says.

When the couple receives the expected inheritance is a factor here. “If Mike reaches age 66 and it has not been received, it may be best for him to take his Social Security benefit at this time to create more income and reduce the drain on the investment and retirement accounts,” Mott says. “When Amy reaches full retirement age, she could claim a spousal benefit using Mike’s record, which would be $1,342 per month.” This would create a greater benefit than taking her own benefit of $1,236.

Another option would be for Mike to file at age 66 and suspend his benefit until age 70, allowing it to grow 8 percent per year for almost four years, Mott says. At full retirement age, Amy could then take a spousal benefit. “This strategy would enhance the widow’s benefit that Amy would receive upon Mike’s passing,” she says.

SAVE MORE

Over the next four years, the couple needs to create additional savings in order to be fully prepared for retirement. They also have a couple of significant expenses coming in 2015 and they want to be sure the money is set aside.

Regardless of age or employment status, every family should have an emergency fund to cover unanticipated expenses, surprise repairs or unexpected purchases, Mott says.

“An employed individual should keep from three to six months of expenses in a liquid savings account or CDs, while those in retirement should consider up to a year’s expenses,” Mott says. With a total of $22,500 in their savings and checking accounts, Mike and Amy should re-direct any excess cash flow they have while Mike is working towards an emergency fund, Mott says. At a minimum, they would want to accumulate approximately $54,000 by 2016, with the eventual goal of reaching $100,000 by 2018.

The couple has a health savings account (HSA) with a current balance of $8,500, which they plan to use for medical costs in retirement. For 2015, the maximum contribution to an HSA is $6,650, Mott says, with an additional $1,000 for those over age 55. Given an estimated annual out-of-pocket cost of between $17,000 and $19,000 for medical insurance right now, the couple may wish make the maximum contribution allowed for the next few years to enable that account to grow.

In anticipation of retirement, Mike and Amy should be sure they review their current budget and get into the habit of tracking their spending using an online app or software package. Based on this quick cash flow calculation, it appears they should have substantial excess cash currently, but, their bank balances don't show it. Mott says tracking expenses now, and creating a retirement budget, will be essential when the bulk of the resources needed to meet expenses will be coming from investment and retirement accounts.

"There are many expenses that will be reduced or non-existent once a couple retires, while others may increase," she says. "Because withdrawals from 401(k)s and IRAs are taxed as income, knowing exactly what you need before you withdraw it can help reduce taxes."

INVESTMENT REVIEW

The couple has accumulated more than $1.4 million in their taxable and IRA accounts, but the portfolios have a very high exposure to individual stocks at 90 percent, Mott says. While they indicate that they have a good tolerance for risk, this is not the portfolio they should have going into retirement.

Aside from lacking exposure to short, intermediate and international fixed income, there is overlap in the stocks that are owned in the different accounts, Mott says. While the sum total of these issues is not excessive, it further reduces the couples' overall portfolio diversification. "And while one of these holdings shows a significant yield, it has lost over 60 percent of its value this year and is down over 10 percent annualized over the past three years," Mott says. "By comparison, the S&P 500 has gained 22 percent on a 3-year annualized basis."

Mott says while many of the stocks currently in the portfolio are sporting hefty dividend yields, there are over a dozen that have little to no yield. Some of these stocks have been big winners on a 3-year average basis, but a few were down substantially in 2014. "Reevaluating whether these issues are meeting the goals of providing income and/or growth through appreciation may be a worthwhile exercise," she says. Among Mott's suggestions is that the couple consolidate their accounts. "Managing an asset allocation can be cumbersome with multiple accounts designed to meet the same goal," she says.

Then, using a variety of mutual funds and/or individual bonds, the couple should consider ways to invest the portfolio assets that will generate income, but reduce the risk that the portfolio currently holds. This will benefit the portfolio over the next few years while the income can be reinvested and will be necessary to meet their expenses once they are retired, Mott says.

She recommends a 60 percent stock and 40 percent bond allocation for the next few years, including international, emerging markets and REITs on the equity side, along with a variety of different fixed income maturities. With these recommended allocation changes, Mott says the couple's chance for success will increase.

Net Worth:
Assets:

- Checking: $8,500
- Savings: $14,000
- IRAs: $812,600
- 401(k): $283,300
- Stock purchase plan: $312,000
- Pension savings: $43,600
- Primary Home: $750,000
- Personal Property: $80,000
- Autos: $43,000

Total Assets: $2,347,000
Liabilities:

- Mortgage: $298,700
- Car Loans: $17,400

Total Liabilities: $316,100
Total Net Worth: $2,030,900

Budget:
Annual Income:

- Mike Salary: $175,000
- Mike Bonus: $125,000
- Mike pension: $13,800
- Amy Salary: $21,000

Monthly Expenses:

- Income Taxes: $7,036
- Housing: $2,492
- Utilities: $869
- Food: $1,400
- Personal Care: $400
- Transportation: $1,570
- Medical: $450
- Insurance: $945
- Entertainment: $95
- Vacations: $200
- Charity: $150
- Gifts: $350
- Pet Care: $150

Email your questions to moc.pleHyenoMJN@ksA.