Planning for Retirement

(/retirement/planning-for-retirement/)

10 Things No One Tells You About Early Retirement

The reality of quitting work can be far different from the fantasy. Here's what you need to know

by John Waggoner, **AARP (http://www.aarp.org)**, June 1, 2021 | Comments: 40

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En español (/espanol/jubilacion/jubilacion-segura/info-2021/lo-que-debes-saber-del-retiro-temprano.html?intcmp=AE-RET-TOSPA-TOGL-ES) | Even if you love your job, there are times when you'd rather be alphabetizing the spice shelf than riding a packed train alongside hundreds of sniffling fellow commuters. And as you sway in the car next to a man who has biked four hours to the station, you might be thinking about early retirement.

Unfortunately, early retirement isn't for everyone. In fact, it isn't for most people. Just 11 percent of today's workers plan to retire before age 60, according to an Employee Benefit Research Institute (EBRI) survey (https://www.ebri.org/docs/default-source/rcs/2020-rcs/rcs_20-fs-2.pdf). For many of those who do take the plunge, the reality of early retirement can turn out to be far different than the fantasy. Here are a few things to consider before you decide to retire early.

1. Health care is expensive

Medicare, the federal program that provides health coverage for more than 61 million older Americans, doesn't start until age 65. Until then, you'll need an alternative — and it won't come cheap.

"Private health insurance before Medicare (/health/medicare-qa-tool/current-long-term-nursing-home-coverage/) kicks in costs an arm and a leg," says Brian Schmehil, director of wealth management for the Mather Group in Chicago. Current law says your insurance costs can't be more than 8.3 percent of your household income. For a person with a household income of $50,000, for example, a mid-level silver plan would be $346 a month, or $4,150 per year.

2. Tapping your nest egg early can be costly

If you retire before 59 1/2 (/retirement/planning-for-retirement/info-2020/stop-work-timing-factors.html), you'll usually pay a 10 percent early withdrawal penalty from most tax-deferred accounts, such as traditional IRAs and 401(k) plans. "There are some options for getting IRA money before 59 1/2, but it's tricky and can cause major penalties if done incorrectly," says Matt Stephens, founder of AdvicePoint in Wilmington, North Carolina.

And unless you have a Roth IRA, which is funded with after-tax contributions, you'll owe income taxes on the amount you withdraw from traditional accounts funded with pretax contributions. If, for example, you withdraw $20,000 from an IRA before age 59 1/2 and are in the 15 percent federal tax bracket, you'll pay $5,000 in taxes and penalties, leaving you with $15,000.

3. You sacrifice the power of compounding interest

Time is your friend when you are saving for retirement (/retirement/retirement-savings/info-2018/tap-into-savings.html), but not when you are spending. If you sock away $250 a month — $3,000 a year — from age 25 to age 55, you'll have about $237,000 when you retire, assuming you make no withdrawals and earn an average 6 percent annually on your investments. Seemingly not a bad return on your $90,000 in contributions.

But let's say you work 10 more years and retire at 65. In that scenario, you'll have about $464,000, nearly double. Why? The extra decade's worth of contributions helps, but that only adds up to $30,000. The real growth comes from another 10 years' worth of interest earned not only on all the principal you contributed but also the interest earned on the interest that has compounded for four decades.

4. You may have a long, long life ahead of you

A woman who retires at 55 will have to make her savings last (/health/conditions-treatments/info-2020/location-impacts-life-expectancy.html) for 28.6 years, on average, compared to 20.4 years if she retires at 65. A man who retires at 55 will have to stretch his savings for 25.1 years, rather than 17.8. And for couples who make it to 65, there's a 25 percent change that the surviving spouse lives to 98, according to the Society of Actuaries.

"With improved health care, many people are living longer than the national averages," says Angela Dorsey, a certified financial planner in Torrance, California.

5. You'll spend more money than you think

A typical rule of thumb is that you'll spend about 80 percent as much in retirement as you do when you work. After all, you won't be shoveling money into your retirement account, commuting every day and, for that matter, paying Social Security payroll tax, assuming you have no more earned income. But at least in the early years of retirement, when you're younger, healthier and newly freed from the constraints of work, you could very well spend as much as or more than you did before retirement. A J.P. Morgan Asset Management study found that there tends to be a "spending surge" by new retirees (/retirement/planning-for-retirement/info-2020/suze-orman-10-steps-to-your-future.html) on travel, home renovations or relocation, and other retirement-related lifestyle changes that levels off after two or three years.

"Every day is Saturday," says Sean Pearson, a certified financial planner in Conshohocken, Pennsylvania. "Once you don't work, you wake up and look for things to do — basically, how we all feel on Saturday. Some things might be fun and social. Some things might be work around the house. Most things cost some money, which is why Saturday is often the most expensive day of your week."

6. Housing expenses don't retire when you do

Retiring without a mortgage is a common goal for would-be retirees, but it's a goal that many fail to meet. According to an American Financing survey, 44 percent of retired homeowners between ages 60 and 70 still carry a mortgage.

Even if you have paid off your mortgage, other expenses don't go away. “Home maintenance and increasing property taxes can take up a large chunk of your budget,” says Dorsey, the California financial planner. MarketWatch reports (https://www.marketwatch.com/story/homeowners-are-facing-the-biggest-property-tax-hikes-in-4-years-heres-where-homeowners-pay-the-most-11617899650) that the average homeowner paid $3,719 in property taxes in 2020, up 4.4 percent from 2019. As a rule of thumb, homeowners should set aside 1 percent of a home's purchase price annually to cover repairs and replacement. That's $3,500 per year on a $350,000 house.

7. Extra income can be hard to come by

Working in retirement might not be as simple as you think. While 74 percent of workers plan to work for pay in retirement, according to the EBRI study, just 27 percent of actual retirees reported working for pay. Even part-time work can be a challenge. “One thing early retirees don’t seem to realize is that if they are planning on doing traditional part-time work while retired, those jobs require a commitment to a schedule that sometimes is not very flexible,” says Leslie Beck, a certified financial planner in Rutherford, New Jersey. “This can cut into other retirement goals such as travel or visiting with family. I have had retirees surprised by the inflexibility of part-time work.”

If you figure you’ll instead fill the income void with Social Security, remember the earliest you can usually claim retirement benefits is age 62. Even then, you’ll only receive partial benefits (/retirement/social-security/questions-answers/how-much-does-early-retirement-reduce-benefits/). For anyone born in 1960 or later, the full retirement age, when you are entitled to 100 percent of your monthly benefit, is 67. By claiming early at 62, the benefit amount is reduced by 30 percent.

5 questions to ask (and answer) before retiring early

- Can I really afford to stop working?
- Do I need to get a part-time job to make ends meet?
- How will I get health insurance?
- What will I do to occupy my time?
- Are my plans in sync with my spouse/partner's?

8. There's a lot of time to kill

When you retire, you have a 40-hour gap in your week that you need to fill. “Are you sure you have enough activities to keep your body, mind and spirituality occupied for the many years you have ahead of you?” asks Catherine Valega, a certified financial planner in Winchester, Massachusetts.

How much time do you realistically see yourself spending going on long walks, lounging poolside or curling up on the couch with a good book, especially after the novelty wears off? Think hard and think long term before you retire. Do you want to volunteer? Go back to school? Pick up a new hobby or resume an old one? Come up with a plan (/retirement/planning-for-retirement/info-2020/second-act-careers.html) in advance of retirement.

9. You may need to make new friends

If you retire in your 50s, you may find that your current friends aren't around much — because they still have full-time jobs. While you have the luxury of catching a matinee or playing a round of golf midweek, those in your social circle who are working nine-to-five don't.

If you find new friends, they are likely to be older, says Dennis Nolte, a certified financial planner in Oviedo, Florida: “Many of my pre-60-year-old retirees, especially those who are active, lament that their new peer group is significantly older than they are — and thus have a different set of expectations about diet, sleep schedule, even cultural references."

10. Retirement can be tough on couples

"Retirement is a major life transition, and you have to be patient with yourself and your spouse,” says Patti Black, a certified financial planner in Birmingham, Alabama. “Most retired couples do not look like those pictured in ads and commercials.” You'll have to decide how work around the house will change. Will you really share cooking, cleaning and yard work? And do you honestly want to be together 24-7, particularly if you downsize to a smaller home?

These decisions can have serious consequences for a marriage. “Gray divorce (/money/investing/info-2020/financial-impact-of-divorce.html), or divorce after age 50, has doubled since 1990 while declining across all other age groups,” Black warns. “And it is most often the wife who asks for divorce after age 50."

John Waggoner covers all things financial for AARP, from budgeting and taxes to retirement planning and Social Security. Previously he was a reporter for Kiplinger's Personal Finance *and* USA Today *and has written books on investing and the 2008 financial crisis. Waggoner's* USA Today *investing column ran in dozens of newspapers for 25 years.*

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- 10 retirement planning mistakes people make at 50 (/retirement/planning-for-retirement/info-2021/avoid-10-mistakes-at-50-years-old.html)