Know the 9 Risk Factors of Early Retirement

YOUR GUIDE TO RETIREMENT

In recent years, many public employees are retiring much earlier than the traditional age of 65. This is becoming more common and that's the good news! After all, who wouldn't like to start enjoying their "golden years" as early as possible? However, the additional time spent in retirement comes with its own set of risks you'll want to be aware of beforehand.

With this shift to earlier retirements, the retirement years for public employees can span a longer time period than their working careers did. These added years of retirement can present pre-retirees with a more complex set of decisions and risks to consider than a conventional retirement will.

Warren Buffet, one of our country's wealthiest men, once said, **"Risk comes from not knowing what you're doing."** Do you know how to retire at a younger age than traditionally expected without risking the financial assets you've saved for your retirement? For many people, the answer is "no," as retirement tends to be a first-time experience.

As with any new experience, doing something for the very first time can sometimes lead to innocent mistakes. Your first inclination might be to only make provisions for the dreams and goals you would like to fulfill once you retire. However, two things you must do to prepare for the changes that will come with retirement are a careful evaluation of all of your financial assets (Social Security benefits, employer-sponsored retirement plan(s), pension(s), investments, and savings) and an assessment of all the risks that may lie ahead.

1: LONGEVITY RISK

Have you considered what your natural life expectancy might be? Make sure that you *overestimate* how long you are going to live. It could be a real problem if you live to the age of 90 but when you determined your financial plan in retirement, you only planned to live to 75. No, you can't take it with you but you should make sure your money outlives you!

2: INVESTMENT RISK

Are you emotionally prepared for the swings in the markets once you are retired? Have you considered that your retirement accounts may need to be invested in a diverse portfolio? Have a financial plan that relates to your investment strategy and consider the benefits of asset allocation and diversification. Remember, your retirement assets may *need to last 30-40 years!*

You will need to determine if you'll need your retirement accounts to provide both income and growth. This is typical for most retirees and in many cases, a significant change from when you were building your portfolio during your working years. The time may have come to transition from building the retirement account to using the account.

3: INFLATION RISK

How much did your first car or home cost? How much would that car or home cost today? How much will your utilities cost in the future? Will gas and food cost more and more each year? Unfortunately, the one constant in most retirees' lives is that many normal expenses increase regularly.

Make sure your retirement income plan accounts for inflation. Typically, 3% is the minimum expectation but many financial planners use a 4% inflation rate when making projections.

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4: UNPLANNED EXPENSES RISK

Have you ever had to pay a lot for something you never planned for? Perhaps an automobile broke down or a roof had to be repaired. Maybe a family member had a medical emergency. Just because you've retired doesn't mean these normal but unplanned life events cease to happen. Make sure to have a cash reservoir or emergency reserve account set aside for unplanned expenses.

5: DISTRIBUTION RISK

How much should you take from your savings each year to ensure it lasts your lifetime? Are you going to give yourself a raise each year from the portfolio in order to keep up with inflation? What happens to your withdrawals if the portfolio does not perform up to your expectations? Significant research has come to light on sustainable withdraw rates in retirement. Be sure to investigate the implications of your distribution rate. Is it going to be 3%, 4%, 5% or more?

6: INSTITUTIONAL DEFAULT RISK

By now, you may have you heard that Social Security is facing financial burdens. Have you had any fears about the safety of your pension?

These are issues that are largely out of your control. The fact of the matter is that Social Security should be there in some meaningful form and public pension plans boast a far better track record than the often heard about failed private pension plans. However, keep up with the issues and regularly read the publications your plan provides you. If you are concerned, make sure to have a backup plan or savings set aside.

7: MEDICAL AND LONG-TERM CARE RISK

Are you able to carry your current health insurance into retirement? Do you have Long-Term Care Insurance for needs not covered by health insurance and Medicare? Is your spouse also covered on these plans?

Many retirees find that more than 20% of their budget goes towards health care costs. Recent studies have warned that retired couples should be prepared to see their total cost at more than $250,000. This is a staggering number and one that many believe will increase faster than inflation. Make sure your retirement income plan includes an annual budget for these costs as well as a savings reserve for any years you might experience a spike in costs. Strongly consider purchasing Long-Term Care Insurance *before* you retire.

8: SURVIVOR RISK

Have you adequately prepared for the income needs of your spouse or loved ones if something were to happen to you? Are there enough assets? Do you have life insurance or survivorship benefits built into your pension? One of the greatest mistakes you can make is to not provide a continuation of your pension benefits to your spouse if something were to happen to you. Pension plans typically provide an option for you to take a lesser benefit now to ensure that your spouse would also receive a lifetime of income if something happens to you. It's tempting to take the maximum amount and hope for the best, but investigate these choices extensively before making a final election. If you decide not to take these survivor options, calculate the amount of capital your spouse would need if something were to happen to you. If you do not have adequate assets, seriously consider purchasing life insurance.

9: PENSION OPTION RISK

Are you burdened with the number of pension elections you must make but cannot change once elected?

If your pension offers several different pay-out options or allows for a lump sum distribution, sometimes called DROP (Deferred Retirement Option Program) or PLOP (Partial Lump Sum Option), make sure to carefully evaluate your alternatives. Project your needs in retirement and match the pension income option that matches those needs and accounts for all of the factors that drive your retirement income plan.

All nine of these risks are very real and should be factored into any decisions you make about your retirement assets. Mr. Buffet had it right that risk comes from not knowing what you're doing but there are plenty of options available to help you determine the best course of action when it comes to your retirement assets. If you need help, a professional financial planner can assist you in reviewing these risks and help you to accomplish your life goals through the proper allocation of your financial assets.

A small mistake on a small amount of money is a small problem. *That same* small mistake on a large amount of money is a BIG problem, so take some time to carefully prepare and review your retirement plan.