THE Wealth REPORT

Recent research has found that millions of Americans who lost their jobs during the early months of the pandemic have decided to call it quits and retire early.[1]

INCOME IDEAS FOR RETIRING EARLY

Overview

Before COVID-19 came along, people over age 55 represented 25% of the American workforce. There were more workers over age 55 than under age 30.[2] In the course of just a few months, that ratio reversed. While older Americans have proved more susceptible to the ravages of this virus, younger people are willing to stay in the workforce. Even if they've had hours reduced or been laid off, they are seeking and plan to resume work in the future.

That future is not so rosy for more mature workers. We don't know what the normal, onsite work environment will be like a year from now. If the public is still social distancing, that means people are still at risk — and those age 55 and older may not want to take chances with their health. After all, they've been saving for decades. They're not about to miss the opportunity to enjoy retirement just to eke out a few more years of work in an environment fraught with health risks.

"Based on past experience, the longer the situation continues, the more severe the issue of discouraged workers and early retirements."
— Michael Weber, finance professor
University of Chicago's Booth School of Business[3]

Unfortunately, not everyone is in a position to retire right now, at least not the way they originally planned. If you find yourself considering early retirement, do a little prep work to see how feasible it is and what you're willing to do to make it work. To get started, consider these steps:

- Calculate your annual retirement income needs.
- Calculate your net worth based on current assets and liabilities.
- Check out your (and your spouse's) level of Social Security benefits based on different ages you can begin drawing them.
- Estimate how much savings you need to have for the latter stages of retirement, such as the for the cost of long-term care assistance.
- Consider if you need to keep a portion of your portfolio invested for long-term growth.
- Consider your appetite for various forms of risk, including market volatility, sequence of returns, inflation and outliving your money.

Market Risk	Sequence of Returns Risk	Inflation Risk	Longevity Risk
Can you tolerate day-to-day market volatility throughout retirement?	How will a drop in the market shortly before retirement impact you?	Can you live on a fixed income with no raise for 30 years?	What are the chances you might outlive your assets?

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Think about the obvious sources of income, such as Social Security benefits, a pension, your retirement accounts and investments. However, also consider other potential sources, such as real estate, an inheritance or other income-generating investments.

Bridge Income

For some people, retiring early will require a strategy for providing bridge income until you can pursue your original retirement income plan. Unfortunately, that may mean tapping assets that will reduce your nest egg. However, there are ways to avoid depleting assets, or at least eliminating early withdrawal fees attached to retirement accounts.

Traditional IRA: 72(t)
If you retire before you're eligible for Social Security and Medicare benefits, the IRS allows backdoor access to traditional IRA assets without paying the 10% penalty tax on distributions taken before age 59½. It's called the 72(t) provision, and it permits IRA owners to take Substantially Equal Periodic Payments (SEPP) for five years or until you reach age 59½, whichever comes later. Note that you must select from one of three options available (required minimum distribution, amortization or annuitization) to calculate the periodic amount of your 72(t) payments.[4]

401(k): Rule of 55
Another option is the Rule of 55, which allows you to tap your 401(k) or 403(b) plan without an early withdrawal penalty. This provision has specific qualifying criteria, one of which is if you are between the ages of 55 and 59½ and have been laid off, fired or quit your job. The Rule of 55 applies only to the retirement plan sponsored by your most recent employer, not any prior plans where you may have assets.[5]

Bear in mind that both of these tactics have eligibility requirements and limitations, and income taxes are due on all withdrawals (they avoid only the early withdrawal penalty). However, these are examples of options to tap retirement money to help bridge income until you qualify for other benefits.

Social Security: Start and Stop
There are a couple of lesser-known Social Security provisions that can help an early retiree who just needs some bridge income to get his or her assets in order. This may be particularly useful if you are expecting an influx of money from, say, an inheritance. If you need to draw Social Security before your full retirement age, you can start receiving checks and then change your mind later. However, you have only up to one year to halt your benefits, at which point you must then repay all the monies received. You may do this only once in your lifetime, but the good news is that your benefit level will continue to accrue until you apply again.[6]

Social Security: Start and Suspend

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If you don't qualify to stop benefits because you've been drawing them for more than one year, there is another option. Once you reach full retirement age, you may voluntarily request to suspend Social Security payouts until up to age 70. By doing this, your benefits will start earning delayed retirement credits that can help boost the income you lost out on because you started taking benefits early. This might be a good option if your portfolio starts providing a high-level income that renders your Social Security benefits unnecessary. Be sure to keep paying your Medicare premiums, however, as they will no longer be deducted from your suspended Social Security benefits. Be aware, too, that if your spouse's benefit is derived from your employment record, it also will be suspended.[7]

Work Prospects Down the Road

This pandemic won't last forever. If you use one or more bridge income strategies now, you might consider going back to work in a few years to help reboot your nest egg. You can retire again later on.

Fixed Income

Real Estate

Real estate rentals present a higher risk now, but if you pre-qualify prospective tenants based on their credit score and their level of pandemic- and recession-resistant occupations, being a landlord can provide reliable income. Be sure you can sustain periods of no income should tenants not be able to pay rent. And, if you have the latitude and are willing to work out payment plans, you're more likely to secure long-term tenants who appreciate your loyalty and flexibility. If you don't want the hassle of becoming a landlord, you can hire a management company, but expect to pay about one month's rent for the annual management fee.

Note that owning rental properties offers tax advantages and the potential for appreciation over time. This may be a good long-term investment option to help pay for health and long-term care expenses later in life. You could sell the property for cash or house a caregiver in exchange for services. If you don't end up needing the money, real estate can provide a growing asset you may leave heirs tax free, assuming your net worth is below the current $11.58 million threshold ($23.16 million for married couples). As with other assets, the cost basis of real estate inherited by heirs is stepped up to current value at the time of the owner's death.[8]

Guaranteed Income

Social Security

Most Americans qualify for Social Security when they retire, either under their own employment record or that of a spouse. The longer you delay starting benefits, the higher the payout. Whatever level you start at, you basically lock into it for life; it will increase only for inflation. Therefore, it's worth considering other assets you may tap to allow you to delay taking Social Security for as long as possible. After all, this is a guaranteed, lifetime income source.

Pension

There are two key factors to consider with a pension. First, does it stop (or reduce) benefits paid to your spouse in the event of your death? If so, you may want to carefully weigh the value of a regular payout versus a lump sum, if you have the choice. This is a decision that should be assessed within the context of all your other assets, so it's important to consult with an experienced financial advisor to decide which option is best for your circumstances.

Annuity Income

A fixed annuity offers another guaranteed source of income. It's actually an insurance contract that you purchase with a premium, and all the guarantees for income and death benefits are backed by the financial stability of the issuing insurance company, much like a life insurance policy. A fixed annuity offers a fixed income paid in regular installments starting at a specific date in the future. If you want income to start right away, you can purchase an immediate annuity.

If you like the guarantee of income payouts but are worried you'll need periodic increases to keep up with the cost of living, you may want to consider an indexed annuity. This type of annuity guarantees a minimum interest rate to grow your payouts over time, plus it credits interest linked to an equity index such as the S&P 500. When the index performs well, your income base is credited with a portion of that gain, which can deliver potentially higher payouts over time while still protecting the accumulated value from losses due to market fluctuations. Keep in mind the annuity does not actually participate in the index or any equity or fixed interest investment; the index is simply used as a means to calculate interest credits.

Bear in mind that annuities are complex and may include fees. Annuities are subject to limitations and rules, including surrender charge periods, as well as caps and spreads. You should work with an experienced insurance professional to determine if one is suitable for you and, if so, which type would work best.

Variable Income

The earlier you retire, the greater your need for a growth component within your portfolio. Should you and/or your spouse live for many decades, your income will be exposed to a variety of challenges. For example, a fixed income won't keep pace with increases in the cost of living over time. You may experience significant health and/or long-term care expenses. You could simply run out of money and be stuck with nothing but Social Security.

The good news is that the longer you live, the longer your growth-oriented investments have to earn more money and smooth out periods of market volatility. It's also important to recognize that after

significant market drops, such as the ones we've experienced in recent recessions and the pandemic, the stock market has a history of strong recovery. If you retire early, you don't want to be fully out of the market and miss out on those gains.

Investment Portfolio
People who can consider retiring early (before they qualify to receive Social Security benefits) generally have significant assets accumulated in an investment portfolio. However, it may not be enough to last a retirement that will be significantly longer because they retire early.

This means you need to be strategic in positioning invested assets to provide both income and capital appreciation. Financial independence generally indicates that you have enough assets to produce income that meets or exceeds the amount of income you earned while working. Therefore, even if are ready to retire with a million-dollar portfolio, you don't want to take all that money out of the market and stick it in a bank account. By taking small distributions to cover your needs, the rest has a chance to keep growing. The key is to minimize the risk exposure of those invested assets. Discuss inflation-aligned investments with your financial advisor.

Final Thoughts

If retiring early is still going to be very difficult, then the real solution is to pare back your lifestyle. You may want to consider downsizing to a smaller house or a condominium to reduce ongoing utility, tax, maintenance and insurance expenses. You might consider combining households with an adult child, using your assets to build on a mother-in-law suite to his or her house or add a granny flat in the backyard. While you may not be able to leave your child a large inheritance, this could help add to the real estate value of his or her home.

If you have plenty of assets now but worry about running out in the future, you may want to consider moving to a Life Plan community. This would enable you to consolidate expenses such as living, utilities, dining, household maintenance, health and long-term care all under one fee. This can help you estimate your lifetime expenses from the outset.

Here's a key principle to remember: Most people draw retirement income from a number of different sources. By diversifying your portfolio across fixed income sources, guaranteed income sources and long-term growth opportunities within your comfort level for risk, you may be able to retire early while still growing a nest egg for the latter stages of your retirement.

Just as it's a good idea to diversify your investments, it's equally important to diversify your retirement income sources. This may help reduce your tax liability and the risk of your income sources drying up. Remember, retirement may last 20 years or more, so spend a lot of time upfront working with an advisor to develop your plan. This is all the more critical if you decide to retire early.

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[8] Ashlea Ebeling. Forbes. Nov. 6, 2019. "IRS Announces Higher Estate and Gift Tax Limits for 2020." https://www.forbes.com/sites/ashleaebeling/2019/11/06/irs-announces-higher-estate-and-gift-tax-limits-for-2020/. Accessed July 15, 2020.
