Get with the Plan: Even for good savers, there are disadvantages to retiring too early

Ryan, 53, and Erica, 50, have had enough of their working lives. After raising two children who are now on their own, the Essex County couple is counting down their days to retirement. They know it will take some time and additional savings, and they want to be realistic about their goal.

“To fund retirement at age 63, Ryan will most likely work part time in retirement,” Erica says. They’re also keeping a close watch on expenses of all kinds.

“My employer recently changed to a profit-sharing plan. We are waiting to see how this goes,” she says. “They use an investment middlemen and they charge a 1 percent to 1.5 percent annual maintenance fee. I think that is way too much and it may be better to roll that into an IRA.”

The couple, whose names have been changed, have saved $176,500 in 401(k) plans, $56,300 in IRAs, $1,050 in a brokerage account, $17,100 in money markets, $20,000 in savings and $2,000 in checking.

The Star-Ledger asked Margaret O’Meara, a certified financial planner with O’Meara Financial Group in Red Bank, (Securities offered through LPL Financial Member FINRA/SIPC) to help the couple look at their retirement plans and the status of the rest of their finances.

“In reviewing the results of the financial plan that I ran, they are in better financial shape than most Americans,” O’Meara says. “However, all assets for retirement would be spent by the time Ryan was 83, and this assumes that both Ryan and Erica get full Social Security benefits.”

O’Meara says general projections for Social Security show that Americans in their late 50s and 60s now will most likely get full Social Security benefits. For those who are younger, though, exactly what will happen to Social Security benefits remain unknown.

“So it is important to save as aggressively as possible,” she says. “There are a couple of areas where the retirement savings can be improved.”

The couple needs to keep six months’ worth of expenses in an emergency fund, and they’ve already exceeded that amount. O’Meara says the additional amounts — about $12,000 — should be used to maximize Roth IRA contributions for 2012.

“Any leftover amounts should be invested in a moderately aggressive fund like the ones that they currently own," she says. "The ongoing $1,000 amounts (they contribute to cash accounts) should be automatically contributed to the moderate investment, and each year they should maximize Roth IRA contributions."

O'Meara says Erica is smart to be concerned about the fees that are imposed on her employer-sponsored retirement savings plan, but she may not have any options until she retires.

"Erica most likely won't be able to roll her 401(k) into another IRA, but if she can, that would be a good choice to reduce her fees," she says. "Otherwise, the benefits of the 401(k) overall will outweigh the fees that she is charged."

That's because of the automatic savings, pre-tax contributions and tax-deferred growth of the account.

O'Meara says the couple needs to save more aggressively even though they currently save a big percentage of their overall income. They put away $1,000 per month to cash savings, $150 a month to pre-pay their mortgage, and they set aside 18 percent of Ryan's income and 5 percent of Erica's income to their 401(k) plans.

She recommends they maximize Roth IRA contributions first, add to the 401(k) second and invest in a taxable account third. She says they should make these contributions automatic.

Also, if they can save Ryan's bonus, this will help them to have more in retirement.

As for a retirement date, O'Meara says the couple may want to wait longer than their initial plan. She says Ryan should consider working until at least 65.

"By working until 65 he will avoid paying for medical expenses for two years when he is eligible for Medicare," she says.

Better yet, Ryan could continue working until he can get full Social Security Benefits between ages 66 and 67, she says. The best scenario is if Ryan works until age 68 and thereafter, work part time. This would help solve the shortage they will have in retirement and potentially give them some extra money for the fun stuff, O'Meara says. With that, they'd have a 90 percent probability of not running out of money at age 90.

If retiring at 63 is not negotiable, O'Meara says the couple should reduce their expenses to $41,000 a year — a significant cut.

Another option, if Ryan wants to stop working sooner, would be to consider downsizing after retirement, and the couple could use the difference in price from their old home to the new one as an investment for their future.

One item that could save money immediately would be if the couple consolidates their mortgage and home equity line because both loans have interest rates that are above today's market averages.

There are also some housekeeping items the couple should take care of.

First, insurance. O'Meara says Ryan should consider another term policy to increase the benefit to Erica should he die prematurely. The couple counts mostly on his income, and that would need to be replaced should something happen to him.

The couple should also consider long-term care insurance.

"If either Ryan or Erica need some sort of long-term care, this can be devastating to their retirement assets over time as the expenses for this type of care can easily cost over $60,000 per year in New Jersey," O'Meara says. "They are at a good age to review insurance policies and to consider getting this type of coverage."

Disability insurance is another important coverage. Without it, if either of their salaries stopped because of a disability, they'd have trouble meeting current and future expenses.

Finally, they should make sure their wills and health care documents are up to date.

"Most of their assets will pass through beneficiary forms, however; the house and other savings accounts will need to go through probate and having an up-to-date will can help to streamline the process," O'Meara says.

Get With the Plan is designed to illuminate personal-finance concepts and isn't a substitute for actual financial planning or dedicated professional advice. To participate, contact Karin Price Mueller at kmueller@starledger.com.