

CHAPTER 11

PHASES OF RETIREMENT PLANNING

BEGINNING WITH THE YOUNG ENGINEERS

Retirement planning is a lifelong activity that is best started with your first job after college and continuing throughout your career and even after retirement. An overview of the different phases of retirement planning which will happen during your lifetime is shown in Figure 11-1.

The first phase is early career planning followed by mid-career and then late career. In early and mid-careers, your primary retirement planning focus is on your ability to save and invest. The late-career phase covers the last five years of your work. This is the time frame when you will have to decide when you are going to retire, where you are going to live and how to best draw on your investments to support your retirement. The end of your career marks the start of the next major phases of early retirement, mid-retirement, and late retirement. In early retirement you may travel. Generally you are highly social and may even work part-time. In mid-retirement your activities start to slow down. Finally, in late retirement you may require assisted living, be concerned with estate planning, and making your final arrangements.

As you move through all these phases there are four major focus areas one needs to consider when retirement planning and these areas are:

| Focus Area | Phases |
|----------------------------------|--|
| 1. Financial (income) | All phases |
| 2. Benefits (primary is medical) | Late career and all through retirement |
| 3. Residence (where to live) | Late career and all through retirement |
| 4. Activities (your time) | Late career and all through retirement |

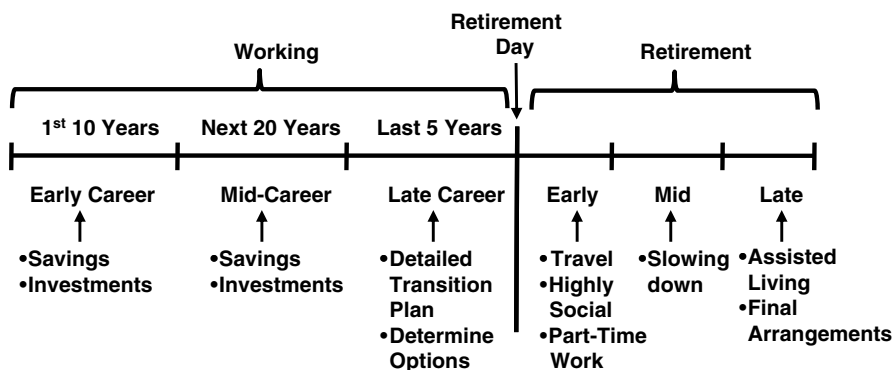


FIGURE 11-1 Overview of retirement planning activities during your career.

The financial focus area covers all phases of your career from the very beginning to the very end. While you are still working, the focus of the financial area is how to best save and develop your investments for retirement. After retirement, the financial area focus is on how to best convert your investments to income and avoid taxes.

The benefits area comes in play after you retire. After retirement one of the major expenses is medical benefits. With the cost of health care and prescription drugs skyrocketing, this becomes the major concern of many retirees. Having a good medical plan so that your retirement savings are not quickly depleted in the event you become ill is primary.

Your residence is the next focus area and this comes into play when people make a decision on where they would like to live when retired. Do they want to stay in the same home, move to a condo for less maintenance, or even move to a warm climate to get out of the cold winters? How is your tax liability affected by changing residence? Do taxes go up or down? How are your medical benefits affected by a change in residence? Do you want to leave family members, relatives, and friends? These are some of the major concerns you will have to consider when selecting your residence for retirement.

The last focus area is activities which deals with what type of activities do you want to be doing once you are retired. Do you want to work part-time? Or maybe do volunteer work, start a hobby, or travel?

Each of these focus areas is dependent upon the other focus areas and decisions in one area may affect the others. For example, moving your residence out of state may affect your financial situation and your activities. Medical policies may require you to live in the same area as your company after retirement. Your travel activities may quickly deplete your savings. For these reasons, you will need to make retirement planning a life-long activity. Good retirement planning should result in a well-balanced plan for each of the focus areas and hopefully allow you to retire in the manner that you would like.

EARLY CAREER RETIREMENT PLANNING

For this phase the most important area of retirement planning is financial. When you're young and just starting your career it's an optimal time to start retirement planning as Jeffrey Wuorio points out in his book, *Retirement Planning* [1]. The earlier you start, the better off you will be when you retire and more options will be available to you. The longer you wait to start planning for retirement, the more pressure you have to save for lost time.

Financial advisors recommend starting early when planning your retirement. The following is an example of the importance of starting young.

Let's take the example of Joe versus John. Joe starts investing in his 401(k) at age 25 and contributes \$10,000 a year for 10 years, then stops contributing. If he earned a 7% rate of return on his money, at age 60, his account would be worth approximately \$630,000. Now John doesn't start saving until age 35. He saves the same amount of \$10,000 per year, but does this for 25 years, until he is 60 years old. At the same 7% rate of return, John's account would be worth approximately \$630,000. Joe contributed only \$100,000 while John contributed \$250,000 and their accounts were worth the same at age 60. If Joe would have kept saving that same amount of \$10,000 a year until age 60, his account would've been worth over \$1.3 million.

The optimum is setting up your finances such that you pay yourself first 15–20% of your salary (see Chapter 49 "Finances"). Following this, one of the best investments you can make is participating in your company-sponsored retirement plan. Most 401(k)s offer some company match. A common company match is 50 cents on the dollar up to 6%, similar to getting a 50% return on your money. Most companies offer a wide variety of mutual funds to invest this money in. Target Date Retirement Funds and Asset Allocation Funds are a wise place to invest if these are offered in your plan. They are managed according to your age and risk tolerance. For example, a 2035 Target Date Fund would be suitable for an individual who plans to retire at or near year 2035; the fund is a blend of stocks, bonds, and cash, and will automatically get more conservative as you get closer to retirement.

Another tip to help you keep on track over the years is not specifying an amount for your contributions but specifying a percentage of your salary. This way your contributions will automatically increase with your raises and salary increases.

If your company does not have a qualified retirement plan or you are self-employed, then seek out the help of a financial advisor to assist you in setting up your retirement plan immediately.

Another retirement option to check into is the pension benefits of your company. If your company has a pension plan, make sure you qualify for it. Most companies who have a pension plan require you to work for them for

at least 10 years before you qualify for a pension. This is something important to consider when you are thinking about leaving the company for another opportunity. If you leave before you become vested or qualify for a pension you could be giving up a large amount of money, especially if you are only one or two years from qualifying for a pension. Thoroughly understanding your retirement benefits could save you thousands of dollars later in life.

MID-CAREER RETIREMENT PLANNING

For this phase the most important area of retirement planning is financial. If you started investing for retirement early in your career, then by the time you reach mid-career (40–55 years old), you should have a substantial portfolio. During your mid-career years you should periodically sit down with all your recent statements from all your investments and see if they are performing to your expectations. Hopefully, as you made adjustments and changes over the years they have resulted in realizing the earnings you wanted. Measure the specific performance of each investment and determine if they are on track with your plan. If not, you are going to have to make some adjustments.

Here are some factors that you should consider as you do a mid-career assessment of your progress.

1. Have there been any significant events impacting your investments and what actions should you take?
 - a. College education for children
 - b. Wedding
 - c. Serious illness
 - d. Market downturns
2. Are you putting away the maximum you can?
 - a. Have contributions increased with salary increases?
 - b. Has the company match changed?
3. Is your spouse also contributing to a retirement plan?
 - a. Is it possible to save more?
4. How have your tax liabilities changed? Should you be investing more as a tax shelter?
5. Finally, are you ahead or behind your plan? What adjustments should you make?

These are all important things to consider when reviewing your investment portfolio. Seek out the advice of your financial planner when making any adjustments. There are many excellent books written on financial planning and retirement investing [2–4].

LATE CAREER PLANNING

As you mature and come to the final years of your career, the tendency is to coast into retirement. When asked “What are your plans for your transition to retirement?” The answer often comes back, nothing really, just going to retire when the time comes. These engineers suddenly go into panic mode when their retirement is less than a few years away. They are totally unprepared for making the transition and often end up returning to work since they did not plan appropriately. Detailed retirement planning should start as early as 5 years before retirement. At this phase all the four major areas need to have a detailed plan (finances, benefits, residence, and activities).

There are many factors to consider when you take the final curve in the career road leading to retirement. Career retirement counselors tell us this will be one of the toughest decisions a person has to make. Many choices and options have to be decided upon.

Finances. At the top of the list of things to be done before you retire is to determine how you are going to use your investments, pensions, Social Security, 401(k), and other assets, to live on during retirement. This is no simple task and is going to involve your company, spouse, and financial advisor. Your objective is to lay out a plan that will give you the income you need as long as you live and hopefully not run out.

Identify the sources of money you plan to draw on, the options for each and then compute a potential yearly income for each year. This will give you a projected income that you can count on during retirement for planning purposes.

The biggest problem most people face is what age is best to retire at? The answer to this question is not simple. It depends on many factors. First and foremost is your health. Being healthy offers you the option to work longer and retire later. Correspondingly, you will be able to receive more benefits. If health is an issue you may want to retire early. When is your spouse retiring is another consideration. Ask yourself, “when can I afford to retire?” The answer to this question depends on your debt level going into retirement, your standard of living, and how much you were able to save and invest over your lifetime. In engineering terms, this is a very complex computation that involves many variables. There are many solutions and only through taking your time and working through all the variables with your spouse, financial advisor, and company human resources, will you come to a satisfactory solution. This is why you want to start analyzing options and considering potential outcomes at least 5 years before you retire. To wait until a couple of weeks before retiring leaves you no time and few options. Let’s illustrate this with a simple example. An income projection sheet for a couple planning on retiring is shown in Table 11-1. The husband is 4 years older than the wife and both are working and have retirement investments. This is only one possible scenario and the purpose of showing it is to identify some of the options and the many choices that need to be made.

TABLE 11-1 Project Income Worksheet for Couple Retiring

| | Age | | | | | | | | | | Remarks |
|---------------------------|------|------|-----|-----|-----|-----|-----|-----|-----|--|--------------------------------------|
| Husband's age | 65 | 66 | 67 | 68 | 69 | 70 | 71 | 72 | 73 | | Retire after 65 years |
| Wife's age | 61 | 62 | 63 | 64 | 65 | 66 | 67 | 68 | 69 | | Retire after 65 years |
| Husband's work income | 75 | 15 | | | | | | | | | |
| Husband's pension | | 18 | 18 | 18 | 18 | 18 | 18 | 18 | 0 | | Run out after 7 years |
| Husband's 401(k) | | 20 | 20 | 20 | 20 | 20 | 20 | 20 | 20 | | Good until 82 years old |
| Husband's Social Security | | 25 | 25 | 25 | 25 | 25 | 25 | 25 | 25 | | Reduce benefits for surviving spouse |
| Wife's work income | 55 | 55 | 55 | 55 | 55 | | | | | | |
| Wife's pension | | | | | | 12 | 12 | 12 | 12 | | Good until 72 years old |
| Wife's 401(k) | | | | | | 10 | 10 | 10 | 10 | | Good until 78 years old |
| Wife's Social Security | | | | | | 8 | 8 | 8 | 8 | | Full benefits |
| Total yearly income (\$K) | 130 | 133 | 118 | 118 | 118 | 93 | 93 | 93 | 75 | | |
| % of normal yearly income | 100% | 102% | 91% | 91% | 91% | 72% | 72% | 72% | 58% | | |

Both have elected to retire at age 65, which means the wife will be working four years longer than the husband. The husband plans on drawing from his company pension, 401(k), and Social Security. The first year after retiring he plans on working part-time to help with expenses. He has elected Social Security benefits based on surviving spouse and not the level or single person options. His pension is good only for seven years and runs out when he is 73 years old. He projects his 401(k) is good until he is 82 years old. The wife is planning on working longer to help with benefits and will retire 4 years later. She plans on selecting her Social Security benefits based on the single person option. For this example, the couple's total yearly income is shown at the bottom. Up to his age 70 they are living on 91% of their original working income. Between ages 70 and 72 the income drops to 72% and down to 58% thereafter. This is only one of many possible scenarios for the couple due to all the options that are available with retirement benefits and retiring age. If the couple decides to retire early or later or she decides to retire at the same time, the numbers all change. Trying to decide which option is best is going to take time and you should't wait until the last two weeks before retirement. Making decisions in haste that you have to live with the rest of your life is not a good plan.

Benefits. What about medical benefits? Did you save enough income to pay those high premiums? What is your plan to transition from company-paid monthly medical premiums to you paying the monthly premiums? For some people the plan is to return part-time to work simply for the medical benefits. Most companies offer retirees the capability to convert their medical benefits through plans that offer lower premiums that they can get by themselves. Look into other groups and organizations such as engineering societies and other professional associations for economical benefits. Check with people you know who have recently retired and ask about the medical benefits and coverage. Is it what they expected? How much does it cost and what are the monthly premiums?

Residence. Where do you plan on living when you retire? Are you going to stay in the same house or downsize to something more economical? Are you counting on retirement income from the sale of your home? Will the market support a quick sale of your home? Many people plan on retiring and moving to a retirement community in another state. They put their home up for sale and move to Florida or Arizona. The problem that may arise is medical benefits often do not allow you to live in another state. Many medical plans require you to reside in the state you retired in. On multiple occasions, I have had engineers tell me they ended up selling their retirement home only to return back to the city where they retired because of medical benefits.

Activities. What are you going to do with your free time after you retire? Many people just say relax and once they retire, become so bored with no planned activities. You will still need activities in your life and stopping cold turkey is not recommended. To ease the transition to retirement, counselors

recommend continuing some type of part-time activity to keep you busy. Here are some great activities you could consider.

1. Volunteer work for a charity organization
2. Starting a new hobby
3. Working part-time
4. Taking a class at the university
5. Teaching a class
6. Writing a book
7. Consulting

An important aspect to consider in your transition to retirement career plan is how the spouse is going to handle you being around 24 hours a day, 7 days a week. The spouse is not ready for the invasion and this often leads to conflict. If you plan on retiring soon, get your spouse involved in the planning and even see a counselor if you can. Have a strategy of how you are going to cohabit the same home “24-7” once you retire.

There is excellent help available and many resources you can draw upon for assistance once you enter the last 5 years of working. Key among these is the US government Social Security website with lots of excellent information (www.ssa.gov). Another good organization to join is the American Association of Retired People (AARP). Their website is (www.aarp.org) and it is loaded with helpful tips on nearly aspect of retirement. The AARP is a national organization with many local chapters. Check for a local chapter and its meeting places in your area.

BEST AGE TO RETIRE

What is the best age to retire? And the answer is, “that depends.” The answer to this question is specific to each individual. However, the following information from a study conducted by the Boeing Company on the longevity of retired engineers from the company, gives us some food for thought. The study identified the years to death for engineers on the basis of age at retirement. This data is shown in Table 11-2.

The data identified the average engineer who retired at age 55 lived to 78 or enjoyed 23 years of retirement. Correspondingly, the average engineer who waited and retired at age 65, only lived for 10 months. Wow! The data clearly indicates a correlation between retiring early and living longer versus retiring later and dying sooner.

How is your health? What are you doing to ensure you are in good health when you retire and you will live to enjoy your retirement? Based on this data, a good transition to your retirement career plan should contain provisions for your health and regular exercise.

TABLE 11-2 Life Expectancy for Age at Retirement

| Age of Retirement | Age at Death | Years to Death from Retirement |
|-------------------|--------------|--------------------------------|
| 55 | 78 | 23 |
| 56 | 76 | 20 |
| 57 | 74 | 17 |
| 58 | 73 | 15 |
| 59 | 71 | 12 |
| 60 | 69 | 9 |
| 61 | 68 | 7 |
| 62 | 68 | 6 |
| 63 | 67 | 4 |
| 64 | 66 | 2 |
| 65 | 66 | 10 months |

(From Boeing Study 10-2-84).

You will be eligible for full Social Security benefits if you “retire” at age 65 as it stands today. The standard retirement age of 65 is scheduled to increase gradually from 65 to 67 by the year 2027. For each year you wait beyond age 65 to collect, the benefits will increase slightly. Currently, if you retire at age 62 you can receive 80% of the benefits had you waited until age 65. Does that mean you should wait until age 65? Not necessarily as Ernst & Young point out in their book, *Ernst & Young Personal Financial Planning Guide* [2]. The amount you receive between age 62 and 65 is 35 months of benefits. This is a sizable amount and if you waited until age 65 to start collecting the higher benefit, it would take more than 12 years of higher benefits to make up the difference.

So the answer to this question, “what is the best age to retire” clearly is an individual choice and is based on the individual health and financial situation. No one answer fits all.

BEST TIME OF YEAR TO RETIRE

When is the best time of the year to retire is another factor to consider. The formula your company utilizes to compute retirement benefits may affect the time of the year. Generally, companies will compute a retirement benefit based on the salary you received in the last full 3 years you worked. Therefore, any promotion or salary increase you receive in the last 3 years actually represents a huge raise for the rest of your life! Why not strive for one last promotion as you near retirement. Also waiting to retiring just after your last work anniversary or full year could mean a more significant amount of money. Another factor to consider is when your company awards vacation. If, for example, you earn 4 weeks of vacation each year and the company

grants your 4 weeks every April, then it is best to wait until after April to retire since you will be able to collect an additional 4 weeks of vacation pay.

You should not select your retirement date until you have identified a good plan and one you feel confident with. Remember that you are going to live with the decisions you are going to make for the rest of your life; therefore, you need high confidence in the choices which are right for you. You do not want to make long shot guesses in hopes you will get lucky. You want decisions that are solid and you should feel very confident of your plan.

Once you get to the point of selecting a date to retire, your first actions are meeting with your human resources and financial advisors. It may take months for human resources to put together the paperwork and get it approved for your retirement. They do not like surprises, especially when people show up unexpectedly and announce they are retiring that day and think human resources can get everything arranged that quickly. The same holds true for your financial advisors. It takes weeks to process paperwork and setup payments. In either case, it maybe 1 or 2 months before you see your first check. I have heard stories from engineers where they planned exotic travel immediately after retirement as a kick-off. They never realized it would take several months before they would see their first retirement check and as a result had to delay their plans. Make sure you have sufficient liquid funds to cover your expenses between the time you retire and you get your first retirement check.

TRANSITIONING INTO RETIREMENT

How you transition from working into retirement is strictly an individual's choice. In this section, I share some of the strategies to help you in your planning. One thing to consider for your transition strategy is the amount of change and stress you are placing on you and your spouse as part of the transition. The more changes you make, the harder and more stressful it is going to be. According to retirement counselors, the most difficult transition is one where your life completely changes over almost overnight. Let me describe this scenario: the husband decides to retire in a couple of months, wants the wife to quit her job also, puts the home up for sale and buys a new retirement residence in another state and several days after retiring moves to the new home leaving all their family, relatives, and friends behind to start a new life in a new place. Clearly, this would be stretching the limits of any person's ability to handle change and making all the major stress factors (loss of job, change of residence, and loss of family and friends) come into play all at once. Your transition plan should control the amount of change at any given time and subsequently minimize the stress. Here are some transition strategies for retiring.

One strategy is to retire and then return to the company to work part-time in special assignments. The company views the engineer as such a valuable asset they are willing to hire back the engineer after retirement. The engineer

receives full retirement benefits and then returns to work part-time for a modest salary and medical benefits. The benefits to the company are the engineer can be used as a resource and help the company. This frees up more time for the engineer but yet provides a small income and medical benefits.

Another retirement strategy is to become an independent consultant and work part-time helping and giving advice to other companies. Or possibly become a teacher and instruct students at a local university. There are also many seminar companies that hire older engineers to teach 1 or 2 day classes and the pay is excellent. This allows the engineer to control the amount of time and days to work offering more freedom while providing a little extra income.

Some people simply leave work and never return to their profession again. For these people, they usually have something lined up that they always wanted to do and now that they have the time, they are going to do something else. They have a plan for the transition and often are working at it years in advance, so there is not a sudden and stressful life change.

One final strategy is stay working beyond 65 years old and hope the company offers you a special retirement package. People select this option mainly because they either have not planned and prepared for retirement and therefore try to work for as long as they can or they really enjoy work and prefer to remain active. Their career strategy is to have the company offer a special incentive bonus to take retirement and in the meantime continue to save for retirement and plan for the day.

The key point here is you must have a strategy for transitioning to retirement to be successful. Controlling the amount and velocity of change while minimizing stress is the goal. Waiting until the last minute and making decisions in haste or waiting until you are retired to figure out what to do next is not a good transition plan.

Three Phases of Retirement

Once you retire, your planning is not done by any means. Due to the constantly changing economy, your health, changing Social Security benefits, increasing medical costs, and changing tax laws, you will still need to assess and monitor your situation regularly. Now let's look at the three phases of retirement and how your planning is affected by each.

Early Retirement. In the early retirement phase you are probably going to do the most travel and be highly social. Your ability to get around and driving/mobility will still be good allowing you to enjoy many social events. For this reason, your expenditures will normally be the highest during this phase. Some financial advisors recommend that you should plan for withdrawing more income from your investment savings during this time and reducing the income to live upon in later years since you will not travel and partake in as many social events. Careful financial planning in this stage is required to make sure you do not overspend and end up running short later

in life. If you have not already prepared a will you should absolutely do this during this time. In addition, working with a financial advisor and tax expert, you should start your estate planning to ensure all your hard-earned money would go to the people you want without putting a heavy tax burden on them.

Mid-Retirement. At this phase your mobility reduces and possibly your health issues arise; subsequently couples tend to be more home-bound. The exotic vacations stop and life settles down to just being around the house with family and friends. Your spending declines and moving to maintenance-free low cost living is the norm. You need less income to live on. Health is the primary concern and medical treatment is the primary concern. Making sure you have good medical benefits is key at this point.

Late Retirement. Although not easy to plan for, late retirement is when the planning for assisted living, making arrangements for your estate as well as your final arrangements. Most people are concerned at this point about not being a burden to their children and the quality of life. Living wills, writing the terms and conditions of your final days are very important. Appointing a power of attorney to oversee your estate is a great way to reduce the burden on yourself or loved ones in the final days.

SUMMARY

This chapter provided an overview of the key elements involved in retirement planning, but you will need to dig deeper into each of the areas. The best time to start retirement planning is when you are young, the sooner you get started the better. As you move through all the phases of your career, there are four major focus areas one needs to consider when retirement planning and these areas are: (1) financial (income); (2) benefits (primary is medical); (3) residence (where to live); and (4) activities (your time).

What is the best age to retire? The answer is dependent on how you did your retirement planning, your health, and your personal desires. It is specific to each individual. No one answer fits all. When the time comes, you will need the assistance of your company's Human Resource department, financial advisors, and tax experts. There will be many decisions, research, and educating yourself, to ensure you select the best choices for you. In most cases, you have to live with the choices you made for the rest of your life. Making all these choices is not done in matter of hours, days, or weeks; you should start this type of planning when you are about 5 years from retirement.

How you transition from working to retirement is strictly an individual's choice. The key point here is you must have a strategy for transitioning to retirement to be successful. Controlling the amount and velocity of change while minimizing stress is the goal. Waiting until the last minute and making decisions in haste or waiting until you are retired to figure out what to do next is not a good transition plan.

Once retired, your planning does not stop due to the constantly changing economy, your health, changing Social Security benefits, increasing medical costs, and changing tax laws. You will still need to assess and monitor your situation regularly. As you age in retirement, your lifestyle will change significantly and being prepared for this financially and medically is the best plan. Develop a support structure of family, friends, and advisors, to help in your retirement with people who you can trust and call upon.

ASSIGNMENTS AND DISCUSSION TOPICS

- 1 What are the four primary focus areas you consider when retirement planning?
- 2 Why is it so important to start young?
- 3 What is the best age to retire?
- 4 Name two transitions to retirement strategies?
- 5 What are the money sources for your retirement?
- 6 Why is having activities so important after retiring?
- 7 Describe the phases of retirement.

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