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Planning for early retirement

What are the financial consequences to stopping work in your 50s?

Early retirement may be the ultimate dream for some, but the coronavirus (COVID-19) pandemic made it the only option for many. Figures from the Office for National Statistics show that over-50s had the highest redundancy rate between December 2020 and February 2021[1].

Retiring early can give you that change of lifestyle you've been craving, open doors to new experiences and potentially improve your health. But there are financial consequences to stopping work in your 50s.

WHAT IS THE FINANCIAL IMPACT OF EARLY RETIREMENT?

Traditionally, people retired between the ages of 60 and 65, but there's no set age that you need to give up work. In fact, anyone with a pension pot can access it from age 55 – although this is set to rise to age 57 from 2028.

Retiring early requires some careful planning. It can put significant pressure on your funds as your new income is likely to be less than your pre-retirement earnings. You might have various sources of income for your retirement ranging from your personal and/or workplace pension, the State Pension, investments and other savings. Reviewing your financial situation and determining how much money you need to live a comfortable life in retirement is an important first step.

Something to bear in mind: if you're aged over 55, your State Pension won't be paid until you reach age 67. If you stop working before then, you could be relying on income from your private pension savings for more than a decade.

It's also worth bearing in mind the impact of inflation. Prices have steadily increased over the past decade, for example, holidays, luxury goods and even basic necessities have become more expensive. So if you're looking at a retirement of 25 years or more, you could see the purchasing power of your pension income decrease due to rising prices.

HOW TO ASSESS YOUR FINANCIAL SITUATION

Understanding your individual financial situation can make a big difference when it comes to making decisions around your retirement savings. Fully assessing your personal finances can help give you a clearer picture of whether early retirement is feasible.

HERE'S A CHECKLIST OF WHAT YOU SHOULD CONSIDER:

1. How do you plan for a varied retirement?

If you're planning to retire early, think about what type of lifestyle you want to enjoy in later life. This will then help you determine what you're saving towards. You might plan to travel, embark on a journey of further education or simply spend more time with loved ones – whatever you decide to do, you're going to have demands on your retirement income.

When you're reviewing your financial plans, it could be worth looking at those first early years of retirement as something separate. For example, including more in the budget for multiple holidays a year, or dinners out and trips to the theatre. Then take a look at how your lifestyle may modify as you slow down in later life. There may be fewer trips and holidays to take, but there could be increased care costs.

Taking early retirement means that you almost have to plan for two different retirements. One that caters to the immediate future, where you're likely to still be very active. And one where a slower pace of life comes into play. Each will have a different focus and therefore different demands on your money.

2. How many years do you expect to be retired?

There are obviously no guarantees on how long any of us will live, but when it comes to retirement planning, you'll need to make an informed guess.

It's worth considering family history, as well as factors such as your gender and geographical region. If you expect to live to around 85, but plan to retire at 55, you'll need to save enough to support yourself for 30 years – but don't forget, you may live a lot longer than you expect, and you're likely to want leave something for your loved ones.

3. How much will your State Pension be?

In order to understand your income requirements in later life, you'll need to know when you can collect your State Pension and how much it's likely to be.

The State Pension age is under review and is gradually being pushed back so it's in line with life expectancy. Other factors, such as your gender and the year you were born, make State Pension ages vary.

Currently, the maximum State Pension is £179.60 per week, or £9,350 a year[2]. However, you'll need to have made, or be credited with, 35 years of National Insurance contributions to qualify for the full amount[3].

4. How much do you have in your private pension pot?

As the State Pension is not really enough to live on, the likelihood is that workplace or private pensions will make up a significant part of your retirement income.

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When you retire, you can use some or all of your pension savings to buy an annuity, which then pays you a regular retirement income for either a set period, or for life. Alternatively, you can keep your savings in your pension pot and 'drawdown' only what you need, as and when you need it. You must have a defined contribution pension to be able to do this (your workplace pension provider will be able to inform you on whether you do).

The first step, before making a decision, would be to track down all of your pension pots and ask for a pension forecast. Estimate how much you can achieve via a drawdown, an annuity, or a combination of both. And remember, the value of any investments can fall as well as rise and isn't guaranteed.

5. How can you ensure your pension pot will last?

Having an understanding of your retirement income and outgoings can help you to plan for the future. Perhaps you've reviewed your finances and realised you can retire early, or you might decide to wait a few more years to help you boost your pension pot that bit more.

The key thing to understand is that your retirement is completely personal, and the amount you will need will depend on your specific circumstances and expectations. If you're in any doubt about the financial impact of early retirement, you should obtain professional financial advice.

WHAT DOORS AND POSSIBILITIES WILL YOUR RETIREMENT OPEN FOR YOU?

Life is short and unpredictable. If you would like to retire early and explore a life away from work, you'll need to put a carefully considered plan in place. Retirement can open many doors and possibilities. You may be thinking about seeing the world or starting your own business. To discuss how we could help you, please contact us for further information.

Source data:

[1] Living longer: older workers during the coronavirus (COVID-19) pandemic. Data source, Office for National Statistics, May 2021.

[2] Having more for retirement. Data source, GOV.UK, August 2021.

[3] The new State Pension. Data source, GOV.UK, August 2021.