

The Retirement Numbers Game: What is the Best Age to Retire?

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In the Summer edition of the Pension Press, Steve Waas, HMEPS' Financial Counselor, discussed Social Security. Steve, who is a Certified Financial Planner, is available for individual meetings with participants, and also will be discussing financial topics in our newsletters to help participants better understand these important issues. In this issue, Steve discusses key ages that might be important in your retirement.



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For many City employees, a key date they mark on their calendars is their “eligibility” date. While this can be a very important number for you, it’s just one of many dates that are potentially important to your retirement situation.

What does it mean to be “eligible” to retire within the Houston Municipal Employees Pension System? Most people focus on the date they are eligible to begin collecting a normal retirement benefit. This is the date when a participant can retire from his or her job, and immediately go onto the pension payroll.

Just because you’re eligible, however, does not mean that it is smart to do so. More to the point: just because you’re eligible to retire does not mean you can afford to retire.

This is why many people, upon reaching their eligibility date, try to improve their financial situation by continuing to work. By doing this, not only do they collect a salary longer, but the value of their pension also generally grows (either by accruing more credited service, or by participating in DROP).

But there’s more. By working longer, you get closer to other key dates, which can have a major impact on the affordability of retirement: Social Security retirement benefits, Medicare, relaxation of certain IRS penalties, etc.

Sorting this out can be difficult. To help, here is a list of some of the key ages that might be important in your retirement.

Age 55: You’re 55th birthday might be important if you have a DROP account. What matters is the year that you turn 55, and your date of retirement from the City. These numbers are relevant to whether or not you will be subject to a 10% IRS penalty (on top of normal taxes) on any withdrawals you make from your DROP account.

This is a tricky rule. It is especially tricky for some people if they have other retirement accounts for which the different rules apply. IRA accounts, 457 plans, and DROP accounts each have a different set of tax issues.

Age 59½: This age is also related to IRS penalties, but many people are misinformed as to how it applies. Again: IRA, 457 and DROP accounts all have different tax implications, and you should get qualified counseling before making important decisions.

Age 62: This is generally the youngest age at which you can begin social security retirement benefits. See “Full Retirement Age.”

Age 65: For some people, this could be the most significant age for financial purposes. It is a critical age not because of income you receive, but because of expenses you are likely to incur. This is the age you generally can begin to participate in Medicare. People who retire before the Medicare eligibility age generally face substantially higher health insurance costs. And not only is the cost very high for these people, the uncertainty of these costs is much greater as well. Health insurance costs can change, as can the rules for Medicare eligibility.

“Full Retirement Age” (Social Security): People often have a mistaken impression of the “full retirement age (FRA).” There are two main things to keep in mind. First, you can generally start your Social Security retirement benefits any time between age 62 and 70. The longer you wait, the larger the benefit amount you will be locking in. Second, a primary role of the FRA is to govern how much you will collect if you are still working. Between age 62 and FRA, Social Security benefits will be reduced if you are earning income through a job. This is the so-called “earnings test.” For this reason, many people find that if they are still working when they turn 62, it is better to not start their Social Security retirement benefits and instead let them grow. Once you reach FRA, you can collect these benefits without any reduction even if you are working. Even then you can still gain by waiting, since the benefit amount can still grow.

Age 70: Waiting to begin your Social Security benefits beyond age 62 allows you to lock in a higher benefit amount. However, beyond age 70, there are no more so-called “delayed retirement credits.” So there is no reason to wait beyond this age. See “Full Retirement Age.”

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Age 70 ½: While your money remains in a DROP account or other deferred compensation retirement plan, it is not being taxed. But the IRS does not let you do this forever. The year you turn 70 ½, you must begin to withdraw funds from these accounts (there is an exception in DROP if you are still not separated from the City). But it does not mean that you must take all of the money out. In fact, it is a relatively small percentage each year after reaching this age.

For now, don't get bogged down too much in the detail. Stand back and see the big picture. Suppose you are eligible to retire at age 58. Every year that you continue to work causes financial improvement in several ways. You have another year to save out

of your salary, you are another year closer to Social Security retirement benefits, you have another year on the advantageous active employee's health insurance, you are a year closer to Medicare eligibility, etc. Viewed in this context, the value to you of each day of work is a lot more than just the salary you receive.

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