McPherson Financial Group

FINANCIAL SERVICES

Pension Income and Social Security Leveling

YOU HAVE WORKED AND SAVED FOR YEARS.

Your retirement is just around the corner with only a few years left. You can actually see the light at the end of the tunnel, and just thinking about it puts a smile on your face.

Then, your employer offers you *early* retirement. But can you afford to go out early? There are many factors to consider, and you will need to understand how those incentives may impact you today and in the future.

For many employees fortunate enough to have a pension, your employer may offer an income incentive to allow you to retire early called Social Security leveling.[1] The name may be a little confusing because the plan actually has nothing to do with Social Security and does not impact when or how you will receive your benefits.

THE PENSION PLAN

Traditionally, employer plans allow a participant to start collecting their pension at retirement, typically between the ages of 62 and 65. The plan might have a downward adjustment for taking it at age 62 instead of waiting until age 65.

This downward adjustment makes sense because the pension plan must pay you for a longer period of time if you begin receiving income at age 62. Conversely, there may be an increase for waiting to take the income.

Reviewing your pension plan options can be overwhelming. You have numerous choices to consider, including survivor benefits, lump sum options, what portion to take out for income, etc. For the moment, we are going to address just one aspect of your pension: leveling.

SOCIAL SECURITY

Social Security is set up to provide you with a set amount of income per year. The calculation is based on your full retirement age (FRA). Depending on when you were born, FRA is between 65 and 67 years old. You can find your specific FRA at https://www.ssa.gov/planners/retire/retirechart.html.

If you decide to take Social Security before your FRA, your monthly payments will be permanently reduced by approximately 7% per year. For example, if your FRA is age 67 and you elected to begin Social Security at age 62, your benefits will be reduced by about 30%. If you wait until age 70, it would be approximately 24% more.

The earliest you can apply for Social Security on your own record is age 62, and the latest you can apply is at age 70.

Don't confuse filing for your Social Security benefits and Medicare. Be sure to apply for Medicare (even if you don't need it) at age 65. There are severe penalties if you don't apply on time!

PENSIONS, SOCIAL SECURITY, AND LEVELING

The leveling option is designed to help retirees have a consistent income stream while retiring before they may have otherwise been entitled to collect Social Security. For example, let's say your pension provides you an income stream of $1,500 a month for your life, starting at age 57 (we will ignore survivorship options for this illustration). Let's also assume that you will have $1,000 a month from Social Security at age 62 for a total income of $2,500 a month.

The problem is you can't afford to retire on $1,500 and you don't want to tap into your 401(k) until you absolutely have to. This is where leveling comes into play. Your employer will provide you with a $2,000 monthly pension income from age 57 until you are eligible to start collecting Social Security at age 62. Once you are eligible to collect Social Security, your pension would then be reduced to $1,000, and with your Social Security payment of $1,000, you would have the consistent "level" income of $2,000 a month.[1]

You will, of course, have to provide your employer with a copy of your estimated benefits. Most employers will use the age 62 for their calculation, but some will accept your full retirement age benefit.

FACTORS TO CONSIDER

While this appears to be an attractive way to retire early, you must consider the long-term impact of giving up future income for reduced immediate income. If your leveling stops at age 62 and you must then apply for Social Security (to maintain your current income), you will receive substantially less income over time than having elected income at your full retirement age. The amount will be even greater than if you had waited until age 70 to apply for benefits. Remember, your benefits increase almost 8% per year.

You must also be aware of how these reduced benefits may impact your spouse's survivor benefits, as well as measure how much income you could be giving up in the future.

Finally, you should also factor in your current assets, such as your 401(k), IRA, Roth, and any other investments that may be available to help supplement your income if you choose to retire early.

Most people contemplate the ability to retire early. If your employer offers an early retirement and provides a leveling option, this might be your chance to live that dream.

Before you accept their offer, sit down and look at your numbers. What do they look like if you retire with your pension and leveling versus taking your unreduced pension and waiting to start collecting Social Security? Perhaps you will work another job to supplement your income. Perhaps you can use your own investments to supplement your income needs.

All it takes to know for sure is a little time and planning.

To learn more about your financial options and have your questions answered, contact us at 321-253-2016 to schedule a meeting.

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1. https://pocketsense.com/social-security-leveling-option-1468.html