Should an early retiree take Social Security at 62?

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7/14/09, R2/23/12

People who retire at or before 62 should ask themselves whether they really want to start taking Social Security payments at age 62. Delaying the start significantly increases payments which are often very important later in retirement. My wife and I help a number of impoverished ladies in their eighties who would give their eye teeth for larger Social Security checks, their only income. They regret having made poor financial conditions when they were young, that is, when they were in their sixties.

Benefits of delaying Social Security for a single person:

A single person has a lot fewer considerations than people who are married. Let's look at an example case of a lady named "Single." The most important factor is whether Single has a reasonable chance of living past 80. If death is certain to be earlier, then by all means starting Social Security early will be the best choice.

However, if there is a reasonable chance of living past eighty, then the next thing to consider is whether Single has saved enough for support until Social Security starts at a later age. Single doesn't need a computer to get a rough idea of the savings required. All she has to do is multiply the Social Security annual payments at 66 times the number of years she will delay the start. This assumes she can invest at an after-tax return greater than inflation. The average baby boomer who retires before age 62 does not have enough savings right now to delay till 66, much less age 70.

Example: The annual Social Security Administration report says she will get $1,000 a month at age 62. That's $12,000 a year. Waiting to start till age 66 is four years, so the very least she has to have saved is four times the age 66 Social Security or $64,000 to consider starting Social Security at 66. Actual savings should be more because Single will need money for emergency and replacement reserves as well as possible investment losses. If she has a pension, the savings could be somewhat less.

Let's look at a case where Single also has $300,000 in an IRA at age 62. It's invested in mutual funds that have a before-tax return of 5% after costs and reverse dollar-cost-averaging. (Although dollar-cost-averaging helps people before retiring, it hurts them after retiring.) Further assume future inflation at 4% and tax rates of 15% and Social Security increases at only 3.5%. The results are illustrated in Figure 1. Retirement spending of $23,000 is the same in all three cases. After investments are exhausted, Single will still get Social Security.

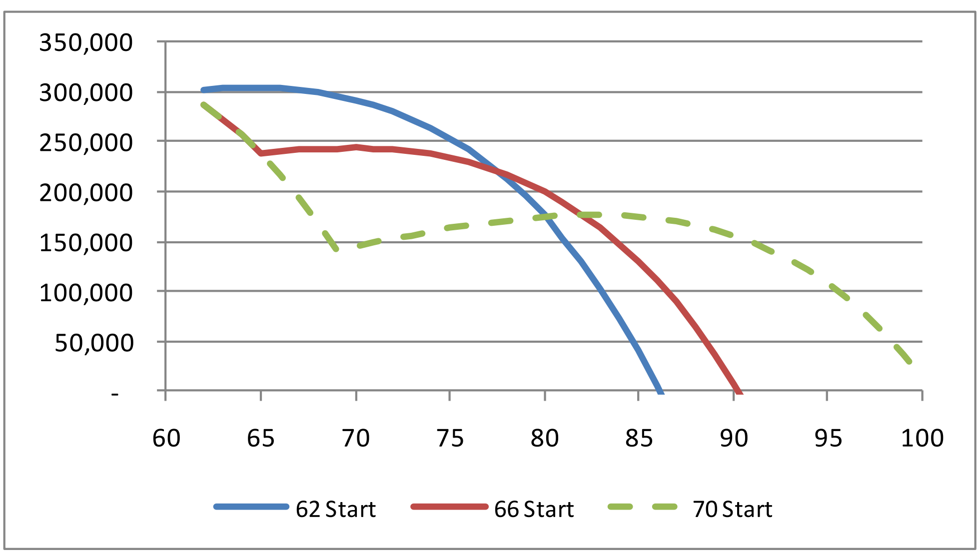

Figure 1. Remaining investment balances for Single.

If Single starts Social Security at age 62, she would use her saving up at age 86 and have only $12,000 a year Social Security thereafter. If Single delays the start of Social Security till 66, she will be able to support her spending until she is 90 and have over $16,000 a year Social Security if she lives to be older than 89. (Both Social Security values are in today's dollars.)

In the case of a single person, it may not pay to delay the start of Social Security until age 70. That would be the case if initial savings were insufficient to support the eight year delay in starting Social Security with a comfortable margin, say significantly over eight years times a $21,000 benefit, or $168,000. However, those who have sufficient savings would do much better. In the case that is illustrated, Single doesn't exhaust her savings and would continue to be able to spend $23,000 a year past 100.

Delaying Social Security to 70 has certain hazards if savings turn out to be marginal. Single could immediately lock in the Social Security value at whatever age that happened but would be left with little to cope with emergencies and could be forced to buy large ticket items on time rather than with cash. On the other hand, if savings are not marginal, there can be huge benefits from waiting till age 70.

Benefits of delaying Social Security for a married couple:

Delaying the start of Social Security till age 70 may be the best choice for the high-earning spouse in a marriage while the low-earning spouse starts at age 66. Let's illustrate this with an example for Mr. and Mrs. Married. Mrs. Married is two years younger than Mr. Married, and Mrs. Married is a low-income spouse. Their Social Security payments are shown in Figure 3. Mrs. Married is able to take advantage of the Social Security earned by Mr. Married because of the very favorable Social Security rules for low-income spouses. That's especially important if Mr. Married dies before his spouse. In the example below, Mr. Married dies at age 85. If you consider the effects of inflation, the payments in today's dollars reduce with age when inflation is greater than the Social Security adjustments as in Figure 3. But it's also true in real life because medical costs become an ever increasing component for the elderly.

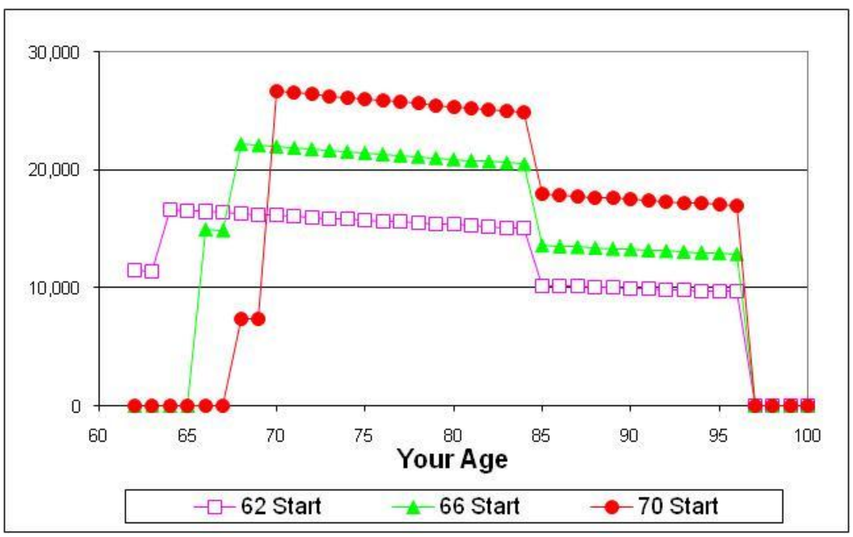

Figure 3. Annual Social Security payments in today's dollars for Mr. and Mrs. Married.

Figure 4 displays the history of their investment balances. The retirement spending is the same in all three cases. Note that as long as Mrs. Married lives into her eighties, if she had started Social Security at 70 she is going to have a lot more investments left than in either of the other two cases. However, note that Mr. and Mrs. Married have used up most of their savings in this case before age 70. They could be locked into their age 62 Social Security should their investments fall or they need a large sum for an emergency.

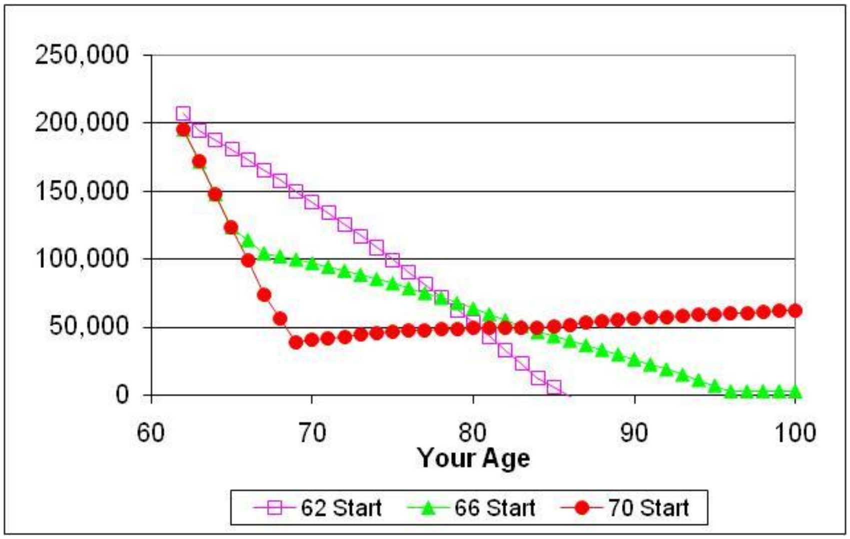

Figure 4. After-tax investment balances for Mr. and Mrs. Married. In the case for the 70 Start, the high-income spouse delays Social Security till 70 while the low-income spouse starts at 66.

Once Mrs. Married gets into her eighties, not only does Mrs. Marriage have a better stash of investments for the rest of her life had she delayed Social Security till 70, she has much higher Social Security income should some emergency exhaust her investments.

Conclusions:

The best age to start Social Security for a single person taking early retirement may be age 66, not 62, providing that the initial savings are sufficient and that the retiree expects to live past age 80. On the other hand, the best ages for a married couple may be when the low-income spouse to starts at 66 and the high income spouse starts at age 70. These results are dependent largely on the initial savings, respective ages of the spouses, and death ages.

Note: All of the figures come from free programs on www.analyzenow.com.