Early Retirement: Still Possible?

Many ophthalmologists, along with most investors, are looking at the financial markets with the greatest of unease and wondering what on earth happened to the notion of a secure retirement. If you happen to be one of those physicians who has planned on checking out of ophthalmology even earlier, say at age 50 to 60, the times are that much more alarming, the challenges are that much greater.

If your dream has been to retire early, now is not the time to abandon it. However, it is definitely time to check the state of your financial affairs and consider possible changes to your early retirement strategy.

This article is the first in a three-part series on financial planning for retirement. The first part focuses on the immediate concern of achieving the financial resources necessary to retire earlier than usual. Part two will explain how practice buy-outs and business succession factor into your ability to retire, and part three will show you some alternative arrangements to complement early retirement status—such as phasing down practice, partial early retirement, job sharing and other strategies.

The Key Question

Ask yourself, “How much do I need to retire early?” Simply put, the answer depends on how much you spend and for how long you will be spending it. Accountants and financial planners like to cite the 70 percent rule of thumb, which suggests that you will be able to retire comfortably on a wealth base that can generate 70 percent of your pre-retirement earnings for your life expectancy. However, the 70 percent rule assumes that your living expenses will decrease by 30 percent. That’s not likely to happen if your idea is to use early retirement to increase your enjoyment of life (i.e., voluntary early retirement typically means more recreation, more entertainment, more traveling, etc.). The better approach is to assume that your desired lifestyle will cost the same as, if not more than, what you spend while working.

Another rule of thumb developed through life expectancy, inflation and market return studies, suggests that you need about $200,000 to $250,000 in capital for every $10,000 in annual pre-tax income required. The research in this area suggests that a safe withdrawal rate of one’s capital is about 4 percent annually. For example, using a 4 percent withdrawal rate, a 30-year retirement expectancy and annual income needs of $150,000, you should have $3,750,000 in capital accumulated prior to early retirement.

Recouping and Reorganizing

The obvious first step is to look for ways to recoup investment losses suffered during the market decline. If the past is any indicator, it’s certainly reasonable to assume that the market will cycle back to achieve at least partial recovery in value. A common market cycle will take anywhere from one to three years to complete, which means that if you have targeted early retirement to commence more than five years from now, you will likely regain some lost value. But that’s only some of the lost value, so additional proactive measures are definitely in order. Fortunately, the timing is good for prospective early retirees to take greater control of their wealth planning. 2002 marked the year that expanded the funding possibilities for ophthalmologists in pension, profit sharing and 401(k) plans. These types of plans are hands down the best overall retirement funding vehicles available to physicians.

New Rules on Contributions

Face it, if the volatile market environment is too much to wait out, it’s time to get serious about increasing your ongoing annual retirement plan contributions. If you’re not maximizing your funding, now is the time to take advantage of recent developments and new laws aimed directly at enhancing retirement opportunities.

• Defined contribution pensions. Basic "defined contribution" pension or profit sharing plans now allow the employer to contribute 25 percent of your earnings up to $44,000 into your plan account annually. Thus, an ophthalmologist earning at least $175,000 can receive the maximum dollar contribution.

•401(k). These plans now have increased limits on employee voluntary amounts: up to $15,000 for this year. Note that the voluntary amounts count against the $44,000 per person limit.

When you hit age 50, you can also increase your voluntary 401(k) contribution with a "catch-up" amount. For 2006 the catch-up is an additional $5,000. More important, catch-up contributions are not counted against the annual $44,000 maximum.

• Defined benefit pensions. Individuals who are age 45 and older should examine the possibility of either starting or switching to a "defined benefit" pension plan. This type of plan allows substantially higher annual contribution amounts than the $44,000 limit set on defined contribution and 401(k) plans. Defined benefit plans are very suitable to individuals at or near retirement age because contributions are keyed, in part, to how much time a person has before scheduled retirement. The shorter the time to scheduled retirement, the greater the amount that can be contributed. While increasing funding amounts in your practice's pension, profit sharing or 401(k) can help you reach your financial goals, you may be hesitant to do so because of the added costs associated with also funding the office's non-physician employees. You shouldn't be. Almost without exception, the retirement and tax benefits gained on the physician side of the equation outweigh the dollar cost of additional contributions for your staff.

Look at Current Expenses

The idea of "living below your means" is a common theme in many early retirement plans. That concept is increasingly relevant, even to the well-paid ophthalmologist, if you have definitive ideas about exiting early from the working world. Settling for less than what you can afford now, while you're a full capacity income earner, obviously increases your odds of recouping lost wealth at a faster pace. Early retirement planning is, in effect, a personal cost/benefit analysis of what you're spending now and how those expenditures fit in with the values you place on your early retirement lifestyle.

As you look down the road, recognize that some expenses will be eliminated or reduced once you retire (e.g., work-related costs, home improvements and furnishings), and some expenses will increase (e.g., leisure and travel, the cost of care for an elderly parent). In a proactive sense, however, there are key expense areas—housing and personal insurance, for example—that warrant review by any potential retiree. Considering housing, decide if your current home is essential for your retirement years. You may conclude that you'd be quite comfortable in a smaller place and/or in a less expensive region. If you're too connected to your present area, consider a less expensive community in the same region.

With regard to personal insurance, your life and disability policy premiums may be depleting your wealth significantly without purpose. If you have saved enough for the education of your children and if you have paid off your mortgage (or close to it), these policies may be absolutely unnecessary. Early retirement planning is an evolving process. Keep your eye on the prize and be prepared to make necessary adjustments on both sides of the ledger.

A version of this article was submitted for publication in Review of Ophthalmology (Winter 2002 issue). It was reviewed and updated in 2006. Permission is hereby granted for the reprinting and use of this article provided that such distribution is free, and provided that the source and ownership of this material is acknowledged to be The Health Care Group, Inc.®. This article can be found online at www.healthcaregroup.com.