What a difference five years can make!

We know that the decision around early retirement is not an easy one. Esta Theron, Business Development Manager at Glacier by Sanlam, examines how early retirement can impact a person's capital retirement savings and the amount of their potential future gross monthly income after retirement.

Food for thought

In Andile's story and the calculations that follow, Esta illustrates that even if early retirement seems appealing, the numbers often aren't. If you are 'forced' to retire early, say at 55, it's best to try to earn a salary in some way, for at least another five years. Retiring as early as 55 is just not the best decision to make, since you could still live for another 30+ years and to do so with confidence, you'll need a great deal of capital.

Working and saving another five years, not only will ensure a larger income, but also will keep you economically active for longer, which has great benefits psychologically. If there is no way out and you have to retire at age 55, consider a combination of post-retirement solutions to ensure the best possible income with growth and to secure some part of your capital for your loved ones.

Andile's story

Andile is currently 30 years old and earns a gross annual salary of R325 000. He intends to start investing R2 031-25 (7.5% of his monthly salary) into his employer's pension fund at the end of each month. If we assume a capital growth rate of 10% per annum in the pension fund, without any increase in Andile's contributions, the difference in the value of his retirement savings between the age of 55 and 60 is illustrated below.

What could be lost in retirement savings if Andile retires early?	
Age when Andile started contributing to his pension fund	30
Monthly contribution to the pension fund (assumed to remain constant over the employment period)	R2 031-25
Capital growth rate	10%
Andile's total retirement savings at 55 years	R2 695 130 (size of Andile's pension fund after 25 years)
Andile's total retirement savings at 60 years	R4 591 616 (size of Andile's pension fund after 30 years)
Difference in the value of his retirement savings	**R1 896 486**

Based on the assumptions we have made, if Andile retires at 55, he would have accumulated R2 695 130 in retirement savings. However, if he retires at 60 years, he would have R4 591 616 in retirement savings. By retiring early, Andile therefore would reduce the capital amount of retirement savings from which he would live off in retirement by almost R2 000 000.

If Andile then chooses to purchase a guaranteed life annuity with the full value of his retirement savings from the pension fund, at 55 years or 60 years, the gross monthly income he would receive during his retirement, based on quotations at 10 June 2021 (rates are subject to change), with the assumptions of a 20-year guaranteed term and a 5% annual growth on income, is presented below.

Expected monthly income during retirement		
Current gross monthly income	R27 083 (R325 000 per annum)	
Age at retirement	55 years	60 years
Value of his pension fund at the time of his retirement	R2 695 130	R4 591 616
Estimated gross monthly income during Andile's retirement	R13 534	R23 070

Let's look at the income comparison

The difference in income received if Andile retires five years later is R9 323 per month (R23 070 – R13 747 = R9 323). So, if he chooses to retire early at age 55, he will have less retirement savings available and he will also receive less income from a guaranteed life annuity.

If, despite the early retirement shortfall, Andile still chooses to retire early from his pension fund because he is not able to postpone his retirement, there are a few post-retirement options available to him. Based on the same previous assumption that there is a capital growth rate of 10% per annum in the pension fund, without any increase in Andile's contributions, we have provided three post-retirement options for Andile which offer varying levels of flexibility.

Option 1:

100% in a guaranteed life annuity with a 20-year guaranteed term and an assumed 5% annual growth on income.

Option 2:

100% in a living annuity with the same income as Option 1. We have assumed income growth at 5% and capital growth at 9% per annum.

Option 3:

Andile's capital could be split as follows:

- R1 500 000 in a guaranteed life annuity with 20-year guaranteed term and 5% annual growth on income, and

- R1 195 130 in a living annuity with income that would match the income in Option 1 and 2 if combined with the income from the guaranteed life annuity.

Each option would provide Andile with the same income annuity amount, but the third option will provide him with a guaranteed lifetime income and the opportunity to preserve some capital on the side as well.

The table below illustrates an example of the outcome of each option atage 55, with retirement capital of R2 695 130, assuming an income growth rate of 5% and a capital growth of 9% (inflation + 4%).

<table>
<tr><th></th><th>Product</th><th>Capital invested</th><th>Income</th><th>Capital/Income available at death</th></tr>
<tr><td>Option 1</td><td>Guaranteed Life Annuity</td><td>R2 695 130</td><td>R13 534 that grows with 5% per annum</td><td>If before 20 years: income continues to pay to the beneficiary</td></tr>
<tr><td rowspan="2">Option 2</td><td rowspan="2">Living Annuity</td><td rowspan="2">R2 695 130</td><td>R13 534 (6%) that grows with 5% per annum</td><td rowspan="2">Capital in the investment is available to the beneficiary</td></tr>
<tr><td>Capital growth assumption of 9% per annum</td></tr>
<tr><td rowspan="3">Option 3 (Combination)</td><td>Guaranteed Life Annuity</td><td>R1 500 000</td><td>R7 644 that grows with 5% per annum</td><td>If before 20 years: income continues to pay to the beneficiary</td></tr>
<tr><td rowspan="2">Living Annuity</td><td rowspan="2">R1 195 130</td><td>R6 103 (6%) that grows with 5% per annum</td><td rowspan="2">Capital in the investment is available to the beneficiary</td></tr>
<tr><td>Capital growth assumption of 9% per annum</td></tr>
</table>

If Andile waits another five years and retires at age 60, when the capital has grown to R4 591 616, the outcome of each option will be as follows:

	Product	Capital invested	Income	Capital/Income available at death
Option 1	Guaranteed Life Annuity	R4 591 616	R23 070 that grows with 5% per annum	If before 20 years: income continues to pay to the beneficiary
Option 2	Living Annuity	R4 591 616	R23 070 (6%) that grows with 5% per annum	Capital in the investment is available to the beneficiary
			Capital growth assumption of 9% per annum	
Option 3 (Combination)	Guaranteed Life Annuity	R2 000 000	R10 039 that grows with 5% per annum	If before 20 years: income continues to pay to the beneficiary
	Living Annuity	R2 591 616	R13 031 (6%) that grows with 5% per annum	Capital in the investment is available to the beneficiary
			Capital growth assumption of 9% per annum	

Important to know

The ASISA guidelines on maximum withdrawal levels noted in the table below should be followed when deciding on the amount of income to be taken from a living annuity. If an annuitant adheres to these guidelines, they should be able to ensure that the capital is not depleted over their lifetime, to provide the chosen income until death – with a little bit of capital to spare. If the annuitant is not able to stick to these guidelines, and requires a higher annuity income drawdown, it is advisable to consider alternative options, i.e. a combination or a guaranteed life annuity.

Glacier's guideline on maximum withdrawal levels

Age range	55 - 59	60 - 64	65 - 69	70 - 74	75 - 79	80 - 84	85+
Male – income range	4.0 - 4.3%	4.4 - 4.8%	4.9 - 5.5%	5.6 - 6.2%	6.3 - 7.2%	7.3 - 8.6%	8.7%
Female – income range	3.5 - 3.7%	3.8 - 4.1%	4.2 - 4.6%	4.7 - 5.1%	5.2 - 5.7%	5.8 - 6.9%	7.0%

All monetary values in this article are assumptions, and for illustrative purposes only. As markets fluctuate and every client is different, values, rates and incomes will vary.

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Glacier Financial Solutions (Pty) Ltd.

A member of the Sanlam Group
Private Bag X5 | Tyger Valley 7536 | Email client.services@glacier.co.za | Tel +27 21 917 9002 / 0860 452 364 | Fax +27 21 947 9210 | Web www.glacier.co.za | Reg No 1999/025360/07
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Private Bag X8 | Tyger Valley 7536 | Tel +27 21 950 2600 | Fax +27 21 950 2126 | Web www.smmi.com *|*Reg No 2002/030939/07
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Glacier International is a division of Sanlam Life Insurance Limited
Sanlam Life Insurance Ltd. | Email life@sanlam.co.za | Tel + 27 21 916 5000 / 0860 726 526 | Fax +27 21 947 9440
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