MarketWatch

Downsize your debt before retirement

By Carol Craigie
Published: Mar 24, 2017 2:15 p.m. ET

The curveballs don't retire when you do

OK, everybody knows we should pay down debt, but how big a deal is it to enter retirement with debt? I mean, we've had it most of our adult lives. What's different? Evidently a lot.

The problems

If you couldn't live on your income before retirement without borrowing, what makes you think you can in retirement? This may seem harsh, but most people have a reduced income in retirement. They may start out close to what they had, but inflation over the years eats into that income and you'll have less purchasing power. While we are working, we are borrowing from our future earning power to pay others in anticipation that we would earn more in the future. In retirement, that picture is reversed. Most people can expect less income in the future as inflation and age take their toll. Your risk of being unable to meet your expenses will increase.

The curveballs don't retire when you do. The most common reason people reach for credit today (i.e. car purchases, car repair bills, home maintenance, medical bills, etc.) are still going to occur and get even more expensive over time. Chores you may have done yourself you may be paying for in the future when your back hurts. Your dental bills will get bigger as your teeth require more expensive treatments. The Consumer Financial Protection Bureau (CFPB) identified those "surprise" expenses as the number one financial issue that causes real difficulty in retirement. If you are carrying balances on your credit cards or have a home equity line already, you may not qualify for additional credit in retirement because of the ratio of your income to your debt, or it may be even more expensive. That can start a real downward spiral in retirement.

Debt takes away the ability to stockpile savings for those curveballs.

The only good debt is a dead debt…with one exception. If you have a surprise bucket of money for the curveballs outside of your qualified plans, aren't worried about meeting your retirement income needs, could pay cash but are earning more in your portfolio than the cost of the debt, then go ahead take that debt. Personally, I dislike debt and don't have a mortgage or any debt at all. I went car shopping and was going to pay cash, but they offered fixed 0.9% — less than 1%. My money is earning more than that, and I have the cash flow to make the payments, so I took the loan. That's the only situation I can see for using debt when you are close or in retirement. Anything else is a risky move.

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If you don't have a decreasing debt plan with a debt-free date target, then debt has an increasing stress plan for you that won't end. Financial stress is the number one stressor in America today and seniors are not exempt. Retirement is supposed to be about enjoying life. Worrying about whether you can meet your bills or if the house will be foreclosed on, isn't my idea of enjoyment. If you don't make a plan, compounding interest has a stressful one for you.

Research from the CFPB released in May 2014 shows that "both the number of seniors entering retirement with debt has increased and the median mortgage debt increased by a whopping 82% over the last decade. Delinquency and foreclosure rates are 5 times as high also." The number of seniors entering retirement with student loan and credit card debt is up, too.

The solutions

Live what you'll have at retirement now. Calculate what your income will be and compare it to your current budget. What will change? Which expenses (such as health and dental insurance) is your employer paying that you will need to pay? Project your variable expenses in addition to the routine ones. If you've been using a program like Mint.com for a few years, you will be able to easily see what you've been spending. Once you've got the budget calculated, live with the budget now. If you won't be able to afford cable in retirement and accumulate the funds for the curveballs or still have debt, drop cable now. If you won't be able to afford vacations, or a housecleaner, or someone to cut the grass, live that way now. If you haven't retired and you find you really don't like that lifestyle, you may choose to work a little longer. But by living it now, you get two benefits: 1) You'll know what it's like and whether it will work for you, and 2) You can put the extra money toward your debt or savings.

Save for the curveballs every month. By projecting the variable expenses and adding a little extra for the real surprises, you can start building a pot of money to pay for those things you normally just put on a credit card. Even if you don't have all the funds saved, by paying for part of the tires in cash and only putting some on a credit card, you'll start lessening your dependency.

'Get a new plan, Stan, and set yourself free'

If you haven't retired yet, figure out how much you need to put toward your debt to pay it before committing to a retirement date. If you're already retired, calculate what it would take to pay it off within five years. If you don't know what it will take, it's hard to come up with a plan to get there.

Be smart about your pay-down plan. Focus on paying off the higher interest rate debt first. An "avalanche" or "snowball" approach to debt can really make a difference. The basic concept is to set your payment amount and pay the minimums on all of the cards but one, which gets a large payment. The "Avalanche" method focuses on the highest interest rate first. A "snowball" approach takes the smallest balance first. As soon as the first debt is paid off, all the money goes to the next one. Avalanche makes the most financial sense, but snowball lets you feel the rewards sooner as the debts go away. Restructuring debt to lower interest plans consistently is also a good policy (as long as you don't get caught in a 0% interest card that jumps up to high interest if you miss the deadline). If you're using credit cards still for those "points," make sure you have built all the charges into your budget. Debitize is a free program that will track what you are spending, pull it from your account and make sure the bill is paid on time. It can have the added benefit of improving your credit score, if you're one of those people who occasionally miss the due date.

Downsize your house and your debt before retirement. If you won't be able to pay off your mortgage, consider finding that retirement house before retirement and moving into it so you can have a paid-up mortgage. Then take the freed-up cash and save.

Get creative with solutions

Think of it as a puzzle or challenge with big rewards for winning. For example, rent out those extra rooms. Try one car and use Uber to cut expenses. Take a part-time job for a few weekends and put the money toward debt. Have a garage sale to prepare for downsizing and use the money to pay it down. If you can't buy your retirement home and live there yet due to work, consider renting an inexpensive place for a year or two and get rid of the more expensive home. Invest the funds or buy that retirement home free and clear and rent it out. If you can make enough to cover your rent, you're golden and moving well toward retirement. If you're retired, consider working in Alaska for a summer. It's an adventure and can pay well! Become a dog sitter. Make a deal with yourself that you will work at least part time until your debt is all paid off. Brainstorm with your spouse and friends. It's amazing how other people see solutions that you simply can't.

It takes courage, a plan, and consistent attention to change habits. Spending money is a habit. We get used to doing things a certain way: eating certain foods, having lunch at certain places, or using credit cards vs. delaying a purchase until we have the money. If you examine your debt situation and create a debt-free date plan, you'll have the first two parts done. Find someone to help you pay attention to your habits and after about six months, your new habits will take over…and your debt will go down.

Carol Craigie, MA, ChFC, CFP is the founder of Fiscal Fitness Clubs*; a company that helps people take control of their finances, so they get what they want from their money and learn a system to do all those annual financial tasks easily*.

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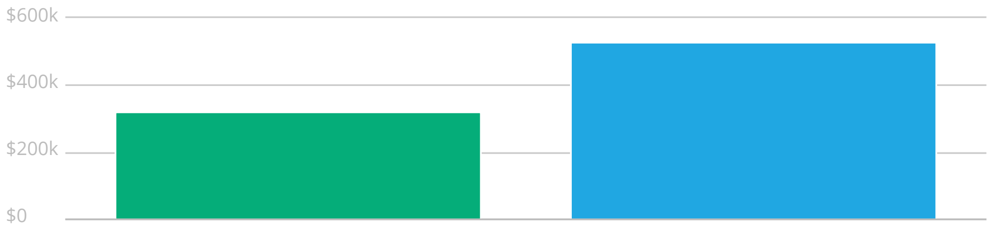
6% of income

Birth Year

1982

Retirement Age

66



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$319,956

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