Assuming you'll retire healthy is an expensive mistake

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After a working life of hard graft, it is only natural to look forward to health, wealth and happiness in retirement.

Unfortunately, the latest research suggests that the vast majority of us won't reach that milestone with all three of those criteria in place. According to the Institute for Public Policy Research think tank, only 16% of women born today will reach retirement age in good health. Just 9% of men will do the same.

Healthy life expectancy can be very different to ordinary life expectancy, although clearly there is a strong correlation. Added to which, healthy life expectancy has risen more slowly—the average British woman can expect to live the whole of her last decade in poor health.

Your odds are better if you are wealthy and your job involves less physical wear and tear. Nevertheless, the overwhelming majority of people will be coping with a number of serious health conditions by the time they reach retirement age.

This has obvious welfare issues, but the financial pressures can be just as stressful.

A sudden health-related early retirement has much in common with being made redundant in your 50s and being unable to find commensurate employment. Your ability to build an adequate retirement pot becomes compromised at precisely the moment you discover that you are going to have to tap your savings earlier than you had anticipated.

The obvious takeaway is: Don't bank on being able to shore up your savings later in your career. However, there are a number of practical steps you can take to prepare for such an unpleasant eventuality.

You could ensure that arrangements for your own care, and that of any dependents, are put in place before they are needed. Many ailments involve a deterioration in mental capacity and can ultimately lead to an inability to make decisions for yourself. In such circumstances, it is vital that you have in place lasting powers of attorney (known as LPAs). These allow a nominated person to legally act on your behalf if you are unable to do so yourself.

LPAs take two forms: One deals with your health and welfare, the other with property and financial matters. The latter might, for example, allow your nominated attorney to rent out your home to meet residential care fees.

An alternative strategy is for an attorney to purchase an immediate needs annuity. This provides a regular income to pay for residential care in exchange for a lump sum. Depending on the person's age, this can cost in excess of 250,000 pounds ($300,000). The income from such an annuity can be tax-free if paid directly to the care provider. Note, though, that since the income stream ends when the patient dies, this latter strategy could prove extremely expensive if care is only required for a few months.

Wills should also be regularly updated, especially if you have children. Early versions might include details of who should care for them in the event of your premature demise. Later drafts, though, could involve adult children acting as your executors or provide them with the financial means to care for a vulnerable relative.

Impaired life expectations do have a (very) faint silver lining financially. Insurance companies in the UK offer significantly better annuity rates for people with health issues. Although it is less common these days, some people purchase an annuity with a pension lump sum to provide them with a guaranteed income for life. If your health has been compromised, the income you could buy with an annuity might be much higher than if you were in good health.

If you have suffered a stroke or heart attack, your annuity income could easily be 75% more than for a healthy person. Even being a regular smoker, drinker or having a high body mass index can increase your annuity income. An estimated 60% of those eligible to buy annuities qualify for some sort of enhanced rate.

Annuities are enjoying something of a renaissance because the income they pay is also heavily dependent on long-term market interest rates, which have risen sharply this year.

The downside of purchasing an annuity is that your heirs will inherit less than they might otherwise have done. For that reason, few financial advisers will recommend buying one if end of life might be imminent.

Ill health also has implications for how you manage your retirement savings. As a rule, anything that impacts your earning ability should cause you to become more conservative with your investments. The most powerful pension planning tool is being employed and having the option to continue working if your savings are insufficient for retirement. If your capacity to earn is reduced or removed altogether, this needs to be reflected in how much risk you are prepared to take with your existing savings.

The low likelihood of reaching retirement age in good health begs another question. Should you retire early to avoid this problem in the first place? The data are surprisingly ambiguous on this. Some studies have purported to show that retiring early not only increases overall life expectancy but can also increase healthy life expectancy. But one famous study suggested exactly the opposite—that working longer led to greater life expectancy. There is no straightforward answer to this question.

What is clear though, is that financial worries can be compounded by boredom and dissatisfaction, leading to post-retirement depression. This is another reason why people should prepare both mentally and financially for retiring earlier than they might otherwise expect.

More positively, if you find your job stressful and you have made adequate financial provision, early retirement might indeed be the healthy option. There are, after all, no prizes for being the richest person in the graveyard.

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