The surprising truth about how much you need to save for a happy retirement

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Ian McGugan

Dick Haas is here to tell you that retirement planning doesn't always work out quite as smoothly as the online calculators suggest it should.

Three divorces have eroded the net worth of the 73-year-old retired financial adviser in Fergus, Ont. So have the costs of looking after his girlfriend, who is afflicted with multiple sclerosis. As her primary care giver, Mr. Haas has had to purchase a van outfitted for handicapped access. He faces a constant trickle of other care-related costs as well.

"I'm on a fixed income, basically, so I really have to watch how I spend my money," he says. With no company pension, he relies on Canada Pension Plan (CPP) and Old Age Security (OAS), as well as a modest investment portfolio, to generate about $42,000 a year in income.

If this story were to stop here, you might go away thinking of Mr. Haas as a prime example of Canada's looming retirement crisis. That diagnosis would match the conventional wisdom on the topic. According to scary statistics publicized by many financial experts, Canadians aren't saving nearly enough for their golden years.

The numbers are intimidating. One guide for Canadian couples, published last year, sternly warned its readers that "the average 30- to 50-something Canadian household will need approximately $2-million for retirement." By that standard, Mr. Haas – like nearly all Canadians – comes up seriously short. He estimates his net worth, including a partially paid-off condo and life insurance, at roughly $500,000.

But here's the odd thing: He doesn't sound like someone who's distraught about his financial situation. In fact, he sounds rather upbeat. Thanks to diligent budgeting, he has enough money to cover his basic needs. He insists that other issues – notably health and companionship – matter far more than income.

"When I look around my condo building, I see health crises and loneliness crises among retirees," he says. "But I don't see any financial crisis. I really don't."

That lack of financial crisis is the big and largely untold story of Canadian retirement planning. Like Mr. Haas, many seniors are living on far less than the multi-million dollar aspirations of the financial planning industry. Yet despite a glaring lack of seven-figure portfolios, most retirees appear remarkably content with their money situations.

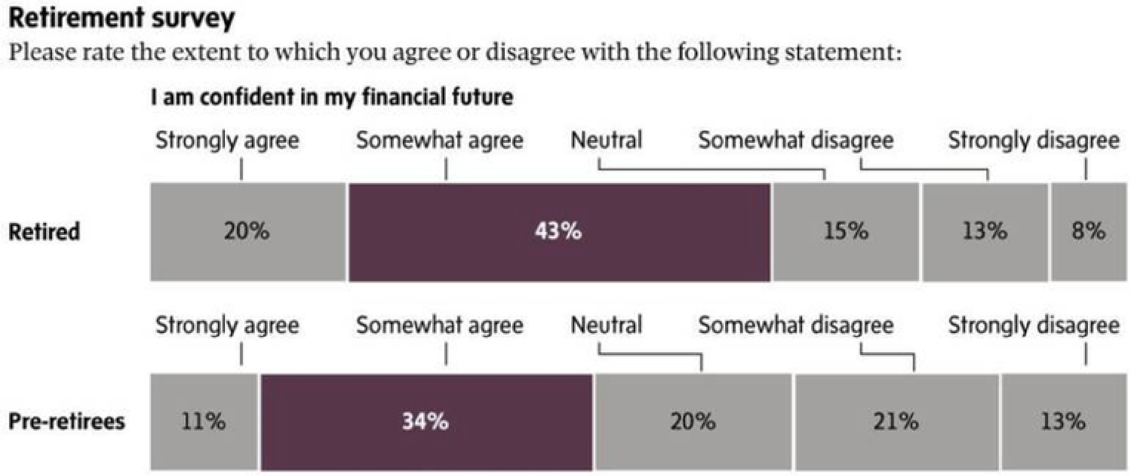
Legacy Wealth Team
Legacy Wealth Management

Office : 1-866-203-0998
jennifer.leung@ipcsecurities.com
www.legacywealthmanagement.com

Melanie Twietmeyer
Wealth Advisor
m.twietmeyer@ipcsecurities.com

Kevin Meckelborg
Investment Advisor
k.meckelborg@ipcsecurities.com

Jennifer Leung
Client Services Manager
jennifer.leung@ipcsecurities.com



JOHN SOPINSKI/THE GLOBE AND MAIL, SOURCE: CANADIAN INSTITUTE OF ACTUARIES

Their optimism is surprising, especially compared to the anxiety that surrounds the topic during our working years. In a survey conducted in 2010 by the Canadian Institute of Actuaries, only 45 per cent of people who were still on the job said they felt optimistic about being able to live comfortably in their golden years.

Strangely, though, the people who should know best – actual retirees – were much more positive. About 63 per cent of them told the pollsters that they looked toward the future with confidence. The vast majority expressed no serious qualms about what lay ahead.

The widespread contentment among Canada's seniors suggests that many of us are approaching retirement with needless trepidation. If you're planning your own escape from wage slavery – and who at work isn't? – you should move beyond the clichés and scare tactics that distort many discussions of the topic. To help you along, here are five observations that can help you plan a smarter, better retirement.

You shall not fear

Start by taking a deep breath. The anxiety that many of us feel about retirement simply isn't warranted.

The majority of Canadian seniors are doing just fine. The actuaries' survey cited above found that only 23 per cent of retirees expressed significant doubts about not being able to maintain a comfortable lifestyle throughout retirement.

Rather than pinching pennies to make ends meet, many retirees don't spend what they have. According to Statistics Canada, seniors account for a whopping 37 per cent of the nation's savers. The percentage of savers among retirees is far higher than in any other age group, a fact that suggests many seniors have excess cash.

To be sure, not every over-65 Canadian is happily stowing away unneeded loonies. People who lack workplace pensions can face a rocky time if they haven't put aside money on their own, according to a study published last year by the Broadbent Institute. Single women, especially those who spent their lives as homemakers, are especially vulnerable to falling short in retirement.

But it's important to put such shortfalls into perspective. About 12.5 per cent of Canadians over 65 fall into the low income category, meaning they have less than half the after-tax income of the median Canadian household. That percentage is actually slightly lower than the comparable number among younger Canadians. If anything, poverty tends to diminish with age.

You shall live on less – and like it

Yes, you still have to save diligently to finance a comfortable retirement. But you may not have to save as much as you think

Conventional wisdom says you need to replace 70 per cent of your working income in retirement to maintain your standard of living. But many retirees thrive on considerably less, especially if they own their own residences.

Consider Ishrat Khan, a 77-year-old retired civil engineer, who has lived all over the world and now resides with his wife in a paid-off North Vancouver home. "Our total income is between $40,000 and $50,000 a year, and I think that is more than enough, unless you run into serious medical problems," he says. Despite an income that's only about half of what he and his wife used to take in during their working years, he says retirement is "wonderful – so much better than being in the office."

He's not the only retiree to find bliss on a modest income. Frederick Vettese, chief actuary at Morneau Shepell, a human resources consulting firm in Toronto, says a large chunk of the money we earn during our working lives goes to expenses that disappear in retirement. Once you're no longer making mortgage payments and RRSP contributions, and no longer paying for summer camp and kids' tuition, your need for money shrinks considerably. It dwindles even more because your lower retirement income means a lower tax bill.

As a result, most of us can maintain our standard of living in retirement on considerably less than the amounts touted by the financial planning industry. Exactly how much less depends on how you've lived during your working years.

If you're a childless, non-saving renter with expensive hobbies – in other words, someone who has always spent right up to the edge of your income with little thought for tomorrow – you may, in fact, need to replace 70 per cent of your working income to keep the party going.

Conversely, though, couples who have raised a mob of children and paid off big mortgages will probably notice little difference in their living standards if they manage to replace only 40 per cent of the income they made while working.

Mr. Vettese says most middle-class homeowners who have saved regularly and raised a couple of kids will be fine if they achieve a 50 per cent replacement ratio. That means a couple who earn a combined $140,000 a year should aim to exit the working world with a paid-off home and a retirement income of $70,000 a year.

That doesn't sound so intimidating, especially when you consider that CPP and OAS are likely to contribute a significant chunk of your target income. A typical middle-class couple who have both worked for decades can look forward to receiving a combined $25,000 to $35,000 from government stipends if they start collecting at age 65.

You shall forget that Freedom 55 nonsense

Of course, for many of us the challenge is waiting until our mid-sixties to retire. We dream of saying say goodbye to work in our 50s.

In most cases, that would be a mistake. You don't have to work into your advanced old age, but planning to stay on the job until your early 60s makes sense for most people. It gives you more time to save, more time to build up pension credits and more years for your investments to grow.

"Early retirement sounds great, but it involves risks," Mr. Vettese warns. "Among other things, it tends to be a one-way street. If you find that your financial calculations are off, or your investment results aren't quite as good as you hoped, and you want to go back to work, it may not be so easy."

Those who plan for an early exit from the office can lose out in other ways as well. The earlier they begin collecting from government programs such as CPP (or Quebec Pension Plan) and OAS, the lower their monthly cheque will be.

In contrast, if you choose to defer CPP and OAS until you're 70, you wind up collecting nearly half as much in monthly payments as you would have received at 65. This can have a huge impact on your retirement planning. A retiree who might have collected $20,000 a year from CPP and OAS at age 65 will see her annual take from those programs soar to close to $30,000 if she delays both to age 70.

To be sure, going this route means a retiree may have to tap her savings to replace the forgone government payouts during the five years she's not working from 65 to 70. However, Mr. Vettese argues, it still makes sense in nearly all cases to defer the stipends.

By doing so, a retiree effectively transfers much of the risk in her retirement plan to government. Ottawa is now on the hook for payments until she dies and it will bump up those payments in line with inflation, no matter what the stock market does

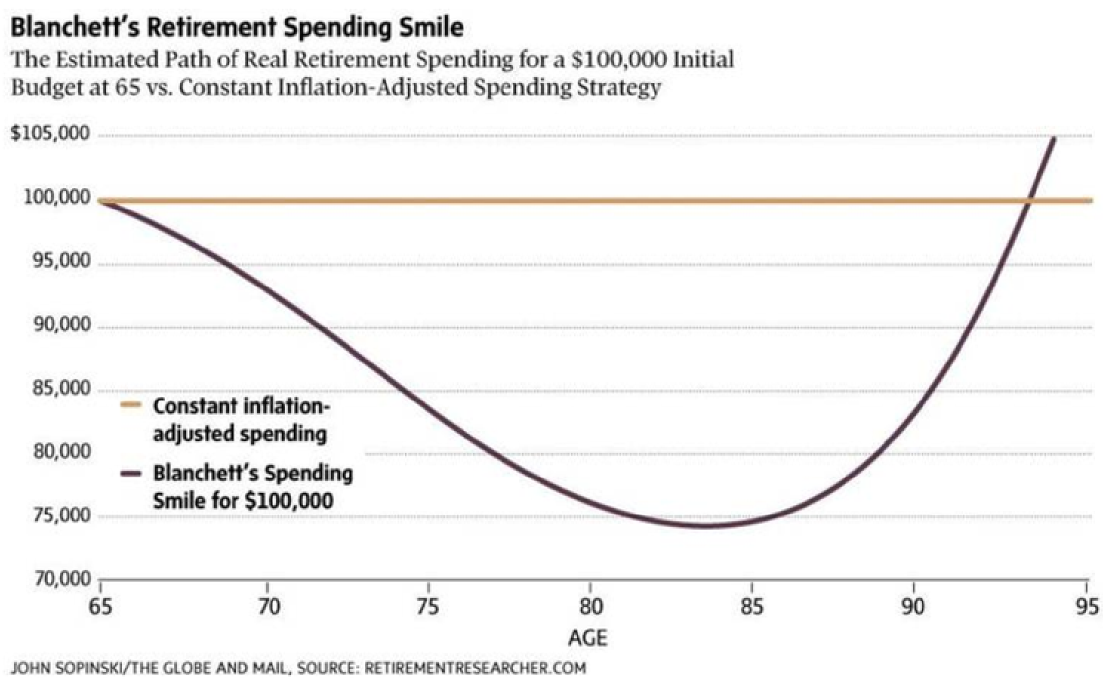
"Unless you're in really poor health and just don't think you'll make it much past 70, it's really a no-brainer to defer when you start collecting," Mr. Vettese says. "But very few people do it."

But you shall not oversave

Don't laugh. Oversaving is a well-documented problem. After spending their lives worrying about having enough for retirement, many retirees are surprised to find their post-work income outstrips their dwindling needs.

In the United States, the average American over 60 reduces the amount they spend by about 2.5 per cent a year, according to United Income, a financial planning software company. As a result, a significant number of retirees enter their 80s richer, on an inflation-adjusted basis, than they were in their 60s.

Chances are that much the same phenomenon is occurring in Canada. An analysis of Statistics Canada data by McKinsey & Co. and Mr. Vettese suggests that spending by middle- and upper-middle class households steadily shrinks after 65.



As they age, retirees in both countries show less inclination to travel, to eat out and to spend large amounts on clothes and entertainment. Well-to-do households, in particular, tend to live way below their means and let money pile up.

"You see a lot of unintended bequests" among affluent retirees who pass away with pots of unspent money, says Michael Finke, a retirement researcher and dean of the American College of Financial Services in Philadelphia.

This tendency to save in retirement reflects declining health and mobility. It also reflects many seniors' obsession with maintaining the size of their starting nest eggs. While it's perfectly rational for retirees to spend down their accumulated savings as they age, many perceive a diminishing portfolio as a sign of risk. As a result, they needlessly scrimp.

Fortunately, there's a simple solution: After you hit 65, you can use part of your wealth to buy an annuity. These financial products are offered by insurance companies and promise to pay you a fixed amount of money every month until you die, just like a company pension.

Surveys suggest that people who annuitize a significant part of their wealth are happier than those who don't. Annuity buyers benefit from knowing they can't outlive their money. They also demonstrate an increased willingness to spend what they have. "Knowing that you'll get another cheque next month gives you the licence to spend the one you have now," says Dr. Finke.

You shall think about more than just money

It's important to realize that a good retirement plan involves more than just financial considerations. "We don't get happiness from swimming in our own money," Prof. Finke says. He urges people to consider investing in their health and hobbies just as diligently as they do their retirement accounts.

That advice comes as no surprise to Mr. Khan, the retired civil engineer in North Vancouver. "You need a sport and a hobby to be happy in retirement," he asserts. In his case, the sport is tennis and the hobby is painting. He's exhibited his art work in many galleries and won several awards.

But planning for retirement also means having a realistic sense of what makes sense at different ages. Retirement for most of us is a progression from "saga to gaga," say financial planners. You begin by welcoming adventure, then move on to a quieter, stay-at-home stage, and may wind up needing substantial medical attention toward the end of your life.

Ken and Judith Albanese are very conscious of the passing stages. Ten years ago, they said good-bye to jobs in Ontario's education sector and moved to Mexico in search of endless summer as well as a lower cost of living that would allow them to retire early on modest pensions and a little bit of savings.

They loved learning about a new culture, studying Spanish and throwing themselves into hobbies they relished – theatre for Ken and health journalism for Judith. "It's been wonderful fun," says Judith.

But now, at age 70 and 65, Ken and Judith are planning to leave their home in San Miguel de Allende, north of Mexico City, and move back to Canada, where they intend to rent in Peterborough, Ont. They want to ensure access to reliable medical care as they age. They also want to return to their own culture and become part of a community while they're still young and vital enough to make friends.

"I think the one thing we've done consistently right is to plan," Ken says. "You always have to be looking ahead and preparing yourself for the next stage of life. In our case, we're thinking of what the next decade will bring, and we're looking forward to it."

Six steps to a successful retirement

Frederick Vettese, chief actuary at consultants Morneau Shepell, lays out a simple formula for retirement success in his book, The Essential Retirement Guide. For those who want clear, direct instructions, his checklist is hard to beat:

1. Save 10 per cent of your pay every year.
2. Invest it in low-cost pooled funds, weighted toward equities.
3. Keep the asset mix the same, through good times and bad.
4. Apart from the mortgage on your home, avoid going into debt.
5. Pay off your mortgage by the time you retire.

6. Buy a life annuity at retirement.