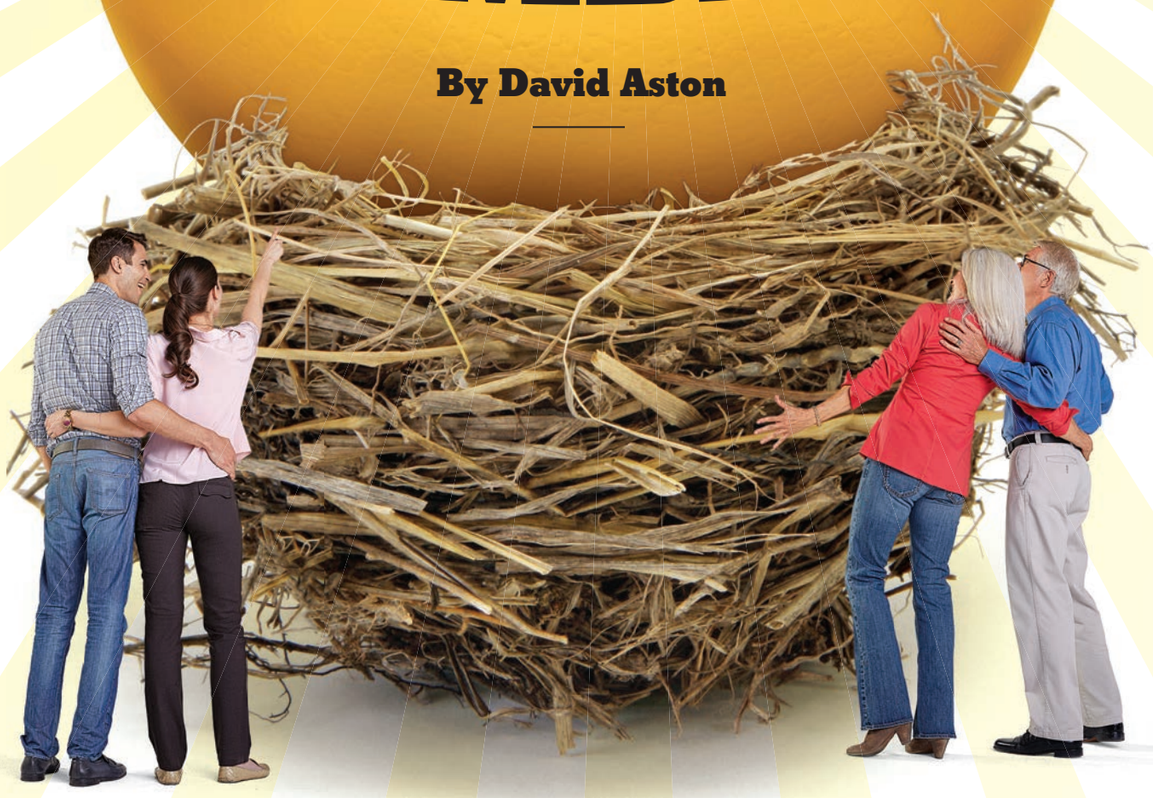
WHAT'S YOUR MAGIC NUMBER?

By David Aston



Photograph by Nikko Ormerod; Makeup & Hair by Eman/Plutino Group

Few of us know how big our NEST EGG needs to be in order to fund a comfortable retirement. Our exclusive calculations reveal how much you'll need to retire—and show you how to get there

Imagine you knew exactly how much money you needed to enjoy the type of retirement you want. Instead of worrying whether you were saving the right amount, you'd have confidence your annual contributions were enough to fund a long and prosperous retirement. Saving would no longer be a guessing game, but a calculated strategy in which you'd be closer to reaching your goal every year.

If you don't know how much you need to retire—or you'd like a second opinion—*MoneySense* is here to help. We'll show you how to come up with good numbers to aim for—and you won't even have to reach for your calculator. We'll also show you how much you'll need to save each year to reach your goal, and what you need to do if you want to retire early.

No one knows exactly what life is going to throw at you, so you'll have to adjust your plans as you go. But knowing what to aim for will empower you to work towards your goal and give you peace of mind as you follow your path to a comfortable retirement. ➤

RETIREMENT IS ON SALE

The good news about retirement is that you'll probably need a lot less income than you did at the peak of your working years in order to maintain a middle-class lifestyle. That's because many of the expenses you have in your middle years usually don't continue into retirement. Typically these include the cost of raising children, paying down your mortgage and work-related costs for transportation, clothing and payroll deductions. You won't need to save for retirement, and with less income, you pay much less income tax.

As a result, we've found the cost of a retirement lifestyle that's middle class or a little better is about $40,000 to $70,000 per couple (before tax). That's borne out by data: The Statistics Canada Survey of Household Spending for 2010 found senior couples on average spent a combined $53,100 a year (including tax payments). Singles aren't able to live as cheaply per person as couples, so in that case we estimate the cost of an active lifestyle that's middle class or a bit better at roughly $28,000 to $50,000. (Statistics Canada found the 2010 average spending for single seniors was only $31,100, but that includes many older widows and widowers.) Another way to figure out the cost of maintaining your lifestyle in retirement is—very roughly—to look at the income in your peak earning years and apply a factor of between 50% and 60% for couples, or 60% to 70% if you're a single. In each case, these rules-of-thumb work best if you have a paid-for home and no other debt when you retire.

While that's a big range, you still get an active, comfortable retirement with a "basic middle class" lifestyle. "If you're at the lower end, you can still have a really nice life," says Sheila Walkington, co-founder of Money Coaches Canada, a national network of 21 fee-only planners and coaches. At that income, you can still afford things like a car, hobbies, entertainment, eating out and vacations, only at a more modest level than better-off counterparts. Of course, you may not be able to afford to do *everything* you want. "It's often about being more careful about how you spend and prioritizing," says Walkington, a financial planner and co-author of *Unstuck*.

Once you have a handle on retirement spending, you can figure out roughly the nest egg you'll need in just a few steps. A key factor is how much you can safely draw down each year. A rough consensus of historical research has found that if you retire at age 65, you can withdraw about 4% a year based on the initial value of your portfolio (plus subsequent inflation adjustments) and run little risk of outliving your money. This means that if you retire at 65, your initial nest egg should be roughly 25 times the amount you plan to withdraw each year in today's dollars. The research typically assumes you invest in a balanced portfolio of stocks and bonds, and lasts for at least 30 years. These conservative assumptions provide a substantial margin of safety in case you encounter an exceptionally poor investment climate while living to a ripe old age. But as retirement researcher Jim Otar of retirementoptimizer.com cautions, "it's not foolproof." If you're very unlucky and your investments aren't enough, you can use the equity from your paid-off home as a backup plan, or simply reduce discretionary spending.

To figure out how big a nest egg you'll ➤

HOW MUCH MONEY WILL YOU NEED TO RETIRE?

The amount you need to save depends on the lifestyle you want in retirement. Here we show what you'll need in today's dollars. Everyone spends their money differently, but to give you an idea, think of a "basic middle class" couple as being able to afford a used car that they keep for eight years or more. Vacations are mostly driving holidays, with occasional jaunts outside Canada. "Average middle class" couples can buy a new car and trade it in more often, and enjoy foreign holidays with average accommodations. "Upper middle class" couples can buy a new car every five years, or have two cars that they replace every eight years or so. They can also enjoy higher-end international travel.

	Annual Retirement Income Needed [1]	Typical Government Benefits Started at 65 [2]	Amount Needed to Retire at Age 60 [3]	Amount Needed to Retire at Age 63 [3]	Amount Needed to Retire at Age 65 [4]	Amount Needed to Retire at Age 67 [5]
COUPLES						
Bare Necessities [6]	$25,000	varies widely	varies widely	varies widely	**$0**	$0
Basic Middle Class	$40,000	$30,000	$520,000	$350,000	**$250,000**	$140,000
Average Middle Class	$55,000	$30,000	$950,000	$750,000	**$625,000**	$490,000
Upper Middle Class	$70,000	$30,000	$1,380,000	$1,140,000	**$1,000,000**	$850,000
Deluxe	$100,000	$30,000	$2,240,000	$1,930,000	**$1,750,000**	$1,570,000
SINGLES						
Bare Necessities [6]	$18,000	varies widely	varies widely	varies widely	**$0**	$0
Basic Middle Class	$28,000	$15,000	$490,000	$390,000	**$325,000**	$260,000
Average Middle Class	$39,000	$15,000	$800,000	$680,000	**$600,000**	$520,000
Upper Middle Class	$50,000	$15,000	$1,120,000	$970,000	**$875,000**	$780,000
Deluxe	$75,000	$15,000	$1,830,000	$1,620,000	**$1,500,000**	$1,380,000

Notes: (1) Retirement income is before tax. Assumes no debt in retirement and for all categories except Bare Necessities, a paid-for home. (2) Typical amount for OAS and CPP based on fairly long work career at average wages or better. Assumes OAS started at 65. People born after March 1958 will start OAS later and need to adjust calculations. Figures shown assume no employer pension (although employer pension income can be added to this column if applicable.) (3) Assumes initial withdrawal rate of 3.5% for retirement at 60 and 3.8% for retirement at 63, plus inflation. Adjustments also made for starting CPP at early retirement date and for bridging OAS equivalent until OAS start date. (4) Calculated by taking (annual retirement income minus government benefits) x 25. This assumes a withdrawal rate of 4% of initial portfolio plus inflation. (5) Withdrawal rate 4.2% of initial portfolio plus inflation adjustments. Adjusted for OAS and CPP start at 67. (6) Retirement income necessary for "Bare Necessities" derived from *Basic Living Expenses for the Canadian Elderly* by Bonnie-Jeanne MacDonald, Doug Andrews and Robert Brown, based on typical basic senior's living expenses averaged for five Canadian cities. Amounts in study adjusted for inflation using Statistics Canada Consumer Price Index. Government benefits in this case comprised of CPP, OAS, and the Guaranteed Income Supplement and vary widely but ensure roughly that necessities at least are covered. People born after March 1958 have to wait longer than age 65 to collect OAS and GIS.

need, start with the annual retirement income you're looking for. Then subtract government benefits like CPP and OAS (and any defined-benefit pension income from employers). That gives you the income you'll need to draw from your nest egg. Then, if you're expecting to retire at 65, multiply that figure by 25 (which provides for a 4% sustainable withdrawal rate, described above) to come up with the bottom line number.

We used this approach to calculate the nest egg you'll need for different levels of income in the table, "How Much Money Will You Need to Retire?" on p. 36. We've also shown the adjustments you should make in case you're looking to retire earlier or later than 65.

If you have a defined benefit (DB) pension, you can subtract the income you'll get from the amount you'll need to live off each year. If your annual DB pension statement doesn't show you how much pension income you can expect when you retire, ask your pension administrator for a projection. Make sure the figure is in terms of today's dollars, in order to make it comparable with other figures presented here.

The bottom line? If you aspire to a middle-class retirement and stop work completely at 65, with no employer defined-benefit pension, you will probably need somewhere between $250,000 and $1 million per couple or $325,000 to $850,000 if you're single, depending on how frugal or luxe you'd like to go.

We recognize that some people have even more luxurious tastes that require much larger amounts, so we've also defined a "deluxe" retirement. But that's only an example since we recognize that when it comes to truly luxurious lifestyles, the sky's the limit. At the other end of the spectrum, if you don't have any savings of your own, you won't starve—you can expect government benefits including CPP, OAS and the low-income Guaranteed Income Supplement will cover your basic necessities.

Now that you have a sense of the size of nest egg you'll need, we can discuss the best way to get there.

HOW MUCH MONEY WILL YOU NEED TO SAVE?

Now that you know how much you'll need at retirement, we'll tell you if you're saving enough each year to get there. The 'Steady Eddy' approach shows someone who starts contributing for retirement as a young adult. The mortgage-first approach shows how much you'd need to save if you focused on your mortgage paydown until your 40s, then saved 20% of your salary. All amounts are in current dollars.

	STEADY EDDY APPROACH			MORTGAGE FIRST APPROACH		
Annual salary (combined)	You need to save 10% a year (starting early)	Recontribute annual RRSP refund	Nest egg after saving 35 years at 3% real return	You need to save 20% a year (starting later)	Recontribute annual RRSP refund	Nest egg after saving 20 years at 3% real return
COUPLES						
$80,000	$8,000	$1,920	$600,000	$16,000	$3,520	$520,000
$100,000	$10,000	$3,100	$780,000	$20,000	$6,000	$700,000
$120,000	$12,000	$3,720	$940,000	$24,000	$7,440	$840,000
$140,000	$14,000	$4,340	$1,100,000	$28,000	$8,680	$980,000
$160,000	$16,000	$5,600	$1,300,000	$32,000	$10,560	$1,140,000
$200,000	$20,000	$8,620	$1,700,000	$40,000	$16,400	$1,500,000
$250,000	$25,000	$10,750	$2,140,000	$50,000	$21,500	$1,900,000
SINGLES						
$40,000	$4,000	$960	$300,000	$8,000	$1,760	$260,000
$50,000	$5,000	$1,550	$390,000	$10,000	$3,000	$350,000
$60,000	$6,000	$1,860	$470,000	$12,000	$3,720	$420,000
$70,000	$7,000	$2,170	$550,000	$14,000	$4,340	$490,000
$80,000	$8,000	$2,800	$650,000	$16,000	$5,280	$570,000
$90,000	$9,000	$3,510	$750,000	$18,000	$6,660	$660,000
$100,000	$10,000	$4,310	$850,000	$20,000	$8,200	$750,000
$120,000	$12,000	$5,160	$1,030,000	$24,000	$10,320	$920,000
$150,000	$15,000	$6,900	$1,310,000	$30,000	$13,800	$1,170,000

Notes: Initial amounts are saved in RRSPs, then resulting RRSP refunds are assumed to be saved in TFSAs. Tax rate for RRSP refund based on Ontario example. For couples, each spouse is assumed to have equal salary. Accumulated unused RRSP contribution room assumed where RRSP contributions exceed annual limits. Current dollars means figures have been adjusted to remove inflationary effects so that amounts reflect current purchasing power.

NEST EGG PROFILES

For these calculations, we assumed investments earned a real 3% return each year prior to retirement. Projected future amounts are expressed in "current dollars" that reflect purchasing power in 2013. Income figures are before tax unless otherwise stated.

SAVING THE RIGHT AMOUNT

While a comfortable retirement should be well within reach of most middle-class Canadians, you still need to save diligently to get there. But how much to save? It depends on whether you plan to save steadily throughout your working life or whether you instead focus on paying off the mortgage before you start seriously saving for retirement.

The steady-eddy approach was made famous by David Chilton in *The Wealthy Barber.* Chilton advocates salting away a steady 10% throughout a long working career. While results will vary with salary and investment returns, we think that approach works well for Canadians with fairly average incomes or better if you can manage it over a lengthy career of 35 or 40 years. Of course—as Chilton points out—if you don't start early and save consistently, you'll need to save more than 10%.

While that approach is effective, few people these days can afford to buy their first home, cover humongous mortgage payments, and also save 10% for retirement. "I think most people in that situation want to do the level 10% savings but can't for the life of them figure out where the money is supposed to come from," says Malcolm ➤

Can I retire in Italy at 55?

Laurie Fayette
Vancouver

Senior business analyst, 36

GOAL

Laurie, who is single, wants to retire by age 55 with an average middle-class income in Italy

Current annual income
$87,000

Annual savings for retirement
$7,400 (8.5%)

Value of investments
$75,000

Other assets
$173,000 of condo equity, defined-benefit pension plan

Photograph by Grant Harder

IS SHE ON TRACK?

With the benefit of an excellent employer pension and her own good saving habits, Laurie is well on her way to achieving her goal of a comfortable retirement at 55. If she keeps on saving $7,400 a year and then bumps that up to $21,500 a year once her mortgage is paid off in nine years, she can expect to have $470,000 at retirement. She is on track to have an income of roughly $65,000 a year before tax in today's dollars at age 55 from a combination of her employer pension, withdrawals from her nest egg, and government benefits when she is eligible, which will be enough to enjoy an above-average lifestyle in Canada or Italy. **DAVID HODGES**

Hamilton, retirement expert and senior fellow at the C.D. Howe Institute.

So as a practical alternative, Hamilton has devised an alternative approach—the 20% "mortgage-first, save later" strategy. The idea is you first apply 20% of your gross income to paying off your mortgage as quickly as possible, then when it is fully paid off, redirect the 20% to savings in a concentrated period.

Hamilton says you should plan to have the mortgage paid off in your 40s, then focus on the savings phase for at least 15—and ideally—20 years. It helps in the savings phase if you also save some of your RRSP refunds on top of the 20%, but Hamilton doesn't expect you to necessarily save all of it. "Life is going to look a lot better when you're debt-free in your 40s," says Hamilton. "When you turn your focus to saving, you'd be surprised how effectively you'll be able to make up for lost time."

Both strategies should provide Canadians with average incomes who retire at age 65 with an ample retirement nest egg, putting them squarely in the middle-class range we described earlier. The table "How much money will you need to save?" on p. 38 shows roughly how much savings you can expect at retirement in today's dollars, using both strategies at different salary levels. (However if your income is below average, it may be harder to reach the middle class range. In our tables, we show how a single person earning an income of $40,000 can expect to end up just a little short of the middle class range as we've defined it.) Under each strategy, we've assumed that RRSP refunds are reinvested into savings and that those amounts are in addition to the 10% and the 20%. Of course, no one can predict the unknown financial future with precision, so take these numbers as middle-of-the-road ballpark figures only. You'll need to monitor your situation and adjust your plans as you go.

What if you'd like to follow the "mortgage-first, save-later" approach but find you don't have the full 15 to 20 years for saving? No need to panic. Most middle-income people can still accumulate quite adequate nest eggs in 10 to 15 years of concentrated saving or sometimes even less. It helps if your income is better than average and you manage to save more than 20%. But don't shorten up on the savings period unless you have to because it leaves less safety margin. "You have to be careful about leaving things late, then finding you're one of the unlucky ones whose skills aren't in demand or are in poor health," cautions Hamilton.

Will we be financially independent by our mid-50s?

Photograph by Jennifer Roberts

If you're trying to catch up on savings, you can boost your chances by increasing your savings rate to 25% or more (plus saving full RRSP refunds on top of that). My sense is that most middle-income people can save 20% fairly comfortably once they have their mortgage paid off, but most can save 25% or more with a bit of stretching. If you have a family, you're in a better position to save larger amounts once your kids become financially self-sufficient. (For a fuller discussion, see "How Much Can You Save?" at moneysense.ca/savingplan.) Also, while it may not be your first choice, you can always try to work longer.

Which approach works best? The "mortgage-first, save-later" approach works well for anyone whose finances are pinched early in their working careers but who enjoy much greater capacity to save later on. That's particularly true for young homeowners with kids and rising incomes. Those rising incomes also generate bigger tax refunds if you're in a higher tax bracket later on.

On the other hand, childless renters have no good reason to put off saving and generally should buckle down with the steady-eddy approach. In addition, renters will need to save more to cover accommodation in retirement compared to homeowners with paid-for homes. You also should save steadily to the extent that your employer matches those savings in a group RRSP or defined contribution pension plan. In that case, the benefit of free money usually trumps other considerations.

Most people with average incomes or better are best off focusing first on building their retirement savings inside an RRSP. This is particularly true if you save your refunds. On the other hand, you're better off putting your money in a Tax-Free Savings Account if you expect to retire on a low income. That's because TFSAs are more flexible when it comes to withdrawals. And unlike RRSPs they are not counted against the Guaranteed Income Supplement (GIS) for low-income seniors. ➤

Devin Chaudhary & Reena Sharma

Milton, Ont.

Engineer, 33 | HR specialist, 32

GOAL

The couple wants to be well-off and financially independent by their mid-50s. Then they will work part-time and downsize to a smaller home. One of their three Florida rental properties will become their vacation home, and they will sell the other two.

Current combined annnual salary
$140,000

Annual savings for retirement
$15,000 (11%)

Value of investments and equity in two rental properties
$280,000

Other assets
A paid-for home ($750,000), $20,000 equity in their vacation home, $25,000 in their kids' RESPs

ARE THEY ON TRACK?

With the help of two good and growing salaries, Devin and Reena shouldn't have any problem achieving their goals. By saving a comfortable 18% of their income in RRSPs (plus refunds) and later downsizing their existing home, they can expect to accumulate financial assets (not counting their home or vacation property) of about $2 million in today's dollars by the time Devin is 55. They should then be able to safely withdraw about $64,000 a year (3.2%) plus inflation adjustments from their nest egg. In addition, they expect to continue to work at a scaled-down pace and salary and later on will draw government benefits. In combination that should provide them with ample income beyond what is required for an upper-middle-class lifestyle. **DAVID HODGES**

WHAT IF YOU WANT TO RETIRE EARLY?

Many people dream of retiring early. To make it happen, you'll need a bigger nest egg, for two reasons. Not only will you be drawing from your nest egg over a longer retirement, but you'll need to bridge the period until you can collect full government pensions.

A rough way to adjust for the cost of early retirement is simply to add your annual spending requirement for each year you retire early on top of the nest egg you would need for retiring at age 65. Say you figure you need savings of $625,000 at age 65, expect to spend $55,000 a year, and plan to retire two years early at age 63. Then you would add the $110,000 to the target nest egg to come up with an adjusted figure of $735,000 in today's dollars to retire two years earlier than the standard date. In practice, many people end up starting CPP earlier than age 65 at a reduced amount. If you're just trying to get a very rough sense of your finances, you may find it simpler to do rough calculations assuming you'll wait until 65 to draw CPP, instead of going to the greater effort of making two more precise but largely offsetting adjustments.

If you're out to make a more precise estimate of the nest egg you'll need for early retirement, you should estimate your CPP based on when you expect to start it. You should also adjust the sustainable withdrawal rate that applies to withdrawals from your portfolio. While there is no consensus among experts on how best to do this, we believe it makes sense to reduce it by about 1/10th of one per cent for every year earlier than 65 that you plan to retire, if you retire in your early 60s. Thus if you plan to retire at 63 instead of 65, you would be able to withdraw 3.8% per year plus inflation adjustments based on the initial value of the portfolio instead of the 4% that would apply at age 65. As a result, your initial nest egg in that example should be roughly 26.3 times the size of your annual withdrawals. If you retire earlier than that, you should be able to shave off a little less than 1/10th of one per cent for years from age 55 to age 60. So if you retire at 55, an initial withdrawal rate of about 3.2% should be reasonable. By similar reasoning, if you delay retirement past 65 for a couple of years, it would be reasonable to increase your initial withdrawals by about 1/10th of one per cent per year.

Can we afford a high-end retirement in Costa Rica?

Photograph by Jason Franson

Also, if you were born after March 1958, you're affected by government plans to transition the start date for OAS from age 65 to age 67. In that case, you'll need additional savings to replace delayed OAS, currently $6,550 a year for long-time Canadian residents. If affected, you should add the amount of OAS you'll have to replace—up to the equivalent of two years worth of OAS—to the size of the nest egg you'll need at age 65. If you retire earlier than 65, you'll have to add additional dollars to your nest egg to bridge the longer gap before OAS starts.

If the cost of early retirement seems prohibitive, another option may be to work part-time or on periodic contracts. Assuming you can find a part-time job that you enjoy or at least that you don't dislike too much, that's a good way to stay active and socially engaged. If you can cover half your spending needs with part-time pay then you can retire roughly twice as early as you could otherwise afford.

READY, SET, GO

The numbers in this story should give you a rough idea of what your retirement will cost. If retirement is still decades away, it should be enough to give you a sense of how much you will need to save. However, if retirement is getting closer, consider hiring a qualified financial planner who can provide detailed projections that are tailored to your objectives and particular circumstances. It will give you peace of mind that you're on the right track.

While it's a good idea to use a plan as a guideline, lots of unexpected things can happen to throw you off track. You'll have to make plenty of adjustments as you go. Do that and chances are you'll be able to achieve a satisfying retirement. Says Walkington: "Most of us are able to live some version of our retirement dreams if we're open to possibilities of how best to make the numbers work." M

Karim & Catherine Keshavjee

Edmonton

Realtor, 50 | Admin. assistant, 47

GOAL

The couple wants to enjoy an upper-midde-class retirement in their mid-60s in Costa Rica with an after-tax annual income of around $90,000.

Current combined annual salary
$105,000

Annual retirement savings
$11,000 (10.5%)

Value of investments and equity in rental properties
$320,000

Other assets
$280,000 equity in their home, $5,000 in their kids' RESPs

ARE THEY ON TRACK?

Karim and Catherine need to save considerably more than they are now to achieve their goal of an upper-middle-class retirement. If they save 20% of their income plus RRSP refunds for the next eight years while they are also building up RESPs, then 25% in the following seven years, they can expect to end up with just over $1 million at retirement when Karim is 65 and Catherine is 62. When combined with government benefits, that should provide them with a retirement income before tax of about $63,000 a year. While it's well short of the annual income they were aiming for, that amount should bring them close to the equivalent of an upper-middle-class Canadian retirement, given that the cost of living is cheaper in a country like Costa Rica. However, one note of caution: With two rental properties and Karim's career in real estate, they have a lot of their financial future riding on the Edmonton real estate market, so they should consider diversifying their investments. **DAVID HODGES**