

A NEW DEFINITION OF RETIREMENT

In 2001, Stats Canada presented some figures that form the basis of this new view. And, since the concept is the same regardless of numbers, I am purposely using approximations to make the point that we need to consider which bottom line to look at when we make financial decisions.

Consider that the average working person settles into a career at about age 30 and intends to work for approximately 30 years. When they finish working they hope to live another 30 years to age 90. Right now, when we leave work it's called retirement, and we tend to think of it as something we do when we reach a certain age. Our average person hopes to fund a retirement that is equal to the same amount of time they spent working. To do this they start to accumulate money and logically want to know "how much money will it take" to support their retirement? The answer is really quite obvious, yet not readily discussed or promoted. In order to leave work and "retire" we must have enough financial resources to provide the *income* necessary to pay for the lifestyle we desire. When this happens we are financially independent. So our average person is really working to develop *income* to provide financial independence within 30 years. **This is the first concept: retirement = financial independence which may or may not correspond to any particular age.**

If our average working household earns about \$60,000 per year or \$3,000ish per month after tax, and for 30 years they receive at least a cost of living increase each year, they will have earned over \$1.5 million during their lifetime. If we subscribe to the popular belief that to retire we need to accumulate a large sum of money by saving as much as possible and getting a good return on our investment, then we naturally want to know *how much* money we need to save? We could answer this hypothetically several ways:

- a) Close to the same amount money as was earned over our working lifetime (\$1.5 million);
- b) Maybe 70% of our pre-retirement earnings because we have been told that retirement expenses will be less than working expenses since everything will be paid for;
- c) A number projected forward based on our current savings; or,
- d) Any number we randomly pick such as the popular \$1 million.

The answer, then, to *how much* will really depend on the individual and their lifestyle choices outside of work – and what amount of *income* is required to support this lifestyle. If we estimate our figures, the asset accumulation model of retirement says that our average household needs somewhere between half and all of what they earned during their lifetime to fund their financial independence – about \$750,000 to \$1.5 million. These figures are commonly forecasted in retirement projections and it's easy to calculate that at various rates of return (say 6, 8, 10 or 12%) on your savings you would need to be putting aside \$500 to \$1000 a month for the 30 years you are working to reach this goal.

Now consider the average take home income - \$3,000 per month and answer these questions:

- How much is a mortgage payment?
- How much is a car?
- How much is food?
- Or, children and entertainment?

Statistics show that the amount the average household is putting towards savings is less than 5% of income. That would give them approximately \$200,000 after 30 years (or approximately \$1,000 per month) towards their financial independence. Even with some government pensions added to the equation it's probably not what most people intended to work 30 years to create.

If we really want to cloud the current view on retirement saving, we add in the statistics on personal debt, and quickly see that a change in perspective is not just a cute idea; rather it is a critical requirement! Personal debt, outside of mortgages, for lines of credit and credit cards in Canada is in the neighbourhood of \$70 billion plus. Approximately 15% of our average household's pay goes to pay this debt – close to \$500 per month.

Why don't people see this and become more diligent about their saving and spending habits? There are many reasons, but one theory is that the amount of money we are suggesting they accumulate is so far from reach that they just ignore it and hope for a windfall. This lottery mentality is why many people still say they are hoping for a "big win" and continue to postpone their future planning.

Currently, someone reaching retirement will be advised to be extra careful with their accumulated savings because they don't want to lose it all because it's all they have. They make their financial decisions based on fear of not having enough or of outliving their money. For 30 or more years they focused on saving and getting a good return to increase their asset pool. Now we change the plan and say "don't lose it - but spend it - but not too much because you might run out".

So here's **the second concept**: Which number is more believable - \$1.5 million or \$3,000? What if we promoted the income that could be generated from an investment rather than simply how much it will accumulate to? For example, "you could invest \$5000 at 5% and accumulate approximately \$20,000 in 30 years" – or "you could invest \$5000 at 5% and receive approximately \$100 per month from the accumulated value after 30 years". Getting a good return is obviously important, but **ultimately it's a source of ongoing income we need to become financially independent**. Our average household needs to develop an income of \$3,000 per month. If this seems obvious, then why isn't this information readily available? And why is it so difficult for people to answer how much *income* they need to be financially independent? Because it's just as obvious that we need to spend less than we earn, and that in order to live we need a source of income, but it is easier to spend money than it is to save it, and it's simpler to live with what we have than to project into the future. This new view simply suggests that we **change our focus from asset accumulation and lottery thinking to a focus on developing ongoing income so we can retire financially independent--at whatever age we chose**.

