Following the 70-per-cent income rule could mess up your retirement plans

Some experts say the often-cited figure is no longer reliable

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ISTOCK

An often-cited rule of thumb is that you'll need 70 per cent of the income earned in your later working years to live comfortably in retirement.

But many experts say the 70-per-cent figure is no longer reliable given the different ways people save for retirement today – and the unique lifestyles they have when it finally comes.

"Rules are shortcuts that, in many cases – especially where one's long-term financial security is concerned – aren't worth taking," says Rona Birenbaum, founder and certified financial planner at Caring for Clients, a fee-for-service financial planning firm in Toronto.

The 70-per-cent rule dates back to when single breadwinners could draw on funds from defined-benefit pension plans, Ms. Birenbaum says. Those pensions are increasingly rare in today's workplaces.

Also, employees today tend to change jobs more often, which means even those with a defined-benefit pension are likely to accrue less in it compared with older generations.

Instead of focusing on income, Ms. Birenbaum believes it's better to look at after-tax cash flow, particularly for couples who can take advantage of various income-splitting strategies and tax-free savings accounts to help reduce the family's overall tax bill.

The 70-per-cent rule is also problematic with today's longer life expectancies, especially among people who are investing conservatively in low-return products such as guaranteed investment certificates (GICs).

"Seventy per cent was easier to achieve when interest rates on GICs were 6 or 7 per cent," Ms. Birenbaum says. "But now they're 1 per cent, and it requires a whole lot more capital to generate your cash flow."

On the spending side, Ms. Birenbaum points to the argument that 70 per cent overestimates the cost of living in retirement.

However, she's had many clients who find the opposite to be true: Some seniors continue to make mortgage and other debt payments and support adult children, while also facing skyrocketing costs for long-term care insurance.

"I'm not comfortable saying to somebody, 'Your expenses are going to go down and then flatline.' I just don't see it that way," she says, especially as many people's lifestyles and needs change in their later years.

"Instead of spending money on travel, they're going [to] want to be in the position to be able to spend it on additional services to enhance the quality of their life."

Simon Tanner, principal financial adviser at Dynamic Planning Partners in Vancouver, says the ideal income in retirement is "an age-old question" that's difficult to answer.

Outliving your money is always a concern, he says, especially today with people living longer, and many retirees more adventurous and energetic than they were decades ago, when the 70-per-cent rule was developed.

He suggests people move away from thinking they'll need a certain percentage of their working income in their senior years and instead plan for active and passive retirement phases, allocating funds to each.

For instance, Mr. Tanner says someone might choose to travel a lot in the early retirement years, which will require more spending.

Warren MacKenzie, head of financial planning at Optimize Wealth Management in Toronto, believes the 70-per-cent rule is problematic because it tends to stay away from using up capital.

"Some people might think they need pension income and investment income equal to 70 per cent of their preretirement income," he says. That might be a good calculation for some, he says – for instance, if they want to leave a large estate to their heirs.

"But if they're comfortable spending their last dollar on the day they die, there's nothing wrong with spending capital," he adds, which includes the money they have tied up in their house.

"The most important thing is for them to be clear on their goals," Mr. MacKenzie says, including the amount – if any – they want to leave to children.

He suggests people set aside the "essential capital" they require to live, which would be invested conservatively and left to heirs when they die, and consider the rest as "surplus capital" – to do with what they want.

"If you have a surplus, and if you know that, well then you can enjoy it. You can spend more, you can give to the kids now, you can get involved with a charity – you can do what you want," he says, while recommending people work with advisers to develop a personalized retirement plan.

"A proper plan will allow you to enjoy your retirement."

While guidelines such as the 70-per-cent rule are unreliable, they can be useful as "a litmus test to say, 'How worried should I be? How urgent is it for me to figure this out?'" Ms. Birenbaum says.

Such rules of thumb are also helpful if they encourage people to develop a financial plan that considers their individual needs and wants in retirement, she says.

The benefit of such a plan, she adds, is that it can build in scenarios for unexpected life events such as a job loss, a health issue or even a financial windfall that can affect retirement goals.

"I can't tell you how often clients' lives change, pretty much making their prior projections useless."

Special to The Globe and Mail

'You can't buy food with your eavestrough'

PAUL BRENT

ISTOCK

House prices have been on a decade-long tear, led by big cities such as Vancouver and Toronto, making owners of even modest homes paper millionaires. For a surprising number of Canadians, ballooning property values have made the family home not only their biggest asset, but the main source of retirement income.

A 2017 Ontario Securities Commission survey found that almost half of Ontarians aged 45 and up are counting on rising home prices to fund their retirement. The research also showed nearly 60 per cent of those preretirees surveyed have little or no retirement savings.

"It's concerning," says Sarah Milton, an account manager with Clearpoint Retirement Solutions in Edmonton. "If people aren't saving, or they are starting late and they haven't got a lot built up, it is hard to make ends meet."

Most of her clients have workplace-based retirement savings plans, but she says only about 40 per cent of Canadian employers today provide them, which puts the onus on individuals to save toward their retirement – or hope the house does the heavy lifting.

THE HOUSE-RICH RETIREMENT DILEMMA

That warm feeling homeowners get as prices flare up around them in short, brutal bidding wars may be reassuring, but it doesn't answer the real dilemma of the house-rich: how to monetize their one big asset, which they also happen to live in.

"You can't buy food with your eavestrough," says Kurt Rosentreter, a portfolio manager and certified financial planner with Manulife Securities Inc. in Toronto.

Mr. Rosentreter, who has clients in Vancouver and the Toronto area, says some find the cash windfall from selling their primary residence isn't enough to both bankroll retirement and buy a smaller place in their desired location. Many of his clients want to stay close to their community, friends and family and have access to good health care providers.

"What I am finding is they aren't downsizing enough to leave a capital base to combine with their existing savings that will fund the lifestyle they want," he says.

He provides the example of a retiring couple selling their $2-million home and buying a $1-million condo.

"You give me $1-million, I invest it in a balanced portfolio, I tell you to pull out 4 per cent a year [$40,000 pretax]. You are closer to being below the poverty line than the $120,000 per year you were making three years ago."

There are always solutions, he adds, but most clients nearing retirement don't want to hear what they are, which include moving out of a larger city to a small town, drastically paring back their lifestyle in other ways, or even renting.

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>
> KURT ROSENTRETER
> PORTFOLIO MANAGER AND CERTIFIED FINANCIAL PLANNER WITH MANULIFE SECURITIES INC.

There are also the options of saving more, working longer, or a combination of the two, which also don't often go over well.

"You've left yourself no other choices, unless you work somewhere that you have a $100,000-a-year pension or you married a teacher with a pension. Then you have more choices."

MORE REASONS WHY YOUR HOME IS A BAD RETIREMENT PLAN

The strategy of betting the house will fund your retirement also breaks a few general investing rules, including a lack of liquidity and diversification.

The house-rich couple with no retirement savings has only one illiquid asset, which they may be forced to sell at a time that's not of their choosing, such as in a depressed real estate market. (Houses are generally the definition of an illiquid, or hard to sell, asset, although in today's overheated Canadian markets they're selling more like liquid assets such as stocks and bonds.)

The other warning is that people shouldn't have all of their retirement eggs in one basket.

"It's not only one asset class; it's on one street. It's hard to be more concentrated than that," says Scott Plaskett, chief executive officer of Ironshield Financial Planning in Toronto. Mr. Plaskett says relying on your home value to retire on is "hugely risky."

Ultralow interest rates have fuelled the current real estate boom across much of the country – a phenomenon likely lengthened by the economic downturn caused by the pandemic – but it may have reached its limit.

"There is another shoe that has got to fall," Mr. Plaskett says. "The governments can't print this much money without creating an inflationary environment. Eventually, that's going to catch up to us and the only way to curb inflation is to slowly raise interest rates."

Warren Buffett said this month that his investment company, Berkshire Hathaway, is now seeing "very substantial inflation."

Higher interest rates will likely kill the real estate boom and put the home-based retirement plan in peril. "You run the risk of the value of your home actually declining until interest rates stabilize," Mr. Plaskett says.

The house rich and savings poor may be able to wait out a short-lived real estate market collapse by continuing to work past their planned retirement date or through a reverse mortgage or home-equity loan. But those are all stop-gap measures.

Mr. Rosentreter of Manulife is vehemently opposed to the idea of adding new debt by borrowing against the home's equity to ride out a housing market decline.

"You just lost [a chunk] of your home value. And now you want to add debt on it? No," he says. "[The] reality is that if your home is your retirement plan and we have a major correction before you could materially downsize, then [you need to] keep working."

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