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TAX MATTERS

Make time your ally: Start saving for retirement - now

I had a conversation with my youngest son this week about careers and working. "One day, son, you're going to get up and go to work every day like I do," I said. "Why do you have to work, Dad?" he asked. "So that I can earn money," I explained. "Why do you have to earn money?" he wondered. "So that I won't have to work any more," I said. "If you go to work so that you won't have to go to work any more, why don't you just stop going to work?" he asked. Good point.

The conversation then turned to how we spend money in retirement and where that money comes from. In the end, he decided he was going to start saving for retirement today. He's nine years old. Now, maybe age nine is a little young to think about retirement, but there's a definite cost to procrastinating when it comes to investing for the future. Let me explain.

Jack and Zach

Let's consider two friends, Jack and Zach. Both are 30. Jack is a do-it-now type of person and plans to invest for retirement by setting aside \$5,000 annually, starting today. Suppose he invests \$5,000 annually in his RRSP or TFSA for 10 years (to age 40), for a total investment of \$50,000. He then stops contributing to his plan and allows his portfolio to grow to age 65. Assuming Jack earns a 7-per-cent rate of return on his portfolio he can expect to have \$374,940 at age 65. (I believe 7 per cent is realistic for average annual return over the years in question; it shouldn't be construed as the expected rate of return for 2012 in particular.)

Zach, on the other hand, is a procrastinator. He waits eight more years before he decides to start investing for retirement. Then, starting at age 38, he saves \$5,000 per year, every year, until age 65. Let's assume Zach also earns the same 7-per-cent return on his portfolio and he invests inside his RRSP or TFSA so that there are no taxes on his portfolio annually. Zach will have

invested a total of \$135,000 (\$5,000 per year for 27 years) by age 65. His portfolio will be worth \$372,420 at age 65 under these assumptions.

Did you catch that? Jack and Zach ended up with about the same amount at age 65, but Jack had invested just \$50,000 in total, while Zach had to invest \$135,000 to achieve the same result because Zach started later. By the way, if Zach had started just one year later at age 39, he would expect to have just \$343,380 at age 65, quite a bit less than Jack.

Bianca and Natalie

Consider the story of Bianca and Natalie, twin sisters who are now 35. Each wants to accumulate \$1-million by age 65. So, they have 30 years to invest to reach their goal. Bianca decides to start saving right away in her RRSP. She'll need to save \$10,600 annually to reach the \$1-million milestone assuming she earns 7 per cent on her portfolio over the years. If she wanted to accumulate \$2-million by age 65, she'd need to invest \$21,175 annually assuming the same rate of return. We'll assume she has sufficient RRSP contribution room to make her investment each year.

Natalie, on the other hand, waits just five years to start investing, beginning at age 40. For Natalie to accumulate the same \$1-million by age 65 she'll need to invest \$15,850 annually at the same rate of return - a full 50-per-cent more each year than Bianca. If she wanted to accumulate \$2-million by age 65 she'd have to invest \$31,650 annually. Natalie could run into another issue: She may not be able to contribute to an RRSP all that she needs to set aside annually, because the number is high enough that it could exceed her RRSP contribution limits. RRSPs are ideally suited to be used over many years - not for "hyper-savings" in the last few years leading up to retirement.

The moral

These stories lead to the same conclusion: Waiting to invest for retirement is a very bad idea. Time is your biggest ally here. If you're behind in your own savings, start now - not tomorrow. If you have children, you need to encourage them to begin saving early in their working careers. Consider this: \$1-million will provide a pre-tax annual income of \$60,000 for 28 years

(assuming a 4-per-cent annual return in retirement). To accumulate this \$1-million, it will take \$10,600 set aside annually, invested at 7 per cent, for a period of 30 years, or \$5,000 annually for 40 years.

Tim Cestnick, FCA, CPA, CFP, TEP is President and CEO of WaterStreet Family Wealth Counsel, and author of The Tax Freedom Zone and 101 Tax Secrets for Canadians 2010, among other titles. tcestnick@waterstreet.ca