# Freedom *for the* Road Ahead

**From financial planning to real estate investing, there are many ways to make early retirement a reality**

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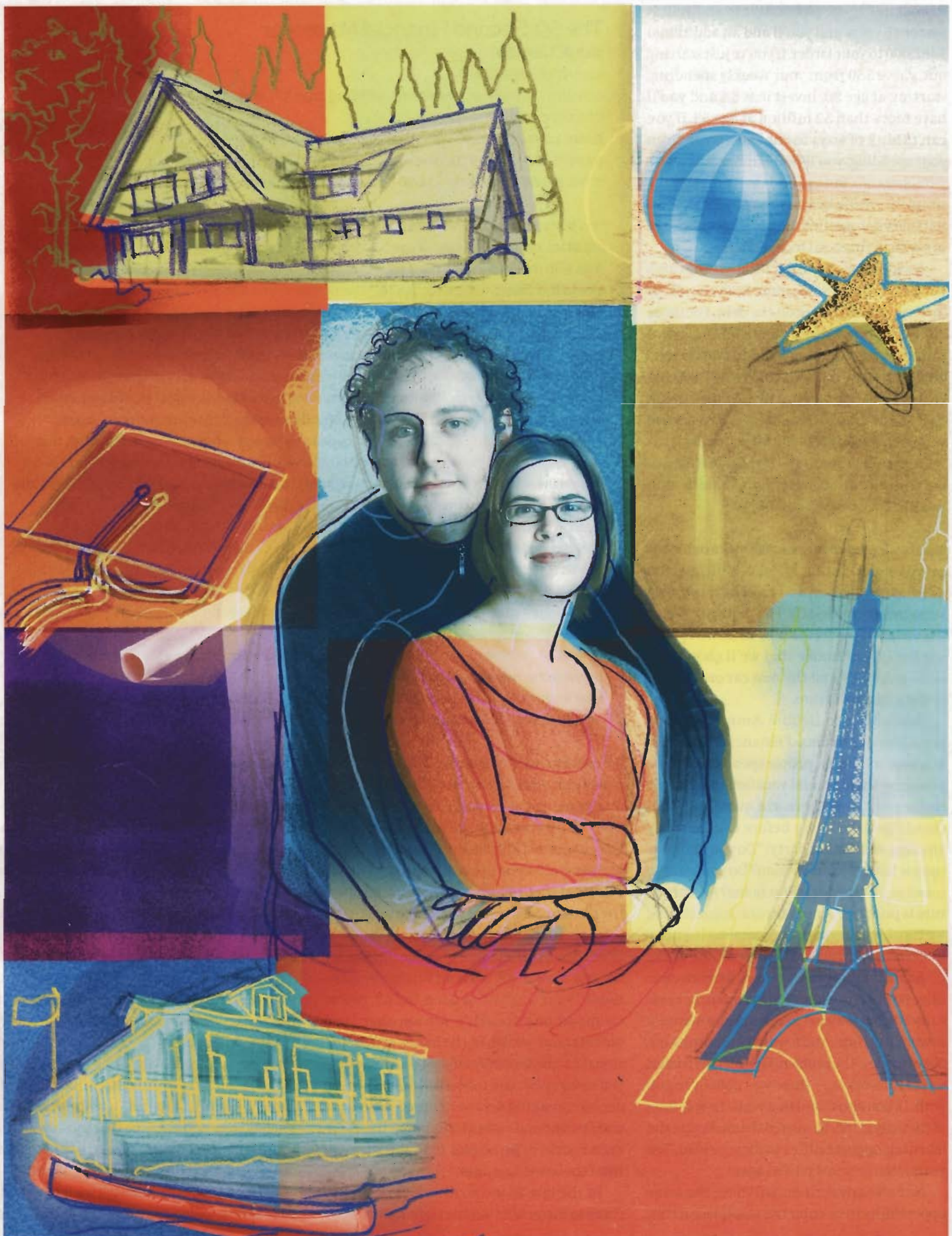
**Financial independence. Early retirement.** Whatever you call it, we want it. Stuck in rush hour traffic, or listening to the boss drone on during another meeting, we dream of the day when every day is like Sunday.

Unless you own a successful business or have a generous pension plan, making these dreams real can seem daunting. Early retirement means we have less time to work and save, and less time to let those savings compound, even though these days we need those savings to last longer than in times past. Veteran financial advisor Rob McCullagh, a certified financial planning instructor at the University of Calgary, refers to a revealing anecdote about three generations of men. The grandfather started work at 17, toiled until age 65 and died 12 years later. The father began work at 22, worked until 60 and died 17 years later. The third generation son began work at age 25, plans to retire at age 55 and may very well live 30 years or more into his retirement.

Despite all of the obstacles, many people will do all the right things to become financially independent at an early age. Will you be among them? To increase your odds, we've outlined some of the problems you'll face – and, more importantly, the strategies you'll need to overcome them.

**Don't let your upkeep be your downfall.** We're all looking for lush investment returns without risk, but your grandmother probably knew more about the formula for wealth creation than today's money managers. In fact, it's tragically simple: if you want to retire early, you must save. And to save, you must spend less than you earn.

Successful wealth accumulators save first. Set up a monthly automatic investment plan and stick with it. And if you're convinced the short-term result will be big trouble at the end of the month, be assured that cutting your expenses doesn't have to be painful. For example, *1001 Ways to Cut Your Expenses* author Jonathan Pond claims you can save up to $500,000 over a 40-year period just by keeping your cars 10 years or longer (save $350 a month in auto lease or purchase payments and insurance, invest it at 5% over 40 years and voila – $520,000). Another high-gain, low-pain strategy is accelerating your mortgage payments. A $582 mortgage payment every two weeks rather than $1,163 once a month (assuming a mortgage rate of 5% on a $200,000 loan amortized over 25 years) will save you more than $25,000 in interest – and retire your mortgage almost four years earlier. Do that by age 40, put that $25,000 and a biweekly contribution equivalent to your



former mortgage payment into an RRSP at 8% for 15 years and you'll add an additional $482,000 to your larder. If you're just starting out, carve $50 from your weekly spending, starting at age 20, invest it at 8% and you'll have more than $2 million at age 55. If you can't think of ways to cut $50 a week from your spending, you'll find hundreds at www.stretcher.com. But the best tip is probably the simplest – think before you spend. Ask yourself that vital question: Is this ____ worth more to me than financial independence?

Avoid borrowing to pay for anything that's not increasing in value more than the rate of interest you're paying on the debt. For those aiming for financial freedom, consumer debt is the enemy. Carrying just $10,000 on your credit cards at 18% will cost you $1,800 per year; pay off the balance instead and invest that $1,800 in an RRSP at 8% over 20 years and you'll have nearly $89,000 for your efforts.

With a few small lifestyle adjustments, we've just created more than $3 million in wealth. The question is, will you?

**Keep your eyes wide open. We make decisions** every single day that affect our ultimate financial destination and most of those decisions involve trade-offs. The motivation is in the vision: if we don't know what we're aiming for, it's inevitable that we'll choose the wide-screen TV and the new car over an uncertain, distant future.

According to Debbie Ammeter, vice-president of Advanced Financial Planning at Investors Group, people spend more time planning their annual vacations than their retirement. But there are questions that should be asked long before the morning after the retirement party: "Do you and your spouse have the same vision? Do you want to travel or just spend time at home? A clear picture is primary." Ammeter also suggests that we consider alternatives to total retirement, like phased retirement with part-time work.

Jim Dillon agrees. He retired from an executive position in the brokerage industry in his early 50s, but it wasn't long before he was back at work full time. And it wasn't because he ran out of money. The problem was that his friends were still working – there was nobody to golf with. Dillon also found that while he was tired of the daily grind, he missed the challenge and learning opportunities work provided. Ten years later, he's now retired again.

Not all early retirees will have the same opportunity to re-enter the workplace if they get cold feet, so it's important to plan well: we don't want a permanent solution to a temporary restlessness. You may even want to consider taking a sabbatical leave a few years before your planned retirement date. By giving yourself some space to think, you may even find that what you want is not early retirement but a new and challenging career.

Once you've hit the sweet spot – accumulated assets sufficient to produce income for the rest of your life without further employment – your work is not done. In fact, you've swapped one vocation for another, and putting your wealth in the hands of a professional can be terribly self-destructive unless you're savvy enough to be a full partner in the decision-making process. There are no hard and fast general rules at this point, but there are a couple of principles that will save you from the worst mistakes.

In the last 15 years, diversification has come to mean holding the right mix of managed mutual funds, but a broader approach is healthier. Begin by thinking about what each asset is for: growth, inflation protection, income, liquidity, or safety of capital? If you understand that your Real Return Bonds (bonds that pay a nominal rate of return plus the rate of inflation) are meant to protect you when inflation rises and provide safety of capital, you won't be disappointed when their returns aren't as high as the latest hot stock.

Consider the most significant risks to your wealth: poor health, divorce, market risk, inflation and your spending. A healthy, fulfilling lifestyle is the best prevention, but Ammeter also suggests that you see a financial planner to help you determine and mitigate the risk of failing health with options like long-term-care insurance that can safeguard against catastrophic expenses which might otherwise decimate your best laid plans.

Be sure you're comfortable with the worst-case scenario. It's easy to work a few extra

## The 60-Second Financial Makeover

**JILL OLIVER:** 28
**BRENT OLIVER:** 29
**COMBINED ANNUAL EARNINGS BEFORE TAX:** $71,468
**CREDIT CARD DEBT:** $3,858
**BANK LOAN:** $31,289 **STUDENT LOAN:** $17,987
**MORTGAGE:** $119,197 (interest rate of 4.89%)
**OTHER INVESTMENTS:** $1,090 cashable GIC and Building Block GIC

You gotta start somewhere. Promotions manager Brent Oliver and his wife, Jill, a library assistant, dream of retiring at age 55. However, they are long way from achieving this goal with mounting personal debt. Financial planner Jim Yih offers four pieces of advice to this younger married couple. "The bottom line is that Brent and Jill need to get serious about reducing their debt if they want to retire early," says Yih. "The challenge for this young couple will be sticking to the basics and accumulating long-term savings."

**STICK TO A BUDGET.** "The word 'budget' in the financial planning world is a lot like the word 'diet' in the health and fitness world. It's not something we want or like to do, but it is absolutely necessary for Brent and Jill. They need to start by tracking their expenses for at least three months and then figuring out what percentage of their income goes to debt."

**PAY OFF THE CREDIT CARDS.** "It is tough to get ahead when you have credit cards that carry 19% to 29% interest rates. That's $1,000 a year paid in interest. In perspective, they are paying the same interest on $4,000 of credit card debt as they would if they had $20,000 line of credit. The Olivers should consolidate their credit card debt using a line of credit or a low interest credit card. Why not use the cashable GIC to pay off the credit cards? The GICs are only paying 1.95% anyways. If Brent and Jill pay off the credit cards, they will have saved 20%."

**SWITCH TO RRSPS.** "Instead of investing into a Building Block GIC, they should purchase RRSPs. The RRSP gives an immediate tax deduction that will provide at least a 26% return in tax savings – a far better savings plan for the future. It makes little sense to save into low interest investments if there are debts to be paid off."

**INVEST IN LIFE INSURANCE.** "With the amount of debt load Brent and Jill carry, they need to make sure their debts are insured. Their cashflow is tight, so it is important they find a really low-cost term insurance. If they are healthy, chances are they can shop around to get better rates than just insuring the loans through their financial institution."

years but it's challenging to get a job at 87 when you've outlived your savings. On the other hand, if you are content with a simple lifestyle, you might be perfectly comfortable living off the Canada Pension Plan, Old Age Security and perhaps the Guaranteed Income Supplement. (Count on a minimum monthly income of about $1,600 per couple or $1,100 per person.)

If you want a more luxurious retirement lifestyle, analysts advise that you shouldn't consume more than 4% of your net worth per year, and if you want your assets to last 30 years or longer, reduce that to 3.79% per year. To achieve an annual income of $70,000 over and above your government benefits (in today's dollars) in 10 years, you'll need almost $2 million and an investment yield in retirement of 6% if inflation averages 3%; just over $1.55 million if inflation averages 2%.

At the end of the day, retirement is personal. The way we earn, save, spend and invest our money is unique, and our success depends on finding a plan that works for us as individuals. For that reason, we wanted to leave you with three very different strategies for achieving early retirement. One of them, or a mix of all three, may be the ticket to your retirement dreams.

**The first strategy is for your inner real estate** titan. Ozzie Jurock, author of *Forget about Location, Location, Location*, is Canada's pre-eminent real estate guru, attracting thousands to his seminars. Many of his devotees report using his advice to build portfolios of rental properties and significant wealth; we asked him how to retire early.

"I tell people to buy a condo, no money down, with a ratio of (rental) income to price of 1% per month," says Jurock. "For example, if you buy a condo for $100,000 you should be receiving $1,000 per month in rent. It pays for itself. Do that five times and you have $5,000 a month. Eighteen or 20 years from now – and we're making the assumption that the value doesn't go up and rents don't increase – you're going to have free cash flow of $5,000 a month."

It sounds good, but how to buy with no money down? Isn't it risky? "You're starting the 'yeah, buts,'" says Jurock. "We think nothing of working all our lives to save $400,000 and then putting it all in the hands of a 25-year-old financial advisor with no real education. Yet when I advise people to buy a condo, they say 'that's too risky!' There are a whole bunch of ways to get 100% financing. It may not be at 4%; it may be at 6.3%. 'Oh, that's horrible,' I can hear people saying. My wife and I owned 28 condos in the '80s when interest rates were 13.5%. If you've got rental income to service the debt, what's the problem?

"There will be headaches," continues Jurock. "There's always something. You have to do the work. You'll have to learn how to be a property manager, but there are thousands of books on the subject. Go to the library."

You've also got to decide if you're an investor or a flipper, adds Jurock. An investor doesn't buy property which doesn't have the rental income to purchase price ratio defined above; a flipper is betting that he'll be able to sell for more than he paid and is taking on significantly more risk should the market turn against him. Do your research, he says. Have a plan of action. Develop relationships with professionals who will assist you along the way. Most importantly, challenge yourself: once you change your belief system, you'll find ways to overcome the obstacles.

**There is power in a plan. Asked if it's possible to** retire early, financial planner Rob McCullagh replies that it's all about how well your foundation is built. Are you successfully and consistently contributing to an RRSP and saving outside of an RRSP? Have you articulated your vision? We also have to be clear, says McCullagh, on the difference between investment and speculation. Speculators may have been burned by the markets in the last five years, but investors with a long-term window see the opportunity.

The first thing to do, he advises, is catch up on your RRSP contribution. According to Statistics Canada, as of 2002 Canadians had accumulated more than $274 billion in unused, allowable RRSP contribution room. But contribution room is defined by actuarial studies to provide for our income needs in retirement, the same way that pensions are designed. "If your employer was behind on your pension contributions," says McCullagh, "you'd expect dramatic action."

It isn't just about retirement, he says, but about building security and comfort. People with savings are in a better position to make decisions throughout their lives. They're also much calmer. "Many of my clients now say things like, 'We didn't think it was possible, but now we've saved a little money and we feel great about getting our statement.' We're not in control of the market," says McCullagh, "but we are in charge of many other aspects (of wealth creation). Make sure you prepare for all outcomes, including inflation."

For help with that preparation, McCullagh believes in the value of professional financial planning. He tells of a client who began saving only $50 a month in an RRSP and $50 in a non-registered plan. Today he's saving $5,000 US a month – made possible by a healthy income and good habits developed early.

Don't get caught in the treadmill of returns, he says, but have the courage to step back and put all aspects of our life in order. It's about vision, consistency and discipline. A financial planner can't help you control the markets, but they can help you get back in control of your own financial destiny.

**Sometimes a simple life is the sweet life.** Alan Dickson, author of *Advance to Go*, doesn't think the stock market volatility of recent years will stand early retirement. "I'm sure there are people there who have made enough to retire by investing in the markets, but I've never met any," he says. "I've met lots who have lost money. I think it may be a good thing when the stock market is down: it doesn't tempt us to get into it.

"We have to focus on the other side, preserving our money rather than making more. The old adage 'A penny saved is a penny earned' isn't accurate in a our tax environment – a penny saved is more like two pennies earned when you consider tax and the cost of going to work. We have to think about where we're spending money.

Asked for an example, Dickson refers to friends, a couple who retired on Vancouver Island at age 55 with a combined total of about $150,000 in their RRSPs. They're now both 66, and, as they intended, their RRSPs are almost depleted. With only CPP and old-age benefits, they're living very comfortably.

"You have to make some choices," says Dickson. "You can't have all the vices. But you can't spend willy-nilly even if you have millions in your RRSP. In 1885, when the average income was $500 a year, Mark Twain was spending $30,000 on household expenses. Then he went broke and had to go back to work. Well, it wasn't just household expenses–he also played the stock market. It isn't how much you make; it's what you spend. People equate happiness with what you have and I just don't see it. There are so many simple things we can do to just enjoy life and it doesn't cost very much."