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RETIREMENT

How much will you need to retire comfortably? Here's how to calculate it, based on your own situation

These two real-life examples and accompanying chart will show you how it's done.

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Mon., May 29, 2023 | ⌚ 7 min. read

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You've probably seen large, intimidating numbers get thrown around when people talk about saving for retirement.

A recent BMO retirement survey found that [Canadians believe they will need to save an average of \\$1.7 million to retire](#).

While that size of retirement nest egg would be nice to have, let's be clear: no one *needs* \$1.7 million to retire. Not even close.

But that begs the question — what *is* a more realistic savings goal? In fact, getting a precise answer is a very individual exercise. There's no single right answer for everyone.

In what follows, I show how to figure out a rough answer applied to your particular situation. To illustrate how to do it, I start with two couples' retirement spending budgets, [drawn from real-life examples described in my last column](#). Then I incorporate other factors at "typical" values and demonstrate how the numbers fit together. The calculations are shown in the accompanying table.

How much do you need to save for retirement?

Based on two examples of middle-class couples retiring at age 65.

		Sheila and Tom	Louisa and Allen
A	Annual retirement spending ¹	\$61,300	\$85,500
B	Minus typical government pension payouts ²	\$42,000	\$42,000
C	Minus employer defined-benefit pension payouts (if any)	\$0	\$0
D	Required annual draw from savings (A - B - C = D)	\$19,300	\$43,500
E	Sustainable withdrawal rate	4%	4%
F	Required amount of savings at retirement (D divided by E)	\$482,500	\$1,087,500

Notes:

1. Includes spending on income taxes.
2. I have assumed OAS and CPP are both started at age 65 and that the annual OAS payout is \$8,290 per person and the annual CPP payout is \$12,710 per person. There is also a modest bump-up to the OAS payout at age 75 amounting to 10 per cent of the age 65 amount or \$830 per person per year. For simplicity, I haven't incorporated the age 75 bump-up into the table or calculations.

The two examples illustrate how middle-class couples can retire comfortably on far less than \$1.7 million, using specific but fairly common assumptions. The first example, based on a modest but still comfortable retirement spending budget, requires retirement savings of less than \$500,000 for retiring at age 65. The second example, which supports a moderate spending budget that I would say is slightly above average, requires savings of almost \$1.1 million for retiring at the same age.

As the table shows, start with annual planned retirement spending. Then deduct how much of that spending is expected to be covered by government pensions and employer pensions. That results in retirement spending that must be covered by drawdowns from savings. Then divide that figure by a withdrawal rate that should be sustainable through a long retirement. That, in turn, determines the amount of savings you should have to start retirement. We discuss each of these factors below.

The dollar amounts in this table are expressed in terms of today's purchasing power in "real" dollars, so that the effects of inflation are removed. Going forward, the amounts for spending, pensions and saving drawdowns should keep pace with inflation and allow you to maintain a stable standard of living.

One key assumption is that the numbers in this table are based on retiring at age 65, the traditional retirement age. If you retire earlier, you will need greater savings because it has to stretch over a longer retirement. If you retire later, you can get by on a bit smaller nest egg, because it doesn't need to last quite as long. (Adjustments for retiring early are discussed below.)

Retirement spend

Start with the amount you expect to spend to get your planned retirement lifestyle, which is shown in Line A. This is the annual cost of living that you anticipate maintaining throughout retirement.

We use planned retirement spending budgets for two couples as examples, as provided by certified financial planner Janet Gray of Money Coaches Canada. (Names and other identifying details have been changed to protect their privacy.)

A couple we have called Sheila and Tom plans to spend a combined \$58,000 a year for a modest retirement lifestyle. Allowing for typical income taxes of \$3,300 would bring total spending to \$61,300.

Another couple, Louisa and Allen, are planning a larger but still moderate budget. They plan to spend a combined \$77,000 a year on their lifestyle. Assuming typical income taxes of about \$8,500, that brings total spending to \$85,500.

Further details about both couples' budgets and lifestyles are described in a previous column, "Modest, but enough: Two middle-class couples share their retirement budgets," which can be found at [thestar.com](https://www.thestar.com). (Note retirement budgets are tougher for singles, because they generally can't share costs for things like cars and accommodation the way couples can.)

Allowing for pensions

In Line B, I show combined Old Age Security (OAS) and Canada Pension Plan (CPP) payouts of \$21,000 per person or \$42,000 per couple, based on both couples retiring and starting their pensions this year at age 65.

The total assumes an annual payout per person of \$8,290 for OAS (the current maximum age 65 amount) and \$12,710 for CPP. That CPP amount is based on contributing to CPP over a fairly long career at mostly average wages or better, although it is short of the current age 65 maximum starting CPP payout of \$15,680.

Long-term residents of Canada generally get the maximum OAS payout, so that is usually straightforward to determine. Figuring out your CPP payout is more complex. (Consider financial planner David Field's cppcalculator.ca if you're looking for help estimating it.)

While our examples assume government pensions are started at age 65, you can choose to start CPP as early as age 60 at a reduced rate. You can also defer the start of CPP and OAS up to age 70 and earn enhanced payouts.

The traditional employer defined-benefit pension is increasingly rare outside the public sector, so I assume a \$0 amount in this example. But if you do have an employer pension of this kind that is also indexed for inflation, insert the age 65 annual payout amount on Line C. (Note an unindexed pension would require a more complex adjustment.)

Annual retirement spending that isn't covered by government pensions or employer defined-benefit pensions needs to be paid for out of your savings. That's shown in Line D.

Withdrawal rates and savings goals

Now we tackle the tricky question of figuring out how much you can draw from your savings at a sustainable rate that involves little risk of outliving your wealth.

Just what this rate should be is heatedly debated by experts, but four per cent for retiring at age 65 is commonly used, and I believe it is appropriate for many people. (In my view, under the right circumstances, it is possible to justify bumping the withdrawal rate slightly higher, but you should only do so with caution after a careful assessment.)

The sustainable withdrawal rate (in Line E) is then divided into the required annual draw from savings (Line D) to get the required nest egg amount for retiring at age 65 (Line F).

As a result, to realize their retirement spending goals based on these assumptions, Tom and Sheila should have savings of about \$482,000 when they retire. In the case of Louisa and Allen, they should have about \$1,087,000. Generally, those savings objectives should exclude the value of the home they own and live in.

When implementing the plan, in the first year of retirement you would withdraw four per cent of the initial amount in your nest egg at retirement. (In Sheila and Tom's case, that four per cent times \$482,500 equals the \$19,300 in Line D.)

In subsequent years, you increase the previous year's amount by the annualized inflation rate, so that the "real" value of retirement spending is maintained at a constant level. (If inflation is three per cent, Sheila and Tom's actual draw in the second year would be \$19,300 plus three per cent for a new figure of \$19,879.)

Early retirement

Doing precise calculations to adjust the figures for retiring earlier or later than 65 can be complex. But for retiring earlier than 65, here is my suggestion for a rough adjustment. Firstly, reduce the withdrawal rate by 0.1 for each year you retire prior to age 65 (but not earlier than age 60). So in the case of Sheila and Tom retiring at 63, their withdrawal rate would be 3.8 per cent. That adjustment would bring their required retirement savings up to \$508,000.

For simplicity, assume CPP as well as OAS are both still started at age 65, resulting in the need to use withdrawals from savings to substitute for two years of government pension payouts. That would add \$84,000 (\$42,000 times two) to the required nest egg size. That brings the total savings requirement to \$592,000 (\$508,000 plus \$84,000).

Bottom line

If you do the calculations and are unsatisfied with the results, you should review your alternatives. Figuring out how to save more or work longer are obvious options. But you should also review retirement spending goals. Many people think they need to spend more in retirement than they really do. Often, you can achieve a more appealing result by being creative, flexible and prioritizing carefully.

Also, understand that this column provides a brief summary of a general approach to a complex topic. To take it further, many people would benefit from getting an in-depth retirement plan based on their individual situation prepared by a qualified financial planner.



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