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Canadian 30 Year Olds are Screwed

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I'm a Chartered Accountant and financial planner. For the last five years, I have helped dozens of 28 to 40 year old individuals and couples plan their finances. Despite the title, I am writing this article because I am worried about them all – I'm afraid they are headed down a road of financial disaster that could ruin them for life. Read on.

I quite enjoy working with young Canadians on their finances. Often financial advisors refuse to help young people because they don't have enough money. I don't look at it that way – at around 30, some of the biggest financial decisions of one's life are made: selecting a career, marriage, having children and purchasing a home – for many, the largest financial decisions in their life happen in a pretty tight time window. With so much at stake, making the right structural decisions are vital –for it sets the stage for the rest of your life. Make the wrong decisions and there may be no recovering.

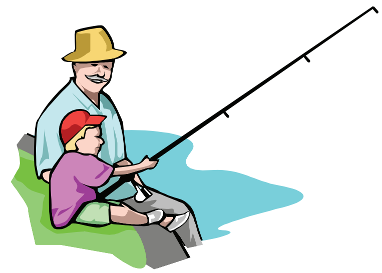
So let me describe my last five years and why I am worried about young people. I feel there are a combination of circumstances that have come together (a perfect storm, so to speak) in recent years to make it almost impossible for young Canadians to get ahead long term. These variables are as follows:

People Spend More Time on the Internet than their Finances

There has been a culture shift in the last 20 years to almost a complete disregard for being responsible with our money. We have all heard about the war and depression era elders who drive their cars for ten years, don't use credit cards, saved regularly and paid off debt fast. Today's young even look at these wise old folks as backward, "cheap" and out of touch. Frankly, it is the young people who are on the road to financial ruin – today's attitudes are almost the complete opposite of our grandparents where "put it on plastic and pay later", take as much debt as we can get, pay off mortgages over 35 years, lease cars, $20,000 vacations and $300 shoes or concert tickets is a norm. Since when does a 16 year old need a $100/month IPhone? Part of this attitude I blame on parents where, at any income level frankly, the parents give the kid whatever they want – lucrative allowances with no work behind them or simply jut an attitude of you spend and daddy & mommy will pay. Unfortunately school budgets (and perhaps priorities) also leave our high school kids woefully lacking in basic financial knowledge - there are no courses on how to manage credit cards, how financial institutions work, what a stock is, when to save for a house deposit, details about disability insurance and so on. After school, our kids don't have a clue about basic money management. As one 60 year old recently told me: "Kurt my 26 year old daughter lives at home with us, only has a part time job working in a mall, spends $4 every four hours on Latte's, orders $30 pizza delivery weekly, just came back from a week in Cuba and doesn't have two dollars in an RRSP, Tax Free Savings Account or even a basic savings account. Worse she could care less about learning about finances – she is more concerned about how many friends she has on Facebook". Folks, these are our young people: you have all seen them – without the basic common sense around personal finance they eventually turn into 30 year olds that make up the rest of this story. And then 40 year olds who are swimming in good cash flow (often six figure family incomes) yet can't manage an RRSP contribution yearly but are happy to pay a lawn service company $500/year to trim the shrubs. Education about basic finances should start at 10 years old – take your kids to the instant teller with you - show them how it works and build from there.

I Wish I Had my Grandpa's Pension – but I Don't

No one has pensions anymore. When our 80 year old parents worked 30 years ago, most Canadians could count on a sweet defined benefit pension to be waiting for them at retirement at age 55. This guaranteed pension provided a permanent base of cash flow, often inflation indexed as well, alongside CPP and OAS until death. While our parents didn't have a lot of money for new cars and big vacations thirty years ago, they did have a fine quality of life and lived within their means. Today, defined benefit pensions are almost entirely gone – unless you are a teacher, police offer, nurse or one of the few lucky souls in a couple of big companies that still offer them. The rest of us have been left to fend for ourselves – either with no pension plan at all, or a basic group RRSP or defined contribution plan that offers no guaranteed pension. What you and the company contribute is all there is. This is a far cry from a defined benefit pension plan and will leave most employees with shockingly little to live off at age 60 or 65. In 10 years of reviewing DC employer pension plans I have yet to see a single plan that would provide an exceptional quality of life in retirement. To make matters worse, most employees in big companies get no educational planning support around these company savings plans, and have no clue how bad off they truly are.



Add to this that the typical 30 year old may have six different employers (or careers) due to restlessness or terminations before they retire – this means that the employee is never anywhere long enough for much pension or other compensation to accrue. Again, reflect on the past: our parents worked for one employer their entire life, were extremely loyal and benefited from seniority, unions and growing compensation, pensions and benefits the longer they were there. Most of that is gone today. It is routine to see 50 year old professionals that have had three or more employers (so far) and with retirement only ten years away, have little or nothing to show for it financially.

Debt Disaster Cause by Choking Real Estate

People have gone real estate crazy in the last decade as the low cost of mortgages has caused a frenzied market for the purchase of detached homes, condos, cottages and spurred massive renovations to existing properties. "Starter homes" in major Canadian cities can cost more than $500,000 today – prices that twenty years ago were considered only available to the wealthy. Now 30 year old kids making $60,000 a year are getting mortgage approvals to carry massive mortgages and think nothing about amortizing it over 35 years – ridiculous. Further, thirty five year olds think nothing about dropping $50,000 on a kitchen upgrade or a bathroom because, after all, it has to be done – we can't live like this. On top of the monster mortgage, these kids are carrying sometimes six figure lines of credit as well. All these 30 somethings are leveraged to the hilt. No wonder the papers are full of stories of how Canadians now have some of the highest debt levels in the world – I have seen this happen over the last five years – my life has been full of dealing with everyone's 30 year old kids. The story has been the same every time: recently married or a baby on the way and they want to buy a home. I ask them what they have saved for a deposit – often no more than $10,000 between them both. Perhaps their parents are chipping in some cash. And they want to borrow from their RRSPs through the Home Buyer's Plan – always a terrible idea – stealing from the longer term goal of retirement.

I pull out my calculator and tell them how much they can afford. Off they go. A week later I get a call to say they bought a home. Did they stay within my limit I ask? Well....no, there was a bidding war. I am horrified to learn that they spent $50,000 more than planned. And that's before closing costs and furniture, property taxes, a new roof and a new car to commute. The stage is set for disaster now. When a couple commits to a huge mortgage that commits more than one third of their net cash flow to debt servicing and fixed costs of ownership, the cracks in their life will start to appear after a few years. Unless they have huge annual incomes, there may be no extra money for vacations, for renovations, to buy new cars or even basic furniture. Inevitably these costs end up on lines of credit, adding even more debt, well, because, they have to have it. I have routinely walked through the homes of couples that are so burdened by big debt that rooms in the home have no furniture. I know why: there is no money for it. Sometimes this can even lead to divorce.

Interest Rate Ticking Time Bomb

Next is interest rates – Canada is full now of monster levels of mortgage debt for the average Canadian all financed at floating 1% mortgage rates as Canadians have taken advantage of the record low rates to buy homes the last few years. So, all the kids with the mega debt are floating in variable rates at 1%. What happens when (when, not if), mortgages rates return to traditional levels of 5% to 8% for a five year closed mortgage? Is this on the horizon? Are we currently the US market three years ago, slowly heading towards real estate disaster in Canada? Will mortgage rate resets over the next several years cause mortgage payments to balloon, young couples to declare bankruptcy as they crumble under the weight of debt and bring our tiny real estate market crashing down to levels never seen before? Never happen right? Let's hope not.

Not Much Changes at Age 40

Since you left high school and could enter the work force, age 40 is the half way point up the hill towards potential retirement at age 60. You have already spent 20 years building wealth and what do you have to show for it?

If these 30 year olds do survive the first few years of mega debt levels, what about the long term? Ten years later at age 40, with so much money going from every pay cheque into mortgage payments, car lease payments and credit card payments, 40 year olds are often woefully behind in savings for their children (RESPs) behind in their RRSP savings and likely don't have a dollar in Tax Free Savings Accounts yet.

The Kids Go To College Before You Retire

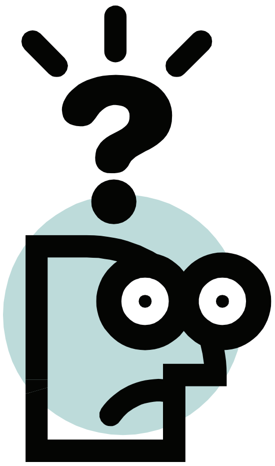
Let's start with the kid's savings – if you had kids around age 30, the kids are now heading to university in only ten years when the parents are 50 years old. With the cost of four years of university easily approaching $100,000 per child in 2011, failing to put gobs of money away for the full 18 years of the child's life could see parents buried under new debt, school debt, at age 50. You need to be mortgage free by age 50, 55 at the latest, to create extra cash flow to help the kids through school. That's why 25, 30 and 35 year mortgages are insane. Twenty years max – or don't buy the place because you can't afford it. If you have any plans to retire around age 60, you need that last ten years to be putting money into savings during what is supposed to be the big income years of your life. But if you float through your 50's paying for the three major financial goals of paying off debt, retirement savings and kid's education, I fear that on a regular wage you won't be retiring at age 60 – not even close. And, if you had your kids later in life like many are today, don't plan on retiring until they are through post secondary school. That's a good general rule to follow – not too many folks can afford $10,000 tuition fees on a retiree's income.

What Do You Need for Retirement?

At age 40, with retirement ideally only 20 years away, you need to save a good $1.5 million dollars quickly. Had you started at 22 and put the $4 Latte money (and more) into a new RRSP, savings at age 40 would have you well down the road to proper retirement savings by now. But now, only starting to focus on retirement savings at age 40 is almost certain doom unless you start to save massive amounts fast and yearly without fail. Even twenty years out from retirement we are in the homestretch already – there is not even enough time to benefit from the compounding impact of savings. Add to this that bond yields are at record lows (around 2% for a one year GIC currently, March 2011) and the new stock market seems to have a major correction every five years, and you need to save even more than you thought. A lot more.

At 40, with career developing, family established and home purchased, now is the time to buckle down and save for your financial goals – it is not the time to do a kitchen renovation or buy a second residence. You can retire on plan but it requires disciplined savings – tying up more money in real estate that I don't believe you will ever sell or downsize doesn't help us with your retirement needs. And be careful: planning to work until you are 70 is not the easy answer either – sure, you can plan to work but a stroke, heart attack or even a car accident can retire you early. Without proper savings in place, a premature retirement due to illness may leave you with 40 years of a less than ideal quality of life. Practically, we all need to strive to have our financial savings in place by age 60 and work because we want pocket change beyond that, not because we need to work. If you don't have your core savings levels reached by age 60 and must work to eat, then back up your income by top notch disability and/or critical illness insurance until you do retire.

Waking Up 50 One Day And Getting the Deer in the Headlights Look



Age 50 in Canada is an interesting age today. I do more financial planning for 50 year olds than any other age. It's like they woke up one day and a light went off – that after 20 years of working hard, raising a family and paying off a home they pop their head up and realize they don't know where they are. The three major finance issues are suddenly converging all at once: they are supposed to be mortgage free at age 50, the kids are starting university next fall and $10,000 of tuition is due now and lastly they realize retirement is supposed to be ten years away. Holy smoke – all at once. Welcome to age 50. Are you prepared? So in my practice we prepare a financial plan based on their goals and show them how to achieve all three major financial needs. Today's 50 year old will make it – they are the last generation to get in before the big mortgages hit and they may still get inheritances from their financially responsible, recession era parents who will die in the next 20 years, providing money for their retirement thankfully. It's today's 30 year olds who will be 50 in twenty years that are screwed. With little hope of being debt free in 20 years, with a bad attitude towards savings and debt elimination, with rising costs of children's education, no pensions coming, frequent career change, wild stock markets, record low interest rates and longer and longer life with rising health care costs, today's 30 year olds need to win the lotto to have a hope of achieving their financial retirement as culturally expected in Canada. Working to age 70, albeit part time, may become the norm for many in the next twenty years.

There Is Hope

It doesn't have to end up this way. Having your cake and eating it too is possible with a bit of fiscal responsibility starting now – and keeping it in check forever:

Massively limit what you invest in your home. You cannot afford to pay big mortgages for decades. You need to get debt free fast (by age 50) and move onto the other goals of saving for kids and your retirement. Do not buy bigger homes. Do not do big renovations. Do not purchase second recreational properties. I am ok with a rental property as it will contribute to your finances long term. The average Canadian family without pensions cannot afford big real estate investments and hope to achieve their other goals - plain and simple.

Select employers and careers that offer defined benefit pensions. Ok, this is far fetched, but having the employer taking care of your retirement savings is a huge weight off your back and allows you to focus on children's savings and debt elimination. You may be more likely to achieve all your goals if the most expensive one of all, retirement, is taken care of by your employer.

Save more – what is remarkable is the number of people I see that have six figure annual incomes and little or no savings. We all have the ability to save and pay down debt faster, but we have to want to do it. This all can end up well, if you want it to. I see families of four living successfully in expensive Toronto off $50,000 a year. I see folks earning $150,000 a year who cannot save $10,000. Set some rules for savings and stick to them. No matter what.

Plan to live off less in retirement. I don't recommend this but it is an option. It is hard to do because people are living longer and it is getting more and more expensive to live. Look at how gas prices change day to day – who knows what it may cost to live forty years from now –plan on living to age 100 - likely one spouse might – it just may happen and you don't want to be broke. It bugs me when I read the news and see so-called experts telling readers that you don't need to have a lot of money to retire. I agree, you don't. We can move you up to northern Ontario where you can buy a home for $50,000, play cards all winter, never buy new clothes, a new car or take an out of province vacation. Sure, we can all do that. But in today's modern age of "me, me, me, buy, buy, buy, want more, want more, want more, *who wants to live like that*? And there's the rub: people today want to take big vacations, they want the latest IPad, they want HD cable and a smart phone – all of this costs money. No one wants to live like his or her parents did 30 years ago. Today we all want nice things, always. Well, nice things cost a lot of money – money you don't have if you don't follow the rules in this article.

Work longer. Ok, here's a happy spin on working past the traditional retirement ages of 60 or 65. Plan to work to age 70. But work part time. Do something you love. Limit the commute. Take summers off. You will never regret the freedom you will have – freedom to spend at will, freedom to travel, freedom to help the kids out and freedom to join the country club. But work by your rules and do it longer. If you don't do this, you'll have to work by my rules in retirement: a strict budget, where I review your costs and have to approve what you spend. You don't want this. You don't want to have to tell your spouse at age 72 there isn't enough money to winter in Florida this year. You don't want to have to look at your investment portfolio everyday and wonder if there will be enough. Plan ahead. Don't let this be you.

Final Thoughts

In closing, I saw an ad recently that showed that Canadians spend ten times (more actually) more time watching videos on line than they do looking at their finances in a year. In many ways, that really sums up this article and my concerns for today's 25, 30 and 35 year olds. The solutions are at hand – it comes down to how you play your cards. Look at yourself right now: today, in your career, while the money is flowing, life is good, and it seems like it always will be. You really deserve that week in Barbados and retirement savings can start next year. One more thing on the credit card Kurt, and then I promise I'll be good.

Living for the short term and then you wake up one day and you are 40 and still living this way with little savings and a lot of debt is showing the signs of problems raised in this article and sadly, possibly creating the potential to not reach your financial goals and dreams long term. Get a financial plan. Establish short term, medium term and long term goals. Write it all down. Implement strategies. Follow up. Measure progress. Adjust the plan. Repeat year after year. Use a financial planner to keep the plan objective and non-emotional. Good luck Canada.

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