



Planning for Retirement

How long can you maintain your current lifestyle when you retire?

Many dental professionals combine a primary focus of providing essential health care to patients together with the secondary focus of running a business. Retirement planning, to avoid risk factors that could interfere with preserving your current lifestyle, should be a key component of managing your business today.

Funding a lifestyle requires capital, and capital comes in two forms: human and financial. Professionals have a much greater return from the former than from the latter during their working years. Thus they generally have the capacity to accept more risk during this stage. However, as retirement approaches financial capital becomes the primary source for a future lifestyle. There will either be enough capital to retire comfortably, or it will become necessary to continue working to acquire more.

For many professionals, financial capital will eventually include proceeds from the sale of a practice. Because of the many variables involved, the actual amount received is not known until the sale closes. To help understand the impact that a practice sale may have in maintaining your retirement lifestyle, consider three dentists and their long-term planning.

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Dr. Burns has not saved any money and is relying solely on the sale of his practice to pay for his retirement. At the age of 60, he receives \$500,000 from the sale of his practice. He invests 30 percent in bonds, 70 percent in stocks and would like to have an annual inflation-adjusted income of \$60,000¹ of which a small portion will come from CPP benefits. Considering the historical pre-tax return measures since 1926 are approximately 11 percent for stocks and six percent for bonds, Dr. Burns' pre-tax long-term return will be approximately 9.5 percent. After factoring in taxes, Dr. Burns will likely run out of money around the age of 74.

If Dr. Burns is in good health, he may live into his 90s. Therefore

longevity will dramatically affect his lifestyle. If Dr. Burns delays retirement until he is 65 then he will be financially secure until approximately the age of 78.

Now let's consider the case of Dr. Saves. At the age of 60 he receives \$500,000 from the sale of his practice but he has also been able to accumulate \$500,000 in an RRSP. Dr. Saves will not only be able to maintain his current lifestyle but around his 98th birthday he will have approximately \$2.7 million. Obviously Dr. Saves is likely to be able to maintain his current lifestyle during retirement.

Our examples assume that the dentists receive the same average long-run returns every year. The evidence supports the likelihood of significant variance in annual returns. With no cash additions or withdrawals, you would still receive the average annual return; however, if there are additions or withdrawals over the life of the investment, the expectation that you will be able to maintain your lifestyle can be significantly altered.

Of course you could place all your money in risk-free assets that provide guaranteed returns, but this strategy will not help you maintain your current lifestyle for very long

once retired. For instance, consider the case of Dr. Adverse who retires at age 60, sells her practice for \$500,000 and has \$500,000 in her RRSP. If she only holds risk-free assets that have a pre-tax return of approximately four percent, she will run out of money around the age of 78. The reason that her funds will not last long is due largely to how low her after-tax inflation-adjusted annual returns on her investment would be relative to her \$60,000 income requirements.

So what is the right thing to do? The answer depends greatly on your individual situation, but for the most part a balance with both risk

and risk-free investments is in order. With some careful planning today, you can maintain your current lifestyle long after the sale of your practice, and enjoy your retirement years in comfort.

Timothy A. Brown of ROI Corporation in Toronto points out that the final sale price of a practice may be lower than anticipated. "Items such as a broker's commission, the mandatory appraisal fee, legal and accounting fees, staff bonuses and payments for accounts payable and practice debts (lines of credit, equipment leases etc.) must be factored in to obtain the net proceeds of sale. In other words, don't

rely upon the estimated fair market value. For your financial plan use the **net** proceeds of sale."

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References

1. Average rate of inflation is projected at the Government of Canada's benchmark of two percent.