How to build a million dollar RRSP — it isn't as hard to get there as you think

Getting to a million or beyond before you end your working years is not as hard as it sounds. And there is more than one way to get there

The best route to a million dollar RRSP is to start saving early and maximize your annual RRSP contributions the moment you start to generate earned income. *Getty Images/iStockphoto*

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A generation ago, having a million dollars in the bank was the gold standard for financial security.

Today, with employer-sponsored defined benefit (DB) pensions becoming increasingly rare for younger workers, you may need at least that much stashed away in a Registered Retirement Savings Plan (RRSP) to have any chance of the retirement you want.

After all, even if you can generate a consistent 5 per cent annual return on your investments, a $1 million RRSP would generate just $50,000 a year in income, and that will be taxed once you start withdrawing it (either in the form of a Registered Retirement Income Fund or RRIF, or via voluntary withdrawals from your RRSP).

The good news is that if you're just starting out your career and have begun to embark on a consistent program of saving and investing, getting to a million or beyond before you end your working years is not as hard as it sounds. And there is more than one way to get there.

So how do you go about building a million-dollar RRSP?

We asked wealth adviser Matthew Ardrey, a vice president with Toronto-based Tridelta Financial, to map out our three routes to that threshold. In each case, the goal is to accumulate the $1 million by the time you turn 60.

It should come as no surprise that the best route is to start saving early and maximize your annual RRSP contributions the moment you start to generate earned income. (A reminder that contributions are normally set as 18 per cent of the prior year's earned income, with a maximum contribution in 2018 of $26,230.)

As you will see, the longer you procrastinate in beginning to save, the more you'll have to contribute once you do begin, or the more risks you'll have to take in your investments.

So without further ado:

1. Steady Eddy

We'll call Saver No. 1 Steady Eddy. If Eddy starts saving in his RRSP at age 25 by contributing $10,000 each and every year and can generate a five per cent annual return from his investments, Ardrey calculates he'll pass $1 million by age 60. This is the classic "slow and steady wins the race" approach to building wealth and puts a lot less pressure on you in your later years.

Because of the power of compounding, by starting at age 25 you'll never have to save more than $833.33 a month, assuming you can generate the 5 per cent return normally achievable with a classic balanced portfolio of 60/40 stocks to bonds.

2. Procrastinating Pete

We'll call Saver No. 2 Procrastinating Pete. If Pete waits until age 35 to begin saving in his RRSP, he can still get to $1 million by age 60 but if he's invested as conservatively as Eddy in example 1, he can no longer do it by saving just $10,000 a year. Now Pete has to sock away a whopping $20,000 every year for the next 25 years (or a hefty $1,666.67 every month for a

quarter century.) Remember, that’s assuming Pete can generate the same 5 per cent annual return as Eddy did in our first example.

3. Aggressive Agatha

We’ll call Saver #3 Aggressive Agatha. Like Pete, Agatha procrastinates until age 35 before even starting to save in an RRSP but she’s willing to invest more aggressively (i.e. more equities) to generate a 9 per cent annual return rather than the more modest 5 per cent return generated by Eddie and Pete. In this case, because of these super-high investment returns, Agatha only has to save $10,000 each year, just like Eddie, despite the fact she started ten years later. What’s the catch? Agatha is taking on a lot more risk than either of the first two examples.

“It’s pretty difficult to get 9 per cent constantly,” Ardrey says, “To get that kind of return, you’d need to increase your risk profile significantly by investing in assets like smaller-cap stocks and maybe you’ve even have to be a successful day trader. I wouldn’t want to have to plan for someone to generate 9 per cent a year.”

If you don’t believe you can save this much, do not throw up your hands and conclude there’s no point even trying.

Start saving early, if you can. *Illustration by Chloe Cushman/National Post files.*

Adrian Mastracci, portfolio manager with Vancouver-based Lycos Asset Management, recognizes that $1 million can be a tall order for some and might discourage some from trying to save at all. Instead, he proposes a more modest target of $500,000 by age 65 rather than age 60.

As in the million-dollar example, the earlier you start saving the better: do so by age 30 and even with modest annual returns of 4 per cent your annual savings target would be an eminently doable $6,800. Wait till 40 to start and with those returns you'd have to sock away a heftier $12,000 each year, while procrastinating till age 50 would require a more daunting $25,000 savings every year.

As before, higher returns would mean more modest savings targets: 6 per cent returns would require annual savings of $4,500 if you start at 30, $9,100 starting at 40 and $21,500 at age 50. If you could achieve an aggressive 8 per cent annual return the annual savings targets would be $2,900, $6,800 and $18,400 respectively.

Then there's the matter of what to do with the tax refunds from these RRSP contributions. Eddy's tax bracket is not going to produce large tax refunds in his early years, but his $1 million RRSP/RRIF means he will eventually pay hefty taxes on all withdrawals. He could invest the RRSP tax refunds into a Tax-Free Savings Account each year, and aim to have a more tax-efficient $1 million spread between registered and even non-registered accounts.

This shows there are multiple variations on these routes to wealth, both in the tax treatment of savings and how you invest. Start early and generate high returns and you'd be able to accumulate $1 million well before age 60, or — better yet — you could shoot for a nest egg of $2 million. Nor is there any requirement to retire at the relatively early age of 60: Even in the first example of Steady Eddy, notice how it took to age 50 to accumulate the first $500,000 but that this doubled in the next ten years. By adopting Mastracci's initial goal of $500,000, you might well be motivated to keep going once you reach it, knowing that the second $500,000 will happen a lot more quickly than the first $500,000.

Keep saving between age 60 and 65 and you'd be that much better off, with the added bonus that you'd have that many fewer years to start drawing down on your wealth.

None of this contradicts the perennial wisdom that the sooner you start to save, the better. By starting in his 20s, Steady Eddy is under less pressure to come up with large RRSP contributions every year and doesn't need to take on excessive risk, with all the worries that entails. Those who delay even ten years put themselves under much more pressure, both in the amounts they have to contribute (Pete) and/or the stress of investing more aggressively (Agatha).

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