Prospering in the New Economic Reality

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My last article, *The World is Changing*, highlighted how many fixed living costs are rising, such as housing, energy, insurance and education. At the same time, constantly evolving technology and an endless array of consumer goods has lured many into debt while trying to create the good life. The middle class is shrinking with fewer winners on top and increasing numbers of people who cannot earn enough to afford the lifestyle they expect. Instead of saving their money, many have given in to consumer debt in order to have it all now.

To prosper in the new reality requires a more focused approach than has worked in the past. Here are some strategies for different age groups to overcome today's challenges and build a solid financial foundation:

Young adults: Ages 18 – 30. No question, you have a harder road to travel than your parents did. However, you have time on your side which makes even small savings extremely valuable. To succeed, you must overcome your own "consumeritis" and create a lifestyle that makes saving money your top priority. If your friends are big spenders, let them know you don't want to be in debt for the rest of your life and you actually want to start saving for your future. You might be surprised to discover that some of your friends are feeling the same way. Choose to spend more time with like-minded people and enjoy free and affordable activities together.

If you are in the lucky situation of living rent-free in your parent's home, let your parents know that you are making the most of their generosity by creating an aggressive debt-repayment plan. Once you are debt-free, start building your savings for a future down-payment on a home of your own. Afterall, you don't want to live in their basement forever, do you?

Make the most of your education. Research which fields are expected to be in demand over the next 10 years and focus your studies on getting a job in one of those fields. For example, as the baby boom generation ages, careers in nursing and related fields should experience increasing demand. With the high cost of an education and 15% youth unemployment, you can't afford to spend tens of thousands on an education that doesn't have a good paying job waiting on the other side.

When you are ready to move out on your own, don't go it alone. If you are not with a life partner, get one or more roommates to share expenses. If you are still single and wanting to buy a house, consider purchasing a home with a trusted friend. Alternately, if you buy alone you can rent out the other bedrooms to friends - they can help you pay the mortgage and allow you to write off a portion of your housing expenses from your taxes. Do your research and be realistic with your expectations: detached houses in urban areas are out of reach for first-time home buyers. Consider a semi-detached or townhouse in out-lying areas for better affordability.

Families: Ages 30 – 50. The decisions you've made in the past have put you on a path that is difficult to deviate from now. These are the hard years financially: competing demands to pay living expenses of a growing family, pay down your mortgage, save for your children's education *and* your own retirement have your money stretched farther than it can reach. You are in the juggling act of your life!

Don't let the recent market correction scare you off from investing: set up monthly RRSP contributions to reduce your income tax payable for earners in middle and upper tax brackets. If you are in the bottom tax bracket, forget about RRSPs – invest instead inside a TFSA. Invest in an appropriate blend of equities and fixed income and stick to your plan. Invest directly with a reputable mutual fund company for low fees – this single decision will have the biggest impact on your long-term results.

Don't leave free money on the table: make the most of government grants under the RESP program and set these plans up early. Get your children actively involved in saving for their own education through age-appropriate chores and work outside the home so they learn the principle of saving money from an early age.

Set your mortgage payments at a level you can comfortably afford – don't worry about being overly-aggressive for now. Tax planning and free government grants should take precedence over fast-paying your mortgage. If you are thinking of moving, don't be greedy: upgrading to a bigger home will bump up your monthly mortgage interest costs, property tax and utilities, plus cost a bundle in real estate sales commissions, moving expenses, land transfer taxes and legal fees. Not only are energy costs likely to continue rising, interest rates won't stay at their current rock-bottom levels forever. Do the math and be sure you can comfortably afford all the additional expenses before making the leap to a bigger home.

Focus on family time. Your kids are growing up fast and you can't get these years back. Teach your children that life is more than just buying new things by spending quality family time outside the mall. Forest hikes, outdoor ice skating and summer camping trips are the stuff great family memories are made of.

Older Adults: Ages 50 and up. You are in the home stretch financially and you need a retirement plan that includes numbers and dates. If you haven't saved up much until now, the good news is that these years will likely provide the highest income of your life. Make the most of it now because you never know when company layoffs might leave you without a job. For those in middle and upper tax brackets, RRSP contributions continue to allow you to defer income and taxes to later years when you can expect to be in a lower tax bracket. If you haven't yet paid off your mortgage, you need a plan to be mortgage-free before you can retire.

Downsizing your home may be appropriate but be realistic! Don't overestimate how much money you will save in this process based on wishful thinking. Research the real estate costs for different options and remember to factor in (again!) real estate sales commissions, moving expenses, land transfer taxes and legal fees to your final calculations. Plan ahead: give yourself plenty of time to do cost-effective improvements such as painting in neutral colours and purging out excess stuff before putting your house on the market.

Expect the basic costs of living to continue to rise, especially energy costs, and choose your downsized home accordingly. The single easiest way to save on energy costs is to choose a smaller home – focus on higher quality not bigger size. Look for energy efficiency in your downsized abode such as improved insulation and draft protection.

Consider investing in alternative energy solutions that will provide lower operating costs over the long term. Examples include geothermal heating, a solar photovoltaic array tied to the grid for electricity generation, and a tankless hot water heater. The cost of green technology is steadily falling as demand increases plus government grants are often available. Calculate the Return on Investment or how many years it takes for your initial investment to be paid off in energy savings. You could live in this home for 20 years or more so a 5 year ROI means you will enjoy many years of deep discounts on your fixed expenses.

Moving out of expensive urban areas is an easy way to find big savings on the cost of your retirement home. Strike a balance between the activities you plan to pursue, the amount of travel you anticipate and your desired proximity to family and amenities when choosing the right location.

With the 2008-2009 market downturn, many on the cusp of retirement were forced to delay their plans when their investments were broadsided by market declines. Protect yourself by increasing the fixed income component of your investments as you approach your planned retirement age. Consider purchasing an annuity with a portion of your retirement savings or the proceeds from downsizing. This will diversify your income stream while providing further insulation from market forces by guaranteeing a portion of your income for life.

Conclusion

Whatever your age or situation, many of the same basic principles apply. Overcome the consumer bug and create a lifestyle that allows you to live comfortably within your means. Strike the right balance between tax planning, investing, paying down your mortgage and taking advantage of government grants and rebates. Choose a home that meets your needs but is not excessive. Tap into energy savings and look to green alternatives to keep your fixed expenses under control. Financial success in the new economic reality requires more discipline than ever before but for those who can adapt, it is still within reach.

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