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Lifestyle Creep: The Silent Threat to Your Retirement Plans

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Keith: Welcome to the Empowered Investor. My name is Keith Matthews, and I'm joined by my cohost, Marcelo Taboada. Marcelo, how are you today?

Marcelo: Keith, I'm good. I'm intrigued by this episode. It's going to be interesting; it hits close to home.

Keith: Why are you intrigued?

Marcelo: Oh, I have a lot of people in my generation falling for what we're going to talk about today.

Keith: So today's topic is lifestyle creep. In the episode, we're going to discuss and define what it is. We'll have a chat about why it's important, why we think listeners and Canadians need to know about this concept, and what are the problems that come with lifestyle creep. We'll discuss signs to identify if lifestyle creep is coming into your family situation. Finally, we'll have a list of recommendations on how to avoid it. So, obviously, the way we're talking about it, it’s something that's not good. When we talk about lifestyle creep... Marcelo, what exactly is lifestyle creep?

Marcelo: Essentially, Keith, it's when you're making an X amount of money, you get a raise, and now you feel like you need to spend a little bit more on things that maybe were luxuries before. Maybe you want to give yourself that extra nicer car. Maybe you want to have that extra vacation. Maybe you want to go out more often to restaurants because you feel like you've got the raise and you've earned it. So, I think that's lifestyle creep.

Keith: Yeah. And I think even on a practical basis, for a lot of our listeners, they would understand if I ask a question, how much does it cost to cover your lifestyle expenses on a monthly or annual basis? And a lot of people would say, I don't know, $7,000 a month or $10,000 a month or six—whatever the number is. Then you meet them a few years later and you go, how much are you spending? And they go, I'm actually not at that number. I'm quite a bit higher. And then you go, how did that happen? They go, I don't know. It's just—I don't know where to start. Like, all of a sudden, things are just costing more money. And then life happens, right?

Marcelo: Yeah. Life happens.

Keith: And when you actually sit and analyze and review, they will say things like, I'm driving a nicer car than I perhaps was before. I'm spending more money on discretionary items, whether it's restaurants, travel, or vacations. I'm renovating my house more than ever before. I'm buying nicer furniture than ever before. And all of a sudden, these expenses creep into a person's lifestyle. And I think one of the easiest ways to define it is sometimes when individuals get raises—whether you get a raise while you're in your working years or perhaps even an inheritance when you're in your fifties and sixties—lifestyle creep occurs when you take that increase and you spend it all. And you don't keep your saving ratios intact. For example, if we use numbers, let's walk this through, Marcelo. Let's say a family earns $100,000 a year. They're hitting their saving targets of 15%, so they're on track financially, or 20%. These are numbers we like to consider as savings rates. Then they get a raise—the family raise—and maybe they go from 100 to 110 or 120. It's when they take that extra money, the 10 or 20, and they spend it all, and it increases their lifestyle, but they don't increase their savings. When you do that over prolonged periods, all of a sudden, you're still saving the same amount, but now let's take that family out five or six years, and they're not making 100; they're making 140. Now their savings rate is quite a bit lower, and they've built in a more expensive lifestyle. And we can obviously multiply these numbers by whatever factor.

Marcelo: I think the example is fairly simple and very clear. And the big implication there is that when you retire, you don't want to downgrade your lifestyle. So if you get used to a certain lifestyle but kept your saving rates the same, then we're getting into trouble now because you won't say, "Okay, I'm going to live the same lifestyle when I retire," but now the money's going to last less because you have maintained your same level of savings for those years and haven't caught up with the savings you needed to maintain the lifestyle that you need when you retire. And that's a problem.

Keith: Yeah. And lifestyle creep applies to all income categories.

Marcelo: Oh, a hundred percent.

Keith: So it's moderate income all the way to super high income. In fact, often super high income individuals have a tendency of saving a certain amount, maximizing their RRSP, maximizing their tax-free saving accounts, and feeling that's enough. Now that has more to do with them not knowing how much they need to save and spending everything else and building in a pretty expensive lifestyle. All of a sudden, it's just crept right up, and they're stuck with it. So you're right. I think the hardest part is as you get closer to retirement is when we start having conversations with individuals and we say, what's your burn rate? And then they realize it's higher than it should be. That's a side effect of the creep that's come in.

Marcelo: And it's all relative, right? Because if somebody makes, let's say, 2 million versus somebody who makes 100,000, if the person making 2 million is spending a million dollars a year just on lifestyle, they will have to save proportionally to that. So I think people sometimes tend to get the outrage when we see these huge salaries, but they also convey that you need to have a savings rate that's proportional to that level of salary. So that means that person making 2 million has to save enough so when they retire, their lifestyle maintains the same. I think it's fair to say that everybody wants to maintain their level of lifestyle when they retire. I know I want to—I don't want to downgrade 30-40%. So, therefore, I need to save proportionally.

Keith: So, we're talking about problems of lifestyle. Are there any other problems that you can think of? Any other side effects?

Marcelo: It is a problem because it can create anxiety. It can create the idea that you're not—I like the word "creep" because it creeps into people's lives, and then you don't realize it until it becomes a bigger problem. And that can create a lot of anxiety and a lot of stress in a person's life.

Keith: It creates anxiety and stress, but it also doesn't allow the person to reach their goal. So if you're a younger person and reaching your goal is to buy a home, it's going to take longer to get there. If your goal is to have a sustainable retirement, the creep that comes in your forties and fifties might actually affect your retirement plans. So these are some pretty big consequences if you don't become aware of lifestyle creep and if you don't address it. I actually think it's akin, on the health side, to a bit of a chronic illness. Even a reverse compounding effect. And we talk about compounding being in our financial world, we talk about compounding being the eighth wonder of the world. This extra little incremental gain. And when you allow it to occur over long periods, you can get massive gains in growth and wealth. Lifestyle creep is almost the reverse of that, but on a negative side.

Marcelo: And the behavioral side too—you'll get worse financial habits.

Keith: A hundred percent.

Marcelo: You just spend on the loose. You don't have a plan.

Keith: So what are some of the signs? How can we help listeners go through identifying whether lifestyle creep is coming into their financial being?

Marcelo: So I think luxuries become necessities. Buying lunch every day instead of bringing your own, spending too much on an apartment, cars you can't afford, vacations. I remember—I told you this off mic yesterday—I remember when I was a kid in my neighborhood, nobody had granite counters. Nobody had super nice hardwood floors. Nobody had super modern kitchens. Only the rich people had that. If I look at my peers and the people who I know that have homes my age, they all have super shiny kitchens, super nice cars, super nice houses. That's the standard now. I think that generationally has changed. Another example I have from my childhood is—

Keith: But hang on. But all these individuals—you may know it, or you may not—but are all these individuals hitting their saving rates? If they're in the accumulation phase, are they saving 20% of their income?

Marcelo: I do not know that. It's murky to me.

Keith: The stats show that they're not.

Marcelo: Correct. If we look at our larger statistics, they show that they don't. Another example I have from my childhood is, back in the day, only rich people, quote unquote, had access to an SUV or a big car, right? Now I see them everywhere. We live in the West Island here in Montreal, Quebec, and I see them everywhere now. You drive through a soccer practice, everybody has an SUV now. So I don't know if it's a generational thing, but I know they are expensive because I've looked at the price. And that's one of the signs that I see.

Keith: I think lifestyle creep has come through across society in general. Relative to where things were 20 years ago, 25 years ago, saving rates were much higher, and people would save before they spent on discretionary items. And I think that the times have unfortunately changed on that front, and people are much more comfortable perhaps overspending and allowing the creep to come in to the detriment of their financial future. So I think those that can become aware of that earlier will increase the odds of not allowing it to affect their families.

Marcelo: Yeah. I speak to some of my friends' parents, and they say something interesting. Back in the day, '80s, '90s, people used to do renovations—I don't know if you saw this when you were doing your house—but people used to do projects in their house or buy things when they saved and had the money. Now, what I see is the opposite of that. People do kitchens on a home equity line of credit. People take vacations on debt. People buy cars financed. And I think that the access to credit has changed this a little bit as well.

Keith: Access to credit, and we haven't had severe recessions, severe financial really tough economic situations.

Marcelo: Last one was in '91, right?

Keith: The last hard recession would have been— Yeah. Like a hard recession. We had 11-12% unemployment; it would have been around '91.

Marcelo: Yeah. I think that changes people's mentality as well. So another one, Keith, is indiscriminate spending. So not thinking twice about what you spend—swipe when you go—you don't think twice. The other sign is not wanting to take a step back and look at your financial house and build a plan. And like you said before, save before spend less. It's more of this attitude, "Oh, I'll spend whatever I want, and then whatever's left, I'll save." I think that's one of the signs.

Keith: Yeah, so those are three good signs to help individuals identify whether they're succumbing to lifestyle creep. I'll add one more. For those who receive inheritances, sometimes we've seen scenarios where an individual says, "I'm going to receive an inheritance of X, and I'm pretty confident that I'm going to put X away into my retirement plan. It'll be there for the long term." And you fast forward, and when that event does happen, when they do inherit, often the money that then is saved isn't the same amount that was expected. And you ask, where did the gap go? How come there's a gap? And then you'll find out: extensive renovations in the home, new car, or more travel. And all of a sudden, what's really going into long-term savings is 30% of what was initially planned. So there's another example of lifestyle creep, and that doesn't happen to younger individuals. It tends to happen to individuals between 50 and 65.

Marcelo: Interesting.

Keith: Yeah. So there are many different forms of this creep that come in. So let's switch and discuss how one avoids lifestyle creep.

Marcelo: Yeah, I think there's a few points. The first one is to make a budget, sit down, make a plan, know exactly where your money's going. One of the things I say to my clients and when my friends and peers ask me for advice, I always—I'm not a big fan of the super detailed budgets. I'm more of a macro type of person. I like to know, macro, where the dollars are going, but you got to know where the money's going. Otherwise, you won't be able to have a plan. And I think one that we didn't add here that I think is huge is: the partner you choose has to have the same money values that you have because that's key when you're sitting down making a budget and agreeing on big-ticket items. So, I think that's one of the things that I've experienced in my marriage. We may have a lot of disagreements, but Alex and I have the same money values. So, I think that's been huge for me, at least.

Keith: You're absolutely right. This reminds me of the episode we did on couples and money.

Marcelo: A hundred percent.

Keith: One of the things that has to occur is as your finances increase, income increases, you have to find a way to not get in the trap of spending it. You have to find a way to save and keep the savings rates up. The saving rates—the percentages of how much you make and how much you put away. I think that's absolutely critical. I've often told individuals—this is for the younger generation—they finish university, they go out and start working. I tell them, live like a student still for the next five years. Don't go out and spend all your money because all you're going to do is start creating bad financial habits. And that concept can go all the way through life, which is just to make sure you live within your means. And living within the means essentially means you've got to get your savings rates away, and then you can enjoy the money that's left over, of course. What else?

Marcelo: Do not make big life changes if you get the increase. Do not jump into a higher lifestyle all at once. Think about if it's going to add more happiness to your life. I think the issue that I'm seeing now with a lot of people in my generation is they are saying things like they're frustrated about the housing situation. So it's almost like this attitude of defeat, saying, "Because I can't afford a house, I'm just going to blow all my money." And I'm seeing people renting apartments downtown for $2,500-$3,000. Whereas the opposite should be the case. They should be maybe finding cheaper rents, trying to save a bit more, and having access to the housing market later on if they really wanted to have a plan. But again, I don't want to sound preachy, but I remember when we bought a house with Alex—this is just from personal experience—we rented an apartment that was cheaper, maybe farther from the city center, that allowed us to have a very good down payment. And it took us four or five years to do that, but we had a plan to do that. And I'm finding that a lot of people feel like, "I won't be able to have a house, so I'm just going to live the big life and forget about the savings and forget about the spending." And they have good jobs, right? And it's just like they're living a life that is not conducive to saving and preparing for retirement because they feel like, "I have the job, I have the title, I deserve it." And that's a problem.

Keith: But you're specifically speaking to the younger generation that's still trying to maybe enter the housing market. And in the last four years, of course, that has just become a major challenge, but that is a completely different topic. There's one extra thing that I think is very relevant, which is happiness doesn't necessarily increase as individuals have more stuff. All the research is pretty clear about once you have a certain amount of income and you've been able to maintain a certain lifestyle, as your income increases or as your stuff increases, it doesn't bring you extra happiness. So I think becoming relevant to that and understanding that is critical to avoiding lifestyle creep and then being able to hold the line. So what about this idea of having friends with similar goals? You mentioned having a wife or spouse with similar goals. Expand that a little bit. You shared with me yesterday a great quote. Go over the quote because I think it is very telling.

Marcelo: Yeah. Nassim Taleb, the author of The Black Swan and Fooled by Randomness, a very famous author, had a great quote that I think just exemplifies lifestyle creep. He said, "The fastest way to become poor is to hang out with rich people, and the fastest way to become rich is to hang out with poor people." And to me, that's so telling because I see this very often. If you have friends who are spending on big-ticket items and have luxury cars and do three vacations a year—again, I don't want to sound preachy, but it's just human nature, right? Like, you're going to want to keep up. If your friends hang out at restaurants that cost $400 a night, then you're going to be enticed to keep up with that. Whereas the opposite is true as well. If you have friends who have similar values, maybe they don't take vacations that cost $15,000, but they go camping, just to use a very basic example, then that's going to be a very different financial situation.

Keith: So my takeaway from you is find the right spouse and find the right friends who share the same financial values.

Marcelo: Correct.

Keith: Nice. Marcelo, let's wrap up the show on lifestyle creep. My final comment would be - it's real. I think it's something that all Canadians need to become aware of—this creep that can occur. Identify it, address it, and make sure you keep your savings rate up and don't build a more expensive lifestyle where you'll regret the decisions that have to come after. Obviously, enjoy life, do all the things you need to do, but have a plan and become aware that this is a concept, and it is a negative issue.

Marcelo: Yeah. And I think if you get a raise, the best outcome is if you want to increase your spending, make sure your savings go up proportionally to the raise, right? And the best outcome is to maintain your lifestyle and just save everything that came as a raise. I think if you do that, you're going to be ahead of so many people and just ahead of the game overall.

Keith: Yeah. And you'll have financial peace of mind later. Actually, you'll know you'll have it now, so that'll bring some peace of mind as well.

Marcelo: Correct.

Keith: Marcelo, thanks so much for today's episode. It's a bit of a casual discussion, but a really important concept. Thanks so much for sharing your thoughts.

Marcelo: Very nice.

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