FINANCIAL FACELIFT

Can Linda and Lamont shift their travel, lifestyle plans to manage their savings in retirement?

DIANNE MALEY
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In their early 60s with retirement on the horizon, Linda and Lamont are back for a second Financial Facelift. They have plenty of options but their goals have changed. Back in 2016, when their first Facelift appeared, they wanted to keep their Toronto house and buy a property in Europe.

"We no longer wish to stay in the city, as we thought back when we met you last," Linda writes in an e-mail. "We prefer to be where we can hike, snowshoe, kayak, and cycle while we are still healthy." They still plan to travel, "but we have decided we no longer wish to own a property in Europe, but rather have extended stays," she adds.

"So now, not only do we have new goals, we wonder what the best strategy is for drawing down our hard-earned savings." Together, Linda and Lamont earn about $370,000 a year. They hope to retire in a year or so. Although neither has a company pension plan, they have substantial savings. "We think we can manage to sell our house for enough to buy something in the country that allows us to get out from under our mortgage, buy an RV and perhaps have some extra money left over," she adds. They have two twentysomething sons, one still living at home.

Their retirement spending goal is $100,000 after tax.

We asked Amit Goel, head of private client investment services and portfolio manager at Hillsdale Investment Management Inc. in Toronto, to look at Lamont and Linda's situation. As well as being a certified financial planner, Mr. Goel holds the chartered financial analyst designation.

WHAT THE EXPERT SAYS

When they retire in a year or so, Lamont and Linda plan to sell their house and move to a lakefront cottage, Mr. Goel says. He assumes that after paying off the mortgage and buying a recreational property for $1.5-million, the couple will be left with more than enough to buy an RV and catch up on unused contributions to their tax-free savings accounts. The remaining funds can be added to their investment portfolio, lifting it from $2.1-million to $2.4-million.

With increased travel costs, they will need to withdraw $135,000 annually (pre-tax) from their portfolio, which represents a 5.6-per-cent withdrawal rate, Mr. Goel says. That assumes retirement cash flow needs of $9,000 a month to age 85 – $6,000 for lifestyle spending and $3,000 for travel. "At age 85, we assume monthly medical costs of $5,000 will add to their expenses," the planner says. "To cover these costs, the portfolio needs to grow at 5 per cent per annum." With registered retirement savings plans representing more than 75 per cent of their investment portfolio, they need to explore tax-efficient withdrawal strategies, Mr. Goel says.

Thanks to a 90-per-cent allocation to stocks and stock funds with a focus on dividends, Lamont and Linda have been earning 7 to 8 per cent a year on their investments, the planner

says. To ensure they can weather short-term stock market volatility when they retire, Linda and Lamont should shift 25 per cent of their portfolio to cash-equivalents and fixed income, broken down as follows: a mix of cash and high-interest savings accounts (10 per cent) for liquidity in the first two years; and guaranteed investment certificates and/or short-term bond exchange-traded funds (15 per cent) to cover cash flow needs in years three to five, the planner says.

For the five-year-plus time horizon, they pursue capital preservation plus growth using low-risk, dividend paying equities for 40 per cent to 50 per cent of their portfolio, Mr. Goel says. “Assuming a three-per-cent dividend yield, this strategy will supplement withdrawals required for retirement living.” The remaining 25 per cent to 35 per cent of their portfolio could be invested in growth securities with a time horizon of 10 years or more as part of their legacy, he says.

Mr. Goel has broken down the couple’s retirement into three phases: ages 62 to 70, 71 to 85, and 85 plus. “Assuming a 5-per-cent growth rate, their RRSP portfolio will increase to $3-million by age 71, when it is converted to a registered retirement income fund and minimum withdrawals are required,” the planner says. “This might force them into a high tax bracket and may potentially lead to Old Age Security clawback.”

One way to avoid this is to start withdrawing earlier from their RRSPs. “From retirement until age 70, they do not have any mandatory taxable income,” the planner says. His forecast recommends they defer taking Canada Pension Plan and Old Age Security benefits to age 70, which will provide them with 42-per-cent and 36-per-cent additional payout, respectively, for the rest of their lives. “Our projections show they can withdraw a total of $75,000 from their RRSPs every year tax-efficiently, representing more than half of their annual cash-flow requirement of $135,000.”

For the remaining $60,000, they can withdraw from their combined non-registered and tax-free savings accounts, which will cover their needs until they begin collecting CPP and OAS at age 70 and making mandatory RRIF withdrawals at age 72. The average tax rate on withdrawals until age 70 is projected to be 7.5 per cent, Mr. Goel says.

In Phase 2, from age 70 to 85, they rely on income from CPP, OAS and RRIF withdrawals, the planner says. “Higher CPP and OAS benefits (from deferring them) and minimum RRIF withdrawals will be sufficient for planned expenses and regular TFSA contributions,” Mr. Goel says. The average tax rate in this phase is projected at 20 per cent.

In Phase 3, 85 plus, their CPP, OAS and minimum RRIF withdrawals continue to fund regular lifestyle and medical needs, the planner says. At this point the planner assumes they will have sold their cottage and moved back to a condo in the city. "If they need higher medical expenses and nursing support, it is suggested they sell the city condo and move to a rented condo with nursing support, or a well-managed retirement home," Mr. Goel says. This would cost an additional $10,000 a month in today's dollars, which could easily be funded from a non-registered investment portfolio created from the sale of the city condo. The tax rate projected is less than 10 per cent.

Among the assumptions in Mr. Goel's forecast are that Lamont and Linda retire in one year, when he is 63 and she is 62. They live to be age 95. They buy an RV for $120,000 when they retire, and pay off their car lease and their mortgage. Pre-retirement, their investments continue to grow by seven to eight per cent a year, falling to five per cent a year thereafter. Real estate and lifestyle costs rise by two per cent a year, in line with inflation.

CLIENT SITUATION

The people: Lamont, 62; Linda, 61; and their twentysomething children

The problem: How best to draw down their savings to meet their retirement goals, including a cottage and extensive travel

The plan: Retire as planned, sell the city house, buy the country home for $1.5-million, invest the surplus. Draw first on the RRSPs to save tax later. Postpone government benefits to age 70. Hold some of their savings in cash equivalents for liquidity, some in GICs or bond funds for safety and the balance in stocks or stock funds.

The payoff: A detailed road map of how much they can spend, and how much they have to make, to achieve all their goals

Monthly net income: $23,665

Assets: Joint cash $32,000; his stocks $89,000; her stocks $23,000; his mutual funds $42,000; her mutual funds $11,000; his TFSA $66,000; her TFSA $21,000; his RRSP $815,000; her RRSP $940,000; RESP $4,000; residence $2.1-million. Total: $4.14-million

Monthly disbursements: Mortgage $2,535; property tax $740; water, sewer, garbage $200; home insurance $200; heat, electricity $245; maintenance $500; car lease $865; other transportation $720; groceries $800; clothing $300; gifts, charity $200; vacation, travel $2,000; dining, drinks, entertainment $900; personal care $50; sports, hobbies $75; subscriptions $70; health care $95; TV, communications $375; RRSPs $2,500. Total: $13,370. Monthly surplus: $10,295

Liabilities: Mortgage $320,000

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351 King Street East, Suite 1600, Toronto, ON Canada, M5A 0N1

Phillip Crawley, Publisher