Can Rose afford to retire in five years and still maintain her lifestyle?

DIANNE MALEY
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Rose is age 55 and single "with two newly independent young adult children," she writes in an e-mail. "I live in Vancouver, have a condo that is paid off and work a full-time job." Her management job pays a base salary of $154,000 a year plus bonus of $25,000.

"I believe I have been financially responsible and would like to retire before 65, but I have no idea if that is something I can afford to do," she adds.

"My goal in (hopefully early) retirement is ideally to be able to maintain my current lifestyle: travel, dining out, attending events," Rose writes. "However, maybe I would sacrifice some of that in order to stop working earlier."

Rose wonders where to invest her cash-flow surplus. She also has some U.S. dollars sitting in a bank account. Short term, she wants to repay a personal loan, build an emergency fund and buy a new vehicle. She hopes to retire in about five years at age 60 with after-tax spending power of $50,000 to $60,000 a year.

"Will I have the funds required?" Rose asks.

We asked Barbara Knoblach, a financial planner at Money Coaches Canada in Edmonton, to look at Rose's situation. Money Coaches Canada is a national network of fee-only financial planners.

What the expert says

Rose recently raided her tax-free savings account to pay off her mortgage in full, Ms. Knoblach says. Before retiring, Rose would like to buy a new vehicle for $45,000 and pay off a $35,000 personal loan. She asks how to make the best use of her U.S. funds – US$30,000 that was part of a compensation package – and how she should use her (almost empty) TFSA in the context of retirement planning.

With her mortgage paid off, Rose has significant surplus funds to put toward retirement savings, paying down debts or big-ticket purchases, the planner says.

Rose has a group registered retirement savings plan and a deferred profit-sharing plan at work. She is contributing $9,170 annually to her group RRSP and her employer is contributing $6,880 annually to the DPSP. These group accounts are invested exclusively in equities, 31 per cent Canadian and 69 per cent foreign.

"Rose confirms that she is comfortable with volatility," Ms. Knoblach says.

In preparing her forecast, the planner assumes Rose will be eligible for 56 per cent of maximum Canada Pension Plan benefits based on her work history and full Old Age Security benefits, and that she will begin collecting them at age 65. The planner ran three scenarios to see whether Rose's goals are realistic.

In the first scenario, Rose continues as is, with no further savings and no investment plan other than her group plans at work. She uses her U.S. dollars to repay her personal loan, postpones her vehicle purchase and spends her surplus. She retires in January, 2026, the year in which she turns 60. The financial planning software projects an after-tax annual spending power of $46,600 a year, Ms. Knoblach says. Rose falls short of her spending target.

Instead, the planner recommends that Rose use her current high-income years to aggressively close the gap in her retirement funding. The second scenario assumes Rose immediately starts making contributions of $3,000 a month to a non-registered, high-interest savings account. This account will serve a variety of purposes – emergency savings, to buy a vehicle, to repay the personal loan and as a cushion of cash for when she begins withdrawing from her registered accounts, the planner says. Rose "revives" her depleted TFSA by depositing the after-tax amount (assumed to be $17,500) of her annual bonus and invests the funds. She buys a vehicle and repays the personal loan before she retires.

Even with the higher planned cash outlays than in Scenario 1, Rose achieves after-tax spending power of $52,200 a year, at the low end of her target range, Ms. Knoblach says. “Aggressive saving and investing over the next several years will enable her to close the gap in retirement funding.”

The planner ran a third scenario in which Rose works to age 65 rather than retiring at 60. As in the second scenario, Rose saves her surplus and contributes her bonus to her TFSA. “Once the TFSA has been maximized, any surplus funds from bonus payments will be redirected to Rose’s non-registered account,” the planner says. After the car purchase and the loan repayment, Rose keeps the first $100,000 of her non-registered account in cash, investing any funds over and above this amount in line with her risk tolerance.

In this scenario, Rose can retire on an annual after-tax spending power of $74,000, Ms. Knoblach says. “She could lead a substantially more affluent lifestyle than currently planned.” Rose will have to decide whether she wants to work the extra years to obtain higher spending power, or if $52,000 a year will be sufficient, the planner says. “I personally recommend aiming higher because Rose is used to a certain lifestyle.” As well, big-ticket expenses – another new vehicle, her children’s weddings, international travel – “will come along the way in retirement,” Ms. Knoblach says. “On $52,000 per year, she will have little flexibility to accommodate these types of one-off expenses.”

The forecasts assume an inflation rate of 2 per cent, an average annual rate of return of 5.5 per cent and that funds last to Rose’s age 95.

Next, the planner looks at Rose’s investments, which are entirely in stocks. “By the time she starts drawing down her registered accounts, the holdings should be restructured to avoid having to draw on equities in the event of a market downturn,” she says. “As a rule of thumb, Rose should always have one year’s worth of RRSP withdrawals in cash or near-cash, and another two years’ worth in conservative investments.” She suggests that when Rose retires, she should have a non-registered, high-interest “holding” account in place from which she pays herself a regular monthly “salary,” as if she were still working.

“Lastly, the TFSA should not be used for emergency savings,” Ms. Knoblach says. Funds held in TFSAs are in after-tax dollars and future withdrawals do not trigger a tax event. “Due to the after-tax nature, funds held in a TFSA should be invested aggressively for the long term, ideally in an all-equities portfolio,” the planner says. Rose may consider transferring the $4,800 worth of stocks in her non-registered investment account to her TFSA to allow for tax-sheltered growth. As well, a TFSA can come in handy in retirement when a big-ticket purchase is needed, she says. “If no TFSA is available, a lump sum withdrawal from an RRSP could bump Rose into a high tax bracket and potentially lead to claw-back of OAS.”

Client situation

The person: Rose, age 55, and her two children

The problem: Can she afford to retire in five years and still maintain her lifestyle?

The plan: Begin saving aggressively in both her TFSA and in non-registered savings accounts. Weigh the trade-off between retiring in five years on $52,200 a year or in 10 years on $74,000.

The payoff: A clear view of the alternatives

Monthly net income: $8,565 (excluding bonus)

Assets: Bank account $5,000; non-registered $4,800; U.S. dollar account US$30,000 (about $38,300); TFSA $5,000; RRSP/DPSP $742,850; residence $1.05-million. Total: $1.8-million

Monthly outlays: Condo fees $545; property tax $250; home insurance $60; hydro $50; garden $15; transportation $530; groceries $550; clothing $200; gifts, charity $255; vacation, travel $350; dining, drinks, entertainment $395; personal care $85; sports, hobbies $220; massage, physio $225; doctors, dentists $65; drugstore $25; health, dental insurance $75; disability insurance $85; communications $190; group RRSP $765. Total: $4,935. Surplus available for saving $3,630

Liabilities: Personal loan $35,000

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