Money Makeover: Can they sail into retirement?

By: Deanne Gage Special to the Star, Published on Mon Dec 07 2015

The People
Charles and Marla, both 50, hope to retire in 18 years. The Toronto-based married couple ran a successful business for two decades, but the 2008 economic downturn drastically affected revenues. So they decided to become teachers. Marla went back to school for her Masters degree and landed a teaching position with a private school last year. Charles has been teaching with the public board for four years. They now collectively earn $156,000 a year.

The Problem
The couple is thinking of the best ways to structure an income stream come retirement. They prefer to invest their money in real estate instead of stock and bonds. They've sold their $1.2 million home and have netted $200,000 from the sale after paying off their cottage and other debts. They are renting a place and want to buy a small townhouse (they are thinking in the $900,000 range). When they retire, they plan to rent out their townhome, reside in their cottage for half the year and on a sailboat (to be purchased) for the other half. Is this a feasible idea? While Charles will receive $35,000 a year from his pension if he stays at his job until age 65, Marla has no pension.

The Particulars

Assets and income
Cash: $200,000 (to be used for townhome down payment)
Cottage rental income: $28,000
Cottage: $750,000

Liabilities
None

The Plan
Charles and Marla's strategy can work if they have the goal of paying off the mortgage by retirement or at least have paid it down far enough that they can extend the amortization and reduce the payment substantially.

Paying off a $700,000 mortgage by retirement is feasible, provided their incomes continue as planned and they have no significant unexpected expenses over that period, says Bruce Thompson, a Regina-based money coach and financial planner with Money Coaches Canada.

Thompson recommends that Charles and Marla start with a 30-year amortization for their mortgage. “This will keep their payments affordable during the school year and then they can pay extra on the mortgage each summer from their cottage-rental income,” he says.

Thompson is concerned about the strategy of renting out the townhouse when retirement arrives. While that would produce great rental revenue throughout their retirement, it would also leave them asset rich and cash poor. “They will have no cash to purchase the boat in the Caribbean or do things like replace vehicles,” Thompson notes. “So they would have to borrow for those things.”

He recommends they sell the townhouse when they retire instead, and downsize to a property outside of the downtown core. “It will allow them to achieve their retirement goals, with the wiggle room to withstand mortgage rate hikes and unforeseen expenses without imploding.”

Based on a conservative five per cent annual growth rate, the townhouse would grow to $2.2 million in 18 years’ time. The net proceeds would be enough to buy a $500,000 boat, a $1.1 million condo and have $600,000 left to supplement their retirement income.

Because they have owned two properties simultaneously and will again soon, Thompson also recommends that they consult an accountant regarding options that they have for using the capital gains exemption for principle residence in the most effective manner.

The $28,000 in rental income from the cottage is now being used to help with their daughter and son’s post-secondary education. When those payments end, Thompson recommends that Charles open a spousal Registered Retirement Savings Plan for Marla, and contribute $20,000 a year for six years. The idea is to try, as much as possible, to equalize the couples’ expected income in retirement (in case pension income splitting is ever repealed). Charles will have pension income and Marla will not.

“These RRSP contributions should generate income tax savings for Charles of $8,500 per year,” Thompson says. That $8,500 could then be contributed to a Tax Free Savings Account and be available as an emergency fund in the short term and create additional cash flow in retirement.

Once Charles’s RRSP contribution limit has been used up (after roughly six years of contributions), the annual surplus should be paid against the condo mortgage.
Finally, the couple will also receive Old Age Security and Canada Pension Plan benefits of totaling $3,100 a month in today’s dollars, Thompson says. All of these sources of income put them in great shape for retirement.