Can this young couple have a child and retire early?

DIANNE MALEY
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED AUG 13, 218

At 31, Ben and Geraldine seem young to be thinking about saving for retirement. She works for the government, he works for a builder. Together they bring in $127,000 a year.

They have a condo with a mortgage and are thinking about having a child at some point. They wonder how to prepare for that financially.

Short term, their goals are to take full advantage of their tax-free savings accounts (TFSAs) and Geraldine's registered retirement savings plan (RRSP) room. She earns the higher income. Longer term, they want to pay off the mortgage and retire early – at the age of 55 – with $60,000 a year after tax to spend.

After they've contributed the maximum allowed to their registered plans, Geraldine wonders whether she should use any surplus cash flow to pay down the mortgage more quickly, build a non-registered investment portfolio, or contribute to a spousal RRSP for Ben.

If she stays with her current employer, Geraldine will have a defined-benefit pension, indexed to inflation. Ben has no pension. "How can we save so that Ben will be able to retire at age 55 too?" Geraldine writes in an e-mail.

We asked Karen Richardson, a money coach at Money Coaches Canada, to look at Ben and Geraldine's situation.

WHAT THE EXPERT SAYS

Once they have contributed as much allowed to their TFSAs, Geraldine should begin contributing to a spousal RRSP for Ben, Ms. Richardson says.

At the rate they are going, their mortgage will be paid off in about 19 years, when they will be 50. "This is before their retirement date, which is ideal," she says. They are paying 3.19-per-cent interest on their mortgage. If they save and invest the money instead, which Ms. Richardson recommends, they will likely earn more over the long term than they would save by paying down the mortgage loan faster.

Geraldine ought not to worry about maxing out her RRSP, Ms. Richardson says. "Though it is a wonderful tax deferral today, at retirement she could actually pay more tax when she withdraws than she is deferring now." Starting at the age of 55, she will have a work pension of $46,020 a year, plus a bridge benefit of $10,525 a year to the age of 64. At the age of 65, the bridge stops and her Canada Pension Plan and Old Age Security start. Her income will rise when she begins collecting CPP and OAS benefits at the age of 65. "All of these combined could result in an even higher income than she is earning today."

A spousal RRSP would help make sure Ben and Geraldine have similar incomes when they retire, Ms. Richardson says. “By equalizing your retirement accounts, together you will pay less tax.” As it stands, taxpayers can split pension income at the age of 55 and RRSP/RRIF (registered retirement income fund) income at the age of 65. A spousal RRSP would protect against potential changes to these pension-splitting rules in future.

If they decide to have a child in five years, they will have to replace Geraldine’s lost income during the time she is on parental leave. Geraldine has saved enough in her TFSA to draw on during her leave, but she has allocated that to retirement savings, Ms. Richardson notes. She suggests they draw up a budget for the year off, divide the expected shortfall by five and save that amount each year. Because it will be needed in five years’ time, the money should be kept in a savings account. They could label the account “maternity leave year off,” she says.

“I like it when my clients nickname their bank accounts for the name of their goals. It keeps everyone focused, and it is really fun to watch your savings grow and your goal become a reality.”

With a child, there will be new expenses – for education, clothing, child care, camp, lessons and other activities. Ms. Richardson suggests the couple review their budget at that time.

With their current savings rate and Geraldine’s pension, the couple will be able to meet their spending goal of $60,000 a year without having to cut back. They will need a rate of return on their investments of at least 3.5 per cent between now and when they retire (which assumes a 2-per-cent inflation rate). Their savings will last to the age of 95, at which point they will still have Geraldine’s pension and their CPP and OAS.

While Geraldine’s pension is indexed to inflation, their other savings are not. “It would be good to ensure they speak to a fee-only planner regarding the asset allocation of their personal savings,” she says. “They want to make sure their savings are earning more than the cost-of-living increase so when they go to take their savings out, it will be worth more than what they put in.”

CLIENT SITUATION

The people: Ben and Geraldine, both 31.

The problem: How to allocate their income in the most effective way to achieve their early-retirement goal. How will having a child affect their finances?

The plan: Geraldine contributes to a spousal plan for Ben. Save up for the anticipated maternity leave in advance.

The payoff: A clear financial roadmap.

Monthly net income: $7,130.

Assets: Cash and short term $22,000; her TFSA $65,665; his TFSA $14,500; her RRSP $16,325; estimated present value of DB pension $66,745; residence $275,000. Total: $460,235.

Monthly outlays: Mortgage $645; condo fees $235; property tax $235; home insurance $20; utilities $110; home maintenance $110; car insurance $200; fuel $310; vehicle maintenance $130; parking/transit $130; groceries $500; clothing $200; student loan $125; gifts, charity $130; vacation, travel $200; other discretionary $300; dining, drinks, entertainment $400; grooming $25; pets $200; sports, hobbies $130; subscriptions $10; life insurance $20; phones, internet, TV $225; RRSP $1,000; TFSAs $900; her pension plan contributions $640. Total:$7,130.

Liabilities: Mortgage $117,500; student loans $8,800. Total: $126,300.