Couple aiming to retire in 2030 will need to make some tweaks to reduce risk

DIANNE MALEY
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED AUGUST 6, 2021

Carlos is age 46, Corinne is 49. They have a residence in Vancouver, a timeshare in Whistler, and a teenage son.

Both Carlos and Corinne work in information technology. As an executive, Carlos earns a base salary of $137,000 a year plus bonus and company stock, lifting his total compensation to $205,000. She makes $81,000 a year.

Their goal is to achieve financial freedom in nine years, when Carlos is 55. They each have defined contribution pension plans at work. Carlos uses his company stock to top up their registered retirement savings plans – including a spousal RRSP for Corinne – and their tax-free savings accounts.

When they retire in 2030, Carlos and Corinne's goal is to have an after-tax income of $100,000 a year, substantially lower than their current income. Their costs will be lower then because they will no longer be paying their mortgage, saving or supporting their son.

They are wondering whether they are on track, and what, if anything, they should be doing differently. They also want to minimize income taxes.

"Can we save enough money in nine years, pay off our mortgage and help our son through university?" Carlos asks in an e-mail.

We asked Barbara Knoblach, a certified financial planner at Money Coaches Canada in Edmonton, to look at Carlos and Corinne's situation.

WHAT THE EXPERT SAYS

In preparing her forecast, Ms. Knoblach ran a number of different scenarios.

In the first, she assumes Carlos and Corinne retire as planned early in 2030. Their earnings, savings and investments continue as they are now. Both they and their employers contribute to their pension plans. They both contribute to their TFSAs, with Carlos planning to make a $25,000 catch-up contribution to Corinne's TFSA early next year.

Their mortgage payments stay at $1,203 biweekly with no lump-sum payments. The mortgage is not paid in full until late in 2031.

They have an all-stock portfolio with an average rate of return of 6.5 per cent and minimal fees. They get 60 per cent of maximum Canada Pension Plan benefits at age 65 and full Old Age Security.

"Based on these assumptions, they could attain an after-tax spending power of $92,700 per year, starting in 2030," Ms. Knoblach says. They would deplete the capital over time, but they would still have the equity in their properties.

To close the gap, they could increase their earnings through raises or promotions, and add the funds to their savings, she says. "They may well be able to hit their $100,000 spending target by Carlos's age 55."

In Scenario 2, they make a few important tweaks. "They should absolutely have the mortgage retired by the time they are planning to exit their careers to ease the burden on their cash flow," Ms. Knoblach says. "Small annual lump sum prepayments could ensure that they will be mortgage-free by early 2030."

They also should shift from their high-risk investment strategy to one that helps ensure they "hold onto the funds they have already accumulated." She recommends they diversify to include fixed income products and cash. "This will lower the projected rate of return (from 6.5 per cent to 5.7 per cent for an 80 per cent equities/20 per cent fixed income portfolio) but will also leave them less vulnerable to potentially severe bear markets like the one experienced in 2008," Ms. Knoblach says. If they do this, they could expect an annual after-tax retirement purchasing power of $84,000 at Carlos's age 55, she says.

As well, they don't have enough disability and life insurance, "seriously calling into question their ability to continue their current savings program in the event of illness or death of either one of them." They also need to prepare wills.

In Scenarios 3 and 4, the planner looks at how Carlos and Corinne could lower their investment risk – hence their returns – and still reach their desired spending target.

In Scenario 3, Carlos has said they would like to keep the Whistler condo until he is about 70, Ms. Knoblach says. If they sold it at Carlos's age 70 and used the proceeds to fund their TFSAs and non-registered investment accounts, they could retire on $88,200 a year at Carlos's age 55.

In Scenario 4, they retire from their full-time careers but continue to work part-time for several more years. They would not have to draw on their retirement savings until they retired completely. "They could fully retire on an after-tax spending power of $104,400 a year at Carlos's age 60 without having to sell any real estate," the planner says.

They also asked about ways to keep income taxes to a minimum.

Carlos and Corinne should seek the help of a financial planner closer to their intended retirement date because a lot can change in nine years, Ms. Knoblach says. For as long

as Carlos is in a high tax bracket, he should continue making contributions to a spousal RRSP for Corinne. This will lower his taxable income now and equalize the retirement assets later.

A defined contribution pension plan typically gets converted into a locked-in retirement account (LIRA) when an employee retires or resigns from their position. A DC pension can also be used for the purchase of a life annuity, or the funds held in the plan can be transferred to another pension plan.

Because Carlos and Corinne plan to retire rather than look for other work, a transfer to a LIRA is the most likely outcome, the planner says. The LIRA can be converted into a life income fund (LIF) as early as age 55, and funds drawn from the LIF can provide a source of retirement income. In contrast to a registered retirement income fund (which originates from converting an RRSP), a LIF has an upper drawdown limit. As the amount that can be drawn from a LIF every year is capped, a LIRA should be converted to a LIF at an earlier age than an RRSP should be converted to a RRIF.

Whether they should convert to a LIF immediately at Carlos's age 55 depends on whether he and Corinne have been able to save enough in after-tax dollars to cover the early years of their retirement, Ms. Knoblach says. As soon as they have maximized their TFSAs (next year), they should direct any surplus funds into non-registered investment accounts, which will be holding the funds intended for use in early retirement. If sufficient funds in after-tax dollars are available, the LIRAs should not (yet) be converted to LIFs, to allow the funds in the plan to compound in a tax-sheltered manner.

Another possible reason to convert the LIRAs early and begin drawing down the funds would be if the clawback of OAS later in life appears likely, owing to the amount of funds held in before-tax accounts.

Finally, the planner recommends that Carlos and Corinne defer collecting CPP benefits to their ages 65 to avoid the penalty for taking CPP early.

CLIENT SITUATION

The people: Carlos, 46, Corinne, 49, and their son, 17

The problem: Are they on track to retire from work at Carlos's age 55 with $100,000 a year after-tax spending?

The plan: Pay off the mortgage before retiring, plan to sell the Whistler condo at some point, add some fixed income to their portfolio, and consider working part-time for a few years after retiring.

The payoff: An understanding of the tradeoffs needed to achieve their goals

Monthly net income: $12,500 (after deducting pension contributions)

Assets: His DC pension $298,000; her DC pension $91,000; his RRSP $90,000; her RRSP $110,000; her spousal RRSP $35,000; his TFSA $111,000; her TFSA $83,000; registered education savings plan $35,000; residence $1.1-million; time share condo $170,000. Total: $2.1-million

Monthly outlays: Mortgage $2,605; condo fee $350; property tax $335; home insurance $100; utilities $200; maintenance, security $145; garden $50; transportation $640; groceries $1,500; clothing $200; charity $60; vacation, travel $1,000; dining, drinks, entertainment $450; personal care $200; club memberships $300; sports, hobbies $500; subscriptions $100; other personal $500; communication $150; RRSPs $835; RESP $100; TFSAs $1,000. Total: $11,320

Liabilities: Mortgage $295,000 at 2.49 per cent