Money Makeover: Can they afford to get out of here?

By: Deanne Gage Special to the Star, Published on Mon Mar 21 2016

The People
Annette, 55, and Reg, 69, are a retired couple based in Toronto. Reg has been retired for a number of years and Annette just stopped working last year. They now hope to make some major lifestyle changes to reflect their second act. Plans include extensive travel overseas, selling their home and purchasing a property in a rural area.

The Problem
The couple has substantial debt on their secured line of credit and credit cards. They used $321,000 from their line of credit to build their house in 2013. While selling their home will wipe out this debt, they wonder if it’s better to pay cash for their next home or get a mortgage so they would have more money to put in investments. They have $444,000 in their Registered Retirement Savings Plans and Locked In Retirement Accounts. Reg also receives Canada Pension Plan and Old Age Security entitlements as part of his retirement income. They also wonder how much travel funds they have at their disposal. Finally, this couple always files their taxes separately, not as a common-law couple. Should they change that approach?

The Particulars

Assets
Annette’s LIRA: $84,000
Reg’s RRSP: $360,000
House: $1.1 million

Liabilities
Home equity line of credit: $321,000
Credit cards: $7,300

The Plan

Assuming Annette and Reg sell their house for $1.1 million as they expect, they would have $750,000 after paying off their debt and real estate fees, says Bruce Thompson, a Regina-based money coach and financial planner with Money Coaches Canada.

He recommends that the couple purchase their next house outright. “While getting a mortgage would leave more of the net proceeds available to invest, it would also increase their monthly cash flow needs for the life of the mortgage. This could potentially require them to increase their taxable income and the amount of tax that they have to pay in each of those years,” Thompson explains.

If they purchase their next home for $300,000, they will be left with roughly $450,000 to invest to augment their existing registered investments and government pensions, Thompson says.

Reg has never had a Tax Free Savings Account and Annette’s TFSA has a nominal balance. Thompson recommends that Reg invest $46,500 of the proceeds into his TFSA (the maximum contribution amount). Annette should top up her TFSA as well. Doing so shelters the money from future taxes. He says the remaining $357,000 or so can be invested within a non-registered investment account.

The couple’s current overall asset mix is approximately 50 per cent equity and 50 per cent in bonds and cash. They have been comfortable with this mix for the most part, but are concerned, understandably, with the loss of value of their investments since the beginning of 2016, especially now that Annette is also retired. “Given the potential length of Annette’s retirement, a balanced portfolio consisting of 65 per cent in the equity market and 35 per cent in bonds and cash would certainly not be unreasonable for the couple. But ultimately, the increase in volatility that they can expect to come with the change would have to be in their comfort zone,” Thompson says. The important question is what rate of return they need to reach their goals.

Thompson calculates the couple will require $45,700 a year for their expenses, not including any money for travel. With the current portfolio structure and assuming a 3.5 per cent rate of return net of fees, the couple could sustain $45,700 a year, indexed to inflation, until Annette reaches age 95. In addition to this amount, Annette and Reg have up to $13,300 a year, for the next 10 years, that they can spend on travel, he adds.

Any retirement plan should allow for contingencies in case of illness or other issues. To allow for this, Thompson says the couple could spend less than the $13,300 a year on travel. Annette could work part-time during the first five to 10 years of retirement. She is an avid photographer and has expressed interest selling her work. They could also consider increasing the equity portion of their portfolio to 65 per cent to potentially increase their average rate of return.

Finally, the couple should start jointly filing their taxes. Thompson notes that starting this year, Reg's retirement income will be greater than Annette's. He withdraws every year from his RRSP, which is eligible for pension income splitting. This means Reg can split up to 50 per cent of his RRSP income with Annette on their tax return. Doing so would lower Reg's taxes payable and increase Annette's but their combined taxes would be less than if they filed separately.