New parents want a plan for future real-estate goals

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SPECIAL TO THE GLOBE AND MAIL
PUBLISHED JANUARY 19, 2018

Marta and Mannie understand that big life changes are an ideal time to draw up a financial plan. For them, it's the birth of their first child and their plan to have a second one in the not-too-distant future.

Marta has left her part-time job to stay home with the new baby, but the family will still be comfortable financially. Mannie brings in more than $170,000 a year in a technical field. Marta plans to go back to work full-time in four years. Mannie is 37, Marta, 34. They have a house with a mortgage and some savings.

Mannie has a defined benefit pension from a previous employer and wonders whether he should take the commuted value. Though they live in Alberta, they dream of building a cottage in Prince Edward Island. Longer term, they plan to buy or build a new home at a cost of $1-million. What changes should they make?

We asked Steve Bridge, a fee-for-service financial planner with Money Coaches Canada in Vancouver, to look at Marta and Mannie's situation.

What the expert says

Going down to one income and having baby expenses means Marta and Mannie will have to pay close attention to their spending for the next few years, Mr. Bridge says. They could cut back on dining out and vacations, for example.

They will also want to put money into a registered education savings plan (RESP), but a word of caution – be wary of scholarship trusts, scholarship plans or group RESPs, the planner says. These plans tend to have high fees and can be more restrictive than self-directed RESPs.

"They will do much better opening a regular RESP on their own through a robo-adviser or through their bank," he says. "I recommend they set up a family plan that allows them to save for more than one child in the same RESP account."

If they contribute $200 per month, they will "just about maximize" the annual Canada Education Savings Grant of $500 a year for each child (they would get $480 per year). "If they continue like this, they will maximize the free grant money ($7,200) in 15 years. They would have $56,158 in 15 years and $65,000 by the time the new baby is age 18 (assuming a 5 per cent annual return).

The RESP money could be invested the same way the couple invests the rest of their savings for the first 13 or 14 years, Mr. Bridge says. "If they have one child, they should move gradually into cash and fixed income leading up to the time the child turns 18 and starts to use the money," the planner says. If they have two children, they could delay this change of allocation until the second child is 13 or 14 years old and then go to a more conservative allocation. Once their future becomes a bit clearer, they could review how the RESP is doing and contribute more if required, he says.

Now, for Mannie's defined benefit pension.

"The benefit of taking the commuted value of a pension is that it puts the money (and the control) in your hands," Mr. Bridge says. Under the pension option, if Mannie were to get hit by the proverbial bus, Marta might receive survivor benefits, depending on which pension option Mannie chose. If he takes the commuted value and passes away, all of the remaining money would go to Marta.

"The disadvantage of taking the commuted value is that the investment risk is now with Mannie and Marta instead of the pension provider, and investors can be their own worst enemies," Mr. Bridge says.

"If Mannie and Marta have the knowledge and temperament to buy a few globally diversified index funds and rebalance once or twice a year (or use a robo-adviser), I would say take the commuted value. But if they want to stock-pick, buy bitcoin or open a restaurant, I would say choose the defined benefit because it will provide a monthly pension payment for life with very little risk."

On the investment front, they are invested heavily in individual Canadian and U.S. stocks, which is risky, Mr. Bridge says. He recommends they consider using index funds or exchange-traded funds with an asset mix of 25 per cent in fixed income and 25 per cent each in Canadian equities, U.S. equities and global equities.

Any future investments should first of all go into a spousal RRSP for Marta (if Mannie has contribution room), then to their tax-free savings accounts. "Put your highest-growth potential investments such as stocks into your TFSA (where you can reap the capital gains tax-free and potentially avoid clawback of Old Age Security benefits) and your fixed-income into your RRSPs," the planner says. "Any way you approach it, your goal is to have equal amounts invested in each of your names by the time you retire to minimize income taxes."

Mannie has stock and stock options in his company, the planner notes. "Having your job and investments in one company in one sector can lead to disaster if that company or sector runs into trouble, so make a plan to divest systematically," he says.

Longer term, they are on track to have their mortgage paid off in 12 years. Selling their current home and spending $1-million on a new home will affect their retirement but is still achievable.

"Let's assume they sell their home in five years for $750,000. After paying off the remaining mortgage of $220,000, realtor commission of about $26,500, moving costs of $5,000 and other costs of about $8,500 (land transfer, potential mortgage fees), they will be left with about $490,000," the planner says. "This means taking out a new mortgage of about $500,000 in five years, with only 16 years left until Mannie plans to retire at age 58," the planner says. Even so, they should be able to have it paid off by then, he says.

As for the cottage, Mr. Bridge recommends the couple wait for a few years until after the dust settles and their finances stabilize.

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The people: Mannie, 37, Marta, 34, and their new baby.

The problem: What changes should they make, given their growing family, to ensure they can achieve their long-term goals?

The plan: Trim spending, open an RESP, contribute to a spousal RRSP, take full advantage of TFSAs, review investments and put cottage plans on the back burner.

The payoff: A better understanding of how to avoid a cash-flow crunch resulting from trying to do too much in too short a time.

Monthly net income: $10,575

Assets: Company stock and options $158,000; his TFSA $31,000; her TFSA $24,840; his RRSP $89,000; her spousal RRSP $10,534; his group RRSP $15,000; his defined contribution pension plan $218,700; commuted value of his DB pension plan from previous employer $208,000; residence $650,000; cottage lot $65,000. Total: $1.47-million

Monthly outlays: Mortgage $3,465; property tax (including cottage lot) $345; property insurance $130; utilities, security $440; maintenance $200; transportation $490; grocery store $500; clothing $210; gifts, charity $130; vacation, travel $1,000; dining, drinks, entertainment $995; sports, hobbies $250; personal care $20; drugstore $50; life insurance $90; disability insurance $310; phones, TV, internet $330; RRSPs $1,630; TFSAs $500. Total: $11,085

Liabilities: Mortgage $380,000