‘Pandemic drop’ has made Lana unsure whether her sizable investments can really sustain her for life

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Retired with no work pension, Lana, who is only 49, can be forgiven for worrying she might run out of money some day. Yet she has substantial investments – proceeds from the sale of her share in a successful business – and a mortgage-free house in a small Ontario city.

“I’m an early retiree, managing my portfolio myself, and I have seen quite a pandemic drop,” Lana writes in an e-mail. “While not as drastic now as it was in the beginning of March, the erasure of almost all my portfolio gains makes me unsure as to whether I will have the ability to sustain retirement without either changes to my portfolio, my withdrawals, my status as a retiree, or a combination of all three,” she writes.

Lana had been renting out a studio apartment in her house on Airbnb, but would prefer to stop. “I’m unlikely to have any further income this year anyhow.”

Lana is spending about $39,200 a year, paid for by the $53,000 she withdraws from her holding company each year as a dividend. She wonders whether this is the best way to structure her personal income from a tax point of view. She wonders, too, if her investments are “well-enough diversified to weather a continued retirement” with the same income. Her overarching goal: “Don’t run out of money.”

We asked Daniel Evans, a certified financial planner at Money Coaches Canada in Vancouver, to look at Lana’s situation.

WHAT THE EXPERT SAYS

To ensure her savings will last, Lana should draw first on her holding company dividends until they are exhausted, then on her registered retirement savings plan and finally on her tax-free savings account, Mr. Evans says.

Including all income sources – holding company dividend, investment returns and rent – Lana’s taxable income for 2019 was about $89,000, putting her in the 31.48-per-cent tax bracket (federal and provincial combined). He recommends Lana stop renting out her flat because she does not need the money to maintain her standard of living.

The loss of rental income – about $10,000 last year – may bring Lana’s current taxable income to the lower bracket of $48,546 to $78,786, which is taxed at 29.65 per cent.

“The indexed $53,000 of dividends is enough to support $39,200 a year after-tax in spending,” the planner says. The after-tax dividend would be about $43,000, giving Lana a bit of a surplus that can be directed to her TFSA.

The dividends will last until 2027, at which point Lana will have to draw on her other accounts. The planner recommends she leave her TFSA intact for the long term because the tax-free status of income earned and compound growth in the account “is simply too good to pass up.”

The planner recommends starting RRSP withdrawals at $20,000 a year in 2027, when her income would be lower because she would no longer be drawing dividends. “Not only would the RRSP be able to grow tax-sheltered for another seven years, but she would also be saving about $1,100 a year in taxes by starting the withdrawals in 2027 rather than in 2020,” he says.

This income would need to be supplemented with $30,000 in non-registered redemptions (indexed for inflation). This amount will fall when she starts collecting Canada Pension Plan and Old Age Security benefits at the age of 65. Alternatively, she could choose to begin collecting CPP at 60, he says.

Because Lana does not plan to contribute further to CPP, she would probably qualify for about 44 per cent ($6,188) of the maximum CPP benefit ($14,109) at the age of 65, the planner says. If she decides to take CPP at 60, her benefit drops to 28 per cent ($3,960) of the maximum. The annual difference in real dollars for taking CPP early is about $2,228.

As long as Lana is taking dividends from the holding company, Mr. Evans recommends she put any surplus savings into her TFSA. She also has the option to move some funds from her non-registered account to max out her TFSA contributions in 2020.

Based on $20,000 a year in withdrawals from her RRSP up until the age of 71 (the time when she needs to convert her RRSP to a registered retirement income fund), the minimum withdrawal required from the RRIF would be $14,500, increasing each year with the mandatory minimums. That assumes a return of 3.51 per cent annually after fees. Any shortfall would come from her non-registered portfolio.

“The TFSA comes in late to the game, funding the later years from age 80 onward, after her non-registered assets have been depleted,” Mr. Evans says.

In today’s dollars adjusted for inflation at 2 per cent a year, the planner’s assumptions show Lana can spend $40,000 a year after tax until the age of 90. “Life expectancy does play a role in recommendations,” he adds, but Lana says 90 is the appropriate estimate. “Given she is careful with spending, this should allow her to continue her current lifestyle.”

Finally, Mr. Evans looks at Lana’s investments. With the stock market outlook uncertain, “it is extremely important for her to revisit her risk tolerance,” he says.

Her current asset allocation is 5 per cent cash, 40 per cent fixed income and 55 per cent equities. Of the 40 per cent fixed income, 15 per cent is allocated to preferred shares and 25 per cent to bonds. Of the 55 per cent in equities, she has 13.75 per cent in Canada, 22 per cent in U.S. and 19.25 per cent in international holdings. “This is a well diversified portfolio for future growth.”

Unfortunately, in today’s low interest-bearing environment, it is hard to find yield in fixed income. “I want to caution her against taking on additional risk in this segment of her portfolio to chase yield.” Preferred shares “are great to have as part of your portfolio, but they behave like equities” – subject to the ups and downs of the stock market – and should be viewed as such when assessing risk, Mr. Evans says.

Lana’s TFSA should be allocated to equities focused on capital growth, he says, because this account is geared for the long term. Eligible Canadian dividends – which benefit from the enhanced dividend tax credit – should be held in non-registered accounts. The RRSP should hold the U.S.-based investments because the Internal Revenue Service recognizes the RRSP as a tax-deferred investment vehicle and so gives a break on withholding taxes that would otherwise be payable on distributions (interest and dividends) from U.S. companies.

CLIENT SITUATION

The person: Lana, 49

The problem: Does she have enough to maintain her lifestyle to the age of 90?

The plan: Draw from the holding company until the assets are depleted, then draw as needed from RRSP and non-registered accounts until she begins collecting government benefits. Adjust her portfolio to lower risk.

The payoff: Financial security despite an unusually long retirement.

Monthly net income (2019): $6,600

Assets: Cash $33,000; non-registered ETF portfolio $405,000; holding company portfolio $370,300; TFSA $56,700; RRSP $322,300; residence $560,000. Total: $1.7-million

Monthly outlays: Property tax $375; water, sewer $85; home insurance $35; utilities $305; maintenance, garden $135; transportation $285; groceries $425; clothing $80; gifts, charity $130; vacation, travel $415; dining, drinks, entertainment $620; personal care $35; club membership $5; health care $180; phones, TV, internet $160. Total: $3,270. Surplus goes to savings.

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