FINANCIAL FACELIFT

Lindsay, 64, is 'house rich, cash poor.' What should she do when she retires this year?

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SPECIAL TO THE GLOBE AND MAIL

PUBLISHED MARCH 14, 2025

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Lindsay, 64, has a retirement spending goal of $75,000 a year.

KAJA TIRRUL/THE GLOBE AND MAIL

Lindsay is 64 years old and single with no dependants. She plans to retire at year's end, when she will be 65.

"Perhaps I should have saved more than I have, but I didn't get my first real job until I was almost 40," she wrote in an e-mail. In her younger years, she travelled and worked odd jobs in different countries – and completed nine years of higher education.

She has worked in the education field for 25 years, now grossing $89,000 a year, and will be entitled to a pension of $45,600 a year, but it is not necessarily indexed to inflation. She owns a mortgage-free house in an Ontario university town and a second one with a mortgage that she bought for her mother, who is 94. "She loves the house, so under no circumstances would I consider selling it before she is ready to leave," she wrote.

She thinks she might sell her own house when she is 80 or so and move into "some sort of co-housing."

Her questions: Should she defer her government benefits to age 70? Should she convert her registered retirement savings plan (RRSP) to a registered retirement income fund (RRIF) and begin drawing from it as soon as she retires? Would it make sense to sell her second house?

Her retirement spending goal is $75,000 a year.

We asked Shay Steacy, a financial planner at Modern Cents Inc. in Oakville, Ont., to look at Lindsay's situation.

What the expert says

"Lindsay is in the situation often referred to as 'house rich, cash poor,' meaning she has a positive net worth in her real estate assets but a lack of liquid assets to fund her spending needs," Ms. Steacy said.

Lindsay's pension income will replace just over half her salary and is guaranteed for as long as she lives, the planner said.

Deferring Canada Pension Plan and Old Age Security benefits would be most beneficial for Lindsay because that would increase her inflation-adjusted, lifetime guaranteed income. She has a 25-per-cent probability of living to 96 and a 10-per-cent probability of living to 100, Ms. Steacy said.

"However, this leaves Lindsay with the five years between retirement and the maximum deferral age of 70 with less cash flow than she needs to meet her goals," she noted.

"I recommend Lindsay use her TFSA and RRSP to bridge the gap, taking monthly withdrawals from each account so that they feel more like the regular paycheque she's been used to getting." Lindsay should convert her RRSP to a RRIF and start taking $1,250 a month from it. She can also start monthly withdrawals of $2,500 from her TFSA to reach her annual spending goals. Her TFSA and RRIF would both be depleted in the year she turns 69, in 2029.

Even when Lindsay starts getting CPP and OAS, she will still have a shortfall between her pension income and spending goals, Ms. Steacy said.

Lindsay plans to sell her home at age 75 or 80, with the proceeds being used to generate an annual income. Ideally, she'd like to move to a co-housing arrangement. "She anticipates her housing costs in a co-living situation after she sells the house would be the same as her living costs now, so her retirement spending goals would not be impacted," the planner said.

To allow her to spend $75,000 a year, Lindsay could use a home equity line of credit to fund the shortfall starting in 2030. Or she could sell the house earlier than she originally planned. "I'd encourage Lindsay to assess her lifestyle, her appetite for accumulating debt and even health or economic variables at the time to help make this decision."

"I wouldn't want her to feel like she needed to reduce her spending goals just because her equity is tied up in real estate," Ms. Steacy said. "Looking at the retirement projections, she should have enough. It will just be about when and how she unlocks the equity in her real estate."

According to the planner's projections, Lindsay will have a net worth of more than $200,000 in today's dollars at age 100 and will still have her defined benefit pension and government benefits.

In preparing her forecast, Ms. Steacy used the following assumptions: A rate of return of 2.9 per cent on her RRSP and TFSA because of the short-term nature of these funds. When her houses are sold, the future rate of return on her TFSA and nonregistered account is assumed to be 4 per cent. Inflation is estimated at 2.1 per cent.

Lindsay's defined benefit pension is not indexed in these projections because the inflation adjustment is not guaranteed by the pension fund.

Lindsay should review the current asset allocation of her TFSA and RRSP to ensure the risk tolerance aligns with a short-term time horizon, Ms. Steacy said. "It's anticipated she will use all the funds within four years, so she doesn't have the capacity to take on market value fluctuations."

Lindsay asked whether it makes sense to keep her second house after her mother no longer lives there. She likes the idea of renting it below market value to someone with a low income.

Right now, her mother is paying some but not all the expenses on the house. There are 10 years left on the mortgage. "If we plan for her mother living there for another 10 years, the mortgage would be paid off by that time and Lindsay would be free of the $1,000-a-month mortgage payment.

"So she could rent it out for a below-market rate to someone who could really use it," the planner said, "because she'd have positive rental cash flow even with a below-market rental income."

If Lindsay has additional costs in the future, she may be forced to sell the second house if she has not already done so.

When the rental is eventually sold, she could generate cash flow by accessing not only the investment returns but the principal as well, the planner said. "Since she doesn't have a desire to leave a large estate, depleting her investment accounts is not a concern."

When Lindsay's home and rental property are sold, she will likely have room in her TFSA to shelter some of the proceeds from taxes. "She should ensure in each year of sale that she fully tops up to her available room."

In years when she has nonregistered assets and additional TFSA room, she should shift investments from the nonregistered account to the TFSA, the planner said.

Client situation

The person: Lindsay, 64.

The problem: Should she defer taking government benefits to age 70? Should she convert her RRSP to a RRIF as soon as she retires? Should she keep her second house or sell it?

The plan: Retire at 65 while deferring government pensions until 70, using her RRSP/RRIF and TFSA to fill the gap.

The payoff: A road map to the future that shows she can achieve her financial goals.

Monthly net income: $5,000.

Assets: $5,000 in cash in bank; $80,000 TFSA; $85,000 RRSP; $500,000 primary residence; $370,000 rental property. Total: $1,040,000.

Estimated present value of defined benefit pension: $543,600 (provided by Lindsay). That is what someone with no pension would have to save to generate the same income.

Monthly outlays: Property tax $300; utilities $220; maintenance $350; transportation $240; groceries $595; clothing $135; gifts $100; charity $230; vacation and travel $1,175; second property carrying costs $460; dining, drinks, entertainment $460; personal care $285; pets $335; sports and hobbies $160; subscriptions $100; doctors and dentists $340; phones, TV, internet $105. Total: $5,590.

Liabilities: $85,000 rental property mortgage at 6.81 per cent.

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