FINANCIAL FACELIFT

Can Thelma, 61, retire soon without cutting back on her spending?

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As protection against financial market volatility, Thelma may want to discuss a 'bucketing' strategy with her adviser to ensure there are enough cash and cash equivalents to safeguard one to three years of required portfolio withdrawals, experts say.

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Thelma will soon be giving up her $170,000 a year health care job to retire and travel the world. She's 61 years old and has two children, 18 and 21; the younger one still lives at home.

Thelma is helping with their university tuition, an expense that will fall away when they graduate.

Given her substantial savings and investments, Thelma is hoping she won't have to scale back her lifestyle spending too much when she is no longer working. Her financial assets, registered and non-registered, total about $1.4-million.

"What is the most tax-efficient way to draw an income from my various sources?" Thelma asks in an e-mail. "When should I take Canada Pension Plan and Old Age Security benefits?"

She also wonders when to convert her registered retirement savings plans to registered retirement income funds and begin withdrawing.

She plans to downsize from her small-town Ontario house, valued at $1-million, in 20 years or so and either rent or buy something smaller.

Her retirement spending goal is $90,000 a year after tax.

We asked Andrea Thompson, a certified financial planner and founder of Modern Cents, an advice-only financial planning firm based in Mississauga, to look at Thelma's situation.

What the Expert Says

Thelma's post-retirement lifestyle will be similar to her current lifestyle, costing about $90,000 a year after tax, Ms. Thompson says.

First, the planner looks at the two components of Thelma's retirement income: fixed pensions and investment assets. At age 65, Thelma's CPP and OAS entitlements would be $1,345 a month and $713 a month, respectively.

"It is more advantageous for Thelma to defer her CPP and OAS to age 70," the planner says. That way Thelma will benefit from a 42-per-cent increase in her CPP to $1,910 a month and a 36-per-cent increase in her OAS to $970 a month, in today's dollars. “Considerations for Thelma are that she is healthy and has adequate other sources of income to draw from prior to beginning her government pensions.”

Thelma’s personal investment assets are spread out over registered, tax-free, and non-registered accounts. Her registered accounts – RRSPs, a defined contribution pension plan and a locked-in retirement account (LIRA) – total more than $1-million.

Thelma will be converting her defined contribution pension plan to a LIRA upon retirement and transferring the investment management of the account to her existing adviser, Ms. Thompson says.

“It is recommended that Thelma convert her registered accounts to income-producing accounts this year – RRSPs to RRIFs, LIRAs to life income funds – and begin taking out the minimum required distributions starting in 2025,” the planner says. “Based on her age, this would require her to draw 3.57 per cent from her registered accounts next year.” That is also based on the account value on Dec. 31. “This would provide Thelma a baseline income of about $41,000 a year before tax,” Ms. Thompson says.

“It is recommended, although RRIF minimum payments do not require any withholding taxes to be applied, that Thelma consider applying a flat withholding tax rate to her entire withdrawal, so as to not have to pay tax installments in the future,” the planner says. “She will want to discuss an appropriate withholding rate with her accountant and investment adviser.”

Thelma’s non-registered assets total slightly more than $400,000. She has about $32,000 in cash and cash equivalents that she can draw from to supplement her cash flow in the first year after retiring.

“Aside from this, the accounts are generating investment income from dividends and interest of about 3 per cent, or $12,000 a year,” Ms. Thompson says. Thelma will have to draw from the principal to supplement her remaining amount required for her desired lifestyle.

The planner has some suggestions for Thelma’s asset allocation. “Thelma’s non-registered account could benefit from a reallocation from a growth-oriented strategy to an income-oriented strategy upon retirement,” the planner says. Currently, Thelma's asset allocation is 70 per cent in equities and 30 per cent in fixed income. Within the equity bucket, there is fairly equal weighting among Canadian stocks, international mutual funds and U.S. mutual funds.

"Thelma could benefit from a shift to more Canadian dividend-paying stocks, which will create a higher level of tax-preferred income," she says. That's because of the dividend tax credit. Income earned from foreign stocks is not granted any preferential tax treatment, and withholding taxes are applied against any dividends received from foreign companies.

As protection against financial market volatility, Thelma may want to discuss a "bucketing" strategy with her adviser to ensure there are enough cash and cash equivalents to safeguard one to three years of required portfolio withdrawals, Ms. Thompson says.

Based on initial projections, Thelma's non-registered account will be depleted by age 70, when she will begin taking income from CPP and OAS, the planner says.

As it is allocated now, the overall blended rate of return for Thelma's investment portfolio, using FP Canada Standards Council's April 2024 guidelines, is 5.1 per cent.

"It is recommended that Thelma continues to transfer money from her non-registered account to her tax-free savings account each year, if possible," the planner says. Thelma's TFSA would remain an emergency fund or a source of last resort for large, unforeseen expenses.

When Thelma begins CPP and OAS, her RRIF and LIF payments will have increased to about $60,000 a year, Ms. Thompson says. Thelma's CPP and OAS payments will have benefitted from deferral, providing a combined $47,500 a year of income, adjusted for inflation. "Any additional income that may be required for any lifestyle gaps could be funded by her TFSA, which could be worth about $250,000 by age 70 with continued deposits."

When considering downsizing her house versus renting, Thelma could afford to do either, the planner says. At age 80, her home would be valued at about $1.6-million, assuming a 3-per-cent a year growth rate. Upon the sale of her home, after realtor and sale-related expenses, this would add about $1.5-million to her TFSA and non-registered accounts.

If Thelma were to downsize to a smaller townhouse costing her $750,000, and conservatively assuming her lifestyle costs would remain the same despite a smaller home size, she would be able to continue to live comfortably into her later years, the planner says.

If Thelma opts to rent, her lifestyle costs would change. Home ownership expenses would disappear; however, her rental costs, conservatively estimated at $5,000 a month, would add to her existing lifestyle expenses. "Overall, it would cost her $2,500 more per month to live in a rental home," Ms. Thompson estimates. This lifestyle spending increase would be entirely possible for Thelma given the increase in investment assets and income that would be available to her upon reinvestment of her home sale proceeds.

Finally, Thelma could benefit from discussing with her adviser the purchase of an annuity with a portion of her RRIF assets to create her own defined benefit pension, Ms. Thompson says. "This could minimize the impact of stock market volatility on the value of her retirement accounts over the long term and protect against longevity risk," the planner says.

Client Situation

The People: Thelma, 61, and her two children.

The Problem: Can she exit the work force soon without having to scale back her lifestyle? What is the best way to generate retirement income?

The Plan: Convert her RRSPs to RRIFs and her LIRAs to LIFs and begin withdrawing as soon as she retires. Postpone government benefits to age 70.

The Payoff: A smooth transition.

Monthly net income: $9,500.

Assets: Cash $5,000; stocks $345,000; locked-in retirement account $72,500; TFSA $110,000; RRSP $350,500; second RRSP $425,340; defined contribution pension $240,000; registered education savings plan $90,000; residence $1,000,000. Total: $2.5-million.

Monthly outlays: Property tax $800; water, sewer, garbage $100; home insurance $125; electricity $400; heating $150; maintenance $750; garden $200; car insurance $500; other transportation $210; groceries $750; clothing $50; gifts, charity $160; vacation, travel $400; children's tuition $900; dining, drinks, entertainment $650; personal care $150; pets $200; sports, hobbies $400; subscriptions $20; doctors, dentists $250; drugstore $125; life insurance $50; phones, TV, internet $450; RRSP $100; TFSA $650. Total: $8,540.

Liabilities: None.

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