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Can Mario and Jasmine afford to retire early with their government pensions?

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Mario is age 46 and earns $129,000 a year. His wife Jasmine is 44 and earns $92,000 a year. They have two children, ages 10 and 13, and a mortgage-free home in Ottawa valued at $950,000.

What distinguishes them from many other Canadians is that they work for the federal government and have defined benefit pension plans. This gives them more choices than most. They would like to leave the working world as soon as possible, mainly because they can.

"Our goal is early yet comfortable retirement by taking a hit on our defined benefit pensions and relying more on our investments," Mario writes in an e-mail.

When they retire, Jasmine hopes to pursue her crafting and get part-time work related to that hobby. Mario hopes to pursue his passion for cooking and do volunteer work.

"Together we hope to travel and enjoy calm and peaceful time together," Mario writes.

By retiring from work early, Mario will give up about 5 per cent of his pension entitlement. Jasmine will get her full pension.

They ask about the right balance between their tax-free savings accounts and registered retirement savings plans. Their goal is to retire when Jasmine will be 55, with a joint spending target of $100,000 a year after tax.

We asked Ian Calvert, a certified financial planner and principal at HighView Financial Group in Oakville, Ont., to look at Mario and Jasmine's situation.

WHAT THE EXPERT SAYS

With retirement about 10 years away, Mario and Jasmine need a financial plan that shows how much they must save to meet their future spending goals, Mr. Calvert says.

Both are fortunate to have defined benefit pensions, he says. Most private sector companies have abolished their defined pension plans and converted them to defined contribution.

"With no liabilities or major debt servicing, they should start a more aggressive savings plan immediately," Mr. Calvert says. "One area that needs to be higher is their TFSAs." The maximum lifetime TFSA contribution is now $88,000 each. Mario's $4,500 and Jasmine's $23,500 in their TFSAs is "simply too low," the planner says.

Now that their mortgage has been paid off, they are overcontributing to their TFSAs, but it will take some time to fund their outstanding balances. "They should make it a top priority to direct all surplus cash flow to their TFSAs," he says.

With no non-registered assets, and three sources of taxable income in their retirement years (work pensions, Canada Pension Plan and Old Age Security benefits), having a larger pot of tax-free assets such as TFSAs will allow for either regular or lump-sum withdrawals in their retirement years without pushing them into unfavourable tax brackets, Mr. Calvert says.

The next big item to consider is their RRSPs. Their pensions, while "an extremely valuable component to their retirement plan," affect where they can save their remaining retirement assets. "When you are accruing pension benefits in the plan, RRSP contribution room is reduced, limiting what you save personally in your RRSP accounts," Mr. Calvert says.

This is known as a pension adjustment. After their pension adjustments, Mario has about $3,700 of RRSP contribution room available each year and Jasmine about $4,000.

"If they made the maximum contribution to both RRSPs, and earned 5 per cent a year, they would have a combined total of about $305,000 by 2034," he says. "This is a very manageable figure for both melting down the RRSP assets and controlling tax brackets in retirement."

In 2035, when they are both fully retired, they will need an additional $30,000 from their RRSPs, Mr. Calvert says. Converting the RRSPs to registered retirement income funds, although not necessary, is recommended because they will be making regular annual withdrawals. Withdrawals from RRSPs typically come with a deregistration fee for each transaction. "If you're establishing a monthly withdrawal plan, the RRIF conversion will avoid this."

Their retirement income would consist of Mario's pension of $73,000 a year, Jasmine's pension of $53,000, and an annual $30,000 withdrawal from their RRSP/RRIF accounts, for total pretax income of $156,000 a year. Subtracting $26,000 for income tax would leave them with $130,000 – equal to their target of $100,000 a year in inflation-adjusted dollars. "This would also keep their incomes below $80,000 a year each and give them a reasonable 29.65-per-cent marginal tax rate (as of today)," Mr. Calvert says.

Their pensions will fall when their bridge benefits end at age 65.

Mario and Jasmine will be drawing heavily on their RRSP/RRIF accounts when they retire. The major goal of these assets is to bridge their retirement income from age 55 to 65, when they begin drawing CPP and OAS benefits. They will then receive an expected 75 per cent of the maximum CPP benefit and 100 per cent of OAS benefits.

"This combined figure should be close to $55,000 by 2044, assuming both benefits are increasing each year," Mr. Calvert says.

By Jasmine's age 65, the withdrawal requirements from the capital left in their RRSP accounts would be insignificant, he says. From then on, the couple would be left with their real estate, work pensions and government benefits, "and, ideally, two healthy TFSA accounts" for tax-free income in case of unexpected expenses.

To achieve this goal, they should aim for a minimum savings target of $25,700 a year outside of their pension contributions. That means $7,700 a year to their RRSPs, $13,000 to the TFSAs and $5,000 to the children's registered education savings plan.

"The RESP should not be forgotten in their savings target," the planner says. "It's a tremendously valuable account that offers tax benefits and enhanced accumulation due to the Canada Education Savings Grant," he says.

The CESG is 20 per cent of annual contributions up to a maximum of $500 a year and a lifetime cap of $7,200. Beneficiaries qualify for the grant until the end of the year in which they turn 17.

To get their RRSP and TFSA savings to an optimal point, Mario and Jasmine should review their portfolio holdings and asset allocation to determine if they are aligned with their risk tolerance and savings goals, Mr. Calvert says. "Without a comprehensive financial plan to identify the future asset goals, it's very difficult to build the optimal portfolio structure to achieve those goals," he says. "In other words, it should be financial planning first, portfolio construction second."

Because of their pension plans, Mario and Jasmine will be less reliant on their investment returns, so they can be "slightly more aggressive and growth-oriented in the portfolio," the planner says. "This means having the capacity to carry a higher equity exposure and higher volatility within a well-balanced and geographically diversified portfolio."

CLIENT SITUATION

The people: Mario, 46, Jasmine, 44, and their children, 10 and 13.

The problem: Can they afford to retire early with a budget of $100,000 after tax a year?

The plan: Draw up a financial plan in which they save $25,700 a year for about 10 years to tide them over until they begin collecting government benefits at age 65. Focus first on their TFSAs, contributing the maximum.

The payoff: An early escape from work made possible mainly by their work pensions.

Monthly net income: $13,850.

Assets: Cash $44,300; GICs $515; his TFSA $4,500; her TFSA $23,500; his RRSP $70,357; her RRSP $42,000; RESP $23,600; residence $950,000; estimated present value of his pension plan $1,120,000; estimated present value of her pension plan $914,000. Total: $3.2-million.

Monthly outlays: Condo fee $85; property tax $600; water, sewer, garbage $75; home insurance $87; electricity $118; heating $75; maintenance $200; transportation $287; groceries $1,200; child care $400; clothing $225; gifts, charity $125; vacation, travel $750; dining, drinks, entertainment $800; personal care $100; sports, hobbies $150; subscriptions $50; health care $55; life, disability insurance $150; phones, TV, internet $142; RRSP contributions $2,000; RESP $300; TFSAs $1,600; pension plan contributions $2,690. Total: $12,265. Surplus: $1,585. (Some expenses may be understated.)

Liabilities: None.

Ian Calvert is a Vice President & Principal at HighView Financial Group.