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Can Naresh and Whitney, both 51, retire in five years and leave no money behind?

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Naresh and Whitney have recently moved back to Canada after working in Europe for a decade or so. They are both 51 years old with no children and no desire to leave an estate.

She earns $163,000 a year in a senior role with an international agency. He is self-employed with variable income. Before they moved to Europe, Naresh worked as a teacher and Whitney worked for the federal government. They will both be getting Canadian and overseas pensions at age 65.

Naresh has two pensions: one is indexed to inflation at $7,980 a year, and the other $7,400 a year, not indexed. Whitney will get $11,600 a year indexed and $12,600 not indexed, for a total of $39,580.

"We'd like to retire in Canada and are trying to determine when we will be financially ready," Whitney writes in an e-mail. "Our profile might resonate with readers who have worked and earned a pension outside of Canada for part of their careers and then returned for their final years before retirement."

They are planning to retire in five years or so with a retirement spending goal of $84,000 a year after tax, rising in line with inflation. "We want to have a retirement budget that will draw down to zero by the time we die." They are concerned about having enough money for "potentially significant" health care costs when they are older. "What planning tools and safeguards would you recommend?"

We asked Ian Calvert, a principal and head of wealth planning at HighView Financial, to look at Whitney and Naresh's situation.

[Can Fiona, 51, afford to take early retirement?]

WHAT THE EXPERT SAYS

Naresh and Whitney's top priority is relatively early retirement, Mr. Calvert says. "They require a financial plan that allows them to comfortably and strategically draw down their assets over their lifetime," the planner says.

"They don't mind seeing their capital decrease each year as long as it's at a sustainable rate."

They have about $1,528,665 in financial assets, including cash, registered retirement savings plans, or RRSPs, tax-free savings accounts, or TFSAs, and non-registered investments. They also have $890,000 worth of real estate.

"Their top priority over the next five years of employment should be adding as much to their investment accounts and cash savings as possible," Mr. Calvert says. "With Whitney participating in a pension plan, and uncertainty with Naresh's taxable income, both should first aim to fully fund their tax-free savings accounts," the planner says. At $7,000 a year each, this would give them savings of $70,000 over the next five years.

After paying income taxes and Whitney's pension contributions, they have a net income of about $98,000 a year now. Their current expenses are modest, at about $58,000 – substantially less than their retirement target – so they should have the capacity for additional savings from now to the time they retire.

[How should Tucker, 67, divide his estate between Jeanie, 55, and two children from a past marriage?]

After the TFSAs, Whitney should top up her RRSP each year to the maximum extent possible; her pension adjustment reduces her contribution room. For Naresh, RRSP contributions would only make sense if his taxable income increases. Any additional savings, after all the contributions are made, should be added to their non-registered portfolio.

"With the goal of retiring at 56, they need to make some decisions about when to take their pension income," Mr. Calvert says. Their pensions will be a critical component of their overall retirement plan, he says.

"Although taking early, reduced pensions would have some immediate benefits, it would be advantageous to wait and receive the full, unreduced pensions at age 65," the planner says. "This will provide a larger safety net of guaranteed income at the later stages of their retirement, while drawing down their assets at a higher rate for the first nine years."

To meet their retirement spending target, which, with inflation, will have risen to $93,000 a year in five years, they should withdraw a substantial amount from their RRSP assets to start, he says.

Beginning in 2031, their first year of full retirement, they should each withdraw $25,000 from their RRSPs or registered retirement income funds, called RRIFs. In addition to the $50,000 of taxable registered withdrawals, they will need about $53,000 from their non-registered assets. This will provide $103,000 of gross cash flow, less $10,000 in personal income tax, to meet their after-tax spending target of $93,000.

This withdrawal strategy is intended to keep both their incomes within the lowest tax bracket of 25.69 per cent, Quebec and federal, Mr. Calvert says.

The years from 2031 to 2038 will be their lowest income years, so it makes sense to start early and make large RRSP/RRIF withdrawals, he says. At this rate of withdrawal, Naresh's RRSP is expected to be depleted by the time he is 63. They should expect a modest decrease in their capital during those years.

Then, starting in 2039, they will receive combined work pension income of about $39,000 a year plus Canada Pension Plan and Old Age Security benefits. Their government benefits will be reduced based on the time they lived outside of Canada, Mr. Calvert says.

"When the pension income starts at age 65, the withdrawal requirements from their portfolio will be substantially less," he says. From that point on, they should expect their capital to increase each year, particularly in their non-registered portfolio and TFSAs.

"This is a very comfortable retirement plan as the required withdrawals from their portfolio after 65 are modest relative to their total capital," Mr. Calvert says. However, that is based on their current expense target.

"Estimating the annual expenses in retirement can be one of the most challenging numbers when building a financial plan," he says. "It's normal to discover the true and accurate expense figures in the first three years of retirement, once they settle into their new routine."

Based on their current position, they could confidently increase their spending beyond the target for the time-being.

"With their current expense target, they would have a projected $3-million in investable assets at age 90," the planner says. This assumes they can achieve an average rate of return of 5 per cent on their investment portfolio.

"They should always keep a secure cushion for unexpected health-related costs as they grow older," he says. "The biggest financial risks are often not routine medical expenses, but in-home personal care and assisted living over a long period of time."

"Given the uncertainty of time and cost, there isn't a one-size-fits-all answer," Mr. Calvert says. "A practical approach is to keep five to 10 years of assisted living costs within their portfolio," he says. "If they have the right portfolio structure, they should be able to increase their spending while keeping a longer-term cushion for health-related expenses."

CLIENT SITUATION

(Income, expenses, assets and liabilities provided by applicants.)

The person: Whitney and Naresh, both 51.

The problem: Can they afford to retire in five years?

The plan: Contribute the maximum to their TFSAs. Defer pensions and government benefits to age 65, drawing on their RRSPs first.

The payoff: Confidence that they can easily meet their goals and needs.

Monthly after-tax income: $9,215.

Assets: Cash in bank $127,650; his non-registered investment portfolio $260,905; her non-registered investment portfolio $482,340; his TFSA $86,435; her TFSA $125,000; his RRSP $107,205; her RRSP $339,130; residence $850,000; interest in family cottage $40,000. **Total: $2,418,665**.

Estimated present value of their pension: $557,800. This is what someone with no pension would have to save to generate the same retirement income.

Monthly outlays: Condo fees $145; property tax, water, sewer, garbage $685; home insurance $80; electricity, heating $110; maintenance $100; transportation $640; groceries $800; clothing $100; gifts $100; vacation, travel $600; dining, drinks, entertainment $500; personal care $50; club memberships $120; sports, hobbies $100; subscriptions $45; other personal $100; health care $300; communications $250; RRSP $120; TFSA $100; her pension plan contributions $1,000. **Total: $6,045**. Surplus goes to TFSAs, her RRSP and their non-registered portfolio, in that order.

Liabilities: None.

Ian Calvert is a Principal, Head of Wealth Planning at HighView.