

Darren and Merella want to spend \$180,000 a year in retirement. Should they sell their properties?

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Darren is 72 years old and retired with a defined benefit pension of \$118,450 a year, indexed to inflation.

His wife, Merella, is 63 and still working as a consultant, grossing about \$100,000 a year on average.

Their combined monthly after-tax income, including Canada Pension Plan benefits, totals about \$15,000, an income level they hope to maintain after Merella retires in five years.

Merella and Darren have a house in the Greater Toronto Area and three rental properties, all of which are mortgaged.

[Why Cyril, 65, and Dina, 59, must downsize to make the most of their retirement](#)

After a recent health scare, Darren wants to get the family's finances in order to ensure his wife and children are provided for. The 100-per-cent survivor benefit on his pension gives them a solid foundation.

Darren's main concerns are how to pay off the \$450,000 mortgage on their family home and



longer term, give \$500,000 each to their two adult children, he writes in an e-mail.

Their retirement spending goal is \$15,000 a month or \$180,000 a year – the same as their current after-tax income but far more than they are spending now.

We asked Ian Calvert, a principal and head of wealth planning at HighView Financial Group of Oakville, Ont., to look at Darren and Merella's situation.

WHAT THE EXPERT SAYS

Darren and Merella's household income is \$252,350 a year, enough to meet their spending target of \$180,000 after tax, Mr. Calvert says.

A total of \$72,000 goes to income taxes payable, which includes Darren's social benefit repayment, or Old Age Security clawback, the planner says.

First, the planner looks at whether this level of spending is sustainable.

Darren and Merella have total assets of \$4,860,000 and liabilities of \$1,448,000, for a net worth of \$3,412,000. Of the \$4,860,000 total, about \$910,000 is held within their investment portfolio, and the remaining \$3,950,000 is held in real estate. They have a primary residence worth \$1,750,000, and three rental properties, of which two are condos, that total \$2,200,000.

In addition to his pension of \$118,450 a year, Darren is collecting Canada Pension Plan benefits of about \$17,000 a year and taking a

minimum withdrawal from his registered retirement income fund (RRIF) of \$13,400 a year. Merella has chosen to take CPP early, so she is getting about \$3,500 a year plus her consulting income of \$100,000 before tax.

"For the time being, their cash flow is in a solid and stable position, but if they plan to maintain their current level of spending, they must focus on the need for larger withdrawals from their savings once Merella's consulting income stops," Mr. Calvert says.

[How Kelvin and Rosita, both 64, can transfer wealth to their four kids with an estate freeze](#)

To plan for this, their focus should shift to the composition of their assets. "Although an excellent total figure, their net worth lacks diversification given the high weighting to real estate assets," the planner notes.

"Having 82 per cent of your total net worth in one asset class is a high concentration risk and presents a number of challenges," Mr. Calvert says. "Canadian real estate has been a great and stable investment in the past and certain pockets have created significant wealth," he adds. "But rising interest rates, shifting demand and a highly leveraged population have created downward pressure in certain regions."

In addition to the concentration risk, there is also liquidity risk, which is elevated in certain condo markets, meaning it could be difficult to sell property.

Merella and Darren are in a fortunate position because they have no urgency or financial pressure to sell in the short term, the planner says. Even so, selling one of the condos would help address their concentration risk and shift their assets more to their investment portfolio, helping to meet their need for withdrawals in the future.

"They could sell their weakest property first, which is a cash flow break-even condo valued at \$450,000," the planner says. The downside to selling is the transactional costs and the capital gain; the property doesn't qualify for the principal residence exemption. "They bought it for \$350,000 so there is a \$100,000

capital gain, of which 50 per cent would be taxable," Mr. Calvert notes.

From a tax perspective, the ideal time to sell would be the first low-income year for Merella because the condo is held in her name only. This would mean holding onto the property for another five years and maintaining her concentration risk.

"If they sell the second condo, it would be best to do so in a different taxation year to avoid reporting two capital gains in the same year," the planner says. The estimated value of the two condos today is about \$925,000. "This injection to their portfolio, less capital gains tax, and less the outstanding mortgages will significantly improve their access to liquid investments for withdrawal purposes."

Next, their investments.

"When they sell, the after-tax proceeds should be allocated to a diversified investment portfolio with a strong dividend yield to help offset the loss of Merella's income," Mr. Calvert says. Also, they should ensure as much as possible is added to their tax-free savings accounts, which have been underfunded in the past.

[As Ross, 62, nears retirement, how can he minimize taxes now – and for his estate in the future?](#)

Their portfolio today has an unusual structure, he says. In addition to holding about 25 per cent in cash, they have some large gains and large losses. "In other words, they have had some big winners and big losers."

Because they are getting closer to the withdrawal phase in their portfolio, they should aim for a more consistent and predictable return with a strong dividend cash flow to offset the loss of Merella's consulting income. "Holding 25 per cent in cash is creating a drag on performance, but it's not a major concern and can be used as a source of dry powder," the planner says. "Having a strategic plan to average into the markets with patience would be an advisable place to start."

Next, the desired gifts to the children.

Darren and Merella want to help their children financially, and like many parents, they want to provide that help today to see the impact, Mr. Calvert says. "A productive approach is to start to fund the children's savings accounts." For instance, instead of a lump sum gift later in life, they could start to fund their children's TFSAs, RRSPs and/or first home savings accounts.

"Not only is this gift being immediately used to start building their investable assets, it's also a great introduction to personal finance and portfolio management," the planner says. By diversifying into three different account types, Darren and Merella are giving their children the ability to save for retirement, save for a first home, if applicable, and have flexibility of a TFSA if they need the funds in the short term.

Can they meet their retirement spending goal?

Once both condos sell, Darren and Merella should net about \$465,000, Mr. Calvert says. This will bring their non-registered funds and cash to about \$850,000. When Merella retires, they will be able to replace about \$75,000 a year of her income. Their withdrawals will come from the after-tax income in their joint portfolio.

"If they are earning on average 5 per cent per year, this should provide them about 14 years of cash flow, assuming their expenses increase at about 2 per cent per year," he says.

If at that time they still have a mortgage balance outstanding, they would have to sell the third rental property or use their TFSAs to pay it off.

It's worth noting that the income and expenses Darren and Merella submitted show a substantial unallocated surplus, some of which Darren says will go to travel. They might want to track their spending for a couple months to see how much they really need. They may find they are able to pay their home mortgage off sooner by increasing the payments.

"With the expected value of their primary residence and TFSAs, meeting their cash flow needs and leaving sizable estate won't be an issue," Mr. Calvert says.

CLIENT SITUATION

(Income, expenses, asset values and liabilities are provided by Facelift participants.)

The person: Darren, 72, Merella, 63, and their two adult children.

The problem: Can they pay off their mortgage, help their children financially and maintain their target income and spending level after Merella retires?

The plan: Sell one or two of the rental condos and invest the proceeds in their portfolio to better diversify their assets. Open investment accounts for their children. Review their spending target.

The payoff: A better understanding of what they can comfortably afford.

Monthly after-tax income: \$15,030.

Assets: Cash: \$250,000; combined TFSAs \$345,000; his registered retirement income fund \$255,000; her RRSP \$10,500; non-registered investments \$131,000; residence \$1,750,000; rental properties \$2,200,000. Total: \$4.94-million.

Estimated present value of Darren's defined benefit pension: \$1,178,000. This is what someone with no pension would have to save to generate the same income.

Monthly outlays: Residence mortgage \$2,050; condo fee \$585; property tax \$710; home insurance \$115; electricity \$200; heating \$200; security \$75; maintenance \$100; transportation \$910; groceries \$1,500; clothing \$100; gifts, charity \$600; vacation, travel \$800; dining, drinks, entertainment \$470; personal care \$50; pets \$100; subscriptions \$50; health care \$200; health, dental insurance \$500; phones, TV, internet \$240. Total: \$9,555. Unallocated surplus \$5,475.

Liabilities: Residence mortgage \$425,000 at 1.7 per cent fixed; first rental mortgage \$244,000, 3.67 per cent variable; second rental mortgage \$166,000, 3.77 per cent

variable; third rental mortgage \$614,115,
variable 3.49 per cent. Total: \$1,449,115.

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