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Retirement plan to downsize and leave Toronto will give couple flexibility and cash flow

DIANNE MALEY
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With a house in Toronto and a government pension, Daphne is feeling comfortable – so comfortable she is thinking about packing in her $100,000-plus-a-year job in a couple of years and retiring. She and her spouse Michael would sell their city home and move to a less expensive locale where Daphne could eke out a living freelancing.

Daphne is 55, Michael is 52. They have a 16-year-old son. Michael, who figures he can work remotely, plans to stick with his $80,000-a-year job until he turns 60.

When she retires from work at age 57, Daphne will be entitled to a pension of $63,500 a year indexed to inflation, falling by $12,000 a year when the bridge benefit ends at age 65. Michael has no work pension. Their savings, apart from the value of Daphne's pension, are relatively modest.

"Our plan is to buy a more affordable home outside of the GTA," Daphne writes in an e-mail. "What should our maximum be to spend on a house to buy outright and what should we keep as a nest egg?" She wonders whether it would be feasible to buy two properties, a house and a vacation place they could rent out on Airbnb when they weren't using it.

They have yet to determine how much they will need to live on. "What will our budget be and what kind of lifestyle will we have, given these parameters?" Daphne also asks about a possible pension buyback.

We asked Ian Calvert, vice-president and principal at HighView Financial Group in Toronto, to look at Michael and Daphne's situation.

WHAT THE EXPERT SAYS

Daphne and Michael have about $2.2-million in assets, but most of that is their $1.4-million residence and the $600,000 commuted value of Daphne's defined-benefit pension, Mr. Calvert says. Their financial assets include two registered retirement savings plans with $65,000 each and a registered education savings plan for their son.

"Although their property and pension are two very valuable retirement assets, Daphne and Michael will have to make some changes to ensure they have adequate cash flow, liquidity, and flexibility as they enter retirement," the planner says. Selling their house upon Daphne's retirement will be a crucial component to their retirement plan, he adds.

With the gap in their retirement dates, Michael and Daphne need to plan for a few years of fluctuating family cash flow. Upon Daphne's retirement, the family income will consist of $80,000 a year from Michael's salary and $63,500 from Daphne's pension.

The forecast assumes they begin collecting Canada Pension Plan and Old Age Security benefits at age 65. So when Michael retires at age 60 in 2029, they will have only Daphne's pension for a couple of years. Daphne would get CPP and OAS starting in 2031 and Michael late in 2034.

"Without having any savings in their tax-free savings accounts or taxable accounts – and relatively small amounts in their RRSPs – they don't have the ability to manage additional or increased expenses," Mr. Calvert says. "Heading into retirement with very little liquid assets is not a good idea, even with a great pension."

The years between Michael's retirement and when they begin receiving their government benefits will be the most challenging for managing cash flow, the planner says. "Having the sale of their house and their larger investment portfolio generating consistent income for these years will be extremely important."

If they sell their house and downsize to a less expensive area outside of Toronto, they should target a home costing no more than $850,000, the planner says. After paying off their $170,000 mortgage, they'd be left with $380,000 to add to their investment portfolio.

"Having $380,000 of new investable assets will be important for their retirement plan and accomplish two key things," the planner says. Firstly, if invested correctly in a portfolio that has a good blend of income generation and growth potential, the $380,000 could generate an additional $15,000 of sustainable retirement cash flow," he says. That assumes a dividend yield of 4 per cent.

Secondly, the $380,000 will give them a healthy buffer and safety net for unexpected expenses, Mr. Calvert says. When Michael is 65, they would have total family income of about $122,500 a year: Daphne's pension income, combined OAS benefits of $19,500, combined CPP benefits of $28,000, and $15,000 a year from their investment portfolio.

"With expected taxes payable at the family level being $21,000, they would have $101,500 to spend each year if their goal is to preserve the $380,000," the planner says.

Once the house is sold, they should take as much as possible from the proceeds and top up their TFSAs, he says. They each have $75,500 of unused TFSA contribution room.

If they needed to increase their annual cash flow, Michael could convert his RRSP to a registered retirement income fund and withdraw $7,000 a year, melting down the account by about age 90. That assumes a 5-per-cent rate of return on his investments.

Daphne asks about the option to buy back years of service from her defined-benefit pension plan.

"A pension buyback can be a valuable move for the right individual with the right pension plan," Mr. Calvert says. If Daphne decided to complete the buyback, her best option would be to use the funds in her RRSP, which would be a direct transfer from the RRSP to her pension plan. Mr. Calvert's forecast assumes a pension buyback of $50,000.

However, Daphne should consider the opportunity cost of removing funds from her RRSP and loss of control on making investment decisions. If she is confident on her longevity, the pension buyback can be a great option to increase her guaranteed retirement income and shift the risk of her retirement assets from her personal portfolio to the pension plan.

As for buying two properties and using one as a rental and vacation property, "this would be a challenge and could cause some serious cash flow problems in the future," Mr. Calvert says. Selling one property for $1.4-million and finding two that are affordable will be difficult in this environment, even outside of Toronto, the planner notes.

Besides, the injection of more cash into their retirement plan is important for both their total cash flow and flexibility, he says. If they bought a rental property and had a disruption in rental income or major repairs, they would not have the cash to manage, Mr. Calvert says. "With the recent surge in real estate prices, many rental properties bought at these levels are now cash flow negative." As well, they should not underestimate the workload of being a landlord and dealing with a potential rotation of tenants, he says.

"A better idea would be to sell the current property, downsize to an attractive house and invest the surplus capital for extra cash flow."

CLIENT SITUATION

The people: Daphne, 55; Michael, 52; and their son, 16

The problem: Can Daphne afford to retire at age 57 and move with Michael to a less expensive area outside the GTA? How much can they spend on a new home and what will their spending budget be?

The plan: Sell the Toronto house and add an estimated $380,000 to their retirement savings, topping up tax-free savings accounts first. Forget the idea of buying two properties.

The payoff: A comfortable retirement

Monthly net income: $10,500

Assets: Cash $15,000; her RRSP $65,000; his RRSP $65,000; RESP $50,000; commuted value of her DB pension $600,000; residence $1.4-million. Total: $2.2-million

Monthly outlays: Mortgage $2,200; property tax $200; water, sewer, garbage $150; home insurance $175; electricity, heat $300; transportation $600; groceries $1,200; clothing $250; line of credit $500; charity $50; vacation, travel $750; club memberships $100; dining out, entertainment $900; pets $200; sports, hobbies $1,200; drugstore $50; communications $300; RRSPs $300; RESP $150; savings account $500. Total: $10,075

Liabilities: Mortgage $170,000; line of credit $54,000. Total: $224,000

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