THE GLOBE AND MAIL

Can this 41-year-old leave her job and 'retire' without the worry of running out of money?

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Special to The Globe and Mail

Published Saturday, October 31, 2020

As the skies darken over the Alberta oil patch, Ruth is preparing to be laid off from her white-collar job within the year. She wonders whether, with her savings, her pension and her property, she has achieved the degree of financial independence that will allow her to "retire" without ever having to worry about running out of money. She is age 41 and single with no dependants. "I was originally planning to retire at 45, but with a layoff looming, I need help determining if I can retire now or next year," Ruth writes in an e-mail. The idea of retiring at 45 came about "because of the Freedom 55 commercials I saw as a child and decided I should try to beat it," Ruth adds.

Her plans are hazy. "I'd like some time to simply do nothing and rest because my job involves long hours and crazy travel," Ruth writes. She'd connect again with family and friends, which would involve travel to Europe, Asia and Australia. Longer term, "I may get a PhD because I enjoy research, mentoring and teaching," she adds. "Or finally put my yoga teacher training to use."

If she does leave her job, she wonders whether she should keep her defined benefit pension – one of the few in the private sector – or take the lump-sum commuted value.

We asked Ian Calvert, a financial planner and portfolio manager at HighView Financial Group in Toronto, to look at Ruth's situation. HighView is an investment counselling firm for high-net-worth investors.

WHAT THE EXPERT SAYS

Ruth expects 12 to 18 months of severance pay if she is laid off, which will cover her expenses for at least a year, Mr. Calvert says. She would not have to draw on her investment portfolio until 2022. After that, she hopes to live off her non-registered investments and net rental income of $17,000 a year until age 55.

"If Ruth's goal is to spend $40,000 per year after tax, her non-registered portfolio would only last until she is 51," Mr. Calvert says.

This assumes she can earn an annualized rate of return of 5 per cent, the planner says. While 5 per cent a year is "a realistic target," it is not a sure thing, he notes. Quitting work so early "puts Ruth in a position where too much of her retirement security in the early years is based on market performance" – and she still exhausts her non-registered savings before age 55, he says.

This also assumes Ruth has steady rental income throughout her plan.

After her non-registered savings are gone, Ruth will likely have to sell her rental house because she will need the proceeds from the sale as a bridge until she receives income from her RRSP (converted to a registered retirement income fund) starting at age 55, her work pension starting at age 62, and her government benefits, Mr. Calvert says. "If her portfolio returns are less than 5 per cent, or she has a period without tenants, she will be

forced to sell her property much earlier than expected."

Ruth is fortunate to be a member of a defined benefit pension plan because they are less common in the private than in the public sector. (In a DB plan, the employer or plan sponsor promises to pay you a predetermined monthly income in retirement.) She has two options. She can keep the pension of $25,626 a year starting at age 62 (not indexed to inflation), or consider taking the commuted value of $286,883. The lump sum would be transferred to a locked-in retirement account, or LIRA.

Ruth cannot transfer the entire commuted value to her LIRA, Mr. Calvert says. In Ruth's case, the maximum transfer value would be $230,634, meaning there would be taxable income of $56,249 and taxes payable of about $24,400. Ruth has no unused RRSP contribution room to offset the extra income, the planner says. "This is an important number to consider when comparing the two options."

If Ruth took the commuted value today and invested the funds earning an average annual return of 5 per cent, she would have about $710,000 at age 62, when her pension would have begun. If she then started a withdrawal plan taking out $25,626 annually, the amount of her pension entitlement, she could ideally have the same level of income, the planner says.

"If managed appropriately, taking the commuted value has the potential to provide the same level of retirement income while still maintaining possession and control of an important balance sheet asset," Mr. Calvert says. "However, this option also comes with the most risk."

Ruth would have to be comfortable assuming both the investment and longevity risk – the risk she will run out of savings if her investments do poorly or if she withdraws more than expected, the planner says. "Poor investment decisions have the potential to jeopardize her entire retirement plan, leaving her with insufficient income and assets," he says. If she decides to have her money managed professionally, she will want to choose a portfolio manager or investment counselling firm that has a fiduciary duty to act in the best interests of its clients.

On the other hand, there is a safe and predictable benefit from staying in the pension plan – as long as her employer and the plan itself do not run into financial trouble. "Her company is in obvious stress, so the ability to meet its long-term pension funding commitments should be considered," the planner says. "This is an extremely important financial decision and Ruth should ensure she knows all the information, benefits and risks before she proceeds."

Ruth also asked about the best time to take her Canadian Pension Plan and Old Age Security benefits. By retiring so young, Ruth is significantly reducing her CPP, which is based on income and years of contributions. Eligibility for the full CPP benefit requires 39 years of maximum contributions.

"If we assume Ruth started making maximum contributions at age of 25, she will only have 17 years of contributions. In other words, she's on pace for about 44 per cent of the maximum benefit at age 65," the planner says. If she opted to take her CPP early at age 60, her payments would be reduced by another 36 per cent.

All in all, Ruth's plan to quit working at such a young age is "very tight," Mr. Calvert says. "I would encourage her to try and work to at least age 50," he says. "This would ensure she doesn't start to withdraw her investable assets for another eight years. As well, she could continue to build up her RRSP and pay into the Canadian Pension Plan.

CLIENT SITUATION

The person: Ruth, age 41

The problem: Can she leave her job within a year and never have to work again? Should she take the commuted value of her pension?

The plan: Consider the risks carefully. Draw first from non-registered savings and rental income. When that runs out, sell rental property and invest the proceeds. Consider working longer.

The payoff: A clear view of the alternatives.

Monthly net income: $10,675 (previous year)

Assets: Cash $10,000; stocks $205,400; TFSA $101,100; RRSP $490,500; commuted value of pension plan $286,883; residence $514,050; rental property $289,500. Total: $1.9-million

Monthly outlays: Condo fees $690; home insurance $45; electricity $45; maintenance $55; transportation $210; groceries $220; clothing $25; gifts, charity $150; vacation, travel $150; dining, drinks, entertainment $165; other personal $20; doctors, dentists $270; life insurance $30; phones, TV, internet $75; RRSP $1,050; pension plan contribution $725; non-registered savings $1,075; TFSA $500. Total: $5,500. Surplus of $5,175 goes to paying off mortgage on rental property.

Liabilities: Rental property mortgage $75,155

Ian Calvert is a Wealth Planner & Portfolio Manager at HighView Financial Group.