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Can Bob and Betty afford to retire while meeting their spending goals?

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When their first Financial Facelift appeared in 2018, Betty and Bob – who had been comfortable financially – had suffered a reversal of fortune. Betty had been downsized from her employer of 25 years. When she eventually found work again, the starting salary in her new job was 40 per cent less than she had been making before, although she hoped it would rise fairly quickly.

Rise it did. In another reversal of fortune, this time for the better, Betty's salary is up 60 per cent to $175,000 a year plus a substantial bonus. Bob is earning $108,000 a year. The youngest of their three children is in first year university and they are turning their attention again to their goal of early retirement. Bob, who works in education, has a defined benefit pension plan partly indexed to inflation. Betty has a defined contribution pension plan with performance tied to financial markets. They have a mortgage on their Southern Ontario house.

Betty will be 52 in a couple of months, while Bob is 57. Their goal is for Bob to retire at 60, and Betty at 59, with an after-tax spending goal of $80,000 a year – lower than the goal in their original Facelift. "What is our financial health?" Betty asks in an e-mail. They want to be in a position to help their children get settled if needed.

Given that Bob plans to retire soon, "What should we prioritize?" she asks, "paying down the mortgage? Investing? RRSPs?" Should they keep making contributions to their registered

retirement savings plans or shift their focus to their tax-free savings accounts? When should they start taking government benefits?

We asked Ian Calvert, a principal and financial planner at HighView Financial Group in Toronto, to look at Betty and Bob's situation.

WHAT THE EXPERT SAYS

For the time being, while interest rates remain historically low, there is a strong incentive not to pay off their mortgage aggressively and instead divert all surplus cash flow to their retirement savings, Mr. Calvert says. But reducing debt payments this close to retirement can add significant flexibility to their retirement cash flow plan, he notes.

"In their case, a hybrid approach would be an effective strategy to consider," the planner says. "Because Betty's income plus bonus will put her in or very close to the 48.35 per cent marginal tax rate, maxing out her RRSP contribution should be a top priority." The maximum contribution room is $29,210 for 2022. "At this level of taxable income ($175,000 plus $35,000 bonus), Betty should expect a substantial tax refund upon filing her personal income tax return, Mr. Calvert says.

Betty's participation in her company's DC pension plan creates a pension adjustment and reduces what she can add to her personal RRSP. Most of her maximum contribution room of $29,210 would go to her DC plan, with an extra $5,000 to $6,000 left for her personal RRSP, the planner says. "Using her tax refund to pay down the mortgage would ensure she is achieving both goals – paying off the mortgage and saving for retirement – and making productive use of her capital."

Bob and Betty have combined investable assets of $1,028,000. Betty is taking advantage of the employer matching on her DC pension. These contributions, topping up her personal RRSP, and an expected annual rate of return of 5 per cent on their portfolio, gives them an expected future value of their portfolio of $1.7-million by 2029, when both have retired, Mr. Calvert says. Starting in 2029, to meet their cash flow needs, "they would need to initiate a sustainable withdrawal strategy from their entire retirement portfolio." This would involve converting all RRSPs to registered retirement income funds (RRIFs) and the locked-in retirement account from Betty's DC pension to a life income fund (LIF).

Their cash flow plan in 2030 – the first full year in which they are both retired – shows total gross income of $153,000 a year. By then, Bob would be 66 and collecting CPP and OAS. Their income would consist of $14,600 of CPP benefits and $8,800 of OAS for Bob, $51,100 of pension income for Bob, total RRIF withdrawals of $40,500 and total LIF withdrawals of $38,000. After income taxes of $30,000 and mortgage payments of $27,600, they would have $95,400 a year of free cash flow to fund their retirement lifestyle expenses of $94,000 (their $80,000 goal indexed to estimated inflation).

After splitting Bob's pension, their taxable income would be about $76,500 a year each, Mr. Calvert says.

"The years from 2030 to 2035 would demand the highest withdrawals from their portfolio since Betty will not yet be getting her CPP and OAS benefits," the planner says. His forecast assumes she begins collecting government benefits at the age of 65. As well, they may still be making mortgage payments of $27,600 a year. "However, even in their highest withdrawal years (2030-35), the demands on the portfolio would be an estimated $78,500 per year." This would result in a sustainable withdrawal rate of about 4.6 per cent a year from their current asset base, he says.

Once their mortgage is paid in 2034 at the latest and Betty starts receiving full CPP and OAS benefits in 2035, they would have a healthy surplus of cash each year, the planner says. "If they can maintain this level of spending, indexed to inflation, they shouldn't worry about the longevity of their retirement assets and could even consider adding extra expenses."

Betty and Bob ask when they should start taking CPP and OAS.

Although Bob is retiring at 60 in 2024, their cash flow will still be healthy because Bob will immediately start collecting his DB pension with a bridge benefit. More importantly, Betty will still be working. From a cash flow perspective, there is no need for either of them to take the reduced CPP benefit at 60, the planner says. Doing so would result in a significant reduction of 0.6 per cent for each month before the age of 65. They would sacrifice 36 per cent of the normal CPP benefit.

One financial weakness on their balance sheet is the lack of TFSA assets. Between their RRSPs, Betty's DC pension and Bob's DB pension, they have great retirement assets. "But all these assets provide taxable income and can create some serious tax pain if a large expense occurred and they had to withdraw a lump sum," Mr. Calvert says. "Betty and Bob should make it a high priority to get some savings in their TFSAs, particularly during the years of 2022-24, when they still have dual family income and surplus cash flow is at its highest."

CLIENT SITUATION

The people: Bob, 57, Betty, 51, and their three children, 17, 20 and 22

The problem: Given that Bob plans to retire in a couple of years, how should they use their surplus cash flow – to pay off the mortgage or add to their retirement savings? Are they in good shape financially to meet their $80,000 a year spending goal?

The plan: After Betty retires, they convert their RRSPs to RRIFs and begin withdrawing. Betty converts her pension to a life income fund and begins tapping it as well. Both take CPP and OAS at 65. In the meantime, they should focus their saving on their TFSAs to give them more flexibility.

The payoff: A worry-free retirement

Monthly net income: $18,550 (including bonus)

Assets: Cash $2,000; stocks $20,000; her RRSP $700,000; his RRSP $250,000; her DC pension $58,000; RESP $25,000; residence $950,000; estimated present value of his DB pension plan $900,000. Total: $2.9-million

Monthly outlays: Accelerated mortgage payments $2,300; property tax $615; water, sewer, garbage $65; home insurance $60; heat, electricity $265; maintenance, garden $150; vehicle lease $565; other transportation $575; groceries $1,200; clothing $200; gifts $300; vacation, travel $700; dining, drinks, entertainment $1,100; personal care $150; club membership $60; pets $75; sports, hobbies $600; subscriptions $25; other personal $100; drugstore $25; communications $500; his pension plan contribution $1,020; her pension plan $1,075; her RRSP $445. Total: $12,170. Surplus of $6,380 went in part to help children with university expenses and to other unallocated spending.

Liabilities: Mortgage $295,000

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