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Do William and Lenore have enough saved to travel and renovate their home in retirement?

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William, a regular reader, "always thought it brave to share your finances [with other readers] and foolhardy at the same time," he writes in an e-mail. "No more." William retired from work at year end, and with the market downturn and a recession looming, he is nervous.

William will be 66 next month. His wife, Lenore, is 53 and works in the arts. William says his separation from his first wife set him back financially.

"As of January, there will be zero employment income coming in," William writes. He has some registered savings, but "I'm but not sure it's enough to get us to the finish line."

In addition to the family home west of Toronto, William has a rental property that is held within his corporation and a small place rented to a relative to cover costs.

Short term, they want to build a $250,000 addition to their house. Their retirement spending goal is $95,000 a year after tax.

William wonders when to begin taking government benefits, and how and when to withdraw funds from his corporation.

We asked Ian Calvert, vice-president and principal of HighView Financial Group, to look at William and Lenore's situation.

WHAT THE EXPERT SAYS

Although they're well-fixed financially, William and Lenore are concerned about funding their retirement lifestyle, including travelling and possibly renovating their home, Mr. Calvert says.

In addition to their home, they have some savings, as well as $1,415,000 held in William's corporation, of which $900,000 is a rental property. They have nothing in their tax-free savings accounts. Their mortgage debt is $238,800.

William has a form of pension – part of the proceeds from the sale of his business – that pays $45,000 a year until 2033. As well, they have net rental income of $16,000 a year. "This still leaves a considerable gap for funding $95,000 of after-tax expenses," the planner says. "Although they have great assets, they require better sources of cash flow and more liquid assets," he says. Real estate represents too great a proportion of their balance sheet.

The first place to look is William's Canada Pension Plan and Old Age Security entitlements, Mr. Calvert says. Next, they should look to the funds in their RRSPs. William should apply for both his CPP and OAS benefits now, he says. "Given the cash flow deficiency and the relative lack of liquid assets, it would be best to start both now."

The second source of cash will be from their RRSPs. "Before starting a consistent withdrawal plan from these accounts, it's best to convert the RRSPs to registered retirement income funds, or RRIFs," the planner says. This does away with deregistration fees that come with each RRSP withdrawal. But converting to a RRIF does commit them both to taking annual minimum withdrawals, he notes. "As they will both need consistent income moving forward, I would not hesitate to make the conversion."

William should start an annual RRIF withdrawal of $25,000 and Lenore $10,000. This would give them pretax income of about $116,000 a year: net rental income of $16,000, William's CPP and OAS of about $20,000, William's pension of $45,000 and combined RRSP/RRIF withdrawals of $35,000.

"This plan would achieve two important goals – it would meet their cash flow needs while also managing their taxable income," Mr. Calvert says. To illustrate, after they split William's pension and RRIF income, his total income will be about $65,000 a year and Lenore's $53,000. "This strategy should only be viewed as a temporary plan given the RRIF withdrawal rate and the loss of William's pension in 2033," the planner says.

To take advantage of their unused TFSA contribution room, they could consider transferring their non-registered stocks and mutual funds to their TFSAs. This would ensure all future growth and income would be tax exempt. The transition would be a taxable event, which means there would be a deemed disposition and any capital gains tax would have to be paid, Mr. Calvert says. As such, they should take into account any capital gain and increase in income before making the transfer.

Starting in 2033, mostly due to the loss of William's pension income, they should plan to draw on the assets in their corporate account, the planner says. "Having assets in a corporate portfolio – although they can come with additional complexities and reporting – can provide some wonderful planning opportunities," Mr. Calvert says. With corporate assets, William can control the timing, and in some cases the type, of income being paid to them personally, the planner says. They could start by paying themselves a taxable dividend of $40,000 (in total). The dividend income would be taxed more favourably than William's pension income was, so a smaller amount of income should be enough to maintain their after-tax cash flow needs, he says.

Then, in 2034-2035, two favourable events occur. First, Lenore will turn 65 and be eligible to receive her CPP and OAS benefits, although she will not be entitled to the full CPP benefit. Second, the mortgage on their home will be paid off. This will reduce the required withdrawals from their corporate account.

These favourable events will be offset by the gradual depletion of William's RRIF, which is forecast to be exhausted in 2039, when he is 83. At that point, a withdrawal of about $45,000 per year from the corporate portfolio, increasing each year, should provide enough cash flow to see them through.

William should ensure the funds held in the corporate account are invested appropriately, Mr. Calvert says. "For instance, if they do decide to use RRSP/RRIFs and William's pension for the first 10 years of their retirement, they will have a long runway to build up the corporate portfolio before they need to begin withdrawing from it," Mr. Calvert says. If they can earn a rate of return of 5 per cent a year on the portfolio, the investable assets in the corporation would be about $880,000 by 2034. "This amount should comfortably fund the withdrawal requirements when needed."

William and Lenore have a capital dividend balance of $270,000 within the corporation. A capital dividend account is a notional account that keeps track of tax-free surpluses. These amounts can be paid out tax-free as capital dividends to shareholders. "For planning purposes, this is an excellent tool," Mr. Calvert says. For example, if William and Lenore need a lump sum – perhaps for their home renovation – using the CDA balance would be much more advantageous than taking the tax hit from withdrawing the funds from their RRSP/RRIFs.

If they do use the capital dividend account for the renovation, it would greatly diminish the liquidity in the corporate account needed for their later retirement years, Mr. Calvert says. "In this scenario, they would need to sell the $900,000 property owned by the corporation at some point."

CLIENT SITUATION

The people: William, 65, and Lenore, 53.

The problem: Do they have enough saved to last a lifetime and maintain the lifestyle they want?

The plan: William applies for government benefits, they convert RRSPs to RRIFs and begin withdrawals. When William's pension ends, Lenore begins collecting government benefits. They take advantage of income splitting and capital dividends from the corporate account.

The payoff: A financially secure retirement.

Monthly net income: $7,915.

Assets: Cash equivalents $8,000; his non-registered (stocks and mutual funds) $63,000; her non-registered $5,000; his corporate investment account $515,000; his TFSA 0; her TFSA 0; his RRSP $307,000; her RRSP $125,000; residence $1,500,000; two rental properties $1,300,000. Total: $3.8-million.

Monthly outlays: Mortgage $600; property tax $505; home insurance $340; heat, hydro $325; maintenance, garden $135; transportation $595; groceries $800; clothing $100; gifts, charity $350; vacation, travel $1,500; dining, drinks, entertainment $575; personal care $100; club memberships $500; golf $150; pets $150; sports, hobbies $100; subscriptions $50; drugstore $25; health, dental, life, disability insurance $465; communications $250; registered education savings plan for grandchildren $300. Total: $7,915.

Liabilities: Mortgage residence $139,000 at 2.65 per cent; rental mortgage $99,800 at 2.79 per cent. Total: $238,000.

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