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Can Noah, 61, and Amelia, 59, afford to retire next year?

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Noah and Amelia wonder if they can afford to retire next year and still maintain their comfortable lifestyle. Noah is 61 and works in education, earning $110,000 a year. Amelia is 59 and works in social services, earning $80,000 a year.

He has a defined benefit pension plan that will entitle him to $62,400 a year including a bridge benefit of about $8,000 a year to 65. She has a defined contribution pension plan with a market value of about $600,000. They have a mortgage-free house in Toronto.

"We would ideally like to take two vacations a year to a warm destination," Noah writes in an e-mail. They may consider part-time work if "the numbers don't work the way we need them to," he adds. They have two children. "We would like to be able to help them out financially with small monetary gifts every once in a while if possible."

Their retirement spending goal is $102,000 a year after tax, the same as they are spending now, excluding pension plan contributions. "Given our retirement goals and expenses, is our retirement date realistic?" Noah asks.

We asked Ian Calvert, a vice-president and principal of HighView Financial Group of Toronto, to look at Noah and Amelia's situation. Mr. Calvert holds the certified financial planner designation.

WHAT THE EXPERT SAYS

Noah's defined benefit pension will be the cornerstone of their retirement income, Mr. Calvert says. His pension will also have a bridge benefit to 65 and an indexing feature. A bridge benefit is designed to supplement the pension of early retirees until they turn 65 and begin collecting government benefits.

Amelia, on the other hand, has a defined contribution pension plan. "In this type of pension structure, the longevity risk and investment decisions are made directly by the individual," Mr. Calvert says.

A crucial component of their retirement plan is the investment management of Amelia's $600,000 defined contribution pension, he says. The investment decisions on this portfolio will play a huge role in the longevity of their retirement assets.

"As these assets will be moving into the withdrawal phase shortly, and withdrawals will be required each year of their retirement, there are a few things Amelia can to do extend the longevity and mitigate the overall risk," Mr. Calvert says. First, they should make sure that this portfolio is invested "smartly and efficiently."

This starts with removing any speculative holdings, which introduce unnecessary risk. "On the other hand, they don't want to be too conservative with these funds either," the planner says. Having exposure to both stocks and bonds will provide a balance of growth and income needed to fund the regular withdrawals. A healthy balance of portfolio income from bonds and stocks – and capital growth from equities – will enable withdrawals to be funded mainly from income, with growth helping to fund long-term inflation protection, the planner says.

In the first year of full retirement, 2025, the family income would consist only of Noah's defined benefit pension income. After tax, there is a cash flow deficiency of $47,240 a year. This assumes pension income of $62,400, less $7,640 in income taxes, to fund a retirement lifestyle target of $102,000 a year after taxes.

"To build their retirement cash flow plan, the first account to target is Amelia's defined contribution pension of $600,000," Mr. Calvert says. Currently, these funds are held in a locked-in retirement account. The LIRA is similar to an RRSP in many ways, he says. "However, as it is a Canadian pension savings account, there are limits on when and how much of the funds you can access each year."

To start a withdrawal plan from Amelia's LIRA to fund their cash flow gap, Amelia should take two steps: First, convert the LIRA to a life income fund. This will make withdrawals easier. It will also necessitate a minimum mandatory withdrawal each year. Second, when the LIRA-to-LIF conversion takes place, Amelia will have the option to "unlock" 50 per cent of the account and transfer the funds to a registered retirement income fund.

"This unlocking feature has no taxable consequences, and the funds will remain in a tax deferred account ," Mr. Calvert says. A RRIF has no withdrawal restrictions.

"When completing the unlocking of pension assets in a LIRA, you're simply adding additional flexibility to your retirement plan by moving the funds from an account that has an annual maximum withdrawal to an account with no maximum withdrawal rules," the planner says. Once the conversion and the unlocking has taken place, their withdrawal plan should consist of $62,400 a year from his pension, $10,000 from Noah's personal RRIF, $20,600 from Amelia's LIF (maximum withdrawal in 2025) and $30,000 from her RRIF. This will provide total income of $123,000 a year, less $21,000 for taxes, leaving $102,000 for after tax spending.

Although this plan meets their spending target, the withdrawal rate from the portfolio will encroach on their capital too quickly, Mr. Calvert says. "If we back out Noah's pension, the total amount needed from their retirement savings is just over $60,000 a year." As a percentage of their asset base in 2025, the $60,000 represents about 7 per cent of their investable assets.

Such a high withdrawal rate is expected to lower the value of their portfolio each year and eventually deplete the accounts by the time they are in their early 80s, the planner says. This is assuming a 5-per-cent annual return on their investable assets.

So in their early 80s, they would be forced to sell their residence. Assuming their real estate grows at 3 per cent annually, their $2-million house today would be about $3.8-million in 2044, when Noah is 81. They would need to sell the house, but the sale "should comfortably support a downsizing event or transition into a retirement living facility," Mr. Calvert says.

The withdrawal rate from their portfolio will "experience some relief" when they start to receive their Canada Pension Plan and Old Age Security benefits. Amelia plans to take her government benefits starting at 65 and Noah at 70. Having one spouse (Amelia) take both CPP and OAS at 65 will bring in two new sources of income (CPP and OAS) earlier, slowing the withdrawals from their portfolio.

Although their registered retirement assets are expected to be depleted in the later stages of their retirement, Noah and Amelia should be able to gift some of the tax-free proceeds from their house when the property is sold. Gifting to the children before the property is sold would be a challenge as it would further accelerate the rate of decline on their assets.

CLIENT SITUATION

The people: Noah, 61, Amelia, 59, and their two children.

The problem: Can they afford to retire next year and maintain their $100,000-a-year-plus lifestyle? When should they begin collecting

CPP and OAS? How should they draw down their savings and investments?

The plan: Amelia converts her registered plans and begins withdrawing monthly. She takes her government benefits at 65 and Noah at 70. If their spending stays the same and they earn a 5-per-cent rate of return, they likely will have to sell their house in their early 80s.

The payoff: A good sense of how far their pension, government benefits and investments will take them.

Monthly net income: $12,205.

Assets: Cash $5,000; GICs $20,000; his TFSA $20,000; her RRSP $80,000; his RRSP $100,000; estimated present value of his DB pension $930,000; her DC pension $600,000; residence $2-million. Total: $3.75-million.

Monthly outlays: Property tax $600; water, sewer, garbage $125; home insurance $130; electricity $100; heating $125; vehicle leases $700; car insurance $350; other auto $410; groceries $1,600; clothing $200; gifts, charity $350; vacations, travel $1,000; other discretionary $200; dining, drinks, entertainment $725; personal care $100; club memberships $600; other personal $400; health, dental insurance $450; communications $300; his pension plan contributions $1,010; her pension plan contributions $635. Total: $10,110. Surplus of $2,095 goes to saving and occasional big-ticket expenses.

Liabilities: None.

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