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Can Lionel and Paula help their child buy a house and still afford to travel?

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Comfortably retired with savings and a mortgage-free Toronto house, Lionel and Paula wonder whether helping their younger child with a condo down payment might jeopardize their travel budget.

Lionel is 68 and earns $500 a month freelancing. Paula is 65 and has a defined benefit pension plan that pays about $3,000 a month indexed to inflation. Their government benefits lift their total income to about $76,500 a year before tax, or $68,500 net.

They have two children, ages 35 and 21. The younger one lives at home and is in his last year of university.

Even though Lionel and Paula are comfortable financially, they're worried about big lump-sum expenditures. "Is it realistic to change our car in the next six months with a budget of $40,000 to $60,000?" Paula asks in an e-mail. If they give their son $100,000 for a down payment, is their $12,000 annual travel budget still realistic?

"I would like to know that Lionel and I will be fine financially," Paula writes. "The final plan is to leave the house, the summer cottage and some money to the two children."

We asked Ian Calvert, a certified financial planner and principal of HighView Financial Group, to look at Lionel and Paula's situation.

WHAT THE EXPERT SAYS

Paula and Lionel have a net worth of about $2.3-million, of which $1.4-million is held in real estate and $900,000 in investable assets, Mr. Calvert says.

Their total family income is about $76,500 a year consisting of combined Canada Pension Plan benefits of $17,500, combined Old Age Security benefits of $17,000, Paula's pension income of $36,000 and Lionel's freelance income of $6,000. Their after-tax income is $68,500 a year, $8,500 a year less than their current spending of about $77,000 a year.

After eligible pension splitting, their taxable income is about $43,000 each, he says. This includes the income from their non-registered investment accounts.

To fund the cash flow shortfall, they need to withdraw from the investment portfolio. A good place to begin would be Lionel's $241,000 RRSP. "Tapping into your RRSP early doesn't make sense for everyone, but it is sensible in low-income years," Mr. Calvert says. Lionel should first convert his RRSP to a registered retirement income fund (RRIF). He will have to make a minimum withdrawal every year afterward. The 2024 minimum withdrawal would be about $11,000.

Converting to a RRIF also makes the withdrawals eligible pension income, which can be split when the couple file their tax returns. It also qualifies for the federal pension income tax credit, he says.

"A withdrawal of $12,000 a year from this account would be an optimal level," Mr. Calvert says. The extra taxable income would keep them both below $50,000 a year, right at the top of the lowest combined marginal tax rate of 20.05 per cent.

"Although this early RRSP/RRIF withdrawal will add to their taxable income now, over the long run it will make their balance sheet and estate more tax efficient," the planner says. For estate planning, the goal is to have more of their net worth in their primary residence, tax-free savings accounts (TFSAs) and non-registered assets. This will reduce their final taxes payable and ultimately increase the size of their estate for their children. RRSP/RRIF assets, in contrast, are fully taxed as income on the final tax return.

Lionel keeps $140,000 of their investment portfolio in guaranteed investment certificates. "This is about 15 per cent of their liquid assets," Mr. Calvert says. This makes sense as long as interest rates remain at current relatively elevated levels. "If they do, it would be a sound strategy to continue to roll the funds into new GIC offerings," he says.

However, they do face reinvestment risk every time a GIC matures. He would not recommend adding any more to their GIC holdings. "You would not want to get caught on the wrong side of an interest-rate movement with a sizable portion of your portfolio."

Lionel and Paula ask if their travel budget is realistic. As it is, their portfolio withdrawals are small relative to their portfolio size, Mr. Calvert says. "Not only should they maintain their travel budget, but they could increase it without eating into their capital." The optimal withdrawal would be $12,000 a year. "They could comfortably increase this figure to $36,000 from the total portfolio value today," he says. This would represent 4 per cent of their investable assets.

Paula and Lionel would like to help their son buy a first home, a condo, some time in the next five years. "Before going down this path, they really need to consider two things: How much can they comfortably take away from their retirement savings without jeopardizing their goals and lifestyle?" Mr. Calvert says. "Perhaps more important is completing a cash flow plan for their son."

"A one-time down payment is a generous act, but if their son can't independently service the ongoing mortgage payments and condo fees, it's not going to end well for either party," he says. The scenario to avoid is giving the down payment then also needing to subsidize the monthly payments if it turns out the son has taken on too much debt.

One option to consider would be taking advantage of the new first home savings account, the planner says. This allows first-time homebuyers to make tax-deductible contributions of $8,000 a year up to a lifetime maximum of $40,000. The funds can grow tax-exempt until they are used for the purchase of a first home.

Their son could open the account now and Paula and Lionel could start gifting $8,000 a year to fully fund the account over the next five years. "It would establish the mutual goal of working towards his first home, it would allow the funds to grow tax free, and it would provide some meaningful tax deductions to their son," the planner says.

"Similar to RRSP deductions, he would have the ability to carry forward undeducted contributions to a future, ideally higher-income year." If they decided to gift the full $100,000, they could use either their non-registered portfolio, depending on unrealized capital gains, or tax-free proceeds from their TFSAs.

"Both the withdrawal for the car and the future gift of $100,000 will have a material impact on their portfolio," Mr. Calvert says. But it shouldn't disrupt their retirement plans if they can limit their yearly spending at the current level.

"Given the modest withdrawal rate from their portfolio, they should expect to see it grow over time." By age 90, they could have a total net worth of $4.6-million, the planner says – $2.9-million from their house and cottage, thanks to real estate price growth, and $1.7-million of investable assets. That assumes a rate of return on their investments of 5 per cent.

CLIENT SITUATION

The people: Lionel, 68, Paula, 65, and their two children.

The problem: Can they afford to help their younger child with a first home down payment of $100,000 without jeopardizing their travel budget and lifestyle spending?

The plan: They can afford the gift, but they need to be sure the son can afford the carrying costs. Consider contributing to a first home savings account (FHSA) for their son.

The payoff: A clear view of whether they should simply gift $100,000 or whether their son would be better off starting with a FHSA.

Monthly net income: $5,710.

Assets: Cash $6,000; GICs $140,000; his non-registered investments $290,000; his RRSP $241,000; his TFSA $123,000; her TFSA $20,000; her RRSP $55,000; registered education savings plan $31,000; seasonal cottage $100,000; residence $1,300,000. Total: $2.3-million.

Estimated present value of her DB pension: $510,000. This is what a person with no pension plan would have to save to generate the same cash flow.

Monthly outlays: Property tax $500; water, sewer, garbage $110; home insurance $135; electricity $90; heating $150; maintenance, garden $100; transportation $510; groceries $1,300; clothing $100; gifts $170; vacation, travel $1,000; cottage expenses $270; dining, drinks, entertainment $445; personal care $125; pets $250; subscriptions $100; dentists $50; health, dental insurance $500; life insurance $155; cellphones $245; internet $130. Total: $6,385. Shortfall comes from investment income.

Liabilities: None.

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