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Can Jason, 61, afford to buy a cottage by the ocean when he retires?

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Jason is age 61 and single again with three grown children. Last year he earned $236,000 gross working as a self-employed consultant. He plans to keep working for another five years.

Although he is renting now, Jason would like eventually to buy a place by the ocean but wonders whether he can afford to. His investments total $1.6-million and his retirement spending target is $85,000 a year after tax, rising in line with inflation.

"Am I making the right moves to reach my lifestyle and financial goals?" Jason asks in an e-mail. Can he afford to buy a house and retire in five years or does he have to work longer?

His plan appears to depend on a possible future inheritance.

Jason asks as well about his investment portfolio and how best to draw down his savings. He'd like to leave as much as possible to his children.

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

WHAT THE EXPERT SAYS

Jason has a great income, investable assets of about $1.6-million and a desire to transition into retirement, Mr. Calvert says. Jason wants to maintain his lifestyle, keep his apartment in the city and buy a recreational property.

Each year, Jason adds $30,000 to his RRSP, $7,000 to his tax-free savings account and $8,000 to a first home savings account to go toward his property purchase.

"At this rate of savings, assuming he can earn 5 per cent on his investments per year, his asset base is expected to be closer to $2,075,000 when he transitions to retirement at the end of 2027," Mr. Calvert says. "At that point, Jason will begin living off his savings," the planner says.

"With this level of savings, a healthy and active lifestyle and $12,000 a year in defined benefit pension income from his previous marriage, Jason certainly has the financial capability to delay his Canada Pension Plan and Old Age Security benefits to age 70 to receive the enhanced benefit." This means an increase of 42 per cent to CPP and 36 per cent to OAS compared to the amount he would receive at age 65.

If Jason delays his government benefits until age 70, his highest withdrawal years from his portfolio and savings will be from 2028, when he plans to retire, to 2031, when he starts collecting government benefits. In his first year of retirement, Jason's expenses, adjusted for inflation, are expected to be slightly more than $94,000.

To fund this gap in a tax-efficient manner, Jason should build a retirement income plan that draws on three different accounts, Mr. Calvert says. His RRSP and locked-in retirement account (LIRA) will provide taxable income. "He will also need to draw on his non-registered portfolio to make this run efficiently," the planner says.

"An ideal cash flow plan would be to take $35,000 a year from his RRSP/registered retirement income fund, $24,000 from his LIRA/life income fund – this would be the minimum withdrawal upon converting to a LIF [Life Income Fund] – and his pension of $12,000, leaving $41,000 from his non-registered portfolio," Mr. Calvert says. This would give him total income of $112,000 a year, less $18,000 for income tax, leaving $94,000 for expenses.

When Jason receives his full CPP and OAS at age 70, forecast to be a combined total of $33,000 a year with inflation, he should make two significant changes to his cash flow plan, Mr. Calvert says. First, he should lower the RRSP/RRIF withdrawal from $35,000 down to the minimum, which will be about $28,000. Second, the injection of new funds will reduce the withdrawal requirements from his non-registered account to $21,000.

The government benefits will add two new sources of taxable income, the planner says. "With Jason's higher taxable income, he will likely experience about $2,000 in social benefits repayment each year" – known as the OAS clawback.

His annual portfolio withdrawal is expected to be $78,000 a year. "With an asset base of around $2,100,000, this would be a healthy withdrawal rate of less than 4 per cent," Mr. Calvert says. "If Jason can generate average annual returns of 5 per cent, he should be able to comfortably maintain his capital base throughout most of his retirement." Starting a monthly withdrawal plan would average out the high and low return years, helping to mitigate the volatility and timing risk of the withdrawals, he says.

"In an ideal scenario, his $2,100,000 is largely preserved, with the RRIF and LIF expected to get smaller, the non-registered account being maintained and the TFSA growing each year." For the transition to his children, the location of his assets will be just as important as the amount of his assets, Mr. Calvert says.

A top priority of Jason's retirement is to maintain his apartment and buy a summer recreational property. He expects to pay $400,000 to $600,000 and is counting on a future inheritance, which he estimates at $300,000.

Jason has asked that we calculate whether he can afford such a purchase. Because the inheritance is uncertain, and wouldn't normally be included in a financial forecast, the following example is to illustrate only.

Assume Jason inherits $300,000 in five years and puts it toward a property valued at $500,000. He then needs to come up with another $200,000.

"Jason is putting away $8,000 a year for this purchase, which will provide about $45,000 in five years, but he will have to decide where to raise the remaining $155,000," Mr. Calvert says. "Taking the $155,000 from his non-registered portfolio would change the composition of his balance sheet in the long run."

With a withdrawal of this size, his non-registered portfolio would be exhausted in 2049 when he's 87, the planner says. This should not disrupt the health of his retirement plan. "Although his non-registered assets would be depleted, it would be later in life," he says. Jason's risk of outliving his funds would be much smaller at that age.

If Jason continues to contribute $7,000 per year to his TFSA, the account is expected to be about $790,000 when he is 87. This would be enough tax-free capital to cover his lifestyle expenses, Mr. Calvert says.

Jason's non-registered portfolio is 100 per cent in equities, mainly U.S. stocks and exchange-traded funds. "If Jason sold off holdings with low and negative capital gains [capital losses], he could raise most of the funds without triggering too large of a tax bill in one year," the planner says.

"However, he should be careful not to let the tax tail wag the investment dog as this could result in a higher concentration risk to his portfolio." A better strategy would be to maintain his current allocation after he makes the big withdrawal. "If this can't be achieved without too large a capital gain, he could also use some funds from his TFSA for the property purchase and replenish them over time."

Jason could also consider a mortgage for the remaining funds, depending on where interest rates are in five years.

CLIENT SITUATION

The people: Jason, age 61, and his three grown children.

The problem: Can he afford to maintain his lifestyle when he retires and still buy a cottage by the ocean? How should he draw down his savings?

The plan: To make the withdrawals tax-efficient, tap different accounts at the same time. The cottage purchase should be viewed as uncertain.

The payoff: A better understanding of the trade-offs over time.

Monthly before-tax income: $12,300.

Assets: High-interest savings account $54,015; TFSA $117,910; RRSP $354,995; LIRA from a previous employer $450,955; non-registered $462,990; FHSA $8,000; cash value life insurance $121,920. Total: $1,570,077.

Estimated present value of his defined benefit pension: $195,000. This is what someone with no pension would have to save to generate the same cash flow.

Monthly outlays: Rent $1,635; electricity $65; home insurance $20; cable $45; grocery store $600; vehicle lease $810; other transportation $365; insurance $115; health care $150; disability insurance $275; clothing $235; gifts, charity $250; vacation, travel $840; dining, drinks, entertainment, sports, hobbies $1,060; other discretionary $115; personal share of business expenses $730. Total lifestyle: $7,310. Surplus goes to business loan $2,880, registered savings and unallocated expenses.

Liabilities: Business loan $25,920.

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