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When should Colin, 64, and Jacki, 62, sell their rental property to help fund retirement?

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As they contemplate retirement in a few years, Colin and Jackie have some questions. He is 64, she is 62. They have two self-sufficient adult children.

Colin makes $250,000 a year and Jackie $75,000 a year, both in financial services. They have a profitable rental property in addition to the family home in Toronto. Neither has a defined benefit pension.

"How should we manage future monthly expenses once we retire?" Jackie writes in an e-mail. "What are the best options available regarding liquidating various investments?" she asks. "Is there any need to sell the second property? Or is it a good option to sell the primary residence so that no capital gain is involved and live in the second property?"

They also wonder when to start collecting Canada Pension Plan and Old Age Security benefits. Their goals include "slowing down and achieving a better balance in life" and travelling as much as possible.
Their retirement spending target is $132,000 a year, including mortgage payments.

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

WHAT THE EXPERT SAYS

Colin and Jackie are in their final working years and want help figuring out how to generate steady cash flow and manage taxes, Mr. Calvert says.

They have total assets of about $4.45-million, of which $2.4-million is in real estate. For their investable assets, they have $800,000 of non-registered savings, divided among individual stocks, actively managed mutual funds and $175,000 in guaranteed investment certificates. In addition to their non-registered portfolio, they have $325,000 in tax-free savings accounts, $500,000 in RRSPs and $250,000 in Colin's group savings plan with his employer.

Colin plans to retire in January, 2027, and Jackie at the end of that year.

Starting in 2028, all sources of employment income will be gone. To fund their retirement lifestyle spending of $84,500, plus their mortgage payments and income taxes, they will need to launch "all three pillars" of retirement income, the planner says: government benefits, Colin's employer-based savings plan and their personal savings.

They should ensure both CPP and OAS start in 2028. "Canadian government benefits provide a reasonable base level of income," Mr. Calvert says; however, Colin and Jackie, who have lived in Canada only since 2011, will be receiving far less than the maximum payments. "CPP retirement benefits are based years of contributions into the plan, whereas OAS is based on years of residency in Canada," the planner notes. Their combined CPP is expected to be $18,000 a year, which is about 46 per cent of the future annual maximum, and a combined $7,500 in OAS, which is about 43 per cent of the maximum.

Depending on their circumstances at the time, they could consider delaying their government benefits to the age of 70 to receive higher payments, Mr. Calvert says.

Their RRSPs and Colin's group savings plan should be utilized next, Mr. Calvert says. "With no further employment income and no defined benefit pension, their taxable income will be significantly lower starting in their first year of retirement," he adds. So starting a withdrawal stream early from their RRSPs makes sense. "This will be taxable income, so finding an optimal withdrawal level will be an important component of their overall plan."

They have a healthy level of non-registered assets, which will generate taxable investment income in the form of interest and dividends, the planner says. They also have taxable rental income. "They need to take this taxable income into consideration when drafting an RRSP/registered retirement income fund (RRIF) withdrawal plan," he says. "They should plan for a total withdrawal of $45,000 from these accounts – $15,000 from Jackie's RRSP, $10,000 from Colin's RRSP and $15,000 from Colin's group savings plan would be an appropriate breakdown."

The last two components of their retirement income plan would be $53,000 a year of gross rental income, leaving them needing $40,000 a year from their non-registered savings. This would bring their total income to $163,500 a year, which would cover their mortgage payments of $55,000, taxes of $24,000 and lifestyle needs of $84,500.

After pension income splitting, their taxable income should be $77,000 each, Mr. Calvert says. "This is an ideal place to be for managing tax brackets as well as protecting their OAS, which is clawed back starting when your income is above $90,997 a year.

Each year, they should continue to transfer $14,000, or $7,000 each, from their non-registered savings to their TFSAs, to take advantage of the tax-free investment gains.

Once their mortgages are paid off, they will experience a significant boost to their annual cash flow, the planner says.

Colin and Jackie are looking for an exit strategy on their rental property. "They've done well with this property and as a result, there is a substantial unrealized capital gain of $450,000," the planner says. The first $250,000 would have [a tax] inclusion rate of 50 per cent, or $125,000. The remaining $200,000 would be taxed at the new inclusion rate of 67 per cent, or $133,333. The total capital gain would be $258,333.

They should avoid selling this property while they are still working. "Layering the one-time capital gain on top of their employment income would push a lot of their reported income into the top tax bracket," the planner says. "Any taxable income above $246,752 will have a marginal tax rate of 53.53 per cent."

A better approach, at least from a tax perspective, would be to sell the property in 2028 and not start drawing any income from their RRSPs or government benefits until the following year, he says. "It's not going to reduce the capital gain, which is going to be a large, one-time spike," the planner says. "Limiting other sources of income during that year will soften the magnitude of the total payable figure as well as boost their CPP and OAS by delaying another year."

Colin has expressed an interest in moving into the rental property and selling their primary residence. "This is an interesting strategy as it would result in a few changes and benefits. Firstly, the sale of their primary residence would be tax-free and would inject a significant amount of after-tax capital into their retirement savings," he says. Secondly, this would change the rental property to their primary residence, defer the capital gain, and remove rental income from their cash flow plan. When selling the property in future, Colin and Jackie would declare how many years they owned the property, how long it was used as a rental property and how long it was a primary residence when calculating the final capital gain.

CLIENT SITUATION

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

The people: Colin, 64, and Jackie, 62.

The problem: How should they draw on their savings and investments to generate monthly cash flow? When should they take government benefits? How can they keep their taxes to a minimum?

The plan: Draw on registered savings first, splitting their pension income and taking rental income into account. Defer the sale of the rental property until after they have retired. Possibly sell family home and move to rental property.

The payoff: An orderly and tax-efficient drawing down of their savings and investments.

Monthly net income: $19,600 (includes net rental income).

Assets: Cash $40,000; GICs $173,000; his non-registered $170,000; her non-registered $160,000; joint mutual funds $300,000; his mutual funds $150,000; her mutual funds $170,000; his TFSA $175,000; her TFSA $150,000i; his RRSP $300,000; her RRSP $200,000; his group savings plan $215,000; residence $1,400,000; rental property $900,000. Total: $4.5-million.

Monthly outlays: Residence mortgage $2,300; property tax $700; water, sewer, garbage $125; home insurance $150; electricity $130; heating $110; maintenance, garden $350; vehicle insurance $440; fuel, oil $330; maintenance, parking $150; groceries $1,000; clothing $200; charity $100; vacation, travel $1,250; dining, drinks, entertainment $750; personal care $100; club membership $25; health care $875; life insurance $250; phones, TV, internet $245. Total: $9,580. Excludes $1,500 monthly mortgage payment and other expenses on rental property. Surplus goes into non-registered savings.

Liabilities: Residence mortgage $390,000 at 1.7 per cent; rental property mortgage $330,000 at 1.6 per cent. Total: $720,000.