FINANCIAL FACELIFT

Susan traverses employment during a pandemic

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In retrospect, Susan's decision to take a break from work a couple of years ago was truly bad timing.

"I am a single, 62-year-old woman who quit my 60-hour-a-week managerial job in late 2018 with a view to rest and recovery and some travel," Susan writes in an e-mail. "I was in the workforce for 38 years except for two four-month maternity leaves," she adds. "After eight weeks of travelling, I returned to Alberta to an even more depressed job market in my field, where layoffs and downsizing have been rampant."

Then the pandemic hit, "amplifying job losses and depressing the housing market. The pandemic has ground my job search to a halt," Susan writes. She has some savings and a fully paid-for house but no pension plan. "I have used all of my tax-free savings accounts and some RRSPs to pay living expenses for the past two years." She's thinking of selling her house in a year or two and moving to Calgary to be closer to family. She wonders if she has enough to retire now and how she should draw on her investments. Her after-tax spending goal is $45,000 a year.

We asked Barbara Knoblach, a financial planner and money coach at Money Coaches Canada in Edmonton, to look at Susan's situation.

WHAT THE EXPERT SAYS

In truth, "Susan has de facto already entered retirement because she has been unable to secure a job since her return to Alberta," Ms. Knoblach says.

The planner starts by reviewing Susan's income sources. Her RRSPs and locked-in retirement account (LIRA) are worth a combined $950,000. Her Canada Pension Plan entitlement is $941 each month if she starts collecting at the age of 62 or $1,199 per month at 65. She will be eligible for maximum Old Age Security benefits.

If Susan sells her house and moves to Calgary, she would incur rental costs of $1,500 a month. Those costs, minus her expenses for her house – estimated at $1,000 per month – will have to be added to her cost of living in the future, the planner says.

"I prepared two retirement scenarios to analyze whether Susan can indeed retire and whether she will be able to do so at her expected standard of living," Ms. Knoblach says. The scenarios assume Susan will not be returning to the work force.

In scenario one, Susan continues living in her house. She defers collecting government benefits until she is 65. She spends $20,000 on a replacement vehicle in the near term.

“Under these assumptions, Susan could retire immediately with an annual spending power of $50,800 per year after tax, adjusted for inflation,” the planner says. That surpasses her spending target of $45,000 a year.

Because her current expenses are only $28,800 a year, this scenario would provide her with an additional $22,000 in spending power every year, the planner says. “She could set aside funds for necessary home repairs as well as for hiking trips and other leisure activities.”

Scenario two assumes Susan sells her house within a year for $450,000. In this scenario, she also holds off collecting CPP benefits until she is 65 and buys a replacement vehicle, the planner says.

Susan’s annual spending power increases to $68,900. Because renting in Calgary will cost about $6,000 a year more than living in her house, Susan’s annual spending can increase to $51,000.

“As the sale of the house is projected to provide Susan with $17,900 in spending power over and above her spending requirement each year, she can retire immediately and relocate to Calgary,” Ms. Knoblach says. The forecasts assume an inflation rate of 2 per cent, an average annual rate of return on investments of 4 per cent and a lifespan of 95 years.

Next, Ms. Knoblach looks at Susan’s investments. Susan has three RRSPs and one LIRA. The RRSPs are spread over two small accounts with holdings of $10,000 to $15,000 each and one large account with holdings of $504,000. All RRSPs are invested in mutual funds, some of which have high management expense ratios, the planner says. The LIRA holds individual stocks and some cash.

“By spreading her registered funds across different advisers, Susan may be paying more in total investment fees than necessary given the size of her portfolio,” Ms. Knoblach says. Having accounts with different firms also makes it difficult to follow a coherent investment strategy. “She could simplify her investments by drawing down the funds in her small RRSPs first and then closing the accounts,” the planner says.

Susan’s large RRSP contains a high percentage of money market and fixed-income products, presumably because withdrawals have been made from this account, the planner says. Because Susan has entered the drawdown stage, she should always have one year’s supply of funds in cash or near-cash investments, Ms. Knoblach says. “The remainder of the funds should be invested in line with her risk tolerance.”

When Susan turns 65, she should convert the LIRA into a life income fund (or LIF) and adjust the holdings to reflect the imminent drawdown from this account, the planner says. “Because there is a maximum that Susan can withdraw from the LIF every year, the drawdown should be started at a younger age than the drawdown from a RRIF (registered retirement income fund), which does not have an upper withdrawal limit,” she adds. Income from the LIF will qualify for a non-refundable pension income tax credit from age 65 onward.

“I do not recommend that Susan convert her RRSPs to RRIFs at this time because she may still find a job and may want to resume making RRSP contributions,” Ms. Knoblach says.

The proceeds from the sale of the house should be used to fill up her TFSA contribution room, followed by the establishment of non-registered investments, the planner says.

Once Susan sells the house, she will not have to make withdrawals from her RRSPs before the age of mandatory RRIF conversion (age 71 with withdrawals starting at 72) because she will have sufficient funds from her non-registered investments, TFSA and LIF withdrawals, Ms. Knoblach says.

When should Susan begin collecting CPP?

CPP benefits are reduced by 0.6 per cent for each month of collecting before the age of 65 and increased by 0.7 per cent for each month they are deferred until after 65, the planner says.

Susan would have to live to the age of 76 to benefit from collecting CPP at age 65 rather than at 62. “Because of their life expectancy, healthy women almost always benefit from deferring their government benefits to a later age.”

Holding off on collecting government benefits for now will provide Susan with an opportunity for the tax-efficient drawdown of her RRSPs before she reaches the age of mandatory RRIF conversion, Ms. Knoblach says. Her taxable income will be lower, thus allowing her to take out money from her RRSPs every year without adverse tax consequences.

The Person: Susan, age 62.

The Problem: Can she afford to retire now and maintain a comfortable lifestyle if she moves to Calgary and rents?

The Plan: Rest easy that she can retire now whether she sells her house or not. Take steps to simplify her investments.

The Payoff: Confidence that she can loosen the purse strings and begin enjoying life a little more.

CLIENT SITUATION

Monthly net income (from savings): $2,495.

Assets: Cash in bank $11,500; LIRA $418,400; RRSPs $531,200; residence $440,000. Total: $1.4-million.

Monthly outlays: Property tax $370; home insurance $100, utilities $295; maintenance, garden $235; transportation $235; groceries $425; clothing $30; gifts, charity $70; vacation, travel $50; other discretionary $20; dining, drinks, entertainment $210; personal care $50; pets $40; other personal $30; health, dental insurance $155; other health care $40; phones, TV, internet $140. Total: $2,495.

Liabilities: Credit cards $1,350.