Personal Finance

The pension plan

Couple plan for early retirement but can they get by with kids in thick of university?

money makeover By: Joel Schlesinger
Posted: **10/17/2015 3:00 AM** | Comments: 0

Retiring in their mid-50s should be a breeze. At least that's what Justin often hears from his co-workers.

"I work for a Crown corporation, and we often talk about retirement, and most say, 'Don't worry: our pension is in good shape, and it pays good money,' " says Justin, in his early 50s, earning more than $120,000 annually.

Taking heed of their advice, Justin plans to retire at 57, while Sophie -- two years younger -- will retire at 55, expecting a monthly guaranteed income from defined-benefit pensions of more than $7,000 a month combined before taxes.

Yet the couple are a little worried. Just as they retire, their two kids will be enrolled in university. As a result, they are concerned they could find themselves in a cash pinch in what can be a costly stretch of years: first seeing their kids through post-secondary and then possibly weddings and down payments on homes.

Justin and Sophie's finances

INCOME:
Sophie: $43,800 ($2,180 net a month)
Justin: $127,600 ($6,000 net a month)

MONTHLY EXPENSES: $6,650

DEBTS: none

ASSETS:
Home: $450,000
RESP: $49,900
Savings: $12,000
Sophie RRSP: $116,000
Sophie TFSA: $22,000
Justin RRSP: $89,700
Justin TFSA: $47,500
Justin pension payment at 55: $5,270 a month
Sophie pension payment at 55: $1,810 a month

NET WORTH: $787,100

While the couple has almost $50,000 in a family RESP, their concern is they could be retiring too early, drawing too much on savings to maintain a lifestyle that would be much the same as today -- about $6,000 a month -- only with more travel.

"Our savings will be our mad money," says Justin, adding they have about $260,000 in RRSPs, TFSAs and other savings.

"But I'm worried with our children in university about retiring if we might need more money than expected."

Certified financial planner Karen Diamond says Justin and Sophie's work pension plans -- along with CPP and OAS -- will have them on firm financial footing throughout retirement. Yet that doesn't mean they don't have a few planning challenges to consider before retiring.

"They have some homework to do to get a reliable estimate of their expected incomes from their pensions and CPP," says the adviser with Diamond Retirement Planning in Winnipeg.

While both will receive work pensions with cost-of-living adjustments that match two-thirds of inflation, they need to take into account their pension income may be reduced by additional benefits, including survivor payments.

"Justin said they were thinking they would each take the 'two-thirds-to-survivor' pension option, but I would encourage them to consider the '100 per cent-to-survivor' option for at least his pension," Diamond says.

The reason being is Justin's pension is more than double that of Sophie's, so losing even a third of his pension income would be a significant drop in cash flow for her.

The drawback of the insurance is it will inevitably reduce their pension payments once retired, making it even more important to fully understand what the impact will be on retirement income.

"Currently, the employer pension estimates shown on their annual statements are only for a single life pension with no survivor benefit only," she says. "So they should either request the various pension option estimates from their employer directly, or go online to do the estimates themselves."

The couple should also firm up their CPP numbers.

Here, too, they should seek estimates -- only this time from Service Canada -- to get a sense of what they can expect when they decide to draw on the government pension. Because they're retiring prior to age 60, it's especially important as they may not be contributing to the plan once retired -- which would reduce the CPP income they are eligible to receive.

To get an estimate, they have two options: one, they can download the forms from the Service Canada website, fill them out and mail them back to Service Canada requesting two different scenarios such as "if I retire at age 55 and take CPP at 60" or "if I retire at age 58 and take CPP at 62."

Or they can create My Service Canada accounts for online access that will allow them to see all their CPP pensionable earnings since age 18, along with estimates.

Yet, Diamond says, the couple also has a few more items on the retirement planning to-do list.

"I'd also recommend they diligently track their expenses for the next couple of years, keeping a record of everything they spend," she says. "I know it is hard to peg exactly what they will need in the future, but tracking expenses this way can help them identify where they may be underestimating their needs."

While Sophie and Justin should be able to cover their current monthly spending of about $6,500 a month with their pensions and RRSPs prior to age 60, they don't want to be forced to draw from registered savings for large expenses because that money would likely be taxed at a high rate.

Fortunately, they have considerable TFSA assets -- about $70,000 combined -- that can provide them with a tax-free source of cash for emergencies and big-ticket purchases.

Sophie also has considerable contribution room after using her TFSA assets to purchase a new car. In the future, if they decide to purchase another car, however, they may want to consider paying for its cost out of their cash flow, and instead of using their reserve "savings that could be used for unexpected needs that often arise and can't be planned for ahead of time."

Moreover, the couple should consider maximizing contributions to their TFSAs rather than contributing to their RRSPs, particularly in Sophie's instance.

"RRSP contributions might make sense in Justin's case, as his deduction saves taxes at a high marginal tax rate, but Sophie's RRSP would be deductible at a lower rate, so it might be advantageous for her to forgo the RRSPs and put her all her contributions in her TFSA instead."

The fact is Justin and Sophie already have plenty of fully taxable sources of retirement income, so they are probably better off diverting as much as possible of the $1,500 they save every month to their TFSAs and non-registered accounts so they have readily accessible cash once retired for various needs, including helping their children with school, weddings or buying homes.

Overall, Diamond says Justin and Sophie can likely manage all their retirement-income goals -- including helping their kids along the way -- yet they may still want to consider retiring gradually.

"Maybe they could take a year off when they are eligible for their pensions, but stay open-minded about working part time or going back on contract?" Diamond says. "I'd like them to consider this strategy if they retire as early as planned just so they don't have anxiety wondering whether or not they will have enough money to see them through the kids' education and the often very active first few years of retirement."

joelschles@gmail.com

Republished from the Winnipeg Free Press print edition October 17, 2015 B19