THE GLOBE AND MAIL

FINANCIAL FACELIFT

Should this civil servant pay off her mortgage or focus on TFSA savings?

DIANNE MALEY
Special to The Globe and Mail
Published Friday, Jul. 17, 2015 3:53PM EDT
Last updated Monday, Jul. 20, 2015 9:39AM EDT

When Lara first wrote Financial Facelift, she had just gone through a "massive and unexpected" renovation of her home costing $100,000, "changing my financial situation from very comfortable to pinched," she wrote at the time. She wondered if she should refinance the house to complete the work and improve her cash flow.

Now, three years later and despite her big mortgage, things are looking a bit better. Lara is earning $160,000 a year as a senior civil servant. She recently paid off her unsecured credit line. But she still has a $310,025 mortgage and a $14,335 home equity line of credit that she hopes to pay off by the time she retires in 12 years. She is 49 going on 50 this year.

This fall, her daughter, who is 19, will head off to university, her education financed by an inheritance from her late father.

Lara needs a new car soon and she still has about $7,000 worth of work to do on the house. She plans to downsize at some point because of the upkeep. "It's a wobbly house. I have arthritis and so it may not be practical when the knee goes for good," she adds. "Also, it's a heavy mortgage." She wonders if she should buy a duplex or a bungalow with a basement apartment so she would have a unit to rent out. Her after-tax income goal after she has retired is $80,000 a year.

We asked Vickie Campbell, a financial planner at Ryan Lamontagne Inc. in Ottawa, to look at Lara's situation.

What the expert says

If Lara retires from her job at 62, her pension will cover her anticipated living expenses of $80,000 a year, Ms. Campbell says. With 25 years of service, Lara's pension will be about $102,000 a year before tax. The planner bases her pension calculation on Lara's salary increasing by the inflation rate.

The pension will drop when Lara begins collecting Canada Pension Plan benefits at age 65.

After Lara pays off her line of credit, she should have about $30,000 a year to pay down the mortgage or invest, Ms. Campbell says. Some of this surplus will go to car replacement.

Lara is paying an extra $10,000 a year to her mortgage, so she should have it paid off by the time she retires at age 62, Ms. Campbell says. "This will allow her the freedom to enjoy her retirement without a liability." Because interest rates are likely to rise over the next few years, Lara should use any surplus funds to pay down the mortgage more quickly.

She recommends Lara open a tax-free savings account, contributing the maximum $10,000 each year. With an estimated 6 per cent return, Lara's TFSA will swell to $160,000 by the time she retires in 12 years.

"This account can be used for contingency or emergency funding, or to pay for extras in retirement," the planner says.

Lara has little in the way of contribution room to a registered retirement savings plan because of her company pension so she would not benefit much from contributing further to an RRSP, Ms. Campbell says. "Investing in her TFSA rather than her RRSP will reduce the tax payable in retirement," she says. As well, the TFSA gives her the flexibility of withdrawing money tax-free.

Lara's RRSP money is invested in segregated funds, a type of guaranteed mutual fund sold by insurance companies that tends to have a high management expense ratio. Because Lara has a defined benefit pension, she will have a stable income to cover her expenses and so does not need the insurance offered by seg funds. She could invest in lower-cost balanced mutual funds or even low-cost exchange traded funds "with an asset allocation that reflects her risk tolerance and time horizon," Ms. Campbell says.

As for downsizing, Lara could sell her house and buy a smaller one costing, say, $300,000. She does not need a rental unit because her income will easily cover her expenses. If she were to sell in five or six years, she could be mortgage-free then, the planner says. "This may provide her with some more peace of mind."

Finally, Lara has asked about the implications of leaving her civil service job to work overseas. "How much would I need to earn to compensate for the reduced pension?" she asks. Years of service play an important part in Lara's pension, Ms. Campbell says. "This, coupled with the fact that her pension is indexed to inflation, means she would have to save the large majority of her new salary to make up the difference." Lara might have to lower her retirement spending goal to make such a move feasible.

+++++

Client Situation

The person: Lara, 49

The problem: How to get back on track to a financially secure retirement.

The plan: Pay off debt first, then shift savings to a TFSA. Don't worry about having a rental unit to cover expenses. Her income will be enough.

The payoff: A comfortable, financially secure early retirement.

Monthly net income: $9,065

Assets: RRSP $65,000; estimated present value of DB pension plan $483,200; residence $425,000. Total: $973,200

Monthly disbursements: Regular mortgage payment $1,515; extra mortgage payment $835; property tax $325; utilities $285; insurance $135; security $35; maintenance $415; home improvements $425; garden $65; transportation $535; grocery store $450; clothing $270; line of credit $1,085; gifts, charitable $165; vacation, travel $290; drinks dining out, entertainment $450; personal care $100; sports, hobbies $50; subscriptions $35; doctors, dentists $120; life insurance $175; telecom, Internet $180; pension plan contributions $1,120. Total: $9,060

Liabilities: Mortgage $310,025 at 3.09 per cent; line of credit $14,335 at 3.35 per cent. Total: $324,360

Read more from Financial Facelift [http://www.theglobeandmail.com/globe-investor/topic/Financial-Facelift].

Want a free financial facelift? E-mail finfacelift@gmail.com [http://finfacelift@gmail.com/]. Some details may be changed to protect the privacy of the persons profiled.

More Related to this Story

- Financial Facelift Should retiree opt for a monthly pension or lump-sum of cash?
- FINANCIAL FACELIFT Is it too late for this saleswoman to re-enter Toronto's real estate market?
- FINANCIAL FACELIFT Four retirement-plan scenarios for couple struggling with cash flow
- FINANCIAL FACELIFT Can this government employee clear her mortgage and retire in style?
- FINANCIAL FACELIFT Is it 'mad' to buy a house and take on a mortgage at 79?

Topics: