FINANCIAL FACELIFT

After downsizing, couple needs help investing their money with little risk

DIANNE MALEY
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Rani and Evan are at a turning point in their lives. Rani, who is 51, started a new job earlier this year. Evan, who is 57, wants to scale back a bit, even if it means working well past the usual retirement age.

Together, they gross a little more than $110,000 a year.

A year ago, they sold their big, old house in an Eastern Ontario city and bought a new, smaller one. In doing so, they took on a $210,000 mortgage. They have two grown children.

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When Rani left her teaching job, she took her 11 years' worth of pension money and put it in a registered retirement savings plan. In her new job, she has a hybrid pension plan that allows her to make additional contributions beyond what is required for her defined benefit plan and even to transfer her existing RRSP to a separate pension pool. She has not yet done so.

"Neither my husband nor I are investment savvy and we are looking for investment options that do not require us to have a lot of knowledge or spend a lot of time monitoring them," Rani writes in an e-mail.

"How should we be investing our money to ensure an adequate return with minimal risk?"

Evan, a health care professional, wonders whether he should begin collecting his Canada Pension Plan benefits at age 60 when he scales back from working five days a week to four.

"He doesn't really plan on fully retiring," Rani writes. They also wonder if they should be directing their cash flow to their RRSPs, tax-free savings account or mortgage loan. So far, finishing touches to the new home – a fence, a deck, the garden – have eaten up whatever extra cash they have.

We asked Marc Lamontagne, a fee-only financial planner at Ryan Lamontagne Inc. in Ottawa, to look at Evan and Rani's situation.

What the expert says

For Evan to begin drawing CPP benefits at age 60 is not the best strategy, Mr. Lamontagne says. If he delays taking CPP until he is 70, his benefits would double from $680 a month at age 60 to $1,482 at age 70.

“The long-term financial benefits far outweigh the short-term loss of income” of about $475 a month after tax, the planner says. “It is like a saving strategy, though it drastically reduces their longevity risk – the risk of running out of money in retirement.”

As for their savings, Rani and Evan have more options than most people thanks to Rani’s flexible work pension – but if they want higher returns, they have to invest in marketable securities.

“You really can’t have a decent rate of return and minimum risk,” Mr. Lamontagne notes. For the best return, they could hire a professional money manager who invests in low-cost exchange-traded funds. For safety, they could stash their money away in risk-free but low-yielding guaranteed investment certificates.

“Interestingly, they do have a partial third option, which I would highly recommend,” Mr. Lamontagne says. Thanks to Rani’s combined defined contribution-defined benefit pension plan, she can transfer her existing RRSP to her company plan as well as make new contributions, the planner says. The plan’s additional voluntary contribution option works very much like a locked-in RRSP.

“The plan is well managed, has a good track record and is very low cost.” The management fee is less than half a percentage point a year. While pension fund investments do bear some risk, Rani could expect an average annual return of 6 per cent, he says.

As to where they should direct any surplus funds, it depends. Saving and investing, especially in tax-sheltered plans, has an advantage over debt repayment given the low interest rate environment. As well, their mortgage will be paid off in 2029, just before Rani plans to retire.

If Evan opts for professional management of his savings, he, too, can expect a rate of return of 6 per cent. In that case, any additional savings should be directed to his RRSP.

“If they can scrape together an additional $5,000 a year on top of what he is already saving, then that will give them a comfortable retirement,” Mr. Lamontagne says. They will have sufficient pension income and assets to meet their desired $48,000 a year in retirement lifestyle expenses. But if Evan chooses a GIC portfolio instead, his expected rate of return will average only 4 per cent. In that case, the extra money should be directed to Rani’s optional pension pool instead.

“Even though the additional voluntary contributions will generate a lower tax refund in Rani’s hands because her income is lower (20 per cent compared to 30 per cent if the money had gone to Evan’s RRSP), the potentially higher rate of return (6 per cent versus 4 per cent) will offset any reduced tax saving,” the planner says.

Client situation

The people

Evan, 57, and Rani, 51.

The problem

Figuring out how to get on track financially for a comfortable and secure future.

The plan

Evan can scale back his workweek, but he should consider deferring CPP benefits. They should take full advantage of Rani's professionally managed pension plan, which allows for a combination of defined benefits and defined contributions.

The payoff

How they fare will depend on whether they are willing to take some risk with their investments, and whether they can save a little bit more than they are now.

Monthly net income

$7,785

Assets

Cash in bank $3,000; his TFSA $12,000; his RRSP $215,000; her RRSP $159,000, his work pension (RRSP) $43,800; home $360,000; estimated present value of her work pension $9,000. Total: $801,800

Monthly disbursements

Mortgage $1,390; water, sewer $115; home insurance $50; hydro, heating $165; maintenance and improvements $480; car loan $560; other auto $475; groceries $650; vacation, travel $250; personal discretionary (grooming, dining out, entertainment, clubs, pets) $700; disability insurance $30; telecom, Internet, TV $210; RRSP $100; pension plan contributions $245. Total: $5,420

Liabilities

Mortgage $210,000; car loan $36,000. Total: $246,000.

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