THE GLOBE AND MAIL

FINANCIAL FACELIFT

Can we use our home as a main source of retirement income?

DIANNE MALEY
Special to The Globe and Mail
PublishedFriday, Apr. 11 2014, 7:19 PM EDT
Last updatedFriday, Apr. 11 2014, 8:04 PM EDT

Ever since they bought their suburban Toronto house several years ago, Libby and Sam have been obsessed with paying off the mortgage.

They've whittled it down from $415,000 to about $180,000 now and aim to have it retired by December, 2019.

Sam and Libby are in their early 40s, earn $158,000 between them and have no children. Both work in financial services. She has a defined contribution pension plan (similar to an RRSP) to which both she and her employer contribute, while he has a defined benefit pension plan that will pay him a fixed amount each month.

More Related to this Story

- FINANCIAL FACELIFTWhere should couple allocate any extra money?
- FINANCIAL FACELIFTCan couple maintain their globe-trotting ways into retirement?
- FINANCIAL FACELIFTLurking debt threatens part-time dreams

With so much of their net worth in their home – valued at roughly $900,000 – they have questions about retirement planning.

"Given that we don't need to leave any inheritance to the next generation, our initial plan is to use our home as our main source of income in our retirement years," Libby writes in an e-mail. Their pension plans, savings and government benefits round out their income pool.

"What is your thought on using our home as a nest egg, selling it, keeping it, or selling and buying a smaller place?" she asks.

They would like to retire at age 60. "Is this realistic? If not, what age looks more reasonable in order to be able to replace 70 per cent of current income in our retirement years?" Libby asks.

We asked Marc Lamontagne, a financial planner at Ryan Lamontagne Inc. of Ottawa, to look at Libby and Sam's situation.

What the expert says

Financial planners don't usually recommend relying on your home to finance your retirement, Mr. Lamontagne says.

In Libby and Sam's case, once the mortgage is paid off, they'll have an extra $48,000 a year to invest, he notes. They are making extra payments to principal of $18,000 a year. That is on top of their current combined registered, non-registered and employer-funded savings of about $32,000 a year.

"So there is no need to rely on their home as a retirement asset," the planner says. They can stay there as long as they please.

Sam and Libby ask whether they will have enough to replace 70 per cent of their income when they retire, but they likely won't need that much, Mr. Lamontagne says.

"They will actually need much less income in retirement because they will no longer have work-related expenses, mortgage payments, or the need to save," he notes. Their budget shows lifestyle expenses of $38,000 a year.

"Even if they add on another $10,000 a year to account for occasional expenses such as home or car repairs, they still only need roughly $50,000 a year [after tax] in retirement," he says. With their work pensions, and Canada Pension Plan and Old Age Security benefits, "they will have more than enough money to retire at age 60 – or even earlier.

If they retire at age 60, Sam's DB pension plan will pay $33,756 a year from age 60 to 65, including the bridge benefit. This will fall to $27,492 at age 65. They can begin drawing CPP at age 60 (about $7,975 each) and Old Age Security at age 67 (about $6,620 each).

From age 60 to when they begin collecting OAS at 67, their income will fall short of their requirements, the planner calculates. Their combined after-tax income will be $44,700 a year. The shortfall of $5,300 a year can be drawn from their non-registered account.

Once they begin collecting OAS, their after-tax income will rise to $52,670 a year, so they will no longer need to draw on their savings except for big-ticket items such as a new vehicle.

Once the mortgage is paid off, they can take full advantage of their registered retirement savings plans and tax-free savings accounts. Any surplus beyond these contributions can be invested in their non-registered portfolio.

Looking at their stock investments, they have too large a proportion in shares of their employers, Mr. Lamontagne says.

"A good guideline is to keep a single stock holding to less than 10 per cent of their investable assets," he adds. They do not need to take on a lot of risk with their investments to reach their retirement goal.

The people

Sam, 42, and Libby, 43.

The problem

Does it make sense to view their home as a key retirement income source? Will they be able to retire at 60?

The plan

Give more thought to just how much money they will need when they quit working. They may find they do not need 70 per cent of their current income because their expenses will be lower.

The payoff

The security of knowing they may not need to sell their home.

Monthly net income

$8,720

Assets

Residence $900,000; cash and equivalents $11,500; employee stock-purchase plan $40,000; her DC pension plan (mkt. value) $98,400; his RRSP $155,000; her RRSP $78,000; estimated present value of his DB plan $89,235. Total: $1.37-million

Monthly disbursements

Mortgage $2,512; property tax $500; other housing $320; transit $400; other transport. $465; groceries, clothing $500; gifts/charitable $110; vacation $210; entertnmt. $250; other discret. $125; insurance, drugstore $60; telecom, TV, Internet $212; RRSPs $875; her pension plan $482; stock purch. plan $525; her TFSA $250. Total: $7,796. Surplus: $924

Liabilities

Mortgage $180,100

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

Want a free financial facelift? E-mail finfacelift@gmail.com [mailto:finfacelift@gmail.com]

Some details may be changed to protect the privacy of the persons profiled.