Teacher must plan income, manage debt

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FINANCIAL POST

Lise, 65, as we'll call her, teaches art at an elementary school in Quebec. Single, she is her sole means of support. In her four decades of work she has built up savings and investments of $626,300. Her only debt is a $47,000 mortgage on her $175,000 condo. The mortgage has nearly eight years to run before it is paid off. That will be well into a retirement she hopes can begin in mid-2016. The question is: Can her savings and a teacher's pension of $25,700 a year, Quebec Pension Plan benefits and Old Age Security support her?

"My goal is to visit my family in Europe as often as my finances permit," Lise says. "But are my investments to supplement my pensions well-placed? I want to have $35,000 a year to spend."

Family Finance asked Benoît Poliquin, lead portfolio manager of Exponent Investment Management Inc. in Ottawa, to work with Lise.

CURRENT FINANCES

Lise's defined-benefit pension will provide $2,142 a month before tax, which is about 30 per cent of her present monthly $7,157 paycheque. Other sources have to add income so that she can cover allocations other than $1,083 savings a month at present. With a reorganization of her balance sheet, all that can happen, Poliquin suggests.

Her monthly after-tax income, which includes her salary and her Quebec Pension Plan benefits, which she is already receiving, adds up to $4,283, the planner notes. Her $47,000 outstanding balance on her mortgage is a problem, for retired persons should be debt-free.

Lise has $46,000 in cash earning almost nothing that can be used to pay off the mortgage, which will have several thousand dollars less owing when it comes up for renewal in 2016, about

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MONTHLY SPENDING SNAPSHOT

Expenses		$4,283
Real Estate	Mortgage residence	$869
	Property taxes	$200
	Condo fees	$140
Transport	Bus pass	$75
Personal	Food	$300
	Clothing, grooming	$226
	Charity & gifts	$80
	Medical & drug	$300
Other Basics	Utilities	$70
	Phone, cable, Internet	$130
	Miscellaneous	$380
Financial	Savings	$1,083
	Home insurance	$30

it provides. She has no Tax-Free Savings Account. Her TFSA space in 2014 is $31,000 and she can use it to shelter income from $432,300 she holds in taxable accounts. She can add money from $162,000 of maturing term deposits rather than transferring taxable investments to the TFSA. If she did the latter, the in-kind transfer would trigger tax on accrued but unrealized gains, the planner notes.

There is also a problem of asset allocation. It is haphazard, that is, whatever goes with the mutual funds she has chosen. Not only is the allocation unfocused, it does not relate to her risk tolerance and the potential swings on portfolio value that go with capital markets, Poliquin says.

At present, most of Lise's retirement income will be government and teacher's pensions, all of which are indexed. Value will not fluctuate with interest rates, but in every other sense, this income is as solid as government bonds. In her investment portfolio, she has a major fund company's balanced fund with about 35 per cent bonds and another company's balanced fund with a similar bond weighting. Add it up and about 80 per cent of Lise's assets and income are from bonds.

Bonds used to pay interest well above what corporate stock dividends yield, but no more. Stock dividends, though less secure than interest on investment grade corporate bonds and government bonds, tend to be much higher than bond interest. Chartered banks pay 3.5 per cent to 4.5 per cent dividends on their common shares, worth about a quarter more after application of the dividend tax credit, while banks' bonds pay about 1.5 per cent to 3.5 per cent depending on the bonds' terms and seniority. The same relationships exist for large-cap telecom stocks, pipelines and mature industrial company stocks, Poliquin says.

Moreover, dividends have a

the time she will be retiring. The remaining problem is to increase her cash flow. That can be done by adjusting her investments.

Lise's monthly pensions will include $907 from the Quebec Pension Plan, which she already receives, $564 from Old Age Security, $2,142 from her teacher's pension, $747 from taxable investment income and $742 accumulating in her RRSP. It adds up to $5,102 before tax and about $3,400 after tax on all income other than that held in RRSP. That's an annual after-tax income of $40,800 and more than Lise's $35,000 annual retirement income goal.

RAISING RETURNS

Her assets both registered and unregistered are in a buffet of bank-sponsored mutual funds. Her portfolio of term deposits is in taxable accounts. This is backwards, Poliquin says. Interest-bearing deposits such as bonds and bank deposits should be in registered accounts that have no current tax exposure because they are fully taxed as income. Her dividend-paying investments should be in taxable accounts in order to make use of the dividend tax credit and the tax reduction

Leisure	Restaurant	$100
	Entertainment	$100
	Travel	$200
Assets		**$801,300**
Real Estate	Residence	$425,000
	Rental house	$325,000
Investments	RRSP	$35,000
	Cars	$22,000
	TFSA	$5,400
Liabilities		**$47,000**
	Mortgage	
Net worth		**$754,300**
Retirement Readiness		★★★★☆

tendency to increase over time at a rate that usually matches or surpasses inflation. The downside of using dividends for income is that the underlying shares can fluctuate in price dramatically.

If the portfolio was adjusted to reduce bonds to one-third and dividend-paying stocks to two-thirds, then Lise's $626,300 portfolio could generate about two per cent more income. That's about $12,500.

Lise is paying about 2.1 per cent in management fees on her $418,300 of financial assets other than cash and GICs. That works out to $8,784 a year. She could save roughly half of that, about $4,400 a year, by using an independent portfolio manager who would charge just one per cent of funds under management, Poliquin notes.

Adding up extra investment income and fees she can keep, Lise could have $16,900 more pre-tax investment income for travel or anything else she wishes. Add in the savings-ending mortgage payments, $10,428 a year.

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