TOUGH DECISIONS 2012

Tough financial planning and investing decisions require careful consideration.

– By Al Emid

Individuals aged 50 years and upwards face tough financial decisions, some of them reflecting this generation's good-news-bad-news realities. The good news is that they are living longer than some of their forebears, but the bad news is that their accumulated wealth therefore must last longer. The good news is that they have increasing tax breaks, but the bad news is that the tax system has become more complex.

With careful consideration, they can make dollar-effective and tax-effective decisions but they also require appraisal of emotional needs. These decisions boil down to one question:

"How will I live when I retire?"

Shifting attitudes towards equity investments tops the list. When this writer first covered financial planning for national publications, then-current truisms taught that as an individual approached retirement, he or she should reduce or eliminate equity investments in favour of fixed income holdings. Now, basement-level interest rates and increased longevity make that approach less advisable.

Another obsolete rule held that equities in an individual's portfolio should equal 100-Age = X% explains Rona Birenbaum, Certified Financial Planner and owner of Toronto-based Caring For Clients Inc. Now, a more appropriate mix combines factors such as income needs and attitudes towards volatility. "I think there is more of a custom approach than there used to be," she says.

Longevity risk means other tough decisions. This refers to the danger that the individual may outlive accumulated resources. This one means calculating allowable cash flow based on assumption of family health histories, and using 90 years of age as a baseline.

"It also means factoring in conservative investment returns," Birenbaum says. She sees compounded annual return of 4% and 3% inflation as acceptable, and includes factors such as whether the equity in the home would fund living costs if the individual lives past age 90.

Another tough decision goes beyond mathematics and age projections. Birenbaum and other advisors regularly encounter clients conflicted between giving children substantial sums and retaining funds for retirement.

Resolving this means working through scenarios, often literally called 'What If' scenarios. Using specialized software, the individual or financial advisor can subtract a stated sum from their assets and run a scenario on what the loss would mean to age 90, she explains.

Deciding between Registered Retirement Savings Plan and Tax-Free Savings Plan deposits amounts to the newest difficult decision. An RRSP deposit saves on the current year's taxes and allows tax-free compounding inside the plan, but payouts may lead to higher-than-otherwise taxes in retirement years. A TFSA deposit does not attract an immediate tax break but does provide tax-free compounding and payouts.

Each individual's situation is different, but the calculation should be made with a view to the projected tax bracket in retirement more than the bracket at time of deposit. In many cases, the lower the anticipated bracket the more it skews the choice to an RRSP deposit as opposed to the TFSA, she explains.

The choice should also include looking at the impact of payouts on social benefits, according to Jean-Pierre Laporte, pension specialist at Toronto-based law firm Bennett Jones LLP. TFSA payouts do not count as taxable income for purposes of determining the benefits clawback while RRSP payouts do affect the calculation.

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Empty nesters face another series of difficult decisions on the home front. These include the possibility of selling the home and moving to a condominium or apartment. The shift seems appealing. "You're constantly bombarded with people saying, 'Why do you still shovel your driveway?'" as well as estimates of the differential between house sale proceeds and condo purchase costs.

"Empty nesters typically view the decision through two different perspectives," Laporte explains. "What are your objectives? Are you downsizing so that you will have a pot of money so that you can go on cruises, or are you downsizing because you don't have a pension plan and you need to set aside some capital for your old age?" he asks. The first option is voluntary while the second is more critical.

For those thinking of using the money for cruises, this means making direct lifestyle comparisons as well as cash comparisons. A couple moving from a high-priced home in a high-net worth area of the city with the accompanying lifestyle may make serious money on the house sale, but may not be equally comfortable in a lower-priced condo in a less desirable area. Individuals tend to want the same lifestyle, Laporte suggests, meaning that those leaving a high-ticket home will want the same standard of living in a condo and therefore may not save as much as anticipated.

The shift also involves a psychological move, since the homeowners reigned supreme in their homes, but may not want to deal with condo associations, and their rules and restrictions.

"There's a lot of adjustment. People that are set in their ways may regret the shift," he suggests. "The solution here is to contact as many of those who have made the shift as possible, seeing these conversations as a form of due diligence."

Those who sell the home in order to supplement pension income may see the shift as a better alternative than reverse mortgages.

"The early retirement decision has some factors in common with the house sale decision," he suggests. "Again it goes back to square one." It calls for serious cash flow projections, especially since those who do not opt for the package may run the risk of outright termination if the employer has financial problems.

Before deciding, the individual should appraise post-package income possibilities, whether consulting or part-time work and pragmatically appraise the chances of retaining the present job if refusing the package. "Do you take the early retirement package knowing that at age 55 or more you may not be that marketable," he asks rhetorically. The equation includes added income from investing the package proceeds.

Like other tough decisions cited here, this needs examination of all factors. "You can't look at the package in isolation. You've got to look at the whole financial picture," Laporte says. ■

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