Back to Financial planning: Facing the final facts

Financial planning: Facing the final facts

January 29, 2012

Ellen Roseman

Cynthia is 63 and has a terminal illness. When she was diagnosed last April, she sold her Toronto townhouse and cleared about $570,000.

She gave $200,000 to her adult children right away. Now she wants to know how to invest the rest in a low-risk way to make it last during the time she has left.

"I have a rare incurable mantle cell lymphoma," she says, referring to a type of cancer that begins in the immune system. "With treatment, my prognosis is about seven to eight years."

Cynthia isn't her real name. She wants to keep a low profile, since any stress can compromise her health.

After I did a speech to a seniors' group, Cynthia came up to me to ask for investment advice. She was confused about the products recommended by her mutual fund salesperson.

I suggested that she work with a certified financial planner — someone who could analyze her cash flow, tax and estate planning needs and come up with appropriate strategies to make her money last.

Rona Birenbaum, a CFP and partner in Caring For Clients, waived her fees in order to help Cynthia and others in a similar position.

Rona Birenbaum of Caring for Clients speaks to an associate at Queensbury Securities.

Nick Kozak

"The good news: She can have everything she wants," Birenbaum said after crunching the numbers.

"She thought she'd have to downsize from her two-bedroom apartment to a one-bedroom apartment. But I don't think that will be necessary."

Cynthia, who's single, gets $40,000 a year in long-term disability payments from her employer. But the payments end when she turns 65 in 2013.

After 65, she will receive government pensions, but no company pension. She also has a registered retirement savings plan with a value of $70,000, down $6,000 since she opened the account in 2006.

"My RRSP investments have lost money over the past five years, so I have a very low risk tolerance," she says.

Birenbaum did an extensive analysis of her spending, using a spreadsheet with dozens of categories. She found Cynthia needs after-tax income of $2,800 a month — or $33,600 a year — to meet her goals.

Her major expenses include:

$15,720 a year for rent, landline and cellphones and Internet.

$6,840 for groceries, eating out, dental care, prescriptions, vitamins, supplements and toiletries.

$2,400 for vehicle expenses (gasoline and repairs).

$2,400 for recreation (entertainment and vacations).

$2,220 for insurance (life, tenant, auto).

$1,200 a year for charitable donations and gifts.

Birenbaum knew that Cynthia wanted to avoid risky investments.

"Her RRSP was down 19 per cent in 2008," the financial planner said. "That's too aggressive for her."

With $370,000 to invest from her house proceeds (after giving cash to her adult children) Cynthia has enough to live on until age 80, Birenbaum says.

All she needs is an investment return of three per cent a year to give her an after-tax income of $33,000 a year, indexed to inflation. That's 98 per cent of her current after-tax income.

Birenbaum’s plan builds in money for extra expenses that may be needed, such as $25,000 for a new car and $10,000 for health care costs.

Her advice for Cynthia:

Invest $20,000 in a tax-free savings account. (She hasn’t used her $5,000 annual limit yet, so she can carry forward contributions from the past three years.) Put it into the TD Canadian Bond Fund.

Invest $350,000 in mutual funds from NexGen Financial, which offer more control over the tax treatment of her investments.

Put $280,000 into the NexGen Canadian Bond Fund and $70,000 into the NexGen Turtle Canadian Balanced Fund — a mix that gives her only a 10 per cent exposure to stocks.

Birenbaum likes NexGen, a company founded in 2005 by James Hunter (former president of Mackenzie Financial Corp.) because its tax efficiency works well for retirees.

Most mutual funds pay distributions that count as income for tax purposes and can push a retiree into a higher tax bracket.

Fund distributions can also interfere with the guaranteed income supplement (GIS), a government pension that tops up Old Age Security for those over 65 with very low incomes.

With tax-efficient funds such as NexGen’s and Fidelity’s T-SWP, you can choose to get no distributions at all. It’s called the compound growth option.

Cynthia’s portfolio of tax-efficient funds will allow her to qualify for GIS until the end of the year she turns 71.

At that point, she’ll have to convert her RRSP into a registered income fund and start making taxable withdrawals each year.

Birenbaum has other advice for Cynthia that isn’t investment-related:

Make sure her will and power of attorney, which she drew up herself, are witnessed properly. These documents won’t be legal if they’re not.

Keep about $25,000 of surplus withdrawals from her mutual funds in an easy-to-access account for emergencies and extras, such as travel.

Consider using a non-interest-bearing chequing account. It can be as tax-effective as a savings account, once interest and GIS clawbacks are factored in.

Cynthia still feels pretty good, though she has little energy and sleeps more than she used to do.

She’s not taking any drugs or going for any cancer treatments yet.

“My best chance for survival is heavy-duty chemotherapy, followed by a stem cell transplant,” she says.

“My oncologist said my blood work was good and I should continue as long as I can without treatment. He figures I can go for two to three years.

“The only problem is I can’t get a stem cell transplant after 65. Maybe there will be other treatments by then.”

She’s relieved to have a financial plan and a low-risk tax-smart portfolio designed for someone with more important things to worry about, such as staying alive.

Ellen Roseman writes about personal finance and consumer issues. You can reach her at eroseman@thestar.ca.

Tips for conservative investors facing retirement:

•You can get tax breaks on income generated by equity mutual funds and stocks (outside of a registered plan). You don’t get any tax breaks on interest income.

•You should keep some of your money in common or preferred shares or low-risk mutual funds that generate tax-advantaged capital gains and dividends.

•You should look for tax-efficient mutual funds that let you control the type of income you receive.

•Good choices are tax-efficient funds that pay no distributions (compound growth option) or pay non-taxable monthly distributions (return of capital option).

•If you can lower your taxable income, you can avoid having your government benefits (such as OAS and GIS) clawed back.

•As a retiree, you have to focus on the income you can keep after tax, not the total income you receive.