Investments

The Critical 10

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Second year of retirement

Is my withdrawal rate sustainable?

Let’s spend a minute analyzing London Life Freedom 55.

Canadian’s view of retirement has been altered by what was one of the most successful advertising campaigns in the country – Freedom 55. Most of us can still recall the image of the vibrant young retiree jogging on the beach, worry free. That ad was first aired 30 years ago.

The reality of Canadian retirement is that, according to a March 2012 Canadian Business Week report, the average age of retirement in Canada is about 63. The good news is that healthy Canadians are living about 10 years longer than when the London Life ad first aired. The government of Canada has acknowledged this by pushing the age of OAS benefits back from 65 to 67 and by reducing the mandatory amount required to withdraw from RRIFs effectively June 2015.

We all hope for an active and healthy retirement. While we won’t spend every day jogging on the beach, we do still want to enjoy travel, activities with friends, family and perhaps young grandchildren. The first few years of retirement are when you move from retirement savings to retirement income planning. This is a time to review your financial plan with a critical eye towards the sources of retirement income as well as the volatility of the income and how you navigate tax brackets to achieve a good after tax income.

Market volatility has less of an impact over the long term if you are saving for retirement. Different variable returns over a 10 year period can achieve the same result in total accumulation. The chart below shows the impact of $100,000 invested year 1 and earning various returns. Markets never grow at the exact pace each year and during periods of volatility “hold the course” is generally good advice when you are in savings mode.

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1	2	3	4	5	6	7	8	9	10	
7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	**$196,715**
9.4%	14%	13%	23%	-4%	10%	-1%	21%	-4%	-7%	**$196,715**
-7%	-4%	21%	-1%	10%	-4%	23%	13%	14%	9.4%	**$196,715**

The retiree's dilemma is that they are expecting to draw down funds each year during retirement. Being forced to sell off assets at inopportune times to fund cash flow can have a very significant impact on the retirement asset. Below is a chart illustrating a $100,000 investment in year 1 and annual withdrawals of $7000.

1	2	3	4	5	6	7	8	9	10	
7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	**$100,000**
9.4%	14%	13%	23%	-4%	10%	-1%	21%	-4%	-7%	**$112,000**
-7%	-4%	21%	-1%	10%	-4%	23%	13%	14%	9.4%	**$83,586**

The early years of your retirement is a time to move towards less volatility and towards more income paying investments such as bonds or blue chip companies that pay dividends. The higher the portion of your monthly cash flow that is funded by the income earned in the portfolio, the less stress you will experience during periods of market sell offs.

Managing your tax bracket and the sources of your investment income in retirement can have a big impact on after tax income and as a result, may allow you to have increased purchasing power. Couples may wish to explore opportunities to income split as much as possible.

Alberta income	Tax rate
$11,327 - $18,213	15%
$18,214 - $44,700	25%
$44,701 - $89,400	32%
$89,401 - $138,585	39%

This chart is for illustrative purposes only and is not intended to calculate your actual tax liability.

A very simple example is that if a couple is able to split income so that $100,000 is earned by each partner. Tax obligation for each partner would be about $9300 on regular income ($18,600 for the couple). If one partner claims all $100,000 income the tax obligation would be approximately $25,700.

The source of that income is also important. Allocating interest bearing income to registered accounts and earning dividends and capital gains in the non-registered is generally advised.

$50,000 income	Marginal rates	
Interest / salary	32%	$34,000 net
Capital gains	16%	$42,000 net
Eligible dividends	9.63%	$45,185 net

This chart is for illustrative purposes only and is not intended to calculate your actual tax liability.

Retirement is also the time when the government of Canada gets its tax money on all that income earned in your RRSP accounts. Although the limit of mandatory withdraw has been reduced, you still must convert your RRSP to a RRIF at age 71 and begin withdrawing money.

Age	RRIF rate	Age	RRIF rate
65	4.00%	75	5.82%
66	4.17%	76	5.98%
67	4.35%	77	6.17%
68	4.55%	78	6.36%
69	4.76%	79	6.58%
70	5.00%	80	6.82%
71	5.28%	81	7.08%
72	5.40%	82	7.38%
73	5.53%	83	7.71%
74	5.67%	84	8.08%

If you can manage your tax brackets well early in retirement, it may be worth considering drawing funds from your RRSP earlier than age 71. While the proceeds would be taxable at your full rate, you could find yourself in a situation later in life where the minimum RRIF withdrawal is taxed at a higher bracket. This is also a consideration for estate planning, since RRIF assets are taxed at the death of the second spouse as if all funds are removed from the RRIF in the year of death. Leaving behind a large RRIF account also will leave a big tax bill for the estate.

While the early years of retirement are generally when we will be the most active and want higher purchasing power, all retirees are mindful of not depleting their retirement savings too soon. A simple financial blueprint or financial plan can create a variety of retirement income scenarios from which to choose from. Periodic review of the plan is also encouraged to ensure you are executing the retirement income planning strategy that is right for you.