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PENSIONS

How much do you need to retire?

HR helps employees prepare for retirement, but they also need to be ready themselves

By Michael Prittie

HR professionals spend their careers helping others navigate a path to retirement, but it's equally important to ensure their own future is solid — especially in retirement. Here are some steps to consider:

Determine income needs

Traditionally, as a general rule, the average Canadian will require about 70 per cent of her pre-retirement income to support a similar lifestyle post-retirement. However, individuals may require significantly more or require less — it all depends on their non-discretionary and discretionary spending habits.

Non-discretionary takes into account shelter, utilities, food and the like while discretionary items may include travel or other activities in retirement that will accelerate spending. Consider the need to care for others and any debt, such as a mortgage you may still carry. This may translate into a higher income need than traditionally thought.

Reduce or eliminate expenses

In preparation for retirement, consider the following: Will you continue current registered retirement savings plan (RRSP) savings, pension contributions and other expenses, such as travel to and from work? Will you need two cars in retirement?

A good exercise to do is write down all the expenses you incur now and then reduce or eliminate each one to reflect the situation in retirement. If too many still exist, such as a mortgage or other non-tax deductible debt, work out a plan to eliminate the most costly ones prior to retiring. The resulting number is what needs to be replaced with retirement income. You may choose to categorize the list into non-discretionary and discretionary items.

Determine retirement income

Employment and Social Development Canada offers a simple tool online to help people determine their Canada Pension Plan (CPP) entitlements. Current retirees aged 65 and over are entitled to $1,065 per month while those wishing to receive benefits as early as 60 years of age will face reductions of up to 36 per cent. Old Age Security (OAS) benefits are available at 65 and provide $564 per month. Recent legislative changes allow for a deferral of CPP and OAS benefits depending on age and need.

There are two main types of pensions: a defined benefit (DB) plan and a defined contribution (DC) plan. A DB plan provides an income payment for life regardless of economic conditions or the plan's performance. The amount is based solely on a specific formula. In contrast, a DC plan will provide a retirement payout based on how the chosen investments perform. If you have a private pension plan, the most recent summary will show the pension income at retirement age.

Lastly, you'll need to take into account your savings within RRSPs, tax-free savings accounts (TFSAs) and non-registered investments. Similar to a DC plan, these vehicles provide retirement income dependent on how chosen investments perform.

As a very general rule, it should be safe to assume an average five per cent payout under a balanced investment approach. With a registered retirement income fund (RRIF), the annuitant (the beneficiary of an annuity or pension) is subject to minimum annual withdrawals starting at age 65. The minimum percentage required to withdraw increases as people age.

As an example, at 65 years of age, the minimum withdrawal from a registered income plan is four per cent while at 71 years of age, the minimum amount that must be withdrawn is 7.38 per cent. RRIF withdrawal minimums are established by the CRA and apply to plans established prior to Dec. 31, 1992. RRIFs established before this date may have different minimum withdrawal limits.

You will now have a net income figure that will determine whether or not your OAS is clawed back in retirement. If you earn more than $72,800 of net income, each additional dollar of income above this threshold will require you to give back 15 per cent of your OAS benefit. However, there are ways to mitigate this and a qualified advisor can provide solutions, such as income splitting and flow-through limited partnerships.

Surplus or deficit?

This is where it gets a bit more complicated. Ernst & Young has an online personal tax calculator to help calculate after-tax retirement income, which you can compare to your retirement income needs. Simply plug in your total income and if you are living common law or married, be sure to do this separately. Remember to compare individual after-tax income to determine if your spending needs will be covered.

Future health-care needs

When planning for retirement, family history and health play an important role. If you have a family history of longevity, you may want to consider protecting yourself against outliving your income. This applies mostly to those without a DB pension plan. Alternatively, if you feel your health may become a concern, it may be wise to consider long-term care insurance to protect against the growing cost of homecare or assisted retirement living care. These can run into the thousands of dollars per month and erode retirement savings quickly.

The earlier you know your number, the better. This allows you to adjust expenses and increase savings now to meet future retirement needs. Discuss the situation and consult with a financial advisor to determine what steps need to be taken today, if additional tax savings can be found or if existing investments are properly structured to meet goals and objectives.

There are three factors that will affect retirement income: the amount invested, the rate of return achieved and the investment time horizon. If, after calculations, you are short of your target, there are three options: put more money away each month, adjust the asset mix or selection of securities to obtain a potentially higher return, or delay retirement to allow for more time to compound your savings and delay their erosion.

A popular retirement planning adjustment is to take some part-time work in an area you are passionate about — this can be fun and rewarding.

With advance planning and attention to the details, you can achieve a comfortable retirement.

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