Keep the condo … pay down the mortgage

At 57, single, and with no company pension and $185,000 in savings, Etta knows she has to do some careful planning.

She's getting $2,284 a month in long-term disability payments that will be discontinued when she turns 65.

Etta lives in a condominium apartment in Victoria valued at $250,000 with a mortgage of $99,000. Her two children, 29 and 25, are on their own.

"Should I stay in my condo or sell it and rent?" she writes in an e-mail. She figures she will need $28,000 a year to live on, $13,000 of which will come from government pension and support payments (Canada Pension Plan, Old Age Security, Guaranteed Income Supplement), when her disability payments stop in about eight years.

"What do I need to do to plan for age 65 when I lose my long-term disability?"

We asked Trung Lu, a financial planner and investment adviser with Vancity Credential Asset Management Inc. in Vancouver, to look at Etta's situation.

WHAT THE EXPERT SAYS

Mr. Lu explored four different alternatives for Etta and decided the best thing would be for her to stay in her condo and draw down her registered retirement savings gradually from now until she turns 65 to pay down the mortgage.

"Unfortunately, in each scenario an income shortfall occurs, generally around age 80 or a little later," he says in his report. If Etta keeps her condo, she will have the equity in it as a potential source of retirement income. If she sells it, she will have "nothing left to fall back on."

By paying down her mortgage, Etta will need less money to live on when her disability pension stops. As well, by withdrawing money from her registered savings now, "we hope to preserve as much of your GIS (guaranteed income supplement) as possible." GIS is fully clawed back at $15,762 in annual income, not including Old Age Security.

"Just be careful that you don't withdraw too much each year," Mr. Lu cautions. If Etta keeps her annual taxable income below $41,000 (it is now $27,408), she will still be at the 22.7 per cent marginal tax rate. Anything above $41,000 will be taxed at a 30 per cent marginal rate.

Etta's RRSP withdrawals would be about $13,318 a year. After subtracting the 20 per cent withholding tax, she would have $10,654 to pay down the mortgage. Because she will still be making her regular mortgage payments of $446 a month, she will likely have the mortgage paid off by the time she turns 65, Mr. Lu notes.

She could also draw on her non-registered account for mortgage payments if necessary. He recommends she keep her tax-free savings account as an emergency fund.

By paying off her mortgage, Etta will cut her monthly expenses by $446, or $5,352 a year, lowering her required income of $28,000 to $22,648 a year.

If she is not already doing so, Etta should apply to the provincial government to defer her property taxes (a program offered to B.C. residents), Mr. Lu says. This will cut her expenses by another $1,440 a year, bringing her income needs to $21,208.

Her combined CPP, OAS and GIS, plus money drawn from her locked-in retirement account, will almost cover her needs. Her income shortfall will be $63 a month or $754 a year.

With no shortfall, she would run out of money by the time she is 85, at which point she would have to sell her condo.

This assumes a life expectancy of 91 years and a conservative 4-per-cent average rate of return on her savings.

Mr. Lu also suggests Etta use some of the $3,190 in her bank account to pay down her credit card balance of $2,500.

According to the planner's calculations, if Etta were to sell her condo – which, with fees and insurance, costs $720 a month – and rent for $800 or $900 a month, she would not be better off because her income needs would be greater, creating a shortfall of $13,300 a year.