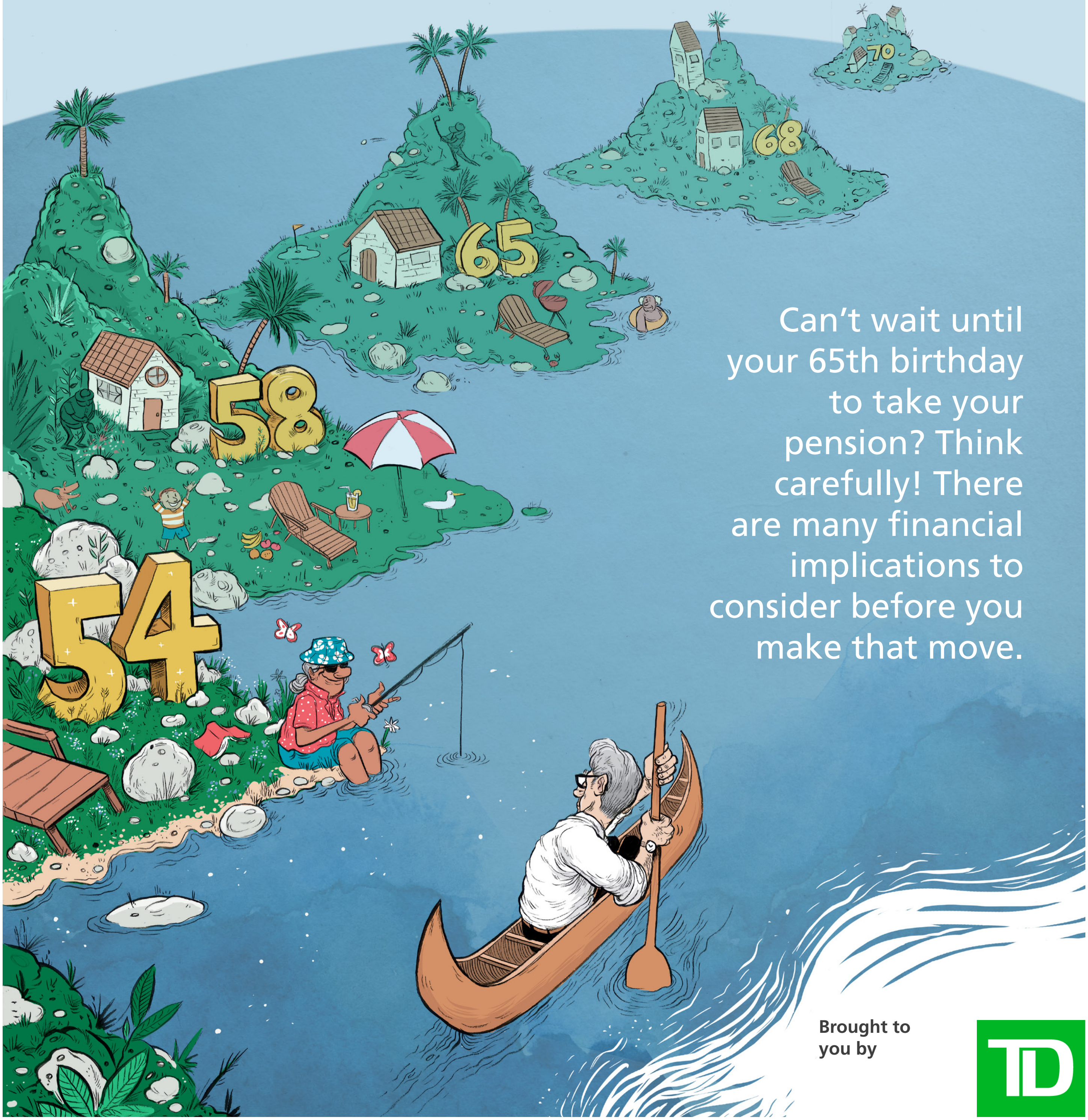
WHEN IS THE BEST TIME TO TAKE YOUR PENSION?



Can’t wait until your 65th birthday to take your pension? Think carefully! There are many financial implications to consider before you make that move.

It's a retirement conundrum that many of us will face: we have been contributing to a well-deserved pension for most of our working lives but the question of when to take it isn't always so easy to answer. At age 65? Or when you retire full-time? Or not until you absolutely need the money?

Conventionally, people use the age 65 as a starting point to retire and to begin taking their pension. But we know that there are many options, such as retiring earlier or later than age 65, or moving to a reduced workload through part-time work or occasional consulting. As well, there are many financial or lifestyles options like whether you also have alternative savings like RRSPs or other assets, to help fund your golden years.

Defined-contribution pension
The employee contributes to the pension. The pension at retirement is based on investment returns.

We also know if we put off taking the pension, the funds may grow and we may have a larger amount to draw from for every year we delay taking it. On the other hand, while we hope to live long, healthy lives, no one knows what's around the corner as you get older: not taking your pension now may mean you may not have the chance to enjoy the full benefit.

As well, once you begin taking your pension, in the majority of cases, you can't stop the process — and that makes the timing crucial.

Bernice Marien, Senior Manager High Value Clients, TD Wealth, says there is no blanket solution since each individual has their own needs and outlook.

"As with any projection, a crystal ball would come in handy. There are many considerations, such as whether the individual is still working and has other income, if they have other assets they can draw from, and it could depend on whether they need the money right away. Their state of health and life expectancy may also come into play," Marien says.

Raj and Emily: The Kids, the House and the Pension

Raj makes $150,000 a year. Emily was packaged out after 30 years — she won't be going back to work but she has an option of taking her company pension before 65 at a reduced rate. Raj has moved from company to company and has a small pension to look forward to ($900 month) but has been contributing to RSPs consistently. Raj thinks he'll work as long as he enjoys it and thinks he can hang on until age 69 if he stays healthy.

Age: *Both 55, health excellent.*
Combined Working Income: *$150K*
RRSPs by age 65: *$800K*
Assets: *Home, $1.5M, paid off.*
Debt: *Son and daughter in 20s going to school. Leaning on home equity as they pay for kids' university tuition bills; they have half of the university bills covered with RESPs but have trouble meeting the rest.*
Lifestyle in retirement: *They are used to living on $90,000 for their lifestyle and they don't want to change that when Raj retires.*

Emily thinks she should take her pension now ($3,000 month gross) but Raj thinks she should wait until she is 65 when the monthly distribution will be higher. They also disagree on the future of the family home. Raj wants to keep the house until they are unable to maintain it (maybe age 75), and then (hopefully) live off the proceeds. He thinks their pensions and RSPs should be enough to allow them to keep the house until they hit their 70s. Emily doesn't want to sell the house ever and would rather spend her pension now and not incur debt and, if their health fails, then, and only then, sell the house and live off the proceeds.

Emily and Raj have many options which make juggling their various decisions difficult — it's even more difficult because they don't quite agree on major ways to finance their retirement. Marien gives a breakdown of the general elements you need to be aware of that will help you decide when the best time is to take your pension:

Health

Longevity, health and what you want to do with your health can influence your pension decision. The latest figures show life expectancy for Canadians at age 50 is 81.6 years for men and 85.1 years for women.[1] While it is hard to generalize, most Canadians who retire at 65 will see themselves slow down gradually over the years. Naturally people will want active plans earlier in their retirement years — so don't put off that hiking tour of Bali.

Ideally, you are robust and fit when you retire and continue to be healthy, mobile and energetic throughout your retirement. That would mean making your savings last as long as possible. Therefore, if your pension is enough to live on, you may consider taking your pension when you retire but delay drawing on your RRSPs. In this way, the investments in the RRSP will grow as long as possible and may be there for you to have when you are still travelling and golfing in your 80s.

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At age 65, health begins to decline and at 77, health problems begin to accelerate with many activity limitations.[2]

At the other end of the spectrum, you may be dealing with health issues in middle age and may wish to enjoy your RSP savings earlier — plus you may need the funds for medical expenses. And if you have more serious health problems in your 60s, you may consider taking the value of your pension in a lump sum cash payment — called the commuted value — in order to receive the full value of the pension if you believe you won't be living into your 80s. If that is the case, your cashed-out pension may be an additional legacy for your loved ones if you choose (see ***Taking the Commuted Value of your Pension,*** page 8).

Marien says when projecting plans for retirement over the lifetime of an individual, she typically uses age 90 as an upper limit.

"But some people are very optimistic because they have longevity in their family and, in that case, we will extend that limit," she says.

She also says people should be mindful of what kind of health benefits that a retirement plan may offer. If you have health issues, the benefits may help pay medical bills, another important consideration on when to take your pension.

Pension and Time of Retirement

The terms and benefits of the pension, and the type of pension you have, will naturally have a significant impact on your decision. If there are options to take the pension before age 65, determine if taking your pension earlier (although for a reduced amount) makes sense. Many people may have more than one pension plan from different companies they have worked for over the years. Or an individual in their 60s may have a pension from one company but is now working for another company. This would give them an option of taking a pension from the first company while still working or letting two pension funds accumulate.

Defined-benefit pension
The employee contributes to the pension. The employer guarantees a certain amount for the pension and makes up the shortfall if there is one.

RSPs/RIFs

You and your spouse may also have been contributing to registered retirement savings plans as well as contributing to your pensions while working. Depending on how much you have accumulated, having the RSPs may allow you to defer taking your pension and let it accumulate to provide a greater benefit.

Further, investments in RSPs/RIFs can continue to grow even though you are making withdrawals. However, individuals must be mindful that withdrawals from an RSP are subject to a withholding tax and this must be factored into the larger financial plan. But unlike a pension, you can decide the exact amount to withdraw from your RSP and when — until age 71 that is — you must convert your RSP into a form of retirement income (typically, a RIF) and take at least the minimum withdrawal. Also, if the minimum RIF withdrawal provides you with more than you need to live, you can deposit the excess in an investment fund and let it grow.

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By 2061, there could be 80,000 Centenarians. This population group grew by 25.7% between 2006-2011.[3]

In any case, Marien says there are many factors that come into play. Some people may wish to begin withdrawing from their pensions soon as possible if they are worried about their former employer's financial stability. Others may wish to defer the pension if it means the deferral would provide a significant increase in income later. If that is the case, those who draw on their RSPs may wish to convert at least part of the RSPs into a RIF to take advantage of the $2,000 pension deduction (if they are 65) for tax purposes and possible income splitting.

If you are finding you have too much cash on hand you can always park the excess funds in a TFSA provided you have the contribution room. But estimating how much money you need in retirement is a challenge in itself.

Cost of Retirement Lifestyle

The cost of your lifestyle in retirement may influence when you begin to take your pension because, if you are able to meet costs through other means (such as the sale of a family home or vacation property or through retirement savings) you may be able to put off taking your pension.

The cost of living usually declines in retirement but it is difficult to estimate by how much. In retirement, costs related to working may go down (transportation, wardrobe), an individual's house may be paid off and children could be independent. You may also downsize your home so that you receive significant funds that could help you in retirement, plus you may save in property taxes and utility bills. But new trends in society may change this picture. Because of the high cost of housing, adult children could be living at home or may not be independent. Or a family may be 'sandwiched' between funding children and actively financing the health care costs for an older parent.

Marien says when working with people who are trying to plan for retirement, she tries to incorporate these factors into the plan:

- What are current lifestyle needs (after-tax cash flow required to meet day-to-day living expenses) and will individuals need more or less? — Usually people will want to sustain their lifestyle.
- Some individuals may expect expenses to decline by 15% or more at age 80 or 85 if they are less active.
- Major expenditures (replacement of vehicles; major household repairs or renovations, travel expenses) are budgeted.
- Don't plan to fund retirement through the sale of the family home. It is assumed that the sale of this property would only be used if needed to fund assisted or long-term care.
- Projections do not take into account any insurance that may exist to cover additional medical costs.
- A conservative approach is taken to meet any future events: a plan should over-estimate lifestyle needs and extend life expectancy beyond the average.

Debt

An important aspect of retirement planning is not to retire with debt. However, we know that more and more Canadians are dealing with debt and carrying that debt, especially consumer debt, into retirement. For estimating lifestyle costs in retirement, that raises the issue of having more money flowing out than coming in, and individuals may wish to decrease their debt load as much as possible as they head into retirement.

A Spouse's Contribution

As well as considering the options above, it is important to consider your spouse's financial situation as well and how your joint funds can be best used. Especially if one partner's situation is different from another's (because it is a second marriage) and one partner has financial concerns independent of the other spouse — such as debt or obligations to children — it is important to seek out professional advice that suits both partners and takes into consideration both their pension and retirement situations.

Leaving Some For Your Kids

When to take your pension will have an impact on what you leave your children and that consideration brings you into the area of estate planning where there are many other financial concerns. Talk with your financial advisor to make sure you have the proper estate planning that works with your pension strategy in order to fulfill your goals.

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At age 50, Canadians with post-secondary education on average worked 14.6 more years until retirement.[4]

If you are living comfortably and perhaps have excess cash, you may be able to lower your tax rate by gifting or lending money to your adult children so that they have funds to invest or to purchase a home. Be sure to speak to a tax professional to ensure that any investment income is not attributed back to you for tax purposes.

Taking the Commuted Value of Your Pension

In some circumstances, it may be worthwhile considering whether to take the commuted value, or lump sum value, of the pension if you believe you may not live long enough to enjoy the full value of your pension. However, there can be serious tax implications to this strategy and the funds may have to be rolled into an RSP or Locked In Retirement Account (LIRA), which can minimize tax issues. Ensure you consult a tax professional to decide on the right route to take. For more information, stay tuned for *When to Take Your Pension Part II – Taking the Commuted Value of Your Pension.*

What Happened to Raj and Emily?

Bernice Marien took a deeper look at Raj and Emily's situation and has good news. She crunched the numbers and says they should have sufficient funds to support their lifestyle expenses and keep their home for as long as they want. Here's the breakdown:

Their lifestyle expenses of $90,000 (after tax and adjusted for inflation) do not have to be reduced. But if they reduced their spending to $75,000 in retirement, they would be ahead by about $950,000 by age 90.

Emily can take her pension at age 55 or 65. In the long run, it will not make an impact on whether they need to sell their home at some point.

If Emily waits until age 65, they will have to draw on their home equity to cover their current costs. But taking the reduced pension at age 55 helps meet the demands of their kids' education costs and outweighs the benefits of taking the full pension at age 65.

Assumptions

If Emily waits to take her pension at age 65 (versus taking it at 55) it would appear to reduce the overall value of their estate by approximately $450,000 by the time they reach age 90 (since they have to lean on credit to fund their kids' education).

Raj and Emily's RESPs for their kids will fund 50% of education costs over the course of the next five years (approximately $25,000 per child for four years each, assuming one year difference in ages).

Raj will commence receiving CPP and OAS at age 70 while Emily will receive 80% of the maximum CPP benefit at age 60 and 100% OAS at age 65.

— Don Sutton, MoneyTalk Life

[1] Mortality: Overview, 2010 and 2011, Statistics Canada, Nov. 30, 2015, accessed Sept. 7, www.statcan.gc.ca/pub/91-209-x/2013001/article/11867-eng.htm.

[2] Health at a Glance: Living longer and quality of life, Statistics Canada, Nov. 27, 2015, accessed Sept. 7, 2017, www.statcan.gc.ca/pub/82-624-x/2014001/article/14009-eng.htm.

[3] Centenarians in Canada, Statistics Canada, Dec. 21, 2015, accessed Sept. 7, 2017, www12.statcan.gc.ca/census-recensement/2011/as-sa/98-311-x/98-311-x2011003_1-eng.cfm

[4] How many years to retirement?, Statistics Canada, Mar. 03, 2016, accessed Sept. 7, 2017, www.statcan.gc.ca/pub/75-006-x/2012001/article/11750-eng.htm