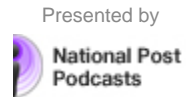


FINANCIAL POST

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Tuition strains clan's budget

Andrew Allentuck, Financial Post



Two civil servants we'll call Ernie and Martha, both 56, and their four adult children live near Toronto. Their \$11,718 monthly after-tax income is substantial, but they have a costly way of life.

One child is disabled and needs to be provided for long into the future. Their other three children are in university, one is attending graduate school, one is in fourth year and the third is in first year.

Ernie and Martha are paying their brood's university bills at a rate of \$1,800 a month (\$21,600 a year) and paying off a \$235,000 mortgage on a cottage and an \$18,900 car loan. They want to take a \$10,000 family vacation, repair their house and two cottages and ensure they have a secure retirement. They wonder if they can afford to do all these things.

"Our goal is to pay for our children's undergraduate education and contribute as we are able to any graduate education they may wish to pursue," Ernie says. "And although we would like to consider early retirement, we wonder if this is out of the question."

Family Finance asked portfolio manager and financial planner Adrian Mastracci, who heads KCM Wealth Management Inc. in Vancouver, to work with Ernie and Martha.

His analysis is that they will need to work another nine years, to age 65, in order to keep cash coming in for any extended studies. They have financed the school bills of their three children in university with a line of credit, paying it down as cash flow permits. Once the kids leave school, Ernie and Martha can consider retirement.

When they retire, they will have government-funded pensions that provide full cost-of-living indexation. Together with pensions, they will have annual cash flow equal to more than half their present incomes.

However, before retiring, they have to build financial security for their family, Mr. Mastracci says. He urges doing it in stages as follows:

CASH MANAGEMENT

Reduce current spending. For example, Ernie and Martha spend \$500 per month on clothing. It is not an unreasonable sum, but it is 4% of their monthly after-tax income.

Divert the \$900 each contributes every year to RRSPs to non-registered savings. The flow of savings would help the couple retire the line of credit. Moreover, their employment pensions and public

pensions will put them in fairly high tax brackets in retirement. There will be no significant tax savings via RRSPs. The cash they reserve can be sheltered in tax-free savings accounts to a limit of \$5,000 per person per year.

They can add to current cash or future bequests to their children by selling one of their two cottages and using the proceeds to pay off a remaining \$235,000 cottage mortgage. Eliminating the mortgage would liberate \$1,290 per month.

RETIREMENT AND BEQUESTS

The couple can already depend on maintaining their current standard of living in retirement. Ernie and Martha generate gross incomes of \$216,000 per year before tax. When they retire at age 65, Ernie's plan will pay him \$49,900 per year and Martha's plan will pay her \$31,000 per year.

They will each qualify for full Canada Pension Plan benefits of \$10,905 per year and full Old Age Security benefits of \$6,204 per year. The sum of indexed employment pensions and public pensions will give the couple \$115,118 in annual pension income. Moreover, if they split their pension incomes carefully, they should not lose any Old Age Security benefits to the clawback.

They would also have income from RRSPs with a current value of \$199,000. If those RRSPs receive no more contributions and grow at 6% per year before inflation (assumed to run at 2.5% per year), at age 65 they would have permanent investment income of \$6,965 per year. If the money is retained, in the 34-year period from now until the parents turn 90 and are presumed to pass away, the funds would grow to \$641,000, leaving each child with a \$160,000 inheritance.

They have established a Henson Trust for their disabled child. It gives discretionary spending authority to trustees and preserves the beneficiary's qualification to receive support from income-tested aid programs. The trust will need to be funded via cash from investments or life insurance in the event the parents pass away before capital targets.

INVESTMENT MANAGEMENT

Tending their savings is the remaining task for the parents. The recent market crash shows how difficult it can be to build wealth securely. The usual method for reducing investment risk is to diversify. The broader the asset mix, the less likely a downturn in any one market will impair achievement of financial goals, the planner says.

"This couple's problems are transitional to the time that their children complete their studies and leave home," Mr. Mastracci says. "In retirement, their cash flow will be ample for travel, for keeping up their way of life and for funding the needs of their disabled child."

"We should have a secure retirement," Ernie says. "For now, we have a cash-flow issue. I think we can manage paying \$1,800 a month of our kids' university expenses for another five years. At retirement, we will have the capital and the cash flow to pay off the debts for those costs."

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SITUATION

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STRATEGY

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SOLUTION

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