RETIREMENT PLANNING FIN 3202-01

CASE ASSIGNMENT (Out of 50 Marks)

ASSIGNMENT DUE DATE: NOVEMBER 24, 2021

Submitted by: Romeo Ally and Mathew Lapres Northey

INSTRUCTIONS:

This assignment requires students to **read through the case below** and to **prepare a financial plan for their client.** Students should divide their financial plan into the following sections:

1. Background
2. Client Goals & Objectives
3. Case Assumptions
4. Financial Management
5. Asset Management
6. Tax Planning
7. Retirement Planning
8. Estate Planning

Student's solution should address ***all of the client's questions that are raised in the notes below.***

Please be sure to site the resources used in your solution in proper format, as applicable. See: https://durhamcollege.ca/wp-content/uploads/apa.pdf for guidance.

New Client Case-The Hills

It's Monday morning, November 16, 2021.

You are an experienced financial planner, specializing in retirement planning. You have been hired by the Hill's to prepare a comprehensive financial plan for them. This afternoon you are scheduled to meet in person with your new clients, Jack & Jill Hill. Prior to today you have only talked to the Hill's on Zoom. In preparation for today's meeting with the Hills, you decide to go through your notes from your earlier Zoom call with them.

Below are your rough notes.

BACKGROUND

- Jack is 64 years old and Jill is 56 years old.
- Both Jack and Jill claim to be in good health and both are still working.
- Jack & Jill have two children:

- **Jerry, age 29.** Jerry was permanently disabled in an accident last year and he currently lives with his parents.
- **Jenny, age 25**. Jenny is a full-time student in a post-graduate program at University and is married to Sam Stone. Jenny and Sam have their own house and they are expecting their first child next month.

CLIENT’S GOALS & OBJECTIVES

1. Both Jack and Jill wish to retire in just over 2 years (January 1, 2024).
2. In retirement, the Hill’s goal is to ensure that their total income is equal to their retirement expenses. Therefore, one of their key retirement goals is to ensure that they do not run out of money in retirement. However, the Hill’s are not very good at managing their money and have never prepared a formal budget to monitor and control their spending.
3. Ideally, the Hills would like to be debt-free when they retire. There are additional notes about this goal in the Retirement Planning Section of this case.
4. Jack and Jill want to ensure that their disabled son will be taken care of financially when he reaches age 60.
5. Jack and Jill want to assist their grandchild with money for his/her future college education.
6. Jack and Jill want to ensure an orderly transfer of their assets to their beneficiaries (their children/grandchildren) when they pass away.

CASE ASSUMPTIONS

- Rate of return is 5% (before tax) on the non-registered investment account.
- Your clients will live to age 90.
- When they retire, the client’s will sell their principal residence (currently valued at $850,000) and they will downsize to a condominium valued at $450,000.
- Ignore inflation.

FINANCIAL MANAGEMENT (Cash Flow Statement, Net Worth Statement & Budget Forecast)

Part A-CASH FLOW STATEMENT

REQUIRED: Complete a monthly Cash Flow Statement (for the month of October) for the Hills.

Use the following format to complete the client's Cash Flow Statement:

CLIENT: The Hills

DATE: OCTOBER 2021

CURRENT MONTHLY CASH FLOW STATEMENT (Revenues – Expenses)

INCOME SOURCES (Monthly)	AMOUNTS ($)
Jill's employment income	$8,333.33
Jack's income (contract)	$2000.00
Investment income	N/A
Total Income	
MONTHLY EXPENSES	**$8,333**
Non-Discretionary Expenses	
House-Related Expenses (Heat, Water, Realty Taxes, etc.)	$650
Food & Household Items	$700
Cars/Gas/Car Maintenance	$1,400
Payments towards the debt ($700 towards the Visa and $700 towards the Line of Credit)	$1,400
Jill's Mandatory Contribution to her Employers Pension Plan	$1,100
Discretionary Expenses	**$7,000**
Monthly RRSP Contributions (in total for both Jack and Jill)	$1,000
Trips/Vacations	$10,000
Entertainment	$683
Miscellaneous Expenses	$400
Total Expenses	**$24,333**
Net Monthly Case In-Flow	**$24,000**

Use the following information to complete the above Cash Flow Statement:

Income

- Jill works for a marketing firm and expects to earn a salary of $100,000 (net of taxes and other payroll deductions) in 2021. Jill also contributes $1,100 per month to her Employer Pension Plan (Defined Benefit), as required by her employment agreement.
- At age 64, Jack currently works on contract (part-time) for a small consulting firm and he expects to earn a net income of $24,000 (net of taxes and other payroll deductions) in 2021. Jack expects to be completely retired by January 2024. Jack is not a member of an employer pension plan and he receives no other benefits (e.g. medical) from his employer. Jack is not receiving CPP payments yet. However, he intends on applying for both CPP and OAS next year, to be received starting January 2024.

Expenses

- The Hills expect their total expenses for 2021 to be $100,000 for the year (monthly average of $.8,333).

Included in their total expenses are the following:

- The Hills' budget for 2 trips per year, for a total cost of $5,000 for the year for both of them.
- In 2018 the Hills took up sailing as a hobby and they now rent a large sailboat twice a year for trips down the east coast of United States. These sailing trips have added a large cost ($7,000 in total for the year) to the Hill's already very expensive lifestyle

Additional monthly costs for October 2021 are listed below:

- House-related expenses such as heat, water, Property Taxes. Etc.)	$650/month
- Food & household items	$700/month
- Cars Lease/gas/car insurance/car maintenance	$1,400/month
- Debt Repayment (Visa ($700 per month and a Line of Credit ($700 per month)	$1,400/month
- RRSP Contributions-Jill $500/month and Jack $500/month	$1,000/month
- Entertainment (Restaurants, etc.)	$683/Month
- Miscellaneous Expenses	$400/month

Part B-NET WORTH STATEMENT

REQUIRED: Complete a formal Net Worth Statement as at October 31, 2021 for the Hills.

Use the following format to complete the client's Net Worth Statement:

Client's Name: Jack and Jill Hill

Date of Statement: October 31, 2021

ASSETS	**Current Value ($)**	**Rate of Return/Year (%)**
House	$8500	
Bank Account	$12,000	0%
RRSP	$245,000	1.5%
RRSP	$225,000	12.4%
Locked in RRSP	$85,000	
GIC	$145,000	1.5%
Corporate Bond	$28,500	2.25%
Total Assets	$749,000	
LIABILITIES		
	$28,000	19%
	$110,000	6%
Total Liabilities	$138000	
NET WORTH	**$611,000**	

Use the following information to complete the above Net Worth Statement:

On October 31, 2021, the Hill's **Assets** included:

- Their principal residence, is in both of their names and is currently valued at $1 million (purchased 12 years ago for $700,000).
- The Hill's have a joint bank account (that is in both of their names) totalling $12,000 in cash. This account pay an interest rate of 0% on cash.
- Jack owns a RRSP valued at $245,000. Jack is a very conservative investor and only hold short-term Treasury bills in his RRSP. This account has earned 1.5% over the past year. Jill is the named beneficiary on this account.
- Jill's RRSP is valued at $225,000. Jill likes to be aggressive with your RRSPs investments. All of Jill's RRSP investments are invested in shares in the car manufacturer Telsa Inc. Unfortunately, Jill's RRSP has declined 12.4% for the year as the shares of Telsa did not perform well in 2021 and has never paid a dividend to its shareholders. Jack is the named beneficiary on this account.
- Jill also has a Locked-in RRSP account with a total of $85,000 in investments. This account was opened by Jill in 2005 when she transferred over the money from her pension plan at her former employer. This account only holds cash and earns no interest. Jack is the named beneficiary on this account.

- Jack and Jill jointly own a GIC valued at $145,000 at the bank. This GIC is very safe and pays out interest to the Hills on an annual basis at a rate of 1.5% per year. This GIC matures in 4 months. Jack expects the interest rates on GICs to increase each year for the next 4 years***. Jack asks you to recommend an investment strategy for improving the yield on this investment.***
- Neither Jack nor Jill have ever opened up a TFSA. They ask you to explain the advantages of opening up a TFSA at this time. Advantages
- Last month Jack's great uncle passed away. Jack's uncle left him a 10-year corporate bond, with a coupon rate of 3% interest per year. After doing some enquires with his uncle's investment advisor, Jack determined that his uncle bought this bond at its face value of $25,000 when it was initially issued three years ago. Today, the bond is valued $28,500. The current interest rate in the economy is 2.25%.

The Hills have 2 outstanding **Liabilities:**

- VISA Balance: $28,000 (at 19% interest /year)
- Line of Credit (secured against the house: $110,000 (at 6% interest /year)

<u>Additional Issues That Students Are To Discuss in The Financial Management Section of Their Client's Financial Plan:</u>

- Is there a need to create a family budget? Why?

There is a need to create a budget because their liabilities are outstanding, and the spend a lot of money on things like family trips, expenses and the sail boating cost for $7000 a year since 2018 while they should be focusing on paying off their current debts.

- Debt management. What debt needs to be paid off immediately? Why? What debt needs to be paid off by retirement date?

They shouldn't have more than 28% debt, before their retirement date. The debt that they need to pay off immediately is the visa balance because they're paying over 2500$ monthly in interest.

<u>ASSET MANAGEMENT (Investment Management Section)</u>

The purpose of this section of the financial plan is to analyze the client investment accounts to ensure that their investments are being managed in a tax-effective manner and are earning the expected rate of return (according to the client's acceptable risk level).

<u>REQUIRED:</u> In this section, you are to analyze the client's investment accounts and provide recommendations to improve the client's rate of return on their investments. In addition, you are required to address the questions highlighted below.

- In this section Jerry was disabled from a car accident last year, Jerry is 29 years old so he can sign up for Canada pension plan disability benefits. And he can earn benefits and get up to $510.85

The Hill Children

Jerry Hill

- Jerry Hill, age 29, not working as he was disabled in a car accident last year.
- The Hill's are very concerned about their son.
- According to the doctors, Jerry will never be able to work full time and will therefore be limited in his capacity to earn a living.
- Jerry receives $3,500 per month from the insurance company as a result of the accident, to pay for his medical care.
- These payments will continue until Jerry reaches the age of 60 and then they will stop.
- Jerry was a student when the accident happened and has never paid into CPP.

Jenny Hill

- Jenny Hill, age 25, is a full-time student and is married to Sam Stone.
- Jenny and Sam are expecting their first child next month.

Jack would like to surprise Jenny with a special gift for her baby: $15,000, to only be used to pay for the baby's university/college education.

REQUIRED: The Hill's would like you to explain the best strategy for saving money for Jerry so that he can take care of himself financially when he reaches the age of 60.

Since Jerry is still receiving monthly insurance of $3500, Her parents can still save enough money and use it for investing. The best way for them is to invest in mutual funds. It is a tax-efficient investment, low risk, and provides a good rate of return that can cover his retirement. Jerry's parents are considered old enough at his age today so it might be a good decision to generate a passive income that is less risky and can offer a return for the long term until his 60th. Mutual Fund is handled by a fund manager that trades directly on different financial assets so it's a good thing that there is someone who's doing the hard work for them unlike trading directly through the stock market, though it offers a high rate of returns, it can also be risky because it requires a lot of time, effort, and knowledge in the market.

REQUIRED: Jack would like you to explain the best strategy for saving money for his grandchild's college tuition.

There are lots of college educational plan that is being offered by the different insurance company. It is a good idea for Jack to invest and save money into these types of plans. As it is very helpful for the future of the child to be secured. By doing so, the child can get annual cash benefits until he/she graduates which is very beneficial both for the parents and the child. Some insurance company also provides dividend earnings depending on the type of the plan.

Jack's Inheritance:

- The Hills are considering selling the bond that Jack inherited from his uncle. They want to use the money to pay off some of their line of credit (debt).

The Hill's would like you to tell them:

i. the current yield on the bond.

Years to Maturity = 7

Current Price = $28,500

Coupon rate = 3%

Par value = $25,000

Using all the information given above, we can conclude that the Current Yield of the bond is 2.63%

ii. advise them whether to keep or sell the bond; and.

They should keep the bond, as the current yield is above that of the economy (2.25%).

iii. If there would be any income tax if they sold the bond.

Whether or not Jack pays interest on the bond depends on if his grandfather had paid any interest on the bond previously. If his grandfather had not paid any interest, then Jack would owe the accrued interest of the 3 years since the bonds issue.

- Jill recently read in the newspaper that opening a Spousal RRSPs is a good way to reduce the overall family income tax burden. ***Jill asks you to explain if her and Jack could benefit from setting up and contributing to a Spousal RRSP.***

They could benefit from the advantages a Spousal RRSP offers. Once they retire, they will be able to participate in income splitting. The spousal RRSP would also save them money on their taxes since both spouses can put money into the spousal RRSP until the holder of the RRSP is 71. They should plan to keep the money for at least 3 years in the Spousal RRSP without withdrawals, so the income isn't taxable via the Three-Year Rule.

TAX PLANNING

REQUIRED: Respond to the Hill's queries below in this section of the financial plan:

- The Hills informed you that they plan to sell their principal residence in 2023 and buy a condominium that year for $400,000 to live in. ***They would like to know if you can estimate the income tax payable on the sale of their home.*** Jack's marginal tax rate is 25%. Jill's marginal tax rate is 40%.
- ***Jill would like you to tell her if she should make her RRSP contribution this year to her regular RRSP or to her Lock-in RRSP. Please provide Jill with an answer.***
- ***Jill would also like you to tell her if there are any other tax strategies or registered accounts that she should consider using in order to minimize the Hill's income taxes.***

Yes. Hill's can make RRSP (Registered Retirement Savings Plan), Hill is the one who can make RSP contributions or anyone as long as they earned income by having a social insurance number and filing a tax return can contribute to RRSP. In required queries, Jack has a marginal tax rate of 25%, and Jill's tax rate is 40%, and by contributing to RRSP, by donating during the calendar year up to 60 days into the following year. And if Jill withdraws the funds from RRSP, it could have resulted in her facing withholding taxes. There are any other tax strategies or registered accounts that she should consider using to minimize the Hill's income taxes by using a (Health Savings Account).

Its personal savings account that you can pay your expenses or costs regarding the health and allow you to put money away and withdraw tax-free. And the main reason for using the HSA is to reduce taxes. Also, the tax strategies or registered accounts that she should consider using to minimize the Hill's income taxes is Invest in Municipal Bonds. It lends money to a state or local government for interest payments over a predetermined period. And the advantage of buying a municipal bond is that once the bond reaches the maturity date, the total amounts of the face value of investments are repaid to the buyer. Purchasing municipal bonds is exempt from federal taxes and tax exemption at the state and local levels. By having a tax-free interest payment, the municipal bond can attract investors. Another tax strategies to minimize the Hill's income taxes by contributing to a retirement account. Because it can reduce the taxes, you owe by the investment you have and avoid taxes you owe on accrue in the total assets.

RETIREMENT PLANNING

- As mentioned above, both Jack and Jill expect to retire in approximately 2 years (January 1, 2024). The Hills expect to enjoy the same lifestyle when they retire as they have now (e.g. same level of living expenses in retirement as they are spending now).
- In retirement, the Hill's goal is to, together, earn a total of $120,000 in gross income per year (before expenses and before taxes).
- Jack expects to earn $55,000 in gross income per year at the start of his retirement (in January 2024). Jack's income will come from his employer pension plan (deferred until 2024) and applicable government pensions.
- Jill expects to earn a gross income of $110,000 in her last year of working (2023). Jill's forecasted retirement income includes annual payments from her employer's pension plan ($66,000). Jill was recently informed by her employer that her pension income amount *was guaranteed at 60%* of her last year's salary before she retires.
- By the end of 2023, the Hills want to sell their home and downsize to a less expensive condominium. They will invest the extra money to increase their income in retirement. The Hills intend to use the extra money from the sale of their principal residence to:
  - Pay off all outstanding debt owing when they retire
  - invest any remaining money into a diversified portfolio. The expected rate of return on this investment account is 5% per year (before tax and inflation). The income from this portfolio will be used to support the Hill's in retirement.

- The Hills intend to live an active life in retirement (travel/sail, dine out, etc.) for as long as they stay healthy (say, up to 10 years into retirement). For financial planning purposes, you should assume that the Hills will live until the age of 90.

<u>REQUIRED:</u>

a. The Hill's would like you to prepare a ***Projected Cash Flow Statement*** for their first month of retirement (January 2024). You are required to simply list their likely sources of income, for both Jack and Jill, in their first year of retirement (2024). Where the income amounts are known, you should include them in your projected cash flow. List known or likely expenses in their first year of retirement. Where amounts are unknown, just list the nature of the likely expenses in their first year of retirement.

b. The Hills do not want to retire with debt, *but they may not have a choice* given their current large outstanding line of credit. ***The Hills would like you to provide some comments about this financial goal.***

   Given the hills income to expenses

c. Jill mentioned to you that she read somewhere that her RRSP will automatically be converted into a RRIF when she retires and that she will have to withdraw money from the RRIF each year. Jill is concerned about the tax implications of this early conversion requirement from her RRSP to a RRIF. ***Please let Jill know if she is correct.***

<u>ESTATE PLANNING</u>

If most of the assets owned by the Hill's are in joint name and each spouse is listed as the named beneficiary on each other investment accounts, do the Hill's still need wills? ***Please explain your answer.***

The hills still need wills, and their inheritances will transfer to the State if in the case they both die without a will and leave no qualifying relatives because they put each other as their beneficiaries. Couples try to avoid having to make decisions by putting things in shared names. Estate planning is the process of moving assets and investments from one generation to the next.

You decide how much of your inheritance you want to leave to your heirs. After death, you want to leave something to someone. The Hill's are a married couple. Estate planning allows a person to determine who will benefit from their estate and to what extent. Estate planning also ensures that taxes levied on the transfer of assets upon death do not deplete the estate. If wills are missing, the state law determines who inherits the assets. Also, in the case of jerry being disabled permanently, they would want to leave their inheritance to him or to another relative because the benefits of (SSA) could disqualify him for receiving public benefits.