FINANCIAL POST

FINANCIAL POST MAGAZINE

# Recovering balance

## Suzanne placed a wager on high-risk investments and got stuck with duds. Can she regain her footing?

**Andrew Allentuck** | Tuesday, December 01, 2009

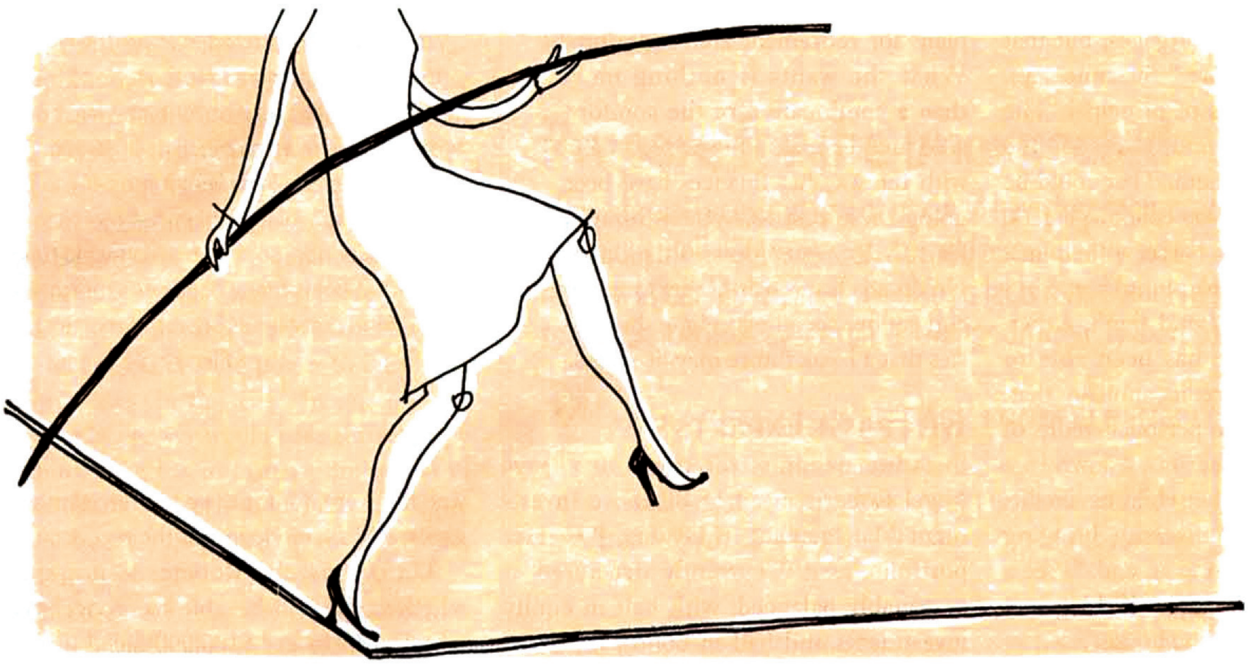

ILLUSTRATION BY ALANNA CAVANAUGH

Putting three kids through university is no mean feat, even at the best of times. Now try doing it while you're also attempting to plan your retirement, and your investments— along with critical income they generate—are slipping into free-fall. That's the predicament facing Suzanne, a 52-year-old freelance writer and single mother in Toronto who placed some risky bets on commercial mortgages. The interest these investments were supposed to yield isn't flowing anymore, and the money she invested could be lost altogether. That's taking a toll on Suzanne's current income, a mere $36,000 annually, and her situation could soon get worse: Child-support payments she receives from her ex-husband will end as her children finish their post-secondary educations, leading to further income erosion in the not-too-distant future. "It has reached a crisis point," Suzanne says. "I knew child support would end when my kids finished university. But I didn't foresee my commercial mortgages getting into trouble."

If Suzanne is in trouble now, at least she has resources that may be sufficient to help her out of her woes. For starters, she has no debt and lives in a mortgage-free house that's valued at $800,000. She's also the beneficiary of an inheritance that has allowed her to build up a portfolio of investments worth $800,000 in stocks, bonds and other fixed-income products, such as the mortgages that are causing her current grief.

Suzanne's problems began three years ago, when she went looking for investments that would pay her a higher return than the mid-single-digit rates she'd been getting from residential mortgages she had been investing in. She soon came across higher-risk commercial mortgages, and decided to invest in two of them. Unfortunately, high hopes have turned to despair. In one mortgage, Suzanne put $43,000 into a private company that is building nine residential and commercial projects in Ontario and Alberta. The recession has reduced the value of the properties, which were supposed to pay interest as high as 15% of capital, and the company has fallen behind on payments. The notes mature in July 2010, but it's unlikely she'll receive more than her principal. Her biggest disaster, though, is a $100,000 investment in a mortgage secured by a commercial building in Ontario, now in foreclosure.

"I had expected to get $1,300 per month from the commercial mortgages, but that isn't happening anymore," Suzanne says. "There is also the loss of principal. The two mortgages could wind up costing me everything I put into them. That could be as much as $150,000 if you count legal fees, since I have just hired a lawyer to help me. It would be a good chunk of my capital."

Her problems don't end there, either. As a parent, Suzanne has been able to claim $11,600 in tax credits annually that, combined with her own personal credits of $9,600, have brought her taxes down to a pittance. She will lose her child tax credits when her kids finish university, bringing her low-tax honeymoon to an end. "I see a crunch is coming," she says. "If things get worse, I could even lose my house."

Suzanne knows there's nothing she can do about the eventual loss of tax credits, but she'd like to take control of her investment portfolio and her expenses, which she admits have gotten out of control. She has been spending 20% more than she takes home after tax, splurging on such extravagances as new clothes and trips to the stylist ($7,200 a year); her own gardener ($600); and plenty reserved for food and dining out ($8,400). Worse, she's been selling assets to cover these expenses, a practice that must stop.

Looking to the future, Suzanne's plans for retirement aren't too lofty. What she wants is nothing more than a continuation of the comfortable, middle-class life she leads. But with the way her finances have been going these past few years, Suzanne fears she's heading down a dark path. Unless she can repair her investments and get her spending in line, she worries that a bleak future may lie ahead.

**What the Experts Say**

Suzanne needn't fret too much, says **Nigel Roberts, head of Bluenose Investment Management** in Oyama, B.C. Her portfolio, as it is currently structured, is reasonably balanced, with half in equity investments and half in bonds, preferred shares and mortgages.

In fact, despite a few investment blunders, Suzanne has retained a solid financial foundation, he says. Her portfolio includes stock in 30 marquee names such as Canadian National Railway and some of the big chartered banks; a few big American names like Wall Street powerhouse Goldman Sachs; a handful of aggressive growth funds from a boutique Bay Street money manager; and a high-yield bond fund. These investments, Roberts says, balance growth and income, and would be working well if it were not for the commercial mortgages, which are victims of the recession.

Unfortunately, Roberts is not sure whether she will be able to recover the principal from her $100,000 failed investment, nor the $9,000 of accrued interest, although he assumes that she'll be able to recover 60% of the principal. Her mortgages losses, when actually realized through sale of her interests or final default, can be carried forward and used to offset future gains, thus creating a tax savings.

Roberts adds that Suzanne erred in investing in individual commercial mortgages. "She would have been better off putting money into a mortgage investment corporation that pools mortgages in lower-risk parts of the market, like single-family residences," he says. "Her returns would be comparable to those on residential mortgages, but she'd have lower risk and saleable, liquid assets."

In addition to fixing her portfolio, Suzanne needs to trim her spending, says Derek Moran, a registered financial planner who heads Smarter Financial Planning in Kelowna, B.C. Discretionary spending now consumes 46% of her after-tax income. Reducing these expenses, Moran says, will help her build a cash cushion.

In terms of retirement, Moran says that Suzanne has a good base, but warns that she needs to keep her eye on her strategy. To begin, he notes that Suzanne's RRSP, which has assets of about $170,000, will provide a modest source of income. Assuming she makes no further contributions and the plan returns 3% per year after inflation, she'll have $249,700 (in 2009 dollars) by the age of 65. If spent over the next 25 years, to age 90, that would support withdrawals of $13,900 per year, he estimates. That's a reasonable start, given that Suzanne has other income streams to support her generally modest goal.

The trick, however, will be keeping an eye on inflation. "If Suzanne continues to live off her $320,000 non-registered capital, spending all the income it generates, she would lose purchasing power to inflation," Moran says. In this case, by age 65, her purchasing power would have shrivelled by a third. "She has to manage the capital to pace inflation, which should run at 3% per year," he says. "She needs to cover inflation and then get 3% on top of that."

If Suzanne attains the 6% gross return target, she'll be able to extract the equivalent of $23,900 each year, starting now, to age 90. Or she could withdraw $34,800 to age 80, knowing that she could sell her house when her financial assets are depleted, Moran says.

And life will get easier when Suzanne's public pensions kick in. Moran estimates that, at age 65, she would have an estimated 25% of the maximum CPP payout, or $2,700 per year, plus OAS of $6,200 per year. Her pension income, plus $13,900 from her RRSP, plus income of $23,900 from non-registered investments would add up to an income of $46,700 until age 90.

## FINANCIAL SNAPSHOT

| | |
|---|---|
| **INCOME** | |
| Salary | |
| $36,000 | |
| **TOTAL INCOME** | **$36,000** |
| **EXPENSES** | |
| Income taxes | $1,100 |
| Property tax | $6,000 |
| Home maintenance | $1,000 |
| Home insurance | $1,400 |
| Life insurance | $600 |
| Auto fuel, insurance, etc. | $7,400 |
| Internet, phone, utilities | $,500 |
| Food, dining out | $8,400 |
| Clothing, grooming | $7,200 |
| Gardener | $600 |
| Snow removal | $400 |
| Travel | $1,000 |
| Charitable donations | $1,100 |
| **TOTAL EXPENSES** | **$42,700** |
| **SAVINGS** | |
| Annual deficit | |
| ($6,700) | |
| **TOTAL SAVINGS** | **($6,700)** |
| **ASSETS** | |
| House | $800,000 |
| Non-registered | $319,600 |
| Mortgage investments | $303,000 |
| RRSPs | $169,500 |
| TFSA | $5,200 |
| Cash | $1,300 |
| **TOTAL ASSETS** | **$1,598,600** |
| **LIABILITIES** | |
| **TOTAL LIABILITIES** | **$0** |
| **NET WORTH** | **$1,598,600** |

In addition to adjusting returns and trimming spending, Moran suggests other ways Suzanne can increase her income. She could sell her house and downsize when her children leave home. The freed-up cash could be invested for income. Or she could go back to school to train for another career, financing tuition out of her savings.

For now, though, Suzanne must try to budget wisely and focus on lower-risk investments that will provide for her future. Her biggest asset could be the experience of having reached too high for yields that were unattainable in all but the best of all possible financial worlds. "She has the financial discipline," says Moran, "to come out of her ordeal a stronger person."