This couple in their 30s have so much promise, but so much debt

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First big job, new house, kids on the horizon – and deeply in debt. That's how things are for Tom and Laura, a couple in their 30s who have competing places for their paycheques to go.

He earns $70,000 a year at a job that will give him a defined-benefit pension one day. She makes about $50,000 a year working two jobs.

Their short-term goals are to lower their debt load and pay for some household improvements – a deck, a shed, a fence, air conditioning and the like – and to buy a new used car. They would like to have children, so they'll be facing a cash-flow squeeze. Longer term, they worry about saving for Laura's retirement because she has no work pension.

"We're looking for any advice to increase our net worth and reduce our debt," Tom writes in an e-mail.

We asked Alison Stafford, a financial planner at Money Coaches Canada in Toronto, to look at Laura and Tom's situation.

What the expert says
Laura and Tom have recently moved into a new home and are looking forward to starting a family, Ms. Stafford says. "As many people do, they are trying to balance their short, medium and long-term goals."

Trying to do everything at once can make it seem like every dollar has several jobs, "which is a recipe for going backwards financially," the planner says. To simplify things and reduce stress, it helps to have a clear path in terms of priority and timeline.

They already have some important pieces in place: They have a payment plan for their short-term debt, they are paying down their mortgage, Tom is building his pension and they are contributing $400 a month to Laura's tax-free savings account and registered retirement savings plan.

“Most importantly, they are not outspending their income,” Ms. Stafford says. They have a surplus of about $700 a month. While they are worried about Laura’s retirement savings, at this stage there are more immediate priorities: paying off their line of credit, their debt-consolidation loan and their car loan; and setting aside funds for when they have children. If Laura and Tom add their $700 surplus to the $400 they already are paying on their line of credit (which has an interest rate of 6.6 per cent), it will be paid off in one year, the planner says. “This will free up $1,100 per month for other purposes.”

That $1,100 a month can then be redirected to their debt-consolidation loan, on which they are paying $940 a month. If they can continue that accelerated payment for another 12 months, that loan will be paid off, freeing up $2,040 a month.

But if they have a baby as early as 2017, the $1,100 will be needed to help them through maternity leave, when Laura’s income will drop. To illustrate, if Laura’s average weekly income now is $885, her weekly employment insurance benefit would be $486.75, or about $390 a week after tax. Laura and Tom will have to top up their income by $500 to $600 a month from their non-registered savings of $11,860. In the meantime, the money should be held in cash or short-term deposits so it will be readily available.

During Laura’s maternity leave, they could still pay $940 a month toward the debt-consolidation loan, but they would have to stop contributing to Laura’s RRSP and TFSA.

When Laura returns to work (likely working one job), the family income will rise again but daycare costs will have to be factored in. As the spouse with the lower income, Laura will be able to claim a tax deduction for child-care costs at year end. If their child-care costs are high and they anticipate a large deduction, she could request less tax be withheld by her employer by submitting a Form T1213 to the Canada Revenue Agency, Ms. Stafford says.

Many things could change between now and the time the couple retire, Ms. Stafford notes. She figures they will need about $54,600 a year after tax to maintain their lifestyle and do some travelling. Tom’s pension at age 65 would be about $2,870 a month. Old-age benefits and the average Canada Pension Plan benefit would give them another $2,400 a month. Laura’s $400 a month in savings, increased annually for inflation, would give her a nest egg of $279,400 by the time she is

65. This, combined with their pensions and government benefits, would give them an after-tax income of $60,500 a year, “more than meeting their needs,” Ms. Stafford says.

CLIENT SITUATION

The people: Tom, 33, and Laura, 35

The problem: Sorting out a seeming crush of financial demands.

The plan: Put one foot after the other, financially speaking. Pay off the high-interest loan, then use the increased cash flow to pay off the next one. If they have a child, draw on non-registered savings during maternity leave.

The payoff: A clear road map to achieve their financial goals so they can stop worrying.

Monthly net income: $7,740

Assets: Residence $450,000; her TFSA $1,060; her RRSP $7,437; his RRSP $7,791, joint non-registered account $11,860. Total: $478,148

Monthly disbursements: Mortgage $1,530; home insurance $56; property tax $463; water, sewer $32; heating $65; hydro $65; telecom $205; car insurance $125; club membership $80; groceries $600; gasoline $340; dining, entertainment $275; personal care $65; pet care $50; home maintenance $50; vehicle maintenance $50; clothing $100; gifts, charitable $62; sports, hobbies $73; subscriptions $10; consolidation loan $940; line of credit $400; car loan $480; her TFSA $200; her RRSP $200; his pension plan contribution $500. Total: $7,016. Surplus $724

Liabilities: Mortgage $335,500; line of credit $12,140, consolidation loan $34,500, car loan $13,700. Total: $395,840