Can she afford to slow down?: Money Makeover

Published on Mon Apr 18 2016

The Person

Susan, 51, lives two hours away from Toronto. After years of working in a stressful career, she decided to shift gears and work part-time as an office cleaner. She earns $25,000 a year and currently taps into her savings to supplement her income. She has a home and one rental property, both with mortgages.

The Problem

Susan needs to generate more income. She is concerned about withdrawing money from accounts intended for her retirement, so she needs alternative options. She's thinking about adding a tenant suite in her principal residence. Meanwhile, the mortgage on her rental property is due this October. Should she renew this mortgage or use her investments to pay off the $59,000 owing? While Susan has a tenant, paying off the rental property would free up $375 a month toward her own expenses.

The Particulars

Assets

Non-registered account: $192,000
Tax Free Savings Account: $41,000
Registered Retirement Savings Account: $135,000
House: $170,000
Condo rental property: $84,000

Liabilities

Principal residence mortgage: $119,000
Rental property mortgage: $59,000

The Plan

After reviewing Susan's lifestyle expenses, she has an initial shortfall of $467 a month, says Anthony Larsen, a financial planner and money coach with Money Coaches Canada in New Westminster, B.C.

Before figuring out how to meet that shortfall, Susan needs to take a second look all her expenses. For instance, does her spending plan include monthly allotments for items that occur less frequently, such as vehicle and home maintenance, medical expenses or veterinary bills? "This will unfortunately increase her monthly cash flow needs but at least it will be a more accurate/realistic number to work and plan with," Larsen says. "I find this oversight to be one of the primary reasons people struggle with their day-to-day finances."

As for where to find the money to supplement Susan's income, Larsen explores her idea about paying off the condo. If she goes this route, Larsen recommends that she use money from her non-registered account instead of her TFSA for this purpose. "TFSA monies grow tax-free but non-registered monies do not," he notes. While non-registered accounts can and will attract capital gains, dividends and interest depending on how the money is invested, there should be little tax for Susan, as some assets are actually in a capital loss position, Larsen adds.

Normally, Larsen would recommend Susan pay off her principal residence mortgage first, as she can deduct the interest on the rental's mortgage. This would also free up slightly more cash, but it would also require more of her non-registered money. But Susan also has stated she'd like to purchase a retirement home in the $200,000 range in the near future.

"As the suggested timing is within three years, I recommend paying off the rental mortgage instead, which will utilize less of her non-registered funds," he says.

That said, as a borrower with limited income, Susan should be wary of taking on a large mortgage. "The strength of her mortgage application will be in the amount of equity (down payment) she will be able to provide," Larsen notes.

Susan has also been investigating the costs to build a rental suite in her principal residence to further supplement her income. Initial quotes reflect upfront costs of about $12,000 to $15,000. She expects to be able to generate rental income of $750 a month. Larsen thinks this idea is feasible. "She needs to weigh the pros and cons of having a renter in her home, but financially it would be prudent and would further improve her cash flow," he says.

With the additional source of money expected from paying off the rental mortgage and securing a tenant in her principal home, Susan will be in a much better position to cover her current cash-flow shortfall. She can then adequately plan for some of her less frequent expenses.

After taking care of these costs, Susan would be left with approximately $280,000 in investments. Susan's investment strategy should be based on when she will need the money. If she decides to purchase a retirement home in the next three years, for example, then the down payment needs to be put in low-risk vehicles that have little volatility until that time.

In any case, until she decides to fully retire, she should not use the remainder of her investments to generate income, Larsen advises. While Susan would like to retire sooner rather than later, Larsen believes it would be more prudent for her to continue working and maintaining that work/life balance. "This will give her investments time to grow and provide better security in the future," he says.