Can Luke get out of debt and develop better money habits so he can buy a home with his partner?

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SPECIAL TO THE GLOBE AND MAIL
PUBLISHED MAY 15, 2020

At 36, Luke should be doing better financially than he is. Single with no dependents, he has a government job paying $108,500 a year and a defined benefit pension plan.

“The biggest issue is I have $55,000 in debt on a line of credit,” Luke writes in an e-mail. He has a house in the Edmonton area with a mortgage and about $24,000 in savings.

“I feel like I’m extremely unhealthy financially, especially for my age and income,” Luke writes. “I should be in a much better place.” The way he sees it, he needs “better habits and strategies, particularly for saving and retirement planning.”

Luke wants to prepare himself financially to buy a new home with his partner, although he realizes this could take a few years.

“What’s the best strategy for getting rid of my debt faster and sooner?” he asks.

We asked Christine White and Liisa Tatem, certified financial planners and money coaches at Money Coaches Canada in Toronto, to look at Luke’s situation.

WHAT THE EXPERTS SAY

Luke has spoken with bankers and debt counsellors, but felt frustrated with the simplistic solutions and advice to just stop spending so much, Ms. White and Ms. Tatem say. Yet that is precisely what he has to do if he hopes to get out of debt. He has to break the cycle of paying bills with his credit card and then paying off the credit card with his line of credit, they say.

Luke thinks he has a saving and retirement-planning problem, but what he really has is a spending problem, the planners say.

Luke has two mortgages, one for $103,000 with 1.5 years to go to renewal, and another for $192,000 that will be up for renewal in 4.5 years. His house is worth about $315,000, giving him a loan-to-value ratio of 94 per cent.

In addition, he has two unsecured lines of credit, one of $19,000 and another for $36,000, both bearing interest at 5.95 per cent. Given the high debt ratio on his house,

he would not be able to roll the credit lines into his mortgage to take advantage of the lower interest rate, the planners note.

Even if he could, consolidating his debts into one monthly payment could be dangerous if he doesn't change his spending habits. "He could just run up the credit card and line of credit again," Ms. White says. "He needs a system in place to manage things differently first."

On the positive side, Luke has some "very healthy financial fundamentals in place," they point out in their report: a well-paying job that he enjoys; a house; a pension; and some savings. "Another healthy sign is that he is reaching out for help."

To help Luke get on the right track, the planners suggest he set up a system to try to keep himself from overspending, starting with setting clear goals. "Write down the goals and keep them visible," Ms. Tatem says. "Focus on something you really want."

They suggest Luke change his mortgage payments from monthly to bi-weekly ($805) to align with his payday. This will help with cash flow so the first of the month is not "top-heavy." He should ask whether he could extend the amortization from 21.5 years now to the original 25 years without paying a penalty. This would help free up cash flow to redirect to the lines of credit.

Next, Luke needs a budget so he knows how much he can spend after his bills are all paid. He also wants to build an emergency fund. He could start by having $100 a month automatically deducted from his paycheque and transferred to a tax-free savings account to serve as an emergency fund. It will take a while to build the fund, "but starting the practice and developing the habit is most important," Ms. White says.

Luke uses his credit card to pay some recurring bills, so he should set up an automatic payment of $400 a month from his main chequing account to his credit card to cover such things as home insurance, online subscriptions, parking and gasoline, the planners say. "This will ensure he always stays on top of his bills and doesn't end up paying interest on them."

Luke should cut his discretionary spending from $1,400 a month to $225 a week (from $16,800 a year to $11,700). "To stick to that $225 a week, he could open a separate bank account and attach it to his debit card," Ms. Tatem says.

He would set up an automatic transfer each payday from his main account to this account. "That is his spending money for the week," Ms. White says. "It is there for spending and enjoying, but once it is gone, it is gone. Stop spending," Ms. White says. "Do not set up an overdraft on this account."

To pay down his debt, Luke can start by paying the minimum amount on both of his lines of credit – about $100 a month on one and $200 on the other – then pay an additional $500 a month on the smaller one, the planners say. Each July, once the payroll deductions for Canada Pension Plan and employment insurance are complete,

he should set up an additional automatic payment to his line of credit for the amount of those deductions (in Luke's case $280 a paycheque) until year end.

"By sticking to these two payment plans, and not adding any more to his line of credit, Luke's consumer debt will be paid off by December, 2024," Ms. Tatem says.

To cover irregular expenses such as car repairs, home repairs, Christmas, sports fees, vet bills and travel, the planners suggest Luke carve off $815 a month and transfer it to three online savings accounts: one for fixed expenses ($330), one for discretionary spending ($285) and one for travel ($200). "Having these funds parked away for use will help Luke to stop dipping into his line of credit," Ms. White says.

The planners suggest Luke leave his credit card at home, "frozen in a jar of peanut butter in the freezer," especially for the first few months. "Living on your own money may feel restrictive at first, but it will bring a clean and fresh sense of freedom when you leave a store knowing you don't owe anyone anything," Ms. White says.

Finally, Luke should consider meeting with a fee-only financial planner or money coach to help him implement and stick to a cash-flow plan. "Successfully managing cash flow is key to having financial control," Ms. Tatem says. "It provides awareness that has more long-term value than anything you can invest in, buy or sell."

CLIENT SITUATION

The person: Luke, 36

The problem: How to get out of debt as soon as possible.

The plan: Set up a system, with a clear goal, a budget, automatic saving withdrawals and bank accounts for different spending categories.

The payoff: Free of consumer debt by the end of 2024.

Monthly net income: $6,375

Assets: RRSP $24,000; residence $315,000; estimated present value of DB pension plan $172,000. Total: $511,000

Monthly outlays: Mortgage $1,745; home insurance $105; utilities $320; maintenance $100; transportation $495; groceries $435; clothing $100; lines of credit $800; gifts $70; vacation, travel $200; personal care $30; dining, drinks, entertainment $430; pet $100; sports, hobbies $35; subscriptions $30; bank fees $35; health care $95; cellphone $125; internet $80; TFSA $100; pension plan contribution $945. Total: $6,375.Actual spending could be higher.

Liabilities: Mortgages $295,000; credit lines $55,000. Total: $350,000

Some details may be changed to protect the privacy of the persons profiled.