How can this couple get out of their $80,000 in debt?

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Carol and Pete are in their mid-30s with two young children. They have a house in British Columbia with a mortgage and other debt besides.

Together, they bring in about $130,000 a year before taxes from Pete's contract job, which pays $96,400, Carol's part-time work and rental income from their basement flat.

They bought their house a couple of years ago for $530,000, but "it was dilapidated and required extensive renovations," Pete writes in an e-mail.

But they had a setback. "One week before we took possession of the house, I was involved in a cycling accident," Pete writes. He was off work for months. "It was brilliant timing."

They had to borrow both for the renovation and living expenses, landing them in about $80,000 of home loan and credit-card debt. Pete eventually did most of the fixing up himself, but the renovation was delayed.

"We would like to be able to pay off the debt but we seem to be spinning our wheels," he adds.

"How can we come up with a plan or budget?"

We asked Barbara Knoblach, a financial planner at Money Coaches Canada in Edmonton, to look at Pete and Carol's situation.

WHAT THE EXPERT SAYS

Pete and Carol need to keep better track of their expenses, Ms. Knoblach says. A systematic approach – such as Money Coaches' On Track money management system – would help.

Here's what she suggests. First, they set up one primary chequing account for fixed costs and regular monthly bill payments. All income, including the Canada Child Benefit, goes into this account. The frequency of mortgage payments matches Pete's pay cycle.

Next, they set up a secondary chequing account for basic monthly expenses such as food, personal care items, fuel and eating out. They cut their spending on eating out from $600 a month to $200.

Because they have an electric car, Pete and Carol say they can do without their truck. If they sold the truck for $6,000, they would cut their vehicle insurance costs by $110 a month and eliminate their fuel costs. They use some or all of the proceeds to pay down debt.

Cutting $400 from eating out and $100 for fuel lowers their basic monthly costs from $2,000 to $1,500.

They transfer $350 a week from the primary chequing account to the secondary one, “always on the same day of the week.” All items are paid for with a debit card.

“The rule is: When the money is gone, stop spending.”

For irregular or annual expenses, they set up three e-savings accounts and transfer $772 a month (more than twice what they are allocating now) from the primary account to these three categories: home and car repair and maintenance; personal expenses such as clothing, gifts, children’s activities and hobbies; and travel. This way, when the expenses arise, the money is there.

These steps free up cash flow that can be used to pay down debt. They begin with the credit card with the lowest balance, paying $1,000 a month to it and making minimum payments on the others. “Ideally, the card should be put on ice during the period of pay-down,” the planner says.

Once the first card has been paid off, they start paying off the second one. “If they’re diligent, Carol and Pete should be able to completely pay off all credit card debt within six months to one year,” Ms. Knoblach says. Then they redirect their efforts to the lines of credit, paying down the more expensive unsecured line first.

At the same time, they begin building an emergency fund, transferring $400 a month to a tax-free savings account. They only have about $6,000 in the bank, less than one month’s worth of expenses, leaving them vulnerable to unforeseen events. The emergency money is held in a high-interest savings account so it will be easily accessible when needed.

As well, they contribute $100 a month to a family registered education savings plan, an amount that is increased once the credit card debt has been eliminated. When it has, they put the entire Canada Child Benefit into the RESP, as well as any birthday or holiday money the children might receive. All accounts used for the money management system are held jointly.

After they have paid off the credit cards and built up an emergency fund, Pete and Carol should start setting money aside for their retirement. So far, neither has a work pension plan.

Longer-term, the outlook for the couple is not bad, the planner says. Carol is taking on more work and could return full time when the younger child starts school. Pete has the prospect of getting hired on permanently at a higher pay rate and being enrolled in his employer’s pension plan.

CLIENT SITUATION

The people: Pete, 34, Carol, 36, and their two children

The problem: How to get out of debt and begin saving

The plan: Set up a disciplined system to track spending carefully. Tackle credit cards first. At the same time, start building an emergency fund.

The payoff: Light at the end of the tunnel

Monthly net income: $8,400

Assets: Cash and short term $6,100; his TFSA $2,980; his RRSP $2,700; residence $750,000. Total: $761,780

Monthly outlays: Mortgage $2,285; property tax $200; home insurance $110; utilities $225; maintenance, garden $75; vehicle insurance $225; fuel $100; maintenance $25; groceries $1,200; child care $650; clothing $50; line of credit $350; vehicle debt $340; credit cards $120; charity $20; dining out $600; personal care $100; sports, hobbies, subscriptions $120; phones, TV, internet $250; TFSA $100; spending that is not accounted for $1,255. Total: $8,400

Liabilities: Mortgage $481,000; home equity line of credit $49,000; unsecured credit line $18,000; credit cards $10,000. Total: $558,000