How one financial planner is helping people addicted to using their lines of credit

ROB CARRICK PERSONAL FINANCE COLUMNIST
PUBLISHED MAY 1, 2018

The home-equity line of credit's (HELOC) great contribution to personal finance has been to disconnect us all from the reality of having to live within our means.

If you can't afford what you need or want, a HELOC solves the problem by allowing you to borrow cheaply against your home equity. HELOCs are a savvy borrower's best friend, but they also delude people into thinking it's viable to spend more than they earn.

Financial planner Sheila Walkington says she has to stabilize clients who rely on their HELOCs by getting them to stop spending more than they're bringing in. Only then can they begin the long process of paying down the balance owing. "My goal is to get them out of debt in five years," she said. "Any longer than that and it's just depressing. And, they have to start saving for retirement."

Home-equity credit lines have been around since the late 1970s, but it took until the 1990s for them to start catching on. The Better Dwelling website reports that the total value of personal debt secured by homes was almost $252-billion in February, up 6.8 per cent from a year earlier.

There's a growing sense of concern about HELOCs because interest rates are rising in two ways. The Bank of Canada has increased borrowing costs three times since last summer, and, as noted in a column last week, at least one bank has moved rates higher on its own for some customers who have a line of credit.

Ms. Walkington is co-founder of Money Coaches Canada and holds the certified financial planner (CFP) designation. She and a couple of her coaches recently looked at their clients' use of HELOCs and found that an average 41 per cent had an outstanding balance on their credit line. A small number were using them for investment purposes, while the majority were supplementing their income to cover living costs or extras. Examples of things people were using their HELOCs for included the cost of having kids in hockey, trips, furniture and home maintenance.

The first step in helping overspending clients is to wean them off of their HELOC by helping them live on their income alone. Ms. Walkington starts with a look at annual expenses – monthly costs plus periodic expenditures such as gifts. "People tell me they spend $2,000 a year on gifts," she said. "But by the time they add it up, it's $4,000. They always think about Christmas, but they forget about birthdays, Mother's Day, Father's Day."

Food is another area where spending can often be cut. Ms. Walkington finds that eating at restaurants is often a big drain on cash, and so is buying prepared meals at grocery stores instead of cooking. She's seen a case where food spending can be halved by planning meals and eating out less.

Examining costs such as these is all part of the stabilizing process – learning to live within your means so you at least don't increase your HELOC balance. Paying off what you owe is the ultimate goal, but Ms. Walkington takes the pragmatic view that this may not be possible right away.

With some clients, she looks for what she calls "bright spots," or opportunities to direct money from one purpose to HELOC repayment. For example, when your child is out of daycare, or your car loan is finally paid off.

HELOC addicts come from all income levels, including many who would be considered high-income. Ms. Walkington said that 61 per cent of her clients have a household income above $100,000, and 28 per cent are above $150,000. "Higher-income people think they're going to get caught up with the next bonus, the next tax refund, the next time something changes. They're deluding themselves into thinking it's a temporary thing to borrow on a line of credit."

In earlier days, HELOCs were a way for financially responsible people with lots of equity in their homes to arrange short-term financing for big purchases such as home renovations at a lower rate than most other borrowing vehicles. Now, some people are hooked on them as a supplemental source of spending money.

The question people keep asking about HELOCs is how affordable they'll be to carry as interest rates keep rising. The as-yet unasked question is why so many people can't live within their means. Is it because they make too little or want too much?