Is paying off debt with a $250,000 inheritance a good idea?

The money could eliminate both Connie's mortgage and personal debt

by Janet Gray Mar 20, 2019

Q. I have a question about my soon-to-be gift/early inheritance. My amazing parents are (as I type!) downsizing and moving into a seniors community. With this downsizing, they have decided to gift between $200,000 and $250,000 to me when the literal and figurative dust settles, which should be about 3 months from now. This leaves me with a lot of … options? Questions? Let's go with thoughts…

I am married, very happily, for 15 years this fall. We have 2 kids, ages 10 and 8. We own a home worth about $800,000 and have a mortgage of just less than $214,000. We own both cars. We do not have credit card debt. We have a credit line with a balance of about $12,000 from a renovation last fall.

We both work full time, grossing about $150,000/yr. My husband, whose 40, just started a job with a defined benefit pension (federal) this year. I'm 39 years old and have been in a defined benefit pension (municipal) job for 7 years now. We have $67,000 in RRSPs (adding about $4,000/yr., and invested in ETFs with Wealthsimple) and $10,000 "cash" in a TFSA—it's "the sky's falling" emergency fund, but we're not adding to it annually.

We have $25,000 in RESPs (adding about $2,400/yr). We consider RESPs to be a gift—we are not interested in fully funding their educations…. or weddings for that matter. We also donate to charity regularly (about $5,000/yr).

With our expenses and automated savings, we generally have a net zero year (ie. no cash building in checking accounts, but no new debt either, unless specifically planned).

My husband would love for the mortgage to be paid off. I am 75% for that idea. This has been a huge year of change for us, and more change may come in the next year depending on my job situation. We may move houses, mainly to lessen my commute. Am I being silly to put all of the inheritance money into a matrimonial home? Anything in life can happen, even when we would never expect it.

I am very sure the credit line is the best idea—but not sure of the rest.

— Sincerely, Confused Connie

A. Dear Confused Connie, you are indeed fortunate to receive this large financial gift. And with it comes questions and often a sense of responsibility about its eventual use. You have a few months to consider your options and do the research. Remember—the best plan always starts with the end goal in mind. What are your family goals? Short, medium and long term. You mentioned a possible move, paying off the mortgage, reducing the line of credit.

In the short term, doing those things would improve your cash flow and save you interest costs. This creates a money cascade—you pay off some things, then you have more cash flow. But then the question is, what should you do with that cash flow? Without housing costs in the mix (i.e. mortgage free) you will have additional funds to increase your RRSP accounts going forward while your incomes are still higher due to working and perhaps additions to your TFSAs.

Your spouse may retire with a 20-year pension and you might have a 25 or 30-year pension and are both a good base of guaranteed retirement income. Adding to your RRSP would supplement the pension benefit or perhaps allow you to retire earlier where your savings would top up the reduced pension benefit. Continue to maximize your kids' RESPs up to $2,500 annually to get the full Grant amount.

Having an emergency fund is a must—if you are comfortable with the current base you have, you don't have to add to it. However, you mention a possible job change. If you have additional expenses or a new higher mortgage payment, you may require some of the gift money in the short term for these unknowns. Otherwise, pay off your debt—especially consumer debt like the Line of Credit.

Be aware that any personally gifted money that is spent on jointly owned items like a home or Line of Credit, will then be equally split in most equalization of property agreements at the end of marriages. You need to have a clear paper trail on that money gift if you want to maintain 'ownership' of those funds in the case of marriage breakdown. I suggest you discuss this further with a family law lawyer.

For now, I recommend you do some homework on what the mortgage prepayment options or payoff early penalties might be. If/when you have decided to move or not, and have consulted with a family law lawyer, you will have additional clarity to allow you to make your best choices. Take the time you need to consider your goals and the results you want to achieve.

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