FINANCIAL FACELIFT

Millennials with debt face rent-or-buy dilemma

DIANNE MALEY
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Johanna and Jack have landed good jobs so they're eager to pay off their student loans. They also want to buy a house and in time, get married and have children.

He is 29, she is 27. They live comfortably in a Toronto-area suburb and enjoy weekend getaways every couple of months. Together, they bring in nearly $140,000.

If they stay in their current jobs, they will both be entitled to government pensions. But that's a long way off. For now, the asset side of their balance sheet is light: $21,500 altogether. On the liabilities side, they have nearly $45,000 in student debt and a $19,500 car loan.

"Should we even be trying to save for a home?" Jack asks in an e-mail. Their plan is to buy when the housing market weakens. The kind of house they want would cost at least $600,000. Should they continue to rent or "should we just go ahead and buy?" Jack asks.

"How can we optimize our cash flow to attain debt freedom as quickly as possible?" he adds.

We asked Christine White, a money coach at Money Coaches Canada in Toronto, to look at Jack and Johanna's situation.

What the expert says

Jack and Johanna like where they live but are uncomfortable with their student debt, so they should pay it off first and then begin saving for a house, Ms. White says.

"This will put them in a much better position to buy their dream home in a few years," she says. If they attempt to do so now, they "will absolutely be house poor."

She suggests they pay a combined $1,600 a month against their student loans so they will be paid off in two and a half years (April, 2017). They should pay the line of credit first because it has a higher interest rate and also because interest on the Ontario Student Assistance Program (OSAP) loans is tax deductible.

Next, they could take their $5,000 cash and move $2,500 each to a tax-free savings account to start building an emergency fund, Ms. White says.

Even though Johanna and Jack are striving to pay down their student loans, they could still contribute at least $50 each to a registered retirement savings plan every payday. That way, they could draw on this money later under the federal government's Home Buyers' Plan for a down payment. They are allowed to borrow $25,000 each, for a total of $50,000.

They should strive for at least a 10-per-cent down payment, which would be $60,000, the planner says. "Ideally, a 20-per-cent down payment would allow them to completely avoid the additional cost of mortgage loan insurance," Ms. White says.

Once their debt is paid off, they can start "power saving" – putting the $1,600 a month that was going toward debt repayment to building up a down payment.

"Following this plan, they can have an additional $50,000 saved in their RRSPs within two years," the planner says ($800 each a month multiplied by 24 would give them $19,200 each after two years. That, plus a 30-per-cent tax refund, or $5,760, would give them $24,960 each). Jack already has $16,000.

Longer term, Jack and Johanna may decide to move back to their home town, especially if they have children. They figure their salaries would be roughly the same if they could get jobs in the public service but the cost of housing would be halved.

"Given that they may want to move back home to be near family for support, they would be wise to pay off their debts, build a down payment and then decide if it's best to buy in the city or wait until they lay down roots," Ms. White says.

Once their car loan is paid off, they should "consciously reallocate" that $500 monthly to some other goal "to avoid it getting lost in discretionary spending," the planner says.

"For example, they could split the payment amount, using half for saving for their home and the other half to save for a new car." All debt payments and savings should be set up to occur automatically and be aligned with paydays if possible, the planner says.

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Client situation:
The people: Johanna, 27, and Jack, 29

The problem: Can they afford to buy the house of their dreams now or should they pay off their debts?

The plan: Pay off the student loans and the car loan, then save as much as possible to RRSPs to take advantage of the federal Home Buyers' Plan. Have at least a 10 per cent down payment, more if possible.

The payoff: A more secure footing with less risk of being house poor.

Monthly net income: $8,665

Assets: Cash in bank $5,000; stocks $500; his RRSP $16,000. Total: $21,500

Monthly disbursements: Rent $1,500; other housing $70; transportation $480; grocery store $600; clothing $420; line of credit $200; car loan $500; OSAP loans $435; gifts, charitable $120; vacation, travel $300; drinks, dining, entertainment $700; grooming $70; clubs $50; golf $150; sports, hobbies, subscriptions $50; miscellaneous cash $225; dentists, drugstore, $40; telecom, TV, Internet $200; RRSP $215; pension plan contributions $1,150; professional association $115. Total: $7,590

Liabilities: His student loan $20,000; her student loan $14,500; her student line of credit $10,000; car loan $19,500. Total: $64,000