Up to their eyeballs in debt

Juggling a mortgage and maternity leave, this Halifax family toys with a westward move

DIANNE MALEY

Hounded by a burgeoning debt load, Kelly and Brad are thinking of leaving their Halifax home and moving West again where things seemed to be better.

Two years ago, they moved to Nova Scotia to be closer to family but now "we seem to be in a deeper mess," Brad writes in an e-mail. They bought an older home and sank quite a bit of money into it, he adds. Their debts – not counting their mortgage – are $100,000 and rising. Out West, they earned good money – about $180,000 a year between them. They were making about $150,000 before Kelly went on mat leave.

"But this earning power is relatively recent," Brad writes. He finished his master's in 2007 and got his first good job that fall. Kelly is on her third maternity leave in four years. He is 39, she is 37.

About a year ago, they began tracking their spending only to find they were running a deficit of more than $1,800 a month, which jumped in October when Kelly went on maternity leave.

"This seems very bad," Brad acknowledges. Should they move back out West in hopes of improving their fortunes? Their No. 1 goal is to pay off their debts and then tackle the mortgage. They also need to save for the children's education, and longer term, their retirement. As it stands, their main asset is their house.

We asked Trevor Van Nest, a professional money coach and founder of York Region Money Coaches in Newmarket, Ont., to look at this couple's situation.

PAUL DARROW FOR THE GLOBE AND MAIL

What the expert says

"Brad and Kelly have been earning one salary for most of the past 10 years but living like they were earning two," Mr. Van Nest says. "They now find themselves in the inevitable position of having hit their borrowing limits and needing to face the elephant in the room."

For the past three months, Kelly and Brad have been tracking their spending. They can now decide where they want their money to go, draw up a realistic budget and start paying off their debt.

First off, they should build a $3,000 emergency fund to ensure they don't give up on their budget when they have a financial emergency such as the car needing new brakes, Mr. Van Nest says. Next step is to pare back spending while Kelly is on mat leave and their take-home pay is down by $1,975 a month.

In their original Facelift application, Brad and Kelly listed their monthly expenditures at $5,925. After reviewing their spending, they realized it was much higher – nearly $8,300. That number does not include the money they have spent on cars over the past three years. They figure they can cut their spending to $6,555, leaving them with $1,745 to apply against their debt once Kelly returns to work. The big squeeze will be on discretionary spending.

The surplus will go to debt repayment using the "debt snowball" method, Mr. Van Nest says – paying off the smallest balance first rather than tackling the one with the highest interest rate. "While this might seem counter-intuitive, studies have found this method works because it helps break a task down into smaller, more achievable milestones," he says. "If Brad and Kelly are able to put $1,745 toward their debt each month, they will eliminate all of it – $101,525 – exactly six years after Kelly returns to work."

When their mortgage comes up for renewal in December, the couple will have an opportunity to free up more money by taking out a loan at a lower rate of interest. They currently pay 5.69 per cent.

As for packing up and moving again, Mr. Van Nest advises against it unless they have substantially higher-paying jobs in hand mainly because housing costs are much higher out West.

Once their debt load is under control, Kelly and Brad can start saving for their children's education using a registered education savings plan that will allow them to take advantage of federal government grants. They have already saved $7,000 to this end, so if they can tuck away $400 a month starting in five years, financed by raises in salary, they can accumulate $122,795 over the ensuing 13 years. This includes the 20-per-cent government grant and assumes a 5-per-cent return on investment.

Special to The Globe and Mail

Want a free financial facelift? E-mail finfacelift@gmail.com. Some details may be changed to protect the privacy of the persons profiled.

CLIENT SITUATION

The people

Brad, 39, Kelly, 37, and their kids, ages 4, 2 and one month.

The problem

How to stop the downward spiral into debt and start saving for longer-term goals.

The plan

Make big cuts in discretionary spending, turning their deficit into a surplus. Put that surplus toward paying down debts, then begin saving for the kids' education.

The payoff

Financial disaster is averted, the mortgage is paid off by the time they retire and the children have the means to pursue higher education.

Monthly net income

$6,445

Assets

Home $300,000; cash $500; Kelly's locked-in retirement account $80,000, Brad's LIRA $40,000 (from previous jobs); RESP $7,000; commuted value of Brad's DB pension plan $10,000. Total: $437,500

Monthly disbursements

Mortgage $1,608; loans $910; maintenance $150; prpty. tax $230; house insur. $117; household goods, $450; utilities $250; telecom $180; food $900; transportation $650; car insur. $117; life insur. $98; vacation $500; entertmt. $200; kids' activities, day care $1,457; pets $80; gifts $100; clothes, grooming $250; misc. $30. Total: $8,277. Shortfall: $1,832

Liabilities

Mortgage $258,103; lines of credit $94,581; student loan $3,256; car loan $3,689; Total: $359,629