Personal Finance

Money Makeover: The parent trap

Does child's student debt stand in way of affordable retirement for single mom?

By: Joel Schlesinger
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As a single mother, Helga has never shied away from helping out her only child and grandchildren.

"This past weekend, for example, I spent $100 on my grandson's birthday," says Helga, who works in the private sector and earns about $85,000 annually.

Helga is worried about a co-signed line of credit with her daughter.

While the grandchild incidentals add up on her monthly budget, it's been a much larger act of generosity that has been affecting her of late.

"Part of the dilemma that I'm in is my adult child has a student loan that I co-signed, and it's affecting me heavily in terms of mortgages and banking now," she says.

Helga's finances

▼ Income:
$85,000 ($3,908 net a month)
Monthly expenses: $3,486

▼ Debts:
Mortgage: $245,000 at 3.77 per cent
Line of credit: $9,000 at 3.2 per cent

▼ Assets:
Home: $325,000
RRSP: $97,000
Workplace pension: $3,895 at age 65

▼ Net worth (excluding pension): $168,000

The student debt is about $27,000 on a line of credit on which her child is making interest-only payments. Meanwhile, Helga is struggling financially and would like to restructure her own debt.

"I find I'm falling behind and living paycheque to paycheque," she says, adding evidence of this is a $9,000 line of credit.

"What I'm thinking of doing is selling my condo, which I don't have too much equity in, so I can pay off the student loan so it's a monkey off her back and mine," she says.

Her condo is worth about $325,000, on which she owes $245,000, and she hopes to sell, buy something less costly and then focus on retirement.

Already, she has about $97,000 in RRSPs. She also has a good workplace pension plan that would pay her almost $3,900 a month at 65, or $3,600 if she retired tomorrow with bridge of $1,100 until 65.

Yet Helga is worried retirement could be thrust upon her before she has time to get on track.

"I'm waiting always for the almighty package," she says. "I'm going to be turning 60 soon, and I'm not sure how long I'm going to be working."

Certified financial planner Karen Diamond says the solution to Helga's problems will not be solved by selling her condo.

"By the time she pays all the costs of selling and moving, even renting instead of buying would probably not be more affordable than staying where she is now," says the adviser with Diamond Retirement Services. "And it wouldn't free up a huge amount of equity to address debt issues."

The fact is Helga's situation won't change unless she addresses the sorest spot in her finances: spending.

"Helga needs to do some serious expense tracking, and her cash flow needs analysis so she has a solid idea of what she really needs and what she really spends."

Still, a good place to start is her debt payments. While selling her home isn't a solution to reduce costs, she can take some steps to decrease her monthly payments.

To help, Diamond consulted with mortgage broker Gordon Brady with Dominion Lending Centres.

Brady says Helga should be able to refinance despite having co-signed the line of credit for her child.

That's because he TDSR — total debt service ratio — is relatively good. This is calculated by determining what percentage her shelter and debt-servicing costs make up her before-tax monthly income.

And in this respect, she's in good shape. The maximum TDSR for qualifying for a mortgage is 43 per cent, and Helga's is well below that at 31 per cent.

"Even allowing for an interest payment on her child's student-loan debt service should be quite manageable," Brady says, adding if her current lender says her child's debt is affecting rates, she should shop around.

At the very least, Helga should investigate whether her lender will allow her to renew the mortgage early.

"Not all lenders do this, but if hers does, she should be able to move to a rate of about 3.25 per on a five-year, fixed-rate term," he says.

Doing this would reduce her payments to $1,267 from the $1,445 a month Helga is paying now, if she leaves the amortization unchanged.

Even without refinancing, however, she can increase her cash flow by moving from weekly mortgage payments to monthly. "Instead of paying $17,326 per year, she could be paying $15,992, freeing up $1,334 annually."

Even without reworking her mortgage, Helga should have additional cash to go toward debts — at least based on her own numbers.

Taking home $3,908 a month to cover $3,486 in expenses, she has more $400 in free cash flow that "is being spent somewhere," Diamond says.

Consequently, the best way to improve Helga's situation is to control her spending. To start, she should examine her last three banking statements and then continue to monitor spending each week for the next two to three months. It's an onerous process, but it's also likely to uncover spending habits that are bleeding her slowly.

"When I meet a client like this and look at actual spending we usually find the problem is not that $400 to $500 is being wasted on one thing, it is that $10 to $50 is being spent several times a month on non-essentials," Brady says.

And then there's her adult child's debt.

"We see this too often — that a parent puts their own financial health at risk in an effort to help the kids," Diamond says.

"The kids don't understand the impact on the parent's income and cash flow, so they assume the parent can afford it."

While it does not appear to be dramatically affecting Helga, she should still discuss developing a repayment plan — if not for her own financial well-being, then at least for her child's and grandchildren's long-term benefit.

These challenges aside, however, Helga's retirement picture is by no means in a shambles, Diamond says. If she retired at 60, for example, her annual before-tax income from her pension, CPP and bridging benefit would be more than $65,000 a year.

Still, Diamond suggests Helga waits to retire until age 62. Then her income would be about $67,000 a year, or $4,247 after taxes a month. This would actually be higher than her current monthly cash flow because she would no longer be paying in CPP, EI and the pension plan. As well, she would receive the pension credit, also reducing her taxes.

The strategy would involve dipping into her RRSPs to the tune of $5,000 a year until age 65 because she won't receive the bridging benefit.

But "she would be better off in the long run," Diamond says, adding waiting to retire will increase her income after age 65.

"It would also give her a couple more years of work at her current pay rate to address some of her cash-flow needs."

And that’s where most of Helga’s work lays ahead. It will likely be a tedious exercise and perhaps involve some tough choices. But it will most certainly be time well spent.

"The more Helga does the necessary homework to map out her plan, the more confident she will be in addressing the unknowns."