

Financial Facelift

A strict ‘cash diet’ for dream retirement

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For two decades, Dick has worked as a commercial airline pilot, earning an average of \$100,000 a year. He and his wife Deedee, who earns \$9,000 working part time, live north of Toronto with their two daughters, age 9 and 12.

Now, at 42 and despite his good salary, Dick has questions about the future. He is the main income earner for a family of four so they are not wealthy by any means. And Dick suspects they have a problem.

“We have no direction as to where to put any extra money we get,” he wrote in an e-mail. “It just seems to get spent.”

He and Deedee, 40, recently remortgaged the family home at its full \$250,000 value to pay down consumer debt. They have little in the way of savings and two children to put through university – but Dick dares to dream.

Under the terms of his defined benefit pension plan – their main retirement income source – Dick could take a lump sum, retire as early as age 50 and seek his fortune in the Far East, where he figures he could work as a pilot and earn big bucks, travelling about with his family on his days off.

But first, they have to pay off about \$300,000 in debts and build some savings. Is it possible to do all that in eight years, or “Is retiring at 50 the dumbest idea I have had in awhile?” Dick asks.

We asked Halifax-based adviser Stephanie Holmes-Winton, author of *Defusing the Debt Bomb*, to look at Dick and Deedee’s situation.

What the expert says

“Dick and Deedee have some pretty ambitious goals,” Ms. Holmes-Winton notes. They also have a spending problem because they have a monthly surplus that does not show up in savings and appears to be unaccounted for.

“It’s time for a 60-day cash diet,” Ms. Holmes-Winton states flatly. Each week, Dick and Deedee can withdraw \$400 from their pay and divide it however they see fit among groceries, dining out, coffee, clothing, entertainment, gifts, children’s activities, dry cleaning, personal grooming and drugs not covered by Dick’s work plan.

“These expenses are what I call active cash flow because they make up the highest frequency of transactions in a given month,” Ms. Holmes-Winton says. If left unchecked, they can lead to burgeoning balances on credit cards and lines of credit. After two months the couple can exceed the \$400 limit but they should continue to pay for these items in cash rather than using credit cards.

Because Dick’s income fluctuates depending on the amount of overtime he works, on low months the couple would pay only the minimum on their line of credit and skip contributions to their tax-free savings accounts. On good months, “they should tuck everything over \$6,900 in income into a high-interest savings account,” the adviser says.

Paying off the line of credit should be a priority. “If they increase the payment to \$500 a month, they’ll have it paid off by December, 2013,” Ms. Holmes-Winton says. Then they could direct any surplus – say \$250 a month – toward the mortgage payment, which would shave at least five years off their 25-year amortization.

When the mortgage is up for renewal, Ms. Holmes-Winton suggests they consider an all-in-one account such as Manulife One to help pay down the mortgage as quickly as possible. As for the children’s education, the \$150 a month Dick and Deedee are saving now is “really all they can afford,” the adviser says. “They should make sure their children understand they, too, will participate in paying for their education.”

If the couple start putting \$500 a month into their tax-free savings accounts and raise that to \$750 when their line of credit is paid off, they could have nearly \$150,000 of investments to draw from tax free in 10 years, Ms. Holmes-Winton says. That assumes an 8-per-cent average annual return on investment.

Dick will not be able to retire as soon as he wants to, but if they knuckle down and pay off their debts, retirement is possible in 10 years or so, the adviser concludes.

“In 2021, Dick should be able to collect a pension of more than \$4,500 a month, plus they’d have \$36,000 (current savings plus growth) and \$150,000 in their TFSAs,” Ms. Holmes-Winton says. If Dick succeeded in picking up a pilot’s job in Asia paying \$150,000 to \$170,000, as he hopes, they could sell their home in Canada, put the money away for their retirement and do all the travelling they want.

Client Situation

The people: Dick, 42, and Deedee, 40

The problem: How to get out from under a \$300,000 debt load, put two kids through university and retire in eight years to travel and perhaps work in Asia.

The plan: Bring some discipline to discretionary spending. Pay off the line of credit first, then the mortgage. Plan on working a little longer than hoped.

The payoff: Financial security, especially given Dick's pension plan, and the freedom to embark on whatever adventures they may choose when Dick retires in 10 years or so.

Monthly net income: \$6,900

Assets: Cash in bank: \$1,000; mutual funds: \$3,500; spousal RRSP: \$13,000, residence: \$250,000. **Total:** \$267,500.

Monthly disbursements: RRSP: \$100; RESP: \$150; pension plan: \$390; groceries: \$200; eating out: \$300; clothing: \$120; pet care: \$80; medical, dental: \$50; mortgage, taxes: \$670; utilities, house insurance: \$220; phones, cable, internet: \$290; maintenance: \$50; entertainment: \$30; gym membership: \$20; swim club: \$90; music lessons: \$230; auto loans and expenses \$1260; life insurance: \$118; leave of absence pension/ buyback: \$175; group insurance: \$37. **Total:** \$4,580.
Savings capacity: \$2,320.

Liabilities: Credit cards: \$500; line of credit: \$10,500; auto loans: \$30,000; mortgage: \$250,000. **Total:** \$291,000.

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