Get inspired to have great *"Dollars & Sense"*

Sound strategies help you plan your way ahead. Find the money to pay down debt, save or invest. Learn to put your debt repayment into high gear, and start now to make your money work (at least as hard as you do)! **Make your financial plan your way!**

Remember, if you aim at nothing, you will hit it every time! Let this be the year you succeed in taking control of your personal finances. Financial recovery and growth take time. Believe it or not, it's not rocket science. The steps are simple, but not always easy.

Feeling a day late and a dollar short? Good financial management starts with understanding where your money is going. Do you feel like you're on the never-never plan with your consumer debt or mortgage? While investing tends to get all the attention, paying down debt is a sure way to increase your net worth and financial well-being. Finally, starting small with saving and investing can yield fantastic results. Learn investment fundamentals to help you growth your wealth.

Part I: Mastering Your Money
Part II: Managing Your Borrowing
Part III: Managing Your Credit
Part IV: Lessons in Dollars & Sense for Children
Part V: Making Your Money Work

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Index

Mastering Your Money

Introduction 3
Laying Down Your Mission Statement and Your Goals 3
Writing Smart Goals 4
Two Important Pieces of Financial Lingo: Net Worth and Cash Flow . 5
Where Does it All Go? – Tracking Your Spending 7
Making Your Budget Work 9
The Next Steps 11
It's All in the Numbers 13

Managing Your Borrowing

Introduction 15
Advantages and Disadvantages of Borrowing 16
Good Debt Versus Bad Debt 16
Lending and the Five C's 17
How Much Debt is Too Much? 18
GDSR & TDSR Calculator 19
Spotting the Danger 19
Debt Management Solutions 20
True Cost of Minimum Payments 22
In Your Best "Interest" 23
Paying Off Debt with Debt-Making Consolidation Work 23
Fold Down Plan 24
Mortgages – A Home is Where the Debt is 25
Paying Down Your Mortgage Faster 26

Managing Your Credit

Introduction 29
Credit-Reporting Agencies 29
On Your Report 30
How You're Rated 31
Scorekeeping 32
Checking Your Credit 34
Errors 35
Singles, Couples and Credit 36
Contacts 37

Lessons in Dollars & Sense for Children

Introduction 39
Children and Money: Allowance Guidelines 39
Children and Money: Allowance Project 41
Helpful Resources 42

Making Your Money Work

Introduction 45
Pay Yourself First 45
Saving versus Investing 46
Beginning at the Beginning – Knowing Your Numbers 48
Rule of 72 48
Now versus Later 50
Risk Tolerance and Risk Capacity 51
Diversification 52
Choosing Your Portfolio 53
Rebalancing Your Portfolio 54
Dollar Cost Averaging 55
Armed with the Fundamentals 56
What can you buy? 57
Where can you put it? 57
Helpful Resources 59

Mastering Your Money

INTRODUCTION

My problem lies in reconciling my gross habits with my net income. ~ Errol Flynn

Managing your money is simple, but not easy. Since any thesaurus will tell you "simple" and "easy" are synonyms, what's the distinction? Money management is simple, meaning the basic principles and skills can be learned without too much energy and most of what you need to do is straightforward and common-sense. The reason money management can be challenging is not in the comprehension of the concepts or practices, but in the application. Taking action to improve financial management can require changing the way you do things – and change can be anything but easy.

Needs, responsibilities, interests, and resources change over the life course. Sometimes you have a choice in the matter and sometimes you don't, but either way, in light of the financial implications, you must adapt. The material which follows covers strategies for creating and sticking to a budget, finding the money to save, invest, or pay down debt, and reworking your finances in the face planned or unplanned changes in life. The rules for weight loss: eat less and move more. The rules for financial success: spend less, pay off debt, and save more. See? It's simple, not easy.

LAYING DOWN YOUR MISSION STATEMENT AND YOUR GOALS

Without a mission statement, you may get to the top of the ladder and then realize it was leaning against the wrong building! ~ Dave Ramsey

Every plan needs a place to start. Ideally you want to go into any change with the right mind-set – one of confidence or optimism, rather than anxiety or cynicism.

Optimism is the faith that leads to achievement...no pessimist ever discovered the secret of the stars, or sailed to an uncharted land, or opened a new doorway for the human spirit. ~ Helen Keller

Writing a Mission Statement is a great way to begin. A mission statement defines your purpose and primary objectives. This is not necessarily about your finances, in fact, it may not be about money at all. A good mission statement is one that highlights who you want to be and what you want to achieve. The job of your mission statement is to provide a measuring stick to help you stay focused and align your financial plan with your values. It can provide both guidance and motivation. In terms of personal finance, purchases or expenses that do not in support your mission statement deserve a critical look. You can write a mission statement as an individual, household, or family.

You support your mission statement by writing your list of your goals **(Step 1)**. This further targets your thinking and starts to lay out the details of what you want to accomplish. Again,

your goals need not be specifically financial, but more often than not, goals will have a financial tie or root.

Why should you write down your goals? Research has proven people who write down their goals are much more likely to accomplish them than those who don't. Goals can help you clarify your wants, motivate action, maintain focus, overcome obstacles, and gauge your progress. Sharing your goals with others you're close to can build your practical and emotional support team. This is particularly important for couple- or family-related goals.

WRITING SMART GOALS

Goals should be:

S	**Specific:** Clear and explicit. Answer questions like: Who? What? Where? Why?
M	**Measureable:** Determine concrete criteria for measuring progress.
A	**Attainable:** Having a plan for how it will be done. Plan discrete steps to help bring your goal to fruition.
R	**Realistic:** Choose goals that matter to you and which you are both willing and able to work.
T	**Time- bound:** Ground your goals by setting a target deadline. Time-bound goals promote of sense of urgency.

Goals will probably compete for your time and resources, so you will have to set priorities. You will likely pursue more than one goal at a time. It's reasonable to be paying off a credit card, saving for a family vacation, and building your retirement nest-egg all at the same time.

Using The Master Planner

Change can be exhilarating, stressful, and terrifying. Having a process to both plan for and deal with change can reduce anxiety and help you plan effectively for the road ahead.

Step 1 Determine Your Goals

The first step in any plan is to identify those goals (both short and long term) that are important to you or to others close to you. Feel free to use extra paper if you have more goals.

SHORT TERM GOALS

1. ____________________
   ____________ DATE ______
2. ____________________
   ____________ DATE ______
3. ____________________
   ____________ DATE ______
4. ____________________
   ____________ DATE: ______

LONG TERM GOALS

1. ____________________
   ____________ DATE: ______
2. ____________________
   ____________ DATE: ______
3. ____________________
   ____________ DATE: ______
4. ____________________
   ____________ DATE: ______

★**The next 5 steps** are about your **Net Worth** and **Cash Flow**. Your **Net Worth** is a snapshot of your financial position and **Cash Flow** represents the income coming in and the expenses going out. **Net Worth** reflects your past choices and **Cash Flow** is a picture of your present decisions.

Consider the timeframe of your goals. Short-term goals are ones you intend to accomplish in a year or two, medium-term goals in two to five years, and long-term goals in five years or longer.

Setting goals is critical for you to get where you want to go, but you'll also need a good list of goals when you want to work with a financial professional, such as an investment advisor or financial counsellor. Professionals help you to design and action a plan to reach the goals you've defined.

Some goals to consider include:

- Paying off consumer debt
- Building your emergency reserves
- Purchasing or Paying off a home
- Preparing for or Educating the Kids
- Saving for a big purchase or expense
- Owning your own business / investment property
- Investing for Retirement

TWO IMPORTANT PIECES OF FINANCIAL LINGO: NET WORTH AND CASH FLOW

Your net worth to the world is usually determined by what remains after your bad habits are subtracted from your good ones. ~Benjamin Franklin

Your **Net Worth** is a snapshot of your financial position today and reflects your past choices. A **Net Worth Statement** (**Step 2**) takes the total value of what you own (assets) and subtracts the total of what your owe (debts). Looking at net worth from year to year is a quick way of measuring your financial progress.

Step 2 Calculate Net Worth

Your **Net Worth Statement** (below) is a summary of your assets (what you own) and debts (what you owe). It is a snapshot of your financial position today and reflects the choices you have made in the past.

		$
ASSETS	Cash/Savings/Chequing Accounts	
	Tax Free Savings Account (TFSA)	
	Non-registered Investments	
	Registered Retirement Savings (RRSP)	
	Personal Residence	
	Vehicles/Recreational Equipment	
	Cash Value of Life Insurance/Other	
	TOTAL ASSETS	
DEBTS	Mortgage(s)	
	Vehicle Loans	
	Credit Cards	
	Personal Loans	
	Lines of Credit	
	Family/Other	
	TOTAL DEBTS	
	ASSETS – DEBTS = NET WORTH	

Step 3 Calculate Cash Flow: Net Income

A. MONTHLY TAKE-HOME INCOME

Knowing your income today and through a planned change gives you a context for your other decisions.

	CURRENT	REVISED
Wages/Salary/Pension		
Wages/Salary/Pension		
Family/Child Benefits		
Other Regular Income		
TOTAL MONTHLY INCOME: A		

It's not unusual, especially in early adulthood for your net worth to be a negative number, meaning more debt than assets. What's more important is that when net worth is compared year to year that progress is being made. There are two paths to increase your net worth:

1. Increase your Savings.
2. Decrease your Debt.

The mint makes it first, it is up to you to make it last. ~ Evan Esar

Cash Flow is the stream of money coming in and out of your house. Income comes in and expenses go out. If less money goes out than in, you'll have money to assist you with your goals. If more goes out, then debt will grow.

First, get a handle on the amount of income coming in from all sources (**Step 3**). It's easiest to plan with money which comes in consistently. Irregular income can be challenging to plan with, so where possible, use irregular income for irregular expenses.

Your Lifestyle is the sum of your current choices. It's made up of two types of expenditures: Basic and Descretionary. **Basic Lifestyle** (**Step 4**) is the cost required to cover your survival or basic needs. These are typically less flexible, but if you are highly motivated to make a change that will allow you reach your goals, then you can make changes to find economies. **Discretionary Lifestyle** (**Step 5**) represents the fun expenditures that are the "fun" parts of life and where you have "choice". Your priorities can shift and change based on your circumstances and you may be able to find significant cost-cutting opportunities.

Step 4 Calculate Cash Flow: Basic Lifestyle

B. BASIC LIFESTYLE EXPENDITURE

Your basic lifestyle can be thought of as the measure of income needed to maintain your lifestyle at a survival level. Estimate your current monthly expenses in each category.

		CURRENT	REVISED
Food			
Housing	Mortgage/Rent		
	Utilities		
	Insurance		
	Maintenance		
	Property Tax		
Transportation	Insurance		
	Gas		
	Parking		
	Maintenance		
	License		
Personal Care	Essentials		
	Basic Clothing		
Education	Tuition/Fees		
	Books/Supplies		
Child Care			
Life Insurance			
Health, Drug, Vision, Dental			
Medical Treatment			
Debt	Vehicle Loans		
	Credit Cards		
	Personal Loans		
	Lines of Credit		
	Family		
	Other		
Other			
TOTAL BASIC LIFESTYLE: B			

Action: While survival costs are less flexible, significant savings can often still be found when motivated to make a change.

WHERE DOES IT ALL GO? - TRACKING YOUR SPENDING

Before you try to keep up with the Joneses, be sure they're not trying to keep up with you. ~ Erma Bombeck

You're not alone if you've ever felt there is more month than money. It will take a bit of detective work to find out where your money goes. There are two key ways to track your spending. One way looks at what you do today and going forward, while the other retraces your financial steps.

How are you spending it? This is tracking on the fly. Write down everything as you spend in a small notebook. At the end of the tracking period (1 week or 1 month), total the expenses by category. Repeat this for three to six months. The weakness of this method is that your spending may change just because you have to write it down as you'll be very aware of your spending (though that's not a bad thing). Sadly, when you stop tracking, you're likely to go back to old habits.

How did you spend it? This is looking back at how you spent. Review 3 to 6 months of bank, line of credit, and credit card statements. Grab your highlighters and group your expenses by category. If you use your debit card or credit card for most of your spending, you will be able to see "where", "when", and "how much" for each expense. The only weakness of this approach is the inability to figure out your cash expenditures. Divide your total by the number of months of statements used. This gives you a picture of your "spending reality".

Step 5 Calculate Cash Flow: Discretionary Lifestyle

C. DISCRETIONARY LIFESTYLE EXPENDITURE

Your discretionary lifestyle expenses can be thought of as areas where you have "choice" and your priorities can change based on your circumstances. Estimate your current monthly expenses in each category.

		CURRENT	REVISED
Services	Cellular Phone		
	Cable/Internet		
Eating Out	Meals		
	Snacks/Coffee		
Recreation	Entertainment		
	Hobbies		
	Memberships		
	Season Tickets		
Travel/Vacations			
Insurance	Life or CI/LTC		
	Travel		
Personal Care	Extra Clothing		
	Salon/Spa		
Furnishings/Renovations			
Gifts/Celebrations			
Donations			
Savings			
Other			
TOTAL DISCRETIONARY LIFESTYLE: C			

Action: These expenses can be reduced to allow you to plan for change. Try to reduce expenses to free up funds for your goal or to allow for a reduction in income. You may be surprised the amount of money you can free up if you are highly motivated to reach your goal.

Why Track? Punishment? Believe it or not, this is not a punitive exercise designed to drive you nuts. This is about getting a clear picture of where your money does and doesn't go, so you have the information you need to make changes if you're not happy. You can't change what you don't know. Because it sharpens your awareness, this activity can forever change how you see your spending.

You're watching for categories where spending is higher than expected, and you're annoyed about it. These are prime areas to make some adjustments. Try to consider no expense off-limits. Make sure you're getting good value for your hard-earned dollar.

You also want to pinpoint categories where spending is lower or non-existent. It's very common for life to get busy and money tight, so the first thing stripped from the budget is "fun" – something essential to your well-being. Many of these items are experiential, such as travel, cultural events, and family outings. Money spent on "**experiences**" has more lasting value and a greater likelihood of creating a sense of happiness than money spent on "**stuff**". The shine wears off a new gadget very quickly, but the memories of the family ski trip to Jasper last a lifetime.

Some irregular or annual expenses may not have occurred during your tracking period, so you may have to look back further or use an educated guess. Annual expenses, such as vehicle registration or school fees, must first be converted to monthly equivalents by dividing by 12 before entering it in your cash flow. Estimate costs for expenses which occur irregularly throughout the year. It can be easier to start with an annual cost figure, just don't forget to divide by 12 to get the monthly amount. If you're a homeowner, a reasonable estimate for home repairs and improvement is 2% of your home's value per year. Check out the website for the Canadian Automobile Association (www.caa.ca) for their data on the maintenance cost of vehicles.

Once you have gained a clear picture of your expenses and listed them under "Current" in **Step 4** and **Step 5**, you can redefine your expenses under "Revised". "Current" is what you do spend and "Revised" is what you plan to spend going forward, so it will be your reworked budget. Assume you will adopt these changes over the long term, so be reasonable with any planned cuts to your budget.

When crisis isn't looming, implement changes gradually over time the way you would incorporate a new fitness regime. If disaster is on your doorstep, taking the aggressive approach to cost-cutting can make you feel more in control. Dramatic cuts will help you survive a short-lived catastrophe, but they are tough to sustain. Think **short-term – big cuts** and **long-term – modest cuts**.

Budget changes need not be just about elimination. You can reduce the frequency with which you do something, find a cheaper alternative, buy used, and any number of other strategies. Try to be creative and get your partner and kids involved in deciding what stays and what goes.

Summarize your income and expense values to determine if you have a budget surplus or deficit (**Step 6**). A surplus means you have more income than expenses, so extra funds are available to take advantage of an opportunity to save, invest, or aggressively pay down debt. A deficit means more expenses than income and more work to do. The next steps see if you can pull together money to balance your shortfall by reworking your debt (**Step 7**), finding more income (**Step 8**), or accessing savings (**Step 9**).

Step 6 Calculate Cash Flow Summary

This calculation reveals your bottom line – whether your **Cash Flow** shows a surplus (positive) or a deficit (negative) result. A surplus is the funds available to shoot for your goals. A deficit is a call to action – to further adjust spending, to access assets, rework debt, or increase income.

	CURRENT	REVISED
TOTAL MONTHLY INCOME: A		
TOTAL BASIC LIFESTYLE: B		
TOTAL DISCRETIONARY LIFESTYLE: C		
SURPLUS/DEFICIT		

Action: While planning with surplus cash flow is easier, a deficit can still be workable. The next steps reveal strategies to bring your cash flow into a balanced or surplus position.

Step 7 Debt Planning

Doing some careful planning with your debt can greatly ease a transition. It is ideal to eliminate debt prior to a change as it will free up funds from your cash flow. If you will carry debt through a change, consider these simple steps. The key is making changes before a reduction or loss of income.

Complete a table with these headings on a separate page to see your debt fully, then:

DEBT	LIMIT	BALANCE	MIN PYMT
Retail Card	$1,500	$1,000	$27
Visa	$2,000	$1,500	$45
Credit Line	$10,000	$3,000	$80

1. If mortgage term is ending, renew early - before a change.
2. Consolidate where possible. Base new payments on expected reduced income.
3. Combine debts by transferring a higher interest debt on to a lower interest account (you'll see the options in your table).
4. Renegotiate interest rates to get the best current rates available.
5. Target your debt to <u>your</u> best advantage:
   a. Highest interest rate debt first (saves most money), or
   b. Highest monthly payment (eases cash flow the most).
6. Seek a Financial Counsellor for guidance if you're unsure.

MAKING YOUR BUDGET WORK

Once you have a budget prepared, good techniques make it work. Systems succeed if everyone responsible for household spending participates. Choose a method that works best for your situation and adapt it as needed.

Receipt Method: Get a receipt with each purchase. If receipts aren't available or provided (e.g., parking meter) write a reminder note. Keep all of your receipts in one place – a compact accordion folder works. Total up your receipts by category each week. It's a quick way to see how much of your allotted budget you've used.

Chequebook/ Accounting Method: This is the best system for someone who appreciates detail and precision. Record your budgeted amount for each category on the top line of a ledger or spreadsheet and subtract each expense as paid. You'll know exactly what is left to spend at all times.

Envelope/Jar Method: This technique popularized by Gail Vaz Oxlade on her television program *Til Debt do U$ Part*. This is a highly visual scheme for controlling spending. This is not for every expense in your budget, but highly effective for things like food, transportation, clothing/gifts, and entertainment. You begin each week by filling each jar or envelope (for a more portable alternative) with the weekly share of the month's expenses for the category. You goal is to get to the end of the week before you get to the end of the money. Any money left at the end of the week, gives you extra for the following week. It's a simple, in-your-face budget controller. Enter your budget on Gail's worksheet and it will tell you the amount of money you want to put in your jars (http://www.gailvazoxlade.com/articles/budgeting/magic_jars.html).

Calendar Method: Household expenses can be weighted more heavily in one half of the month than the other. If they exceed the income received in that period, it can present a challenge for managing to a budget. Start with a blank page of a monthly calendar and write in the amounts of your paycheques and other income sources on the dates they are received. In another colour, write in the amounts of your major expenses on the dates they are due. You'll quickly see if one pay period is too heavy with expenses. Readjust by talking to your banks, utility and finance companies. Can you split the payment to coordinate with your pay periods (semi-monthly, bi-weekly, or weekly)? Can you change your payment date? You're trying to prevent a "have" part of the month and a "have not" part of the month. It's better to have a little, all the time.

No Budget: What? No budget at all? Yes, it's possible. This strategy is "pay yourself first" and it's been around a long time. It's referred to in *The Wealthy Barber*, by David Chilton, *Automatic Millionaire*, by David Bach, and *The Richest Man in Babylon*, by George Samuel Clason (published in 1926). This idea is best implemented when debt is well under control, but requires no detailed record keeping. The premise is to automatically direct into savings your specified contribution from each paycheque as soon as it is received. You're paying yourself before paying any of your other monthly expenses. In doing so, the theory is it will guarantee you get money set aside for the future and the rest of your spending will effortlessly contract to meet the new constraints. One oft-mentioned amount in planning literature is 10% of gross income. Sound like a lot? Start smaller and work your way up gradually.

Make it Automatic: Make as much of your budget **automatic** as possible by turning your budget into a machine. Set up automatic payments for regular monthly expenses either through pre-authorized payments (automatic withdrawal), pre-authorized credit card plans (as long as you pay your credit card off in full every month), or payments you set up through your online banking. Use the same technique for your savings, whether RRSPs, TFSAs, RESPs, or emergency funds. As much as possible, coincide your payments with your actual paydays, whether monthly, semi-monthly (twice per month), bi-weekly (every two weeks), or weekly.

THE NEXT STEPS

If your budget balances with a surplus, and you're content with the timeline required to reach your goals, then you've reached the end of the process. If the pace to achieve your goals is too slow, because your surplus is too small, or goals seem unattainable because your budget is in a deficit, the next steps will help you find solutions.

Debt Planning (Step 7): The most advantageous way to manage debt depends on your individual situation and your priorities. It's not just a question of saving the most money in the long run.

If your main goal is rapid debt repayment, then the focus is on the interest you pay. That is, you prioritize tackling the debt with the highest interest rate, while maintaining minimum payments on the others. This gives you the best bang for your buck. As you crush each debt, you move on to the debt with the next highest rate.

You can also speed debt repayment through consolidation at a lower interest rate. A lower interest rate means you can pay more against the principal.

If you expect your income to decrease, such as with job-loss or retirement, then renew any existing debt obligations before the change, but base your payments on the resources you will have after the reduction. In this situation the goal is not to save interest, but minimize the bite of debt payments on your cash flow. This means your goal is minimizing your debt service (monthly cost of your debt). So,it can make sense to pay off a debt that has a large monthly payment first, even if it is lower interest than others. This will free up more money for other expenses.

Step 8 Look for Other Income

A loss or reduction of income is a challenge in many life changes. Take stock of any entitlements for severance and employment insurance benefits. Consider other creative ways to generate additional household income.

SEVERANCE

You may be able to shelter part or all of your severance payment from immediate taxation.

Amount of Severance		A
Less Eligible Amount to Rollover to RRSP		B
Amount Paid Out as Taxable Income (A-B=C)		C
Tax Withheld at Source:	$1 - $5,000 10% Tax $5,001 - $15,000 20% Tax $15,001 + 30% Tax	D
	NET PAYOUT (C-D)	

ACTION: Find out how long it will take to receive severance and whether the amount is payable over more than one installment. Can it be paid on January 2 of the following year (to reduce tax)?

EMPLOYMENT INSURANCE

First benefits paid from EI are delayed by 2 weeks. If you are entitled to severance, the delay to receive benefits is longer.

Normal Weekly Salary/Wages	A
Total Severance (Excluding Pension)	B
Estimated Gross Vacation Pay	C
Number of Weeks Delay in Benefits (Divide B+C by A and add 2 weeks)	
EI AMOUNT (A x 55%) to a max of $514/wk	

ACTION: Learn more about Employment Insurance. If you have time, prepare by saving enough funds to bridge the gap between wages/salary and the start of EI benefits.

OTHERS: Be creative

- Part-time /Temporary Work
- Renting out a Room
- Child Care
- Freelance/Contract Work
- CPP Disability
- Retirement Pensions

It's very easy to become overwhelmed with debt and you may not have all of the answers. A not-for-profit, federally regulated financial counselling organization called Money Mentors (www.moneymentors.ca) can provide expertise and help you unravel a tricky debt situation. You may also be able to access free financial counselling through your Employee Assistance Program at work. Check with your EAP provider for more information. Debt does not have to limit your future – it is solvable.

Look for Other Income (Step 8): Whether you are experiencing a job loss, are retired and finding things too tight, or simply want to commit to getting ahead faster, explore alternatives to add to household income.

In situations of job loss, Severance or Employment Insurance may be options to research, to cover you until you can find another position.

Be creative in exploring other options to augment or replace income. Make sure you consider the overall impact on family. Having a second job may make you more money so you can pay debt off faster, but it could cost you too much in terms of family time. In the short-term just about anything is feasible, but if you burn yourself out, your plan will backfire. Remember to take care of yourself!

Accessing Savings (Step 9): Dipping into your savings can help with both income and expenditures. Savings can replace or supplement your income sources. Savings could also be used to pay off a debt to ease your debt service.

Step 9 Look into Accessing Savings

Savings can help on both sides of your cash flow: income and expenditures. Savings can replace or boost other income sources. Savings can also pay off debt to reduce expenses. Generally, use investments without tax implications (savings accounts & TFSAs) first. Next, draw on non-registered investments. RRSPs are your last choice (except for school). Speak to an advisor about your particular situation.

TAX FREE SAVINGS ACCOUNT (TFSA)
TFSA is an ideal source when a need arises. Withdrawals are tax free and the amount of the withdrawal will be added to your future contribution room the following year.

NON-REGISTERED INVESTMENTS
For investments outside of RRSPs and TFSAs, investment income must be declared annually even if the income is reinvested or compounded. Capital gains are only taxed when the investment is sold or gifted.

ACTION: Research the additional tax you should set aside.

REGISTERED RETIREMENT SAVINGS PLAN (RRSP)
Money drawn from your RRSP is subject to tax at source, unless being used for returning to school under LLP.

Amount of RRSP withdrawal			A
Tax Withheld at Source:	$1 - $5,000 $5,001 - $15,000 $15,001 +	10% Tax 20% Tax 30% Tax	B
		NET PAYOUT (A-B)	

ACTION: Determine your Marginal Tax Rate to estimate any additional tax you may owe at tax time. See table below.

ALBERTA TAXABLE INCOME	INTEREST, RRSP, PEN, EARNINGS	CAPITAL GAINS	DIVIDENDS	
			NON-ELIGIBLE	ELIGIBLE
$0 - $11,138	0	0	0	0
$11,139 - $17,787	15.0	7.5	0	0
$17,788 - $43,953	25.0	12.5	13.35	-0.03
$43,954 - $87,907	32.0	16.0	21.61	9.63
$87,908 - $136,270	36.0	18.0	26.33	15.15
$136,271 +	39.0	19.5	29.87	19.29

Drawing on some types of savings, such as savings accounts and TFSAs, avoids a tax bill, so use them first. Selling non-registered investments could result in some taxes owing, so use these second. Your last choice in your RRSP, unless you're returning to school using the Lifelong Learning Plan (LLP), will result in a tax bill based on your marginal tax rate. The lower your income for the year, the less taxes will be due. A financial advisor can help you determine how to best use your savings. Once your situation improves, your job will be to replenish your savings. Use your "rainy-day fund" when it rains – that's why you saved it.

IT'S ALL IN THE NUMBERS

The final task is to bring together your figures from each of the steps along the way. It's a little more math to tell you whether the sum of your efforts allows you to reach your goal (planned change) or survive a crisis (unplanned change). A positive final answer is proof you can do it. If the number is above zero, you can have it even sooner than you believed.

It's not over if you show a shortfall. Revisit your numbers and try again to find places to squeeze out some pennies - every bit counts. If it's still not adding up in your favour, consider recruiting the fresh perspective of a professional.

The three great essentials to achieve anything worthwhile are, first, hard work; second, stick-to-itiveness; third, common sense. ~ Thomas Edison

Step 10 Putting it Together

Now is the time to try to put it together. This final examination is whether through adjustments of basic and discretionary spending, debt planning, finding other income, and evaluating accessing savings, you show a balanced bottom line.

	CURRENT	REVISED
SURPLUS/DEFICIT (see STEP 6)		A
DEBT PLANNING (see STEP 7)		
How much were you able to reduce the monthly cost of your debt?		B
LOOK FOR OTHER INCOME (see STEP 8)		
How much replacement/alternative income per month were you able to find/plan for?		C
How many months can you receive this income?		
ACCESSING SAVINGS (see STEP 9)		
How much can you pull out of your savings on a monthly basis to balance your cash flow?		D
How many months will your savings last?		
How much money could you free up monthly if you used savings to pay off debt?		E
★FINAL NUMBERS (F = A+B+C+D+E)		F

ACTION: An answer at F of $0 or greater reveals a workable change. If your result is negative, find professional advice and/or explore the additional resources below for more help.

RESOURCES	
Employment Insurance	www.servicecanada.gc.ca
Financial Planning	www.getsmarteraboutmoney.ca
Investing	www.morningstar.ca , www.canadianmoneysaver.ca, www.globeinvestor.com , http://ca.finance.yahoo.com, www.financecenter.com
Insurance	www.insurance-canada.ca , www.termlife.win.net
Budgeting/Debt	www.moneymentors.ca , www.fcac.gc.ca
Credit	www.fcac.gc.ca
Find an Advisor	www.cfp-ca.org , www.cafp.org, www.advocis.ca

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Managing Your Borrowing

INTRODUCTION

The only reason a great many American families don't own an elephant is that they have never been offered an elephant for a dollar down and easy weekly payments. ~Mad Magazine

Canadians love to borrow. Generations ago, families were embarrassed to have debt. Today, we both brag and complain about our debt as part of regular social interaction. Debt has become so "normal" that it has risen 7 times faster than the increase in household incomes. For many, monthly savings has been replaced by monthly debt payments.

Times have changed and consumers are much more comfortable with debt - too comfortable. Debt has been increasing steadily over the past two decades, growing acutely rapidly over the past decade. Average total debt as a percentage of disposable income of reached a figure 165.5% in 2013 and debt per household has increased 75% since 2000 (http://www.vanierinstitute.ca).

Low interest rates were taken by some consumers as a "go-ahead" to spend. The "buy now, because borrowing is cheap syndrome, has put consumers in a precarious position as they attempt to service (make payments) their debt. Debt can be a trap. Debt is a result of using credit to fund consumption instead of income. Successful debt repayment may involve some sacrifice.

Insight into the world of credit and lending practices can help make you a more informed and successful consumer. You want the right products, great interest rates, and cost-effective strategies for paying off debt.

ADVANTAGES AND DISADVANTAGES OF BORROWING

Debt is money or other assets owed or due to a lender. The lender could be a financial institution, company, or even an individual. Debt encompasses everything from mortgages, lines of credit, vehicle loans and leases, personal loans, student financing, credit cards, to overdraft protection on your bank account. Debt is not all bad. Borrowing can be very constructive when carefully planned, and implemented. The ability to borrow has benefitted most consumers at some point in their lives.

Debt can also be a negative consequence of income loss or reduction, inadequate financial literacy or poor money management, living beyond one's means, family emergencies or life changes, and lack of planning or saving. There are as many explanations for debt as people with debt. Debt boils down to the product of spending when we did not have the money or when we did not want to use our savings.

Borrowing or financing has some advantages:

- Permits financing a major purchase when you only have a small amount of savings, e.g., purchasing a home after saving the down payment.
- Frees you to make a needed purchase today, when you do not have enough money or do not want to withdraw money from your savings, e.g., buying a car needed for transportation to work.
- Opportunity to acquire assets for the purpose of increasing your wealth, e.g., financial investments, revenue property, small business.
- Helps you manage an emergency or other sudden or unplanned expense.
- Allows you to spread the cost of a large purchase over a longer period of time, e.g., replacing your furnace.
- Consolidate other small debts to reduce overall monthly payments and interest charges, e.g., consolidating a few credit cards into one lower-interest payment.

Despite the advantages of borrowing, there are also some disadvantages:

- Money borrowed today means committing monthly payments from future (not-yet-earned) income, resulting in a decrease in your future lifestyle until the debt is paid off. Debt payments take away from your other needs and wants.
- Interest payments, even on low interest debt, will add up. The trade-off is money spent on interest is not available to spend on something else. Interest rates on some debts may also be subject to increase, making for higher debt payments.
- Borrowing for consumption can become a habit and borrowing may replace planning and saving for purchases, so each purchase costs extra.
- It allows impulse (unplanned) purchases; because today's easy access keeps financing within reach and makes it possible to take on too much.
- Financing that involves providing collateral ties up your asset for the life of the debt.
- Debt can make you more vulnerable to change, e.g., decrease in hours at work, retirement.
- Inability to make debt payments can hurt your credit rating and prevent future borrowing or even affect your capacity to renew an existing mortgage.

GOOD DEBT VERSUS BAD DEBT

There are some basic guiding principles which suggest some debts are more beneficial, because they are more likely to enhance your financial wellbeing than others.

As a general guideline good debt is borrowing which results in an increase in value. As a rule, financing to purchase a home, revenue property, business or investment is a good debt because those assets are expected to appreciate (increase in value). Borrowing for school is also considered to be a good debt because obtaining an education is likely to produce higher

lifetime employment earnings. Even if a debt is a "good debt" it does not mean you should borrow. Anytime you borrow, you should give careful thought to how the debt will affect you down the road.

Bad debt on the other hand is borrowing to purchase consumables, such as vacations, clothing or restaurant meals, or assets which depreciate (decrease in value), like electronics, furniture, or recreational vehicles. For consumables, the value is gone immediately, but the bill remains. Depreciating assets may decrease in value faster than the balance decreases on the debt.

There are some types of debt that do not fit well in either the "good debt" or "bad debt" categories. It might be better to think of these debts as "necessary debt". Though a depreciating asset, so would meet the definition of a bad debt, a vehicle may be essential for your lifestyle and thus vehicle financing may be a necessary debt. Financing an emergency could also be thought of as a necessary debt. It may have been better to have had savings to manage the emergency, but in a pinch, borrowing can get you through challenging situation.

Debt reduction should be the first priority of a financial plan. Not only can paying off debt make your cash flow easier to manage, debt repayment is a sure way to improve your financial wellbeing. Paying down debt can increase your net worth more quickly and dependably than investing. That is because money *"invested"* in debt repayment gives you a tax-exempt, guaranteed rate of return equal to the interest rate on the debt. If you have a credit card at 18% with a balance, an extra dollar paid on that card will give you a guaranteed rate of return of 18%.

LENDING AND THE FIVE C's

Lenders utilize several tools to determine whether to extend credit to consumers. Most borrowers repay their debts, but to reduce the risk of default, lenders develop lending guidelines based on the five C's of credit. The five C's of credit are **Character**, **Capacity**, **Capital**, **Collateral**, and **Credit**.

Character: What is your mind-set toward credit? Lenders will try to determine whether you will abide by your financial commitments and repay the debt.

Capacity: Can you afford the debt? This is based on two ratios, Gross Debt Service Ratio (GDSR) and Total Debt Service Ratio (TDSR). Lenders will calculate these ratios at the time of application to see if, based on their criteria, you can afford the financing. If the ratios are too high, you are normally declined for credit.

Capital: What is your net worth? The higher your net worth the more likely you can afford the debt. If payments on the debt become too difficult, then you also possess assets which could be used or sold to pay off the debt.

Collateral: Do you have something or someone to guarantee the debt? This could be a large asset such as a vehicle or home, or could be a person willing to act as a cosigner on your debt.

If you default on payments the lender can seize your asset or expect your cosigner to pay the debt.

Credit: How good is your credit? Lenders will check your credit report at a credit reporting agency to see how well you have upheld your financial commitments in the past.

HOW MUCH DEBT IS TOO MUCH?

Lenders use two ratios to determine the amount of debt a borrower can manage, **Gross Debt Service Ratio (GDSR)** and **Total Debt Service Ratio (TDSR)**. The word "service" refers to monthly payments – the amount of money needed to service (pay) certain expenses such as housing and consumer debt.

Gross Debt Service Ratio (GDSR) looks at the proportion of your income that is required to pay your basic housing costs. It is the total cost of housing payments (including principal, interest, taxes, and heating) divided by the family's total gross income. Your GDSR should not exceed 32%. Spending a greater portion of your gross income than 32% can make it difficult to cover other expenses. This can be called having a "housing burden".

Total Debt Service Ratio (TDSR) looks at the proportion of your gross income that is required to cover basic housing costs and all other consumer debts. It is the percentage of your gross monthly income that will be used for housing and other outstanding loans and debts. Lenders will usually allow up to a 40% TDSR, and it is rare to be able to borrow from a good lender, such as a bank, if your TDSR is above 40%.

Remember "Gross Income" is your income before deductions such as income taxes, Canada Pension Plan premiums, Employment Insurance premiums, and workplace benefits. For most borrowers, a TDSR of 40% would equal more than half of their take-home pay.

Keep in mind, GDSR and the TDSR are guidelines lenders rely on when extending credit. Consumers need to judge for themselves what they can manage in terms of debt. Family size and lifestyle factors, such as spending habits are not considered. Don't let you lender be the judge of what you can afford. Use your budget and your gut!

Also, try to look down the road. Are there any factors that may impact how much debt you can afford? Are you planning to start a family, return to school, start your own business, or retire? Changes in our lifestyles can reduce income and strain the budget. For example, if you are planning to start a family, and one parent will stay home with children for a few years, borrowing should be limited to what you can afford on only one income. Too many parents are forced back into the workplace for financial reasons when they would prefer to be at-home-parents.

Are you getting too close to the edge? Calculate your GDSR & TDSR.

(A) Total of Monthly Housing Costs

- Mortgage or Rent Payment ________
- Property Taxes + ________
- Heat + ________
- 50% of Condo Fees + ________

TOTAL (A) ________

(B) Total of Monthly Debt Payments

- Car Loans / Leases
- Credit Card Payments + ________
- Line of Credit Payments + ________
- Personal & Student Loans + ________

TOTAL (B) ________

(C) Calculate your **Gross Debt Service Ratio (GDSR)**

- (A) Total of Monthly Housing Costs ________
- Divide by Gross Monthly Income ÷ ________

PERCENTAGE (%) ________

(D) Calulate your **Total Debt Service Ratio (TDSR)**

- (A) Total of Monthly Housing Costs ________
- (B) Total of MOnthly Debt Payments + ________

TOTAL (A + B) ________

- Divide by Gross Monthly Income ÷ ________

PERCENTAGE (%) ________

SPOTTING THE DANGER

"I'm living so far beyond my income that we may almost be said to be living apart." ~ E.E. Cummings

In addition to your GDSR and TDSR, there are other ways to spot if your debt is starting to control you. Ask yourself:

- Are you only able to make the minimum payments on your debts?
- Has your debt been increasing?

- Have you missed debt payments or had to take advantage of the "miss-a-payment" feature on your loans or mortgage?
- Have you used a cash withdrawal from one credit card or line of credit to pay another (also called *Kiting*)?
- Are you at or near the limit on most of your credit cards?
- Have you obtained new credit because your current credit cards or lines of credit are at the limit?
- Have you borrowed additional money since consolidating your debts?
- Have you received a call from a lender looking for missed payments?
- Have you borrowed money from friends or family to make ends meet?
- Are you unable to set aside even a small amount of savings for a rainy day or emergency?
- Do you feel as though you are living from paycheque to paycheque?

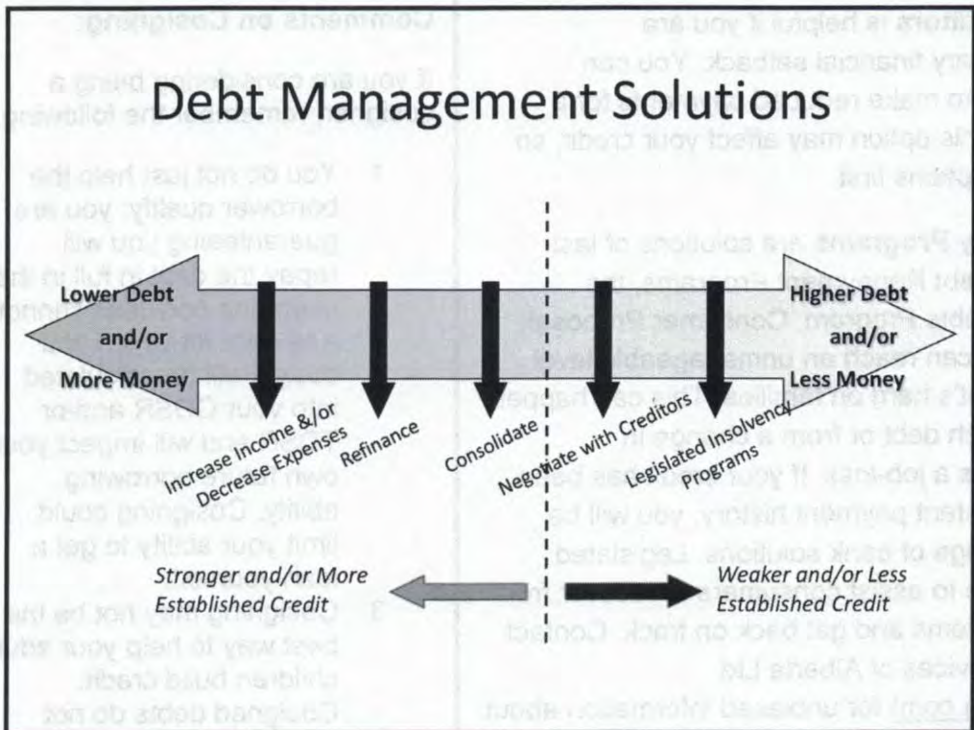
If you answered "yes" to more than a couple of questions, it's time to look at solutions and perhaps get some professional advice.

DEBT MANAGEMENT SOLUTIONS

Conventional wisdom says the primary goal in debt repayment is to minimize interest, which saves money. This means focusing on paying debts with the highest interest first. From a purely mathematic point of view this strategy is correct. While this strategy saves the most money, sometimes the right plan is more about cash flow. When cash flow is tight, such as when income declines in retirement or when a parent reduces work to raise children, the goal may need to be to minimize the monthly debt payments to ease cash flow. It can make sense to pay off a debt with a large payment first, even if it is lower interest. Eliminating a big payment can reduce your overall debt costs or can free up funds to pay other debt. It can also make sense to extend a debt over a longer period to reduce the size of the monthly payment, e.g., lengthening your mortgage amortization. Here, the benefit is a reduction in the amount of income you need to cover your expenses. Which strategy is right, depends on your cash flow.

Managing debt can be tricky. There are many solutions for managing your debt. The solution best for you depends on:

- Amount of Debt – Larger amounts of debt often require more aggressive solutions.
- Number of Debts – Solutions that reduce the number of debts by consolidation may be beneficial.
- Strength of Credit – With more established credit, solutions available through a lender, such as consolidation, may be options.
- Amount of Money available to pay debt – Finding money in the budget to pay down debts can make paying off debts faster and easier.



Increase Income and/or **Decrease Expenses** are appropriate solutions when the debt level is lower or when more money can be made available to pay debts. For example, an at-home-parent could generate extra income looking after children in his/her home. The extra income could accelerate the pay down of the household debt. Alternatively, you may find expenses you can reduce to free up the money to add to your debt repayment. If you find some extra money in your budget your can try a ***Fold Down Plan*** (see below).

Refinancing refers to lengthening the duration of a loan in order to reduce the monthly payment. Good credit is essential for this to work, but extending the loan can help the payment "fit" better in your budget.

Consolidation is often the preferred solution for reducing the total number of debt payments and reducing the overall interest. Good credit is vital and collateral or a cosigner is often required. This solution is especially effective if you have a number of debts or several credit cards with higher interest rates. One loan could pay them off entirely, trading several monthly payments for one loan payment at a better interest rate. Consolidation can be done with a loan or personal line of credit. For home owners, consolidation could happen by way of a home equity line of credit, a second mortgage, or by rewriting the primary mortgage. Rewriting your primary mortgage can result in paying the consolidated debts over the lifetime of your mortgage, costing you piles of interest. This solution should be reserved for situations where your budget is so tight, you cannot afford to make all of your debt payments. See *Paying Off Debt with Debt – Making Consolidation Work*.

Negotiating with Creditors is helpful if you are experiencing a temporary financial setback. You can arrange with creditors to make reduced payments for a short period of time. This option may affect your credit, so attempt the previous options first.

Legislated Insolvency Programs are solutions of last resort. They include Debt Repayment Programs, the Orderly Payment of Debts Program, Consumer Proposal, and Bankruptcy. Debt can reach an unmanageable level and result in stress that's hard on families. This can happen from taking on too much debt or from a change in circumstances, such as a job-loss. If your credit has been affected by an inconsistent payment history, you will be unable to take advantage of bank solutions. Legislated programs are available to assist consumers to recover from extreme financial problems and get back on track. Contact Credit Counselling Services of Alberta Ltd. (www.creditcounselling.com) for unbiased information about legislated programs.

Comments on Cosigning:

If you are considering being a cosigner, remember the following:

1. You do not just help the borrower qualify; you are guaranteeing you will repay the debt in full in the event the borrower cannot.
2. Any debt for which you cosign will be calculated into your GDSR and/or TDSR and will impact your own future borrowing ability. Cosigning could limit your ability to get a loan yourself.
3. Cosigning may not be the best way to help your adult children build credit. Cosigned debts do not always appear on both the borrower's and cosigner's credit reports.

TRUE COST OF MINIMUM PAYMENTS

Many consumers get in the habit of making only minimum payments on their credit cards. That can be costly. Compare the cost of repaying debt at minimum payments as compared to repaying at a fixed payment:

Minimum Payments versus Fixed Payments

	Payment Type	Total Cost to Repay (Months to Repay)			
		7%	10%	18%	29%
Amount Borrowed	**Minimum or Fixed**	**Personal Line of Credit**	**Low-Rate Credit Card**	**High-Rate Credit Card**	**Retail Credit Card**
$5,000	Minimum	$6,165 (143)	$6,853 (163)	$9,799 (226)	$24,686 (532)
$5,000	Fixed	$5,577 (38)	$5,882 (40)	$6,984 (47)	$10,287 (69)
$10,000	Minimum	$12,372 (177)	$13,776 (195)	$19,799 (272)	$50,403 (650)
$10,000	Fixed	$11,153 (38)	$11,764 (40)	$13,967 (47)	$20,575 (69)

* Minimum payments are based on 3% of the outstanding balance.
* Fixed payments are based on 3% of the starting balance.

Paying off debt with minimum payments takes so long because you are paying 3% payments (sometimes less) per month on a declining balance. This prolongs the repayment and costs a great deal more interest. Anything you can do to pay more than the minimum will dramatically shorten your repayment. In the example, selecting a fixed payment based on 3% of the starting balance reduces the repayment period by 75% to 90%. This is an easy way to take command of your debt.

IN YOUR BEST "INTEREST"

Borrowing can mean paying tens or hundreds of thousands of dollars in interest over a lifetime, much of it unnecessarily. It's in your best "interest" to minimize your costs of borrowing. First point to remember is interest rates on loans, lines of credit, and mortgages are negotiable. Second, there are good on-line resources to help you shop around for the best credit value.

The Financial Consumer Agency of Canada (www.fcac.gc.ca) is an outstanding source of information on loans, mortgages, and credit cards. In particular, you can compare hundreds of credit card offers from different providers on a wide range of criteria; including, minimum income required, minimum credit limit, interest rates (purchases, cash advances, and balance transfers), grace periods, minimum payments, annual fees, and rewards and benefits.

Just switching from a high interest rate credit card to a low interest rate credit card could save you 10% interest per year. If you are carrying a balance greater than $1,000, it makes good sense to switch to a low-rate card to help you pay the debt down faster. At a lower interest rate more of your payment goes to the principal. Even with an annual fee of $30 to $60, you will save money. Switch back to the high-rate card after the debt is paid in full, and pay your card in full every month. If you pay the balance on your credit card in full every month, you don't need a low-rate card.

PAYING OFF DEBT WITH DEBT – MAKING CONSOLIDATION WORK

Taking out a new debt to pay off old debt won't work unless you understand the reason the debt accumulated. Make the necessary changes to prevent debt from accumulating again in the future. This may mean:

- Tracking your spending so you understand where your hard-earned money is going
- Reducing spending so that your money is going to things you value and is consistent with your goals
- Monitoring your budget to stay on track and so you know what you can manage for a consolidation loan payment
- Eliminating extra credit cards or lines of credit to help prevent accumulating new debt

Before visiting your financial institution to apply for a consolidation loan, take the time to work out your budget. Knowing what you can afford for a consolidation loan payment will prevent you

from taking on too much. It's natural to want to repay your debt as quickly as possible. Be too aggressive and your plan could backfire. You may find yourself short of money and using your credit cards again to cover the deficit. If necessary, take a longer borrowing term and make extra payments.

FOLD DOWN PLAN

Consolidation may not an option for dealing with your debt if:

- Your payment history shows missed or late payments
- Your TDSR is too high (greater than 40%)
- Your credit history is limited (few prior credit contracts)
- You do not have enough collateral (assets, i.e., house or vehicle) or a cosigner to offset the lender's risk in extending the financing

A **Fold Down Plan** is a good alternative to a consolidation. All you need to do is find a little spare money in your budget. The example below shows a Fold Down Plan. It is easy to set up.

Step 1: List your debts in order from highest interest rate to lowest interest rate. If you have two debts with the same interest rate, list the one with the smaller balance first.

Step 2: Determine the minimum payment for each of the debts. For credit cards and lines of credit, use 3% of the current balance. For loans, list the payment required under your contract.

Step 3: Find some money. Cut some discretionary spending in your budget or find some additional income.

Step 4: Focus on the highest interest rate debt first. Take the additional money you found in your budget in Step 3 and add it to the minimum payment of the highest interest rate debt. Pay the new amount on the highest interest rate debt and minimum payments on all other debts.

Step 5: When the first debt is paid in full, **"fold down"** its entire payment on to the minimum payment of the next highest interest rate debt on your list.

Step 6: As each debt is paid, continue to "fold down" the payment on to the minimum payment of the next debt.

The point of the Fold Down Plan is to get the greatest "bang for your buck". That means targeting high interest debts first. This solution also gives you the satisfaction of seeing the number of debts shrink as you progress. You can visit www.bankrate.com and use the *"Debt Payoff Calculator"* to create and print your own Fold Down Plan. You can also get set up with an easy to use online software program called *PowerPay* (www.powerpay.org) to create a Fold Down Plan and save your results in case you want to make changes at a later date.

Fold Down Plan (Example)

Debt ($21,500)	Balance	Minimum Payment	Phase 1				
Retail Credit Card 28%	$2000	$60	$260	Phase 2			
Retail Credit Card 28%	$3000	$90	$90	$350	Phase 3		
Bank Credit Card 18.5%	$5000	$150	$150	$150	$500	Phase 4	
Bank Credit Card 10.5%	$2500	$75	$75	$75	$75	$575	Phase 5
Bank Line of Credit 7.5%	$9000	$180	$180	$180	$180	$180	$755
TOTAL PAYMENTS		$555	$755	$755	$755	$755	$755
TIME			9 Months	9 (18) Months	8 (26) Months	2 (28) Months	7 (35) Months

MORTGAGES – A HOME IS WHERE THE DEBT IS

People are living longer than ever before, a phenomenon undoubtedly made necessary by the 30-year mortgage. ~Doug Larson

Since a home is the largest purchase most of us make, the mortgage will be our largest debt. Most consumers underestimate the amount of interest we will ultimately pay for home ownership. How do you make the right mortgage choice?

Mortgages can be complicated products. Understanding the options available to consumers can be daunting, especially when you're in the midst of making your purchase. One exceptional resource available to demystify mortgages is a publication entitled *"The ABCs of Mortgages"* from the Financial Consumer Agency of Canada (www.fcac.gc.ca). Topics covered include important terms, types of mortgages, payment options, down payments, mortgage default insurance, as well as consumer rights and responsibilities. The publication is free and can be downloaded from the website.

For general guides to home ownership check out Canada Mortgage and Housing Corporation or CMHC (www.cmhc-schl.gc.ca). CMHC has two publications about buying a home; *"Home Buying Step by Step"* and *"Condominium Buyers' Guide"*. Both publications cover financial

readiness to buy, estimating costs, finding your home, closing costs, and homeowner rights and responsibilities. These publications may be downloaded or mailed to you free of charge and you can explore interactive versions on the CMHC website. CMHC also has publications on home renovation and maintenance.

PAYING DOWN YOUR MORTGAGE FASTER

Paying off your mortgage early is a financial goal for many consumers. In Canada, we are inundated with "expert" opinions suggesting we should not rush to pay off our home. Unfortunately, much of this information comes from the United States, where interest on your mortgage is tax deductible. Since that is not the case in Canada, does it make sense to pay your mortgage off early?

The decision to pay extra on your mortgage should be evaluated within the context of your overall financial plan. For example, if you still have consumer debt, which is higher interest than your mortgage, pay it first. If making extra mortgage payments means you are unable to save for emergencies, save first.

How do you pay down your mortgage faster? The simple answer is...**PAY MORE**. Extra payments are applied to your principal. Remember, early in your mortgage you are paying more to interest than you are to the principal. Extra payments can really shorten your amortization.

Shorten Your Amortization: If you are just in the process to buy, choose the shortest amortization you can afford, while still meeting your other financial goals (i.e., saving). Already a homeowner? If you can afford a higher mortgage payment each month, next time you renew your mortgage, ask your bank to shorten your amortization.

Score a Lower-Interest Renewal: If the going mortgage rates are lower at the time of your mortgage renewal, or if you negotiate a cheaper rate than you had, keep your mortgage payment the same. Each payment will apply a few extra dollars to your principal, paying down your mortgage faster. At the time of renewal you can also put down as large a chunk on your mortgage as you want, without penalty.

Make Prepayments: Ask your lender about prepayment options for your particular mortgage. These are extra payments you can make without being charged a penalty. They may include: doubling your payment (occasionally or regularly), boosting your normal mortgage payment by a prescribed percentage (i.e., Mortgage Payment +10%), and paying a lump sum on the anniversary of your mortgage each year up to a fixed percentage of the original mortgage. Squirrel away extra cash, income tax refunds, and work bonuses and drop it on your mortgage.

Accelerate Your Mortgage: You have likely heard that paying your mortgage more frequently will pay your mortgage off faster and save interest. As you will see in the table below, that is not always the case. Paying more frequently can make paying your mortgage more manageable budget-wise, but will only save you a few dollars. The big savings comes with choosing "accelerated" payment options. Compare bi-weekly payments and bi-weekly accelerated mortgage payments. A bi-weekly payment is based on $1/26^{th}$ of a year's worth of mortgage payments, and you pay 26 times over the year. A bi-weekly accelerated payment is based on

1/24th of a year's worth of mortgage payments, but you pay 26 times over the year. In effect, you make an extra month's worth of payments when you choose the accelerated option. If you already have a mortgage, check to see if you selected accelerated payments. Accelerated options can save you a bundle.

Paying Your Mortgage More Frequently

$300,000 Mortgage, 6% Interest, 25 Year Amortization					
Payment	**Payment**	**Payments Per Year**	**Total Amount Per Year**	**Amortization**	**Total Payments**
Monthly	$1,919	12	$23,028	25 Years	$575,825
Semi-Monthly	$959	24	$23,016	25 Years	$575,115
Bi-Weekly	$885	26	$23,010	25 Years	$575,062
Weekly	$442	52	$22,989	25 Years	$574,742
Bi-Weekly Accelerated	$960	26	$24,960	21 Years	$524,778
Weekly Accelerated	$480	52	$24,960	21 Years	$524,191

Save and Pay Combo: Should you save in your RRSP or pay down your mortgage? How about both? Make contributions to an RRSP (personal or spousal), claim the contributions on your income tax, and then use the income tax refund as a lump-sum payment on your mortgage each year. Paying down your mortgage while investing in RRSPs allows you to meet two significant financial goals:

- Getting rid of your mortgage as quickly and efficiently as possible to retire debt-free.
- Putting money early and consistently into RRSPs to maximize long-term growth to retire with financial security.

How much can you save? Consider a homeowner in the 32% marginal tax bracket with a $300,000 mortgage at 6% interest. If she saves $250 per month in an RRSP, the income tax refund based on her contributions of $3000 per year would be $960. If she uses the refund each year as a prepayment, it would reduce her 25-year amortization by 2 years and save $26,000 in interest. As her income rises, she may be able to make higher RRSP contributions and pay her mortgage off even faster. Imagine a couple both using the save and pay combo!

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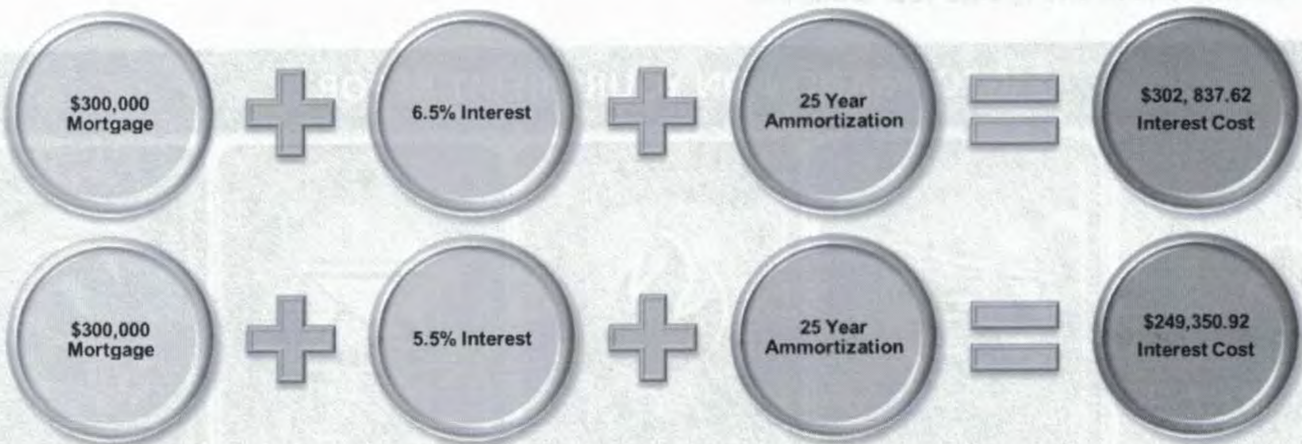
Managing Your Credit

INTRODUCTION

With increasing media attention being paid to consumers and their credit, Canadians are becoming more interested in their credit status. Despite this, credit reports, credit scores, and credit ratings are still a mystery to most of us. It is critical to understand, build, and maintain good credit. Over a lifetime, great credit can save you tens to hundreds of thousands of dollars. The better your credit, the better the interest rate you can get from lenders. From car loans to lines of credit to mortgages, great credit equals great savings, but only if you negotiate with lenders for preferred interest rates.

Look at an example of two different interest rates on a mortgage. Saving just 1% on your mortgage rate saves over $50,000 over 25 years. Surprisingly, many consumers do not negotiate their mortgage rate with the lender. It is much easier to negotiate a good rate when you know where your credit stands.



Consumers also face new risks in today's market. Identify theft and credit fraud are genuine threats to your personal credit and overall financial well-being, and rates are rising. Recently, much publicized offenses have occurred affecting millions of consumers nationwide. Your credit report is a tool to help prevent you from becoming a victim.

CREDIT-REPORTING AGENCIES

Credit-reporting Agencies are businesses whose role is compiling your history of borrowing and payments and providing that information to your lender and other authorized individuals and businesses. Legislation defines who and for what purposes an individual or business may check your credit with your consent. A credit check can be conducted with an application for credit, insurance, employment, or even housing rental. Think of a credit-reporting agency as a massive

filing cabinet of consumer information. Lenders and other authorized businesses get your permission to look at your file, usually on their application form. They review your credit report and then decide, based on their own criteria, whether or not to give you the loan, mortgage, insurance, job, or rental agreement, and on what terms (interest rate, term of borrowing, collateral, deposit, etc.).

In Canada there are two major credit-reporting agencies: Equifax and TransUnion. In Alberta, both Equifax and TransUnion are used. If you have ever borrowed money or used credit, you will have a credit report at one or more likely both of these agencies (also called Bureaus).

ON YOUR REPORT

Each Credit-reporting agency contains consistent information about your credit history. The majority of information on your report is provided by you. This is not a "Big Brother" conspiracy of Agencies seeking information about you from the government and lenders. When you complete an application for a bank account, credit card, loan, finance plan, or mortgage, you provide the lender a great deal of personal information. That information will subsequently be used to create and update your credit file.

HOW YOU'RE RATED

Knowledge of how your payment history is reported and how your credit is graded can help you review your history, build strong credit, and prevent damage. Your payment history is reported differently at each credit-reporting agency. Generally though, you are rated and scored on your credit report.

Ratings are assigned to each debt on your credit report. If you have three credit cards, you will have one rating for each account. The rating is a measure of your reliability in making the payments on time. As long as you make all of your payments on time according to your contract, you will have a good credit rating on each debt. A missed or late payment can really cost you. One missed or late payment will knock your rating down one notch. Be consistent afterward with your payments are you can bring the rating back up to perfect – a "1".

Attached to each credit rating is a letter. The letter indicates the type of debt. An "R" is for "revolving" credit, such as a credit card, where your required payment is based on a percentage of your outstanding balance. An "I" means "installment" credit such as a car loan or lease, where your payment was fixed in your contract, and will be the same until the loan is fully repaid. Finally, an "O" is for open credit, where either the entire balance is due at the end of each period such as with a cell phone account, or where the payments have yet to start like with a student loan (while you're still a student).

Each credit-reporting agency will also list your payment history. With Equifax, a payment scale that tracks the number of times your account showed 30, 60, or 90-days late is displayed with each debt. With TransUnion, a payment chart showing the previous 2 years of payments is shown next to each debt.

CREDIT RATINGS

0
- Too new to rate; approved but not used

1
- Pays (or paid) within 30 days of payment due date or not over one payment past due

2
- Pays (or paid) in more than 30 days from payment due date, but not more than 60 days, or not more than two payments past due

3
- Pays (or paid) in more than 60 days from payment due date, but not more than 90 days, or not more than three payments past due

4
- Pays (or paid) in more than 90 days from payment due date, but not more than 120 days, or four payments past due

5
- Account is at least 120 days overdue, but is not yet rated "9"

7
- Making regular payments through a special arrangement to settle your debts (i.e., Orderly Payment of Debts)

8
- Repossession (voluntary or involuntary return of merchandise)

9
- Bad debt; placed for collection; moved without giving a new address

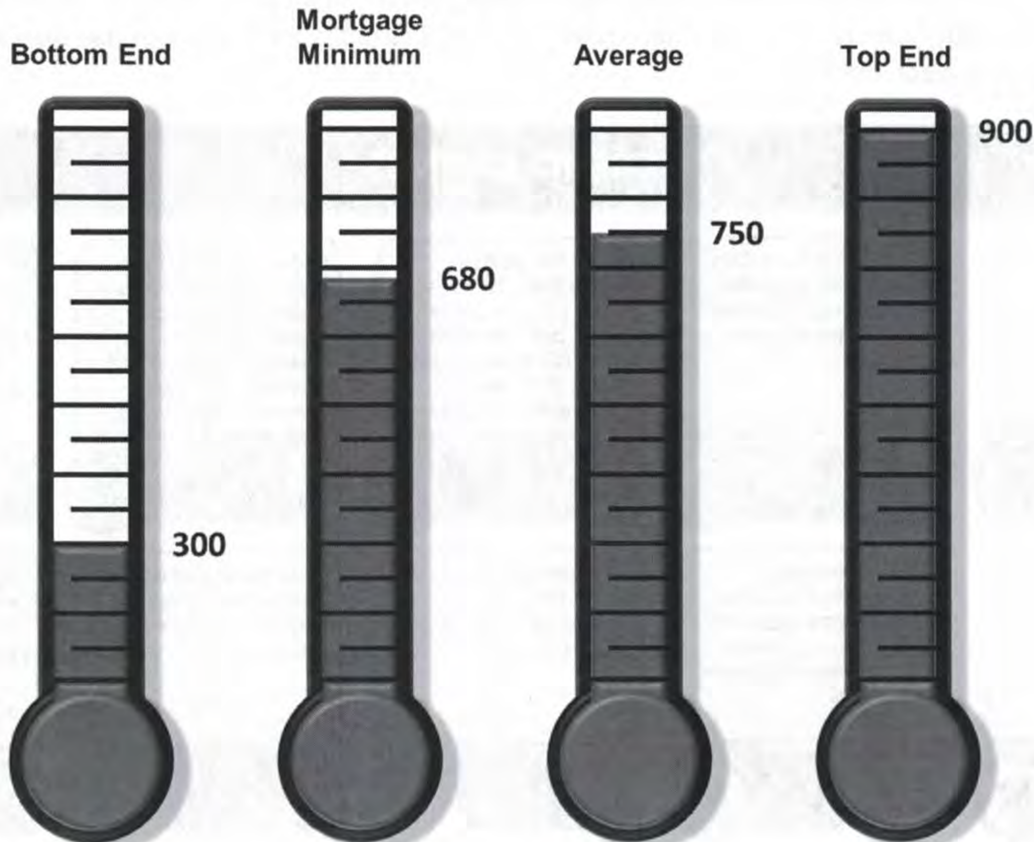
R, O, I
- Types of Credit
  - R = Revolving Credit
  - I = Installment Credit
  - O = Open Credit

Source: Equifax Canada

SCOREKEEPING

The Credit Score is a term most consumers know, but do not fully understand. A high credit score helps you get the best interest rates on loans, lines of credit, and mortgages. The Fair Isaac Corporation designs analytical models to evaluate consumers' credit. Versions are used by credit-reporting agencies to calculate credit scores, and are also used by retailers, insurers, and other companies. Equifax calls their credit score BEACON and TransUnion calls their credit score FICO® Risk Score. You will come across these terms when talking to your lender. Fair Isaac credit scores are the most used credit scores in the world. Whatever the label, each score weighs five aspects of a consumer's borrowing including: amounts owed (30%), payment history (35%), types of credit in use (10%), new credit (10%), and length of credit history (15%). Knowing what helps and what hurts your score gives you the tools to build a high credit score.

Credit Scores range from about 300 to 900. Higher is better. Average is about 750. Borrowers who have scores above 800 are considered by lenders to have the lowest risk of default. Each lender has credit score thresholds a borrower must meet to qualify. Falling short of that threshold (too low a score) results in decline. There are lenders who will work with borrowers anywhere along the credit score spectrum, but there is a price. Lower credit scores will force consumers to go to lenders who accept higher risk borrowers and therefore charge higher interest rates to offset their increased risk of borrower default. High risk mortgages can be more than double banks' posted rates. Car loans can be three or four times the rates offered at the bank. It is worth it to maximize your credit score.



FACTORS THAT RAISE AND PROTECT YOUR SCORE

- Pay bills on time (late payments are as harmful to your credit as missed payments)
- Pay bills in full by the due date (save interest, but also raises your score quickly)
- Pay debts down quickly (make larger payments than required by your contract)
- Stay below your credit limit on credit cards and lines of credit (use less than 35% of your available credit)
- Keep an older account open even if you no longer need to use it
- Limit credit inquiries in a short period of time
- Develop a credit history by having a mix of credit products

FACTORS THAT LOWER YOUR SCORE

- Late and missed payments (late payments are as harmful as missing the payment completely)
- Debts written off or sent to collection agency
- Withholding payments due to dispute with creditor
- Relatively new credit accounts (scores fall when you take on a new agreement)
- Account balances above 35% of available credit as a lender may see you as higher risk even if you pay in full
- Loan balances too high compared with loan amounts (credit utilization score)
- Too many credit inquiries (credit-seeking behaviour)
- History of revolving or non-revolving accounts too short

CHECKING YOUR CREDIT

If you have not seen a copy of your credit report in the last year or two, now is the time. You should take the time to check your credit report each year. At the very least, get a copy of your report before going in to your lender to apply for major financing, such as a mortgage. Right when you are about to finalize the purchase of your dream home is a dreadful time to find there is a problem on your credit report. Estimates vary, but errors on a credit report that are significant enough to result in a credit decline are common. Consumers are responsible for ensuring their reports are accurate. It is not enough that a lender has looked at your credit and did not mention any concerns. Lenders draw your credit report from a credit-reporting agency for their own purposes and are not to disclose to you any of the detail, including your credit score. You can also do your own detective work and scour your report for credit-check activity you did not authorize or evidence of credit accounts for which you did not apply. This can be evidence of identity theft or credit fraud, and requires immediate action.

Are you worried that checking your credit could hurt you? One myth is that checking your own credit report can damage your credit, resulting in a lower credit score. This belief keeps consumers from checking their credit. There is a big difference between you checking your report and a lender checking your report for the purpose of credit approval. There are three types of credit checks: hard, soft, and consumer/personal.

Hard Checks, also called "hard hits", are inquiries that stem from applications you make for credit (credit cards, loans, etc.) and rental accommodation or as parting of an employer's hiring practice (depends on employer). These checks are recorded on your credit report and can be viewed by anyone who checks your report for lending purposes. They count toward your credit score, so too many of these types of checks can hurt your score. Try to keep credit applications to a minimum. If shopping around for financing for a vehicle or mortgage, do all of your applications within a two week period and it will be counted as a single inquiry.

Soft Checks, also called "soft hits", are inquiries that do not affect your credit score in any way. Only you can see these inquiries when you check your own credit. These usually result from your existing account lenders updating their records or used to determine suitable candidates for promotions, credit increases, etc. Insurance companies may also use this type of check to determine the premiums you would pay for a home or auto policy. Higher scores can get you lower premiums - another great reason to build and maintain good credit.

Consumer or **Personal Checks** are inquiries initiated directly by you (not through a lender) and do not affect your score. Only you can see when you previously checked your report.

Convinced you should get a copy of your report? Excellent! Now, how do you do it? First, decide why you want the report. If you are just checking the report for errors or general information, and you are not in a hurry, you can get your report free by mail from both Equifax and TransUnion. Your report will arrive in 2 to 3 weeks. This report will not include your credit score. If you are in a rush or want to know your credit score so you can negotiate more effectively with a lender, you can pay for your credit report or your credit report with your credit score online. You can

receive your report and score almost immediately. It can be a small investment ($15 to $25 per report) to save thousands in interest.

ERRORS

Errors on credit reports are inevitable. A lender could mistakenly pull the wrong credit report when doing a credit check causing you a "hit" on your credit report. A loan or credit card that does not belong to you could appear on your report. Payments you have made may not be properly recorded on your report making you appear delinquent in payments. If you refinance a loan, the bank may forget to close the original account, so it appears you have more debt than you really have. Errors can be a sign that your credit has been compromised, because some errors may be symptoms of identity theft and credit fraud. Recognizing and correcting errors can help you maintain strong credit and prevent nasty surprises when you visit you bank to borrow money.

Generally, there are two approaches for fixing an error. First, you can contact the submitter of the information and have them remove or amend the information. Unfortunately, it can be extremely frustrating to find the right person to complete the task and difficult to follow-up to make sure it was fixed. Second, you can file a dispute with the credit-reporting agency. When you get copies of your credit report from each agency, you will receive information on the process of disputing the accuracy or completeness of the information contained in your file. You can also get the details on each of the credit-reporting agencies' websites.

For each credit-reporting agency, you will file a statement of dispute explaining your concerns and submit photocopies of any supporting documents, such as receipts, legal documents, or letters from lenders. For Equifax, you will complete a *Consumer Credit Report Update Form* and for TransUnion, you will complete an *Investigation Request Form*. Fax or mail the form and information to the credit-reporting agency and an investigation will begin. In fact, Alberta legislation (Credit and Personal Reports Regulation of the Fair Trading Act) requires that a credit-reporting agency report the results of the investigation of your consumer complaint to you in writing within 45 days of its receipt. If the documentation supplied is sufficient to prove the error, the correction is made and an updated copy of the credit report is sent to the consumer and any party that requested your credit report in the 60 days prior to your dispute. If the credit-reporting agency needs more information they may contact the lender, collection agency, or court agency to make a determination. Credit-reporting agencies cannot remove derogatory but accurate information.

On that note, Credit Repair companies have become more common. For a fee they advertise they will repair your credit. Keep in mind, a Credit Repair company can do nothing more than you can for free. They cannot have negative, but accurate, information removed from your report.

Occasionally, even after an investigation, the dispute cannot be resolved to your satisfaction. Also, an entry on your file may be true, but you have a reasonable explanation you want your

lenders to know. In such cases, you can add a short (100 word) explanation or comment to your credit report. This allows you to express your side of the issue. For as long as the information in question is on the credit report, the statement appears and is available to anyone authorized to see your credit report.

Remember, checking one report is not enough. You do not know which credit-reporting agency your lender, landlord, or insurance company will use.

SINGLES, COUPLES AND CREDIT

As singles, we begin to build our credit - most of us starting quite soon after high school. When we get into long-term relationships we merge our financial lives, including our credit. We may take on the responsibility of a mortgage, line of credit, or a vehicle loan jointly as a couple. Over time, couples tend to take on even more of their debt together. While this makes qualifying for financing easier, using two incomes and two credit histories, it has inherent risks.

Debts held jointly as a couple should be reported on both partner's credit reports by the lender. This does not always happen. Often the person listed first on the credit agreement will have the debt and subsequent payment history documented on their credit report, but not on the report of the partner listed second. Today, it is still more common for the man to be listed before the woman on the contract. Fair or not, someone has to be listed first. The consequence for the second person on the agreement is that the good payment history may not be recorded and then will not be reflected in his/her credit score. Credit has to be used to be maintained – "use it or lose it".

This is particularly important for women. On average, women take more time out of the workforce than men, often raising children or caring for aging parents. This can mean women have less consistent attachment to the workforce. A continuous work history is an important criterion for qualifying for financing. The best practice is to maintain the credit you have, because it is much easier than rebuilding.

It is imperative that each partner continues to have and use credit that is in their name alone. This could be as simple as maintaining a single personal credit card. This ensures each partner can maintain their personal credit identity. Though not nice to imagine, relationships end through separation, divorce, and death. To be on your own again, without good personal credit, can make starting over enormously challenging. Renting an apartment, getting insurance, financing a vehicle, and securing a mortgage may be out of reach.

CONTACTS

Equifax Canada

Website:	www.equifax.ca
Telephone:	1-800-465-7166 (8:00 a.m. to 5:00 p.m.ET)
Facsimile:	1-514-355-8502
Mail:	Consumer Relations Department P. O. Box 190, Station Jean-Talon Montreal, QC H1S 2Z2

TransUnion Canada

Website:	www.transunion.ca or www.creditprofile.transunion.ca
Telephone:	1-800-663-9980 (8:00 a.m. to 8:00 p.m.ET)
Mail:	Consumer Relations Centre P.O. Box 338, LCD1 Hamilton, ON L8L 7W2

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Lessons in Dollars & Sense for Children

INTRODUCTION

"The most important thing that parents can teach their children is how to get along without them."

~ Frank A. Clark

Parents want the best for their children and some of the best lessons parents can provide are those about good money management. Give your children opportunities to manage and make decisions about money. As adults, financial missteps can lead to real trouble. Let your children have chances to make mistakes with money when the consequences are not grim - while you have them safe and secure with food, clothing, shelter, and lots of love.

"Remember, the purpose of an allowance is to give your children the opportunity to learn how to manage money through their own successes and failures and the input of their parents."

~ David McCurrach

Small amounts can produce big results, so think of allowance as a tool for teaching your children how to manage money. You know your children best, so you'll need to make a plan that works for your family. Here are some guidelines to consider when giving children an allowance.

CHILDREN AND MONEY: ALLOWANCE GUIDELINES

Once you decide you want to start giving an allowance, there are a few things to consider. The process starts with a conversation with your children. There should be lots of talk before the money starts to flow.

Give an allowance without "strings" by not tying allowance to chores. Families must work together as a team to maintain the household, and since parents are not compensated for the work they put in at home, children shouldn't be either. Parents often give an allowance based on children completing basic household responsibilities, like keeping their rooms clean and emptying the dishwasher. Then, if those chores don't get done, they reduce or withhold the allowance. Paying for chores can be a slippery slope and result in children either expecting to be paid any time you ask them to help out or dodging chores in weeks when they don't "need" the money (especially older kids who earn some of their own money). In addition, taking away allowance doesn't influence behaviour as much as taking away privileges (e.g. computer or television time), particularly since you're covering all of their basic needs. Leave allowance as a lesson designed for raising money-savvy, financially independent adults.

Pay at regular intervals so children know when to expect the money and can make plans in advance. Having a regular amount of personal income is the basis for learning about managing money. Make an allowance schedule and keep it. The frequency of the payments depends of

the age of the child. For younger children, pay an allowance weekly. When children get older and have more experience with money, challenge them to make it last longer by paying every two weeks or twice per month. This will mimic their future employment pay schedules.

- **Age 4 – 10: weekly**
- **Age 11 – 13: bi-weekly or semi-monthly**
- **Age 13+: monthly**

Pay in small denominations so kids can easily divide it. Children need to learn that their money has several jobs, as parents already know. By paying in small bills and change, children can divide their allowance into several categories. See *Children and Money - Allowance Project* for an activity to do with younger children to help them understand and practice the concepts of spending, saving, and sharing.

Discuss amounts and expectations each year. It can be a challenge to decide how much allowance is right for your children. One rule of thumb is a dollar per year of age, per week, so a 10-year old would get $10 per week. Obviously, you need to determine an amount that makes sense for your family and your finances. As your children gain confidence and experience managing their allowance, take the time to annually review their needs. Have an allowance chat with your kids before school starts in September or on their birthday, when you can show them that you recognize their increasing maturity may result in different needs and responsibilities and therefore a raise. Also consider how much money you already give them. Do you often buy a treat after sport's practice? Give that money as part of your children's allowance and when they have to part with their own money for a treat, you may find they want to stop less often.

What expenses do you expect your children will pay for with the allowance? Ask them what they need to spend their money on. Doing so gives them a chance to do some basic budgeting. Younger kids may only be thinking about toys and treats, but when they are ready, you can increase both the amount they receive and the responsibility they have with their allowance. For example, are they ready to take on the task of purchasing a bus pass, haircut, or personal care products? If so, increase their allowance accordingly. For some kids, this may mean a fairly hefty allowance, but remember this was money you were spending anyway. As a general guideline, compulsory school activities can come from parents and optional activities are paid with an allowance. You can also provide "special" allowances. One example is a "clothing allowance" paid a couple of times a year such as spring and fall. You can set the rules. Perhaps all clothing must be approved and any inappropriate items returned and the funds forfeited. A clothing allowance is a sneaky way to cure "brand-itis", that is, the overwhelming desire for expensive brand name items. When there is a spending cap, suddenly buying less expensive brands allows for more clothing items.

No bailouts or advances on the next allowance. You want your children to grow to be adults who can live within their means. If you give children money when the allowance runs out, the lesson learned is that they don't need to budget, because they can always ask for more. Giving advances on an upcoming allowance is an early introduction to the world of borrowing and reduces incentive to save for future fun. While this one is hard for parents, try to resist bailouts and loans.

For extra money, consider a job jar as a way to encourage work ethic. One concern parents have about giving an allowance unrelated to chores is that children will not learn that to make money you need to work. To inspire work ethic, assign a dollar value to extra work around the house or yard. These would be age-appropriate tasks that are beyond their regular responsibilities. Write each job and its pay rate on a slip of paper and put it in a jar. Any time the need for extra money arises children can choose a job from the jar and earn a fair rate for their effort. How about washing the car, raking the leaves, shoveling the driveway, or looking after a younger sibling?

Don't rush getting a bank account for your children. Early on, children struggle to grasp the idea of putting money in a bank account. Imagine what's going on in the mind of a child when they take their hard-saved money to the bank and give it to a stranger, and all they get in return is a little book with a recorded balance. You will have a sense when your child is ready for a bank account. Until that time, have them accompany you to the bank and learn through observation.

Put it in writing. Write your agreement in a contract you both sign. This recaps the amounts, frequency, rules and expectations and demonstrates the importance of upholding financial commitment you have made.

CHILDREN AND MONEY – ALLOWANCE PROJECT

Want to help your child to learn needs versus wants, delaying gratification and making money last, setting goals and budgeting, and philanthropy? This activity can really help children learn the jobs of their money. The three jobs are:

Spend: Money needed for current needs and wants. This job helps children learn to live within their means.

Save: Money to be set aside for future needs or wants, e.g., special purchase. This job helps children develop a lifelong habit of saving for the future.

Share: Money for others, e.g., church, charity, etc. This job helps children learn philanthropy and how their money can make a difference in the lives of others.

Have fun:

1. Have your child choose 3 similar containers (small boxes, pencil cases, jars) – check out Dollar Stores for great deals. Transparent containers are especially effective.
2. Label the containers "Spend", "Save", and "Share" and let your child personalize them with markers, stickers, glitter, etc.
3. Pay your child the allowance in small bills and change and encourage him/her to allocate the funds in the three containers.
4. Have your child clip out a picture of something they want to save for and put it in the "Save" container as a reminder of his/her savings goal.
5. To encourage saving, consider matching savings.

HELPFUL RESOURCES

Moonjar Canada – www.moonjar.ca

Moonjar Canada offers award-winning products, including three-part Moneyboxes as teaching banks, which help younger children learn about money. They also sell classroom kits and lesson plans for educators.

> *"Moonjar Moneyboxes were created as a tool for children and families to incorporate strong financial values and practices into their daily lives. Moonjar Moneyboxes teach children how to allocate money as they achieve their goals, share with others and build their dreams. A great way to start a positive dialogue with kids about money and begin teaching basic financial literacy."*
>
> *~ Moonjar Canada*

Educational Programs – www.fcac.gc.ca

This website is a provided by the Financial Consumer Agency of Canada and is a gateway to learn about money. This site is designed for Canadian youth, young adults, and educators.

The Financial Consumer Agency of Canada is a gateway to several other great financial education/literacy resources:

The City – Financial Life Skills Resource for Teachers and Students

Financial Basics – A Financial Literacy Workshop for Young Adults

The Tool Shop - Tips that summarize the essentials of money management in a way that is clear and easy to remember

Investor Education Fund – www.getsmarteraboutmoney.ca

Established by the Ontario Securities Commission, this website has material suited to teens, adults, and parents, and provides unbiased information on money and investing. It has a program and resources for high school students called "Funny Money" and lots of information for parents on topics such as Registered Education Savings Plans (RESPs), investing basics, and much, much more. This is an excellent website for parents to share with teens.

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Making Your Money Work

INTRODUCTION

"An investment in knowledge always pays the best interest."

~ Benjamin Franklin

There are two important financial fundamentals:

1. spend less that you earn, and
2. put the rest to work.

In order to have money to save or invest, you have to spend less than you earn. That basic rule sounds obvious, but it isn't always easy to do.

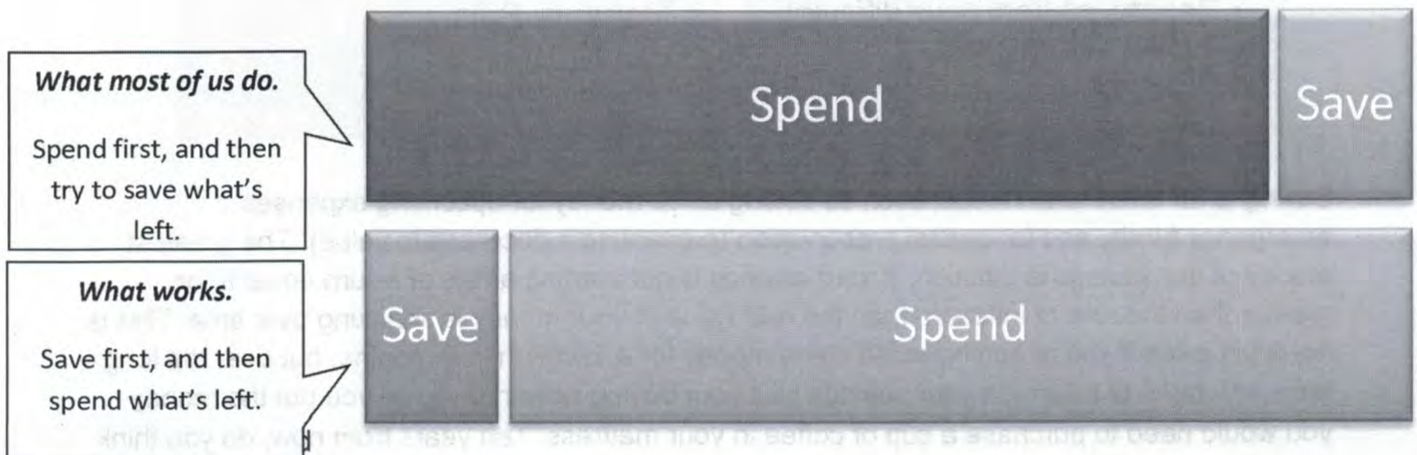
PAY YOURSELF FIRST

"Do not save what is left after spending, but spend what's left after saving."

~Warren Buffet

Pay yourself first is a financial rule splashed throughout financial planning and investing literature. It recommends you make you and your future a top priority by setting aside a portion of your income for saving/investing before you do anything else. Canada Revenue Agency (CRA) has this technique down to a science. CRA requires your employer to collect and remit your income taxes through payroll deduction. So, CRA gets your money before you have a chance to spend it. The trick with paying yourself first is to do exactly the same thing – save before spending. Choose a percentage of your gross (before tax) income and save it from each paycheque – automatically if possible. The recommended amount is 10% (or even more) of your gross income. If that sounds high, start smaller and work your way to 10% over time.

If you try to save what is left at the end of the month, there may not be anything left to save. Save first and the work is done. You can spend the rest on your lifestyle without guilt or worry.



obligations, so be cautious about waiting to save until the timing is **right**. *I can save when the car is paid off. I'll save once the hockey season is over. I'll be able to save after I get my next raise at work.* Just start ... and increase your savings rate over time. The best time to start saving was **before**; the second best time is **now**.

SAVING VERSUS INVESTING

Saving and investing are cornerstones of financial management. Saving and investing are terms often used interchangeably, but more accurately they are related but independent processes. There are differences between saving and investing in terms of degree of risk, rate and stability of return, accessibility of funds, and protection against inflation.

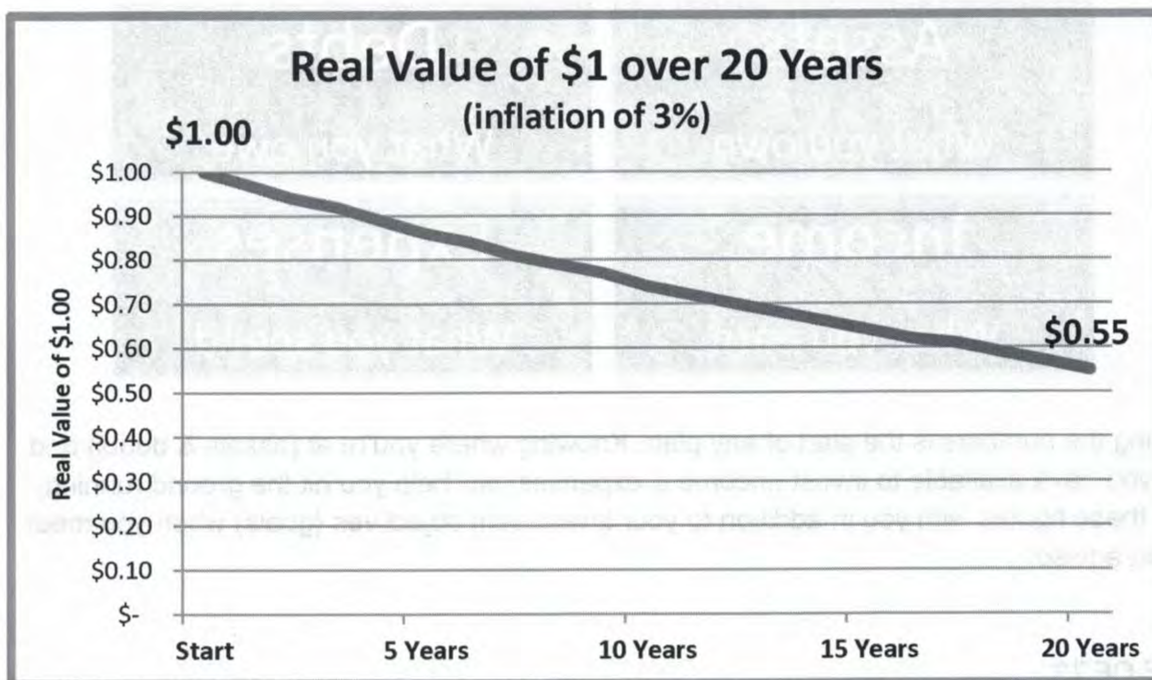
Think of **saving** as parking cash in a safe and liquid (accessible) account or product (also called a security). Safe means that it has a guaranteed rate of return and that the savings is protected by deposit insurance through either a federal or provincial deposit insurer. Most Canadian chartered banks, loan and trust companies, and federally-regulated credit unions and associations are Canada Deposit Insurance Corporation (CDIC) members. Member institutions are listed on CDIC's website (www.cdic.ca). Alberta's deposit insurer is Alberta Credit Union Deposit Guarantee Corporation (www.cudgc.ab.ca). The Financial Consumer Agency of Canada (www.fcac.gc.ca) provides links to deposit insurers for other provinces.

Federal or provincial deposit insurers protect most, but not all types of savings. Check with your institution or deposit insurer to see if specific accounts and products are covered.

Protected	Not Protected
• Savings Accounts • Chequing Accounts • GICs and term deposits • Deposit insurers have different rules and limitations	• Mutual Funds • Stocks • Bonds • Treasury Bills

Saving is for short-term needs, such as setting aside money for upcoming expenses, emergency funds, and for capital preservation (preventing a decrease in value). The greatest enemy of our savings is inflation. If your savings is not earning a rate of return equal to or greater than the rate of inflation, then the real value of your money is shrinking over time. This is not a big issue if you're setting aside some money for a vacation in 6 months, but over the long term, low rates of return on your savings hurt your buying power. Imagine you put the money you would need to purchase a cup of coffee in your mattress. Ten years from now, do you think

that money would be enough to buy that coffee? Probably not – it may only be enough to buy the empty cup. That's the effect of inflation – it erodes the value of money. The following graph shows the effect on the "real value" or "spending power" of your money if you kept it in your sock drawer or in a basic savings account, which typically has a rate of return near 0%. If inflation is assumed to be 3% per year, a dollar today would only worth 55 cents or 45% less after 20 years. Your dollar is still a dollar, but you can't buy as much with it. You need to make your savings work hard enough to keep up with inflation.



The primary goal with your savings is to beat, or at least match, inflation. With that in mind, your goal is the highest interest rate you can find, with the lowest fee structure and ideally, no fees at all. A quick source to research savings options is through www.ratesupermarket.ca. You can search for bank accounts and GICs with the highest rates of return based on the amount of money you have to save.

Investing is taking capital (money) and purchasing an asset that you hope will produce a reasonable rate of return over time, which is higher than inflation, building your wealth. With investing the target is growth.

"How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case."

~ Robert G. Allen

There is a wide range of products for an investor to consider as part of an investment portfolio and several ways to access investments for purchase. Increasing your investment knowledge

can set you up for a more positive and interactive relationship with a financial advisor. If you really have an interest, you can definitely educate yourself to manage your own investment portfolio. The next section talks about a few investing fundamentals.

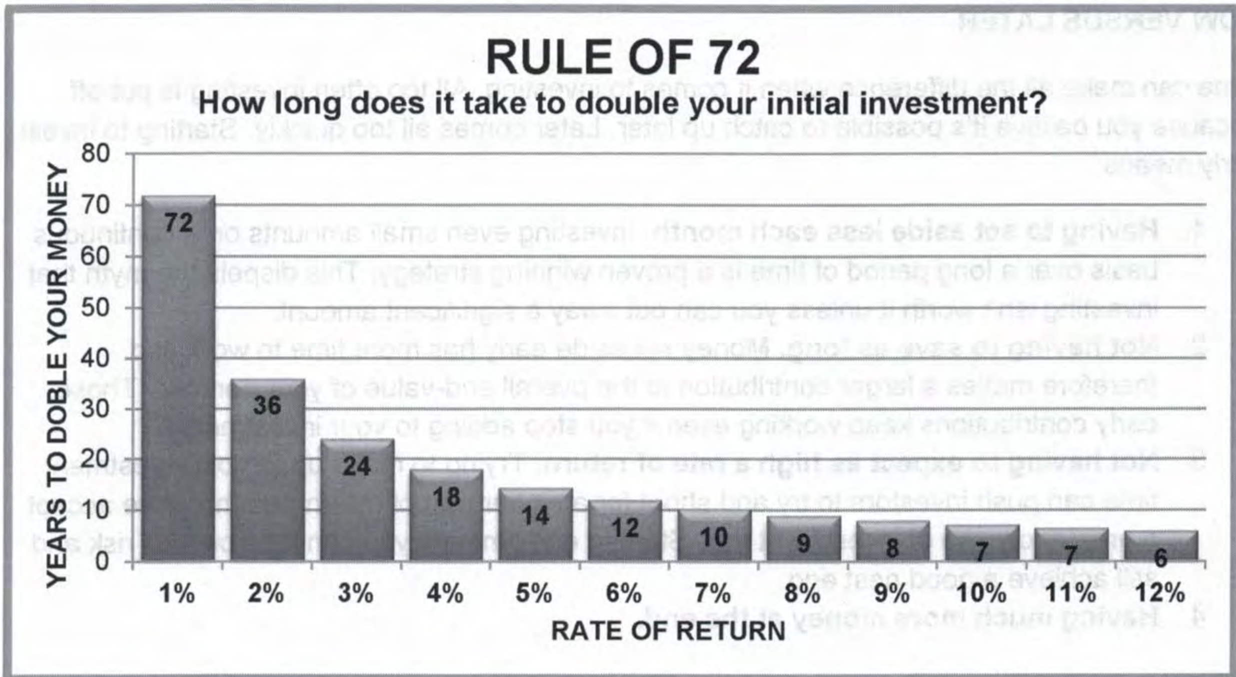
BEGINNING AT THE BEGINNING – KNOWING YOUR NUMBERS

To start an investment plan you need to identify 4 key numbers:

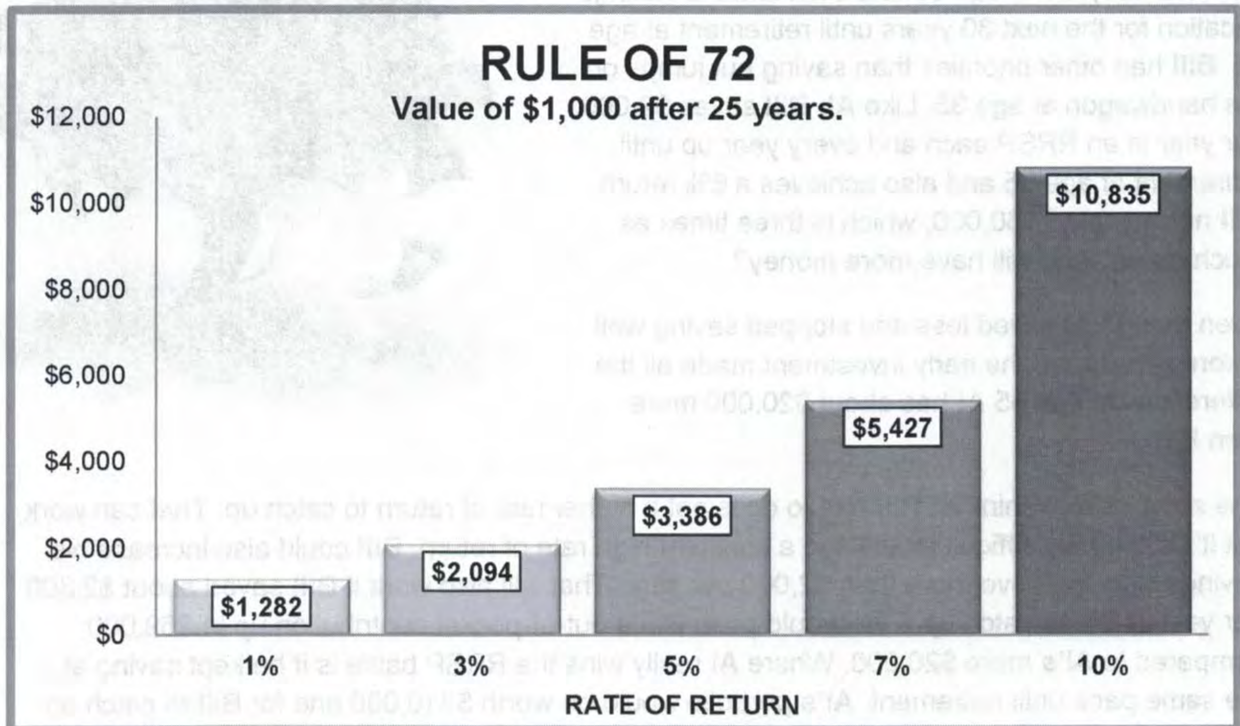
Running the numbers is the start of any plan. Knowing where you're at (assets & debts) and what you have available to invest (income & expenses) will help you hit the ground running. Have these figures with you in addition to your investment objectives (goals) when you meet with an advisor.

RULE OF 72

Albert Einstein has been credited for discovering the financial principle of compound interest. He considered it his greatest discovery, referring to it as the **most powerful force in the universe**. It's not magic, but integral to achieving a significant nest egg. Compound interest is when interest is earned on both the principal (original balance) and the interest it already earned. So, it's interest on interest on interest. The **Rule of 72** is a quick and fairly accurate way to determine how long it will take to double your money. You can use this rule for savings, but it also works on your debt. Compound interest is your ally in investing, but works against you with debt. Divide 72 by the rate of return you can get on your money and the result will tell you the number of years it will take to double your money. With a return of 10% your money would double in a little over 7 years ($72 \div 10\% = 7.2\ \text{years}$). Returns of 6% will double your money in 12 years ($72 \div 6\% = 12\ \text{years}$). The rate of return has an enormous impact on the growth of your investments.



Once you know how long it takes for your money to double and how long your money will be invested, you can estimate the future value of your savings. The chart shows the vast difference in the value of your savings based on rate of return. The higher the rate of return you want to get, the higher the degree of risk you must accept.



NOW VERSUS LATER

Time can make all the difference when it comes to investing. All too often investing is put off because you believe it's possible to catch up later. Later comes all too quickly. Starting to invest early means:

1. **Having to set aside less each month**. Investing even small amounts on a continuous basis over a long period of time is a proven winning strategy. This dispels the myth that investing isn't worth it unless you can put away a significant amount.
2. **Not having to save as long.** Money set aside early has more time to work and therefore makes a larger contribution to the overall end-value of your portfolio. Those early contributions keep working even if you stop adding to your investments.
3. **Not having to expect as high a rate of return.** Trying to make up for lost investment time can push investors to try and shoot for a higher rate of return and therefore accept a greater degree of investment risk. Starting early means you can take on less risk and still achieve a good nest egg.
4. **Having much more money at the end.**

Consider the tale of two brothers, **Al** and **Bill**. **Al** heard investing was important and starts to invest at the age of 25. **Al** saves $2,000 per year in an RRSP and achieves a rate of return of 6% per year. **Al** has invested $20,000 at age 35 and then takes a savings vacation for the next 30 years until retirement at age 65. **Bill** had other priorities than saving but jumps on the bandwagon at age 35. Like **Al**, **Bill** saves $2,000 per year in an RRSP each and every year up until retirement at age 65 and also achieves a 6% return. **Bill** has invested $60,000, which is three times as much as **Al**. Who will have more money?

Even though **Al** saved less and stopped saving well before retirement, the early investment made all the difference. At age 65 **Al** has about $20,000 more than **Bill**.

The sceptics may think all **Bill** has to do is get a higher rate of return to catch up. That can work, but it's extremely difficult to achieve a constant high rate of return. **Bill** could also increase his savings rate and save more than $2,000 per year. That will also work if **Bill** saved about $2,300 per year at 6% to catch up. This would push **Bill's** out-of-pocket contribution up to $69,000 compared to **Al's** mere $20,000. Where **Al** really wins the RRSP battle is if he kept saving at the same pace until retirement. **Al's** portfolio would be worth $310,000 and for **Bill** to catch up he'd need to get a return of almost 10% per year or save about $4,000 per year. It's never too late to start investing, but earlier is definitely easier.

Saving Now versus Saving Later

* Using 6% growth

RISK TOLERANCE AND RISK CAPACITY

You need to understand both your **risk tolerance** and **risk capacity** before you invest. Together these measures help guide the appropriate level of risk for your investment portfolio.

Risk Tolerance is the degree of risk an investor is comfortable shouldering. Another way to look at it is the amount of uncertainty the investor is willing to bear. It's the upset tummy test. It is primarily an emotional gauge of what you can handle based on your situation, but it is also affected by your age, your financial resources, and your investment objective. Choosing investments that go beyond your comfort can result in unreasonable stress, anxiety and even sleepless nights. This is one of the factors analyzed in a client investment questionnaire when you work with an advisor.

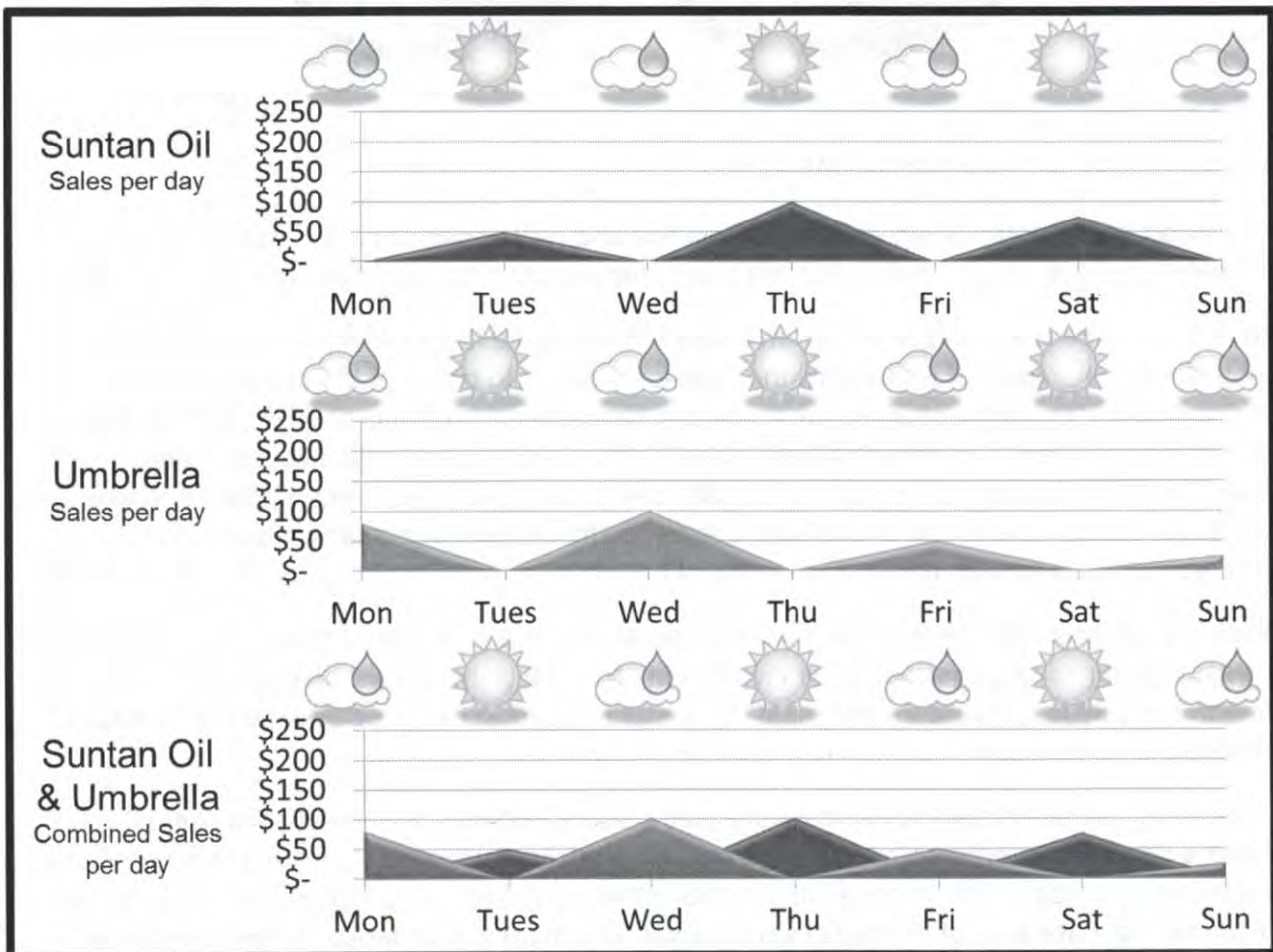
Risk Capacity is different than risk tolerance because it is a measure of the amount of risk an investor needs to take to achieve the investment objective. Advisors will often use sophisticated financial planning software to determine the amount that must be saved and the rate of return required to have enough money to accomplish the goal.

A person's risk tolerance and risk capacity may present a challenge if they do not align. If you need a 6% return in order to have a large enough portfolio, but you are unwilling to employ an investment strategy with the potential to achieve that return, you may face an even bigger risk. You may not have enough money down the road. The more you know about how the market works, the more comfortable you can become with tactical investment risk.

DIVERSIFICATION

Diversification is an investment strategy to reduce investment risk and increase yield through ownership of a wide variety of investments in your portfolio. The rationale behind this technique is that by owning a number of different types of investments, which can do well at different times, regardless of what the economy does, part of your portfolio will be making money. Since you can't predict what will do well, having diversity in your portfolio increases your chances of investment growth. It's unlikely every investment in your portfolio will increase in value at the same time, so it also means you are shielded from all of your investments going down at the same time.

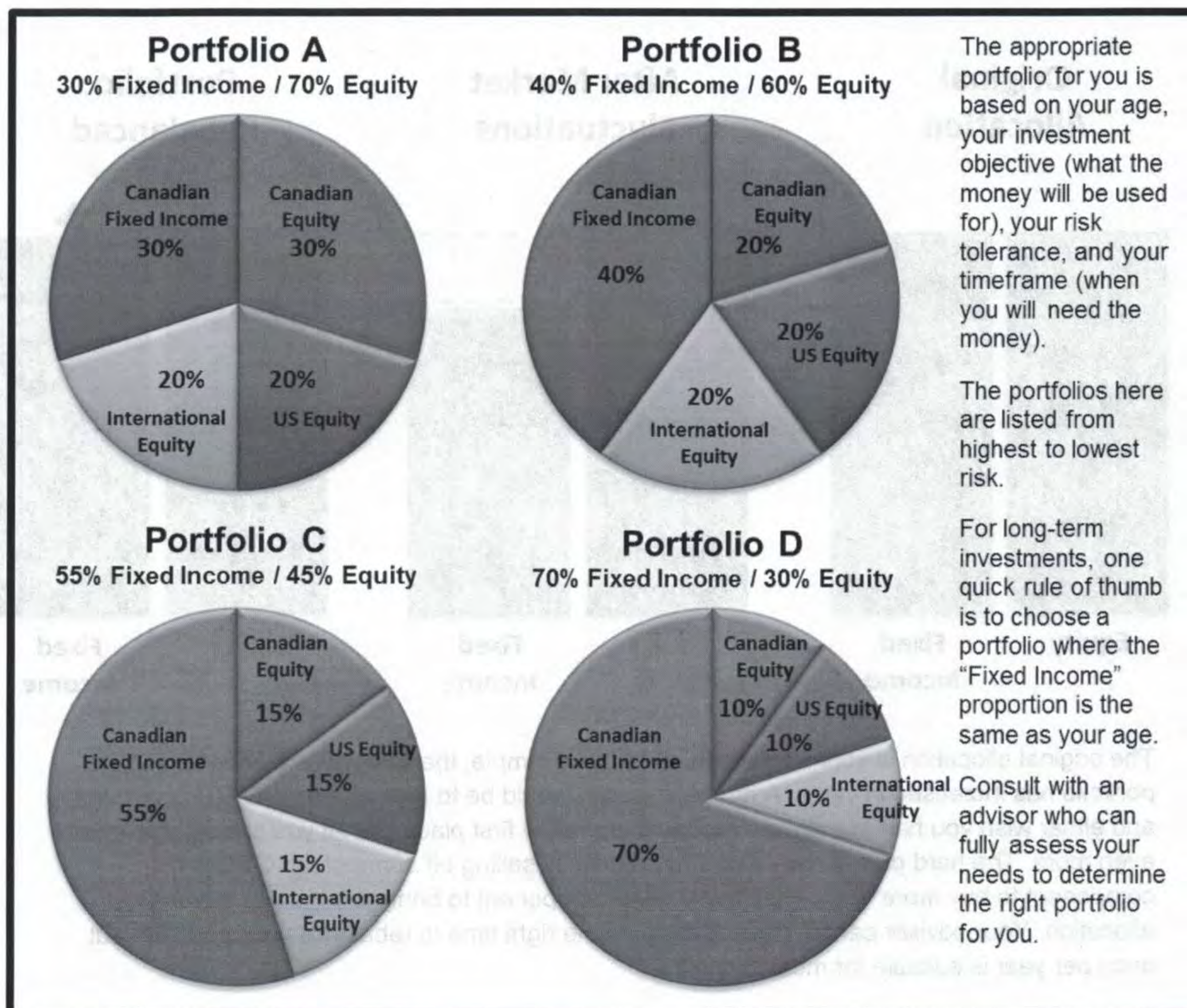
Take a look at the following simple illustration of diversification. Imagine that the only two investments you were considering were the Suntan Oil Company and the Umbrella Company. The track record of the Suntan Oil Company shows it makes money, but only on sunny days. The Umbrella Company only has good sales when it rains. If you own only one of these investments you would experience a lot of volatility – all your eggs are in one basket. As the final image shows, by owning both companies, you as the shareholder make money no matter the weather. In this example, owning both companies smoothes out the effect of the weather.



Diversification can be among higher risk and lower risk investments (e.g., stocks and bonds), among market sectors (e.g., technology and resources), or among regions (e.g., Canadian and International). In a properly diversified portfolio, the positive performance of some investments will offset the negative performance of others.

CHOOSING YOUR PORTFOLIO

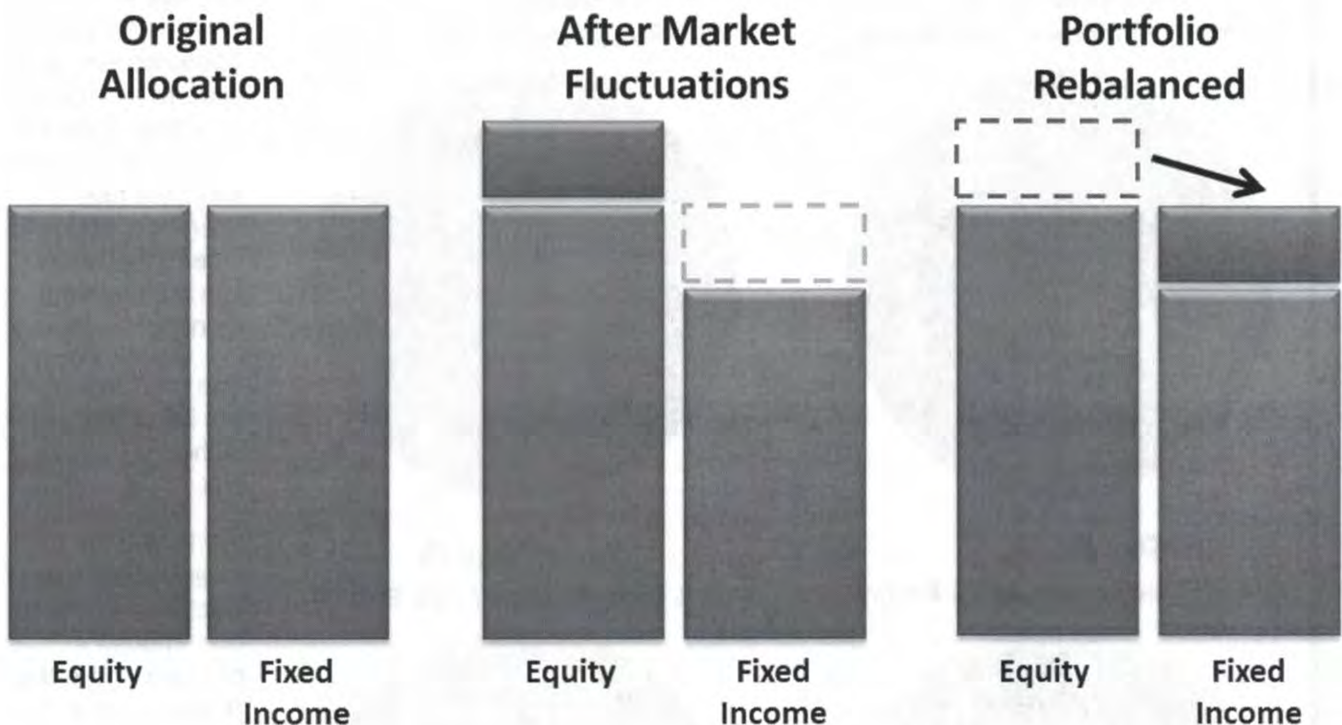
When you build your portfolio of investment assets, you and/or your advisor will pick the proportions of each asset – also called asset allocation. Most advisors will assess your portfolio needs by having you complete a Client Investment Questionnaire and an investment industry standard Know Your Client Questionnaire (KYC). The results of the data gathering assist in defining the right balance of investments. The kinds of data collected include the client's risk tolerance, risk capacity, investment knowledge, and financial position.



Often the results of the Client Investment Questionnaire will depict an asset allocation (portfolio) in the form of a pie chart. Each slice of the pie represents an asset class (type of investment). Examples of investment portfolios follow and each has a different degree of risk. The risk level of your portfolio needs to correspond with your age, investment objective, risk tolerance, risk capacity, and your timeframe. To learn more about the types of investments available visit www.getsmarteraboutmoney.ca.

REBALANCING YOUR PORTFOLIO

The assets you hold in your portfolio will change in value over time. These changes can put your original allocation out of whack. Rebalancing your portfolio involves periodically buying or selling assets to return to your planned asset allocation. The following example with a simplified portfolio of only two asset classes illustrates this theory. This can be one of the challenging parts of investing because it may conflict with what your gut is telling you.

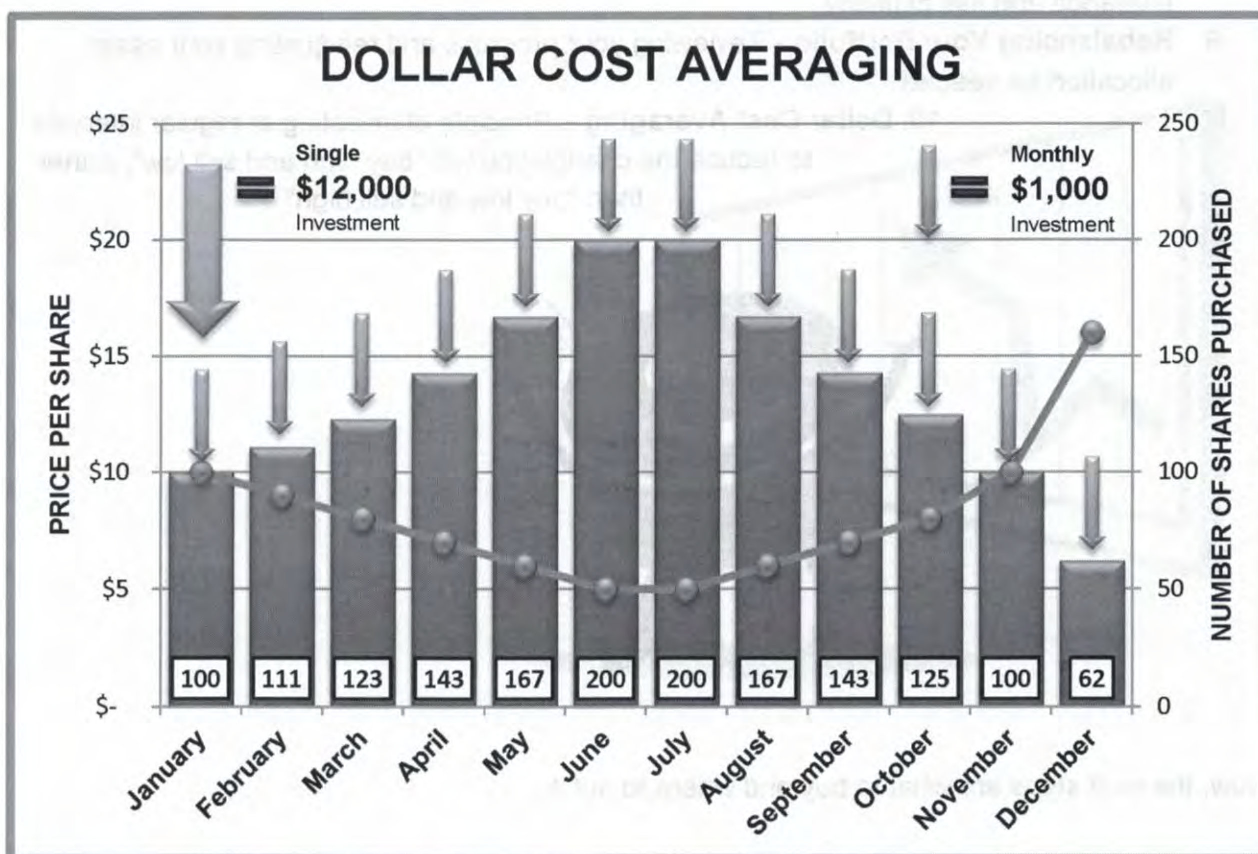


The original allocation is your starting point. In this example, the GROWTH component of the portfolio has increased in value. A natural reaction would be to look at the GROWTH component and either wish you had put all your money there in the first place or that you should now invest even more. The hard part of rebalancing a portfolio is selling off some of the GROWTH component to buy more of the FIXED INCOME component to bring you back to the original allocation. Your advisor can help you determine the right time to rebalance your portfolio, but once per year is suitable for most investors.

DOLLAR COST AVERAGING

Dollar Cost Averaging is an investment principle where you invest at regular intervals regardless of the market conditions. The number one financial rule is "buy low, sell high". The problem is it's difficult, if not impossible, to time the market to tell use when is the right time to buy. The purpose of dollar cost averaging is to reduce market risk and increase investment returns by allowing the purchase of more shares when the price is low and preventing an investment of a large lump sum when the price is very high. Think of shopping. If your favourite brand of toilet paper is on sale, you stock up. You can purchase more rolls of toilet paper on sale than you can at full price. Investments work the same way.

In the scenario below, the investor has the option of making a lump sum investment at the beginning of the year of $12,000 or an investment each month of $1,000. The question is which option will result in a greater rate of return. The trendline running across the chart shows what the price per share was at the time of the purchase. When the price per share is higher, she can purchase fewer shares. Notice the investment initially fell in value, but ended the year up $6 per share. Each bar in the graph represents the number of shares the investor was able to purchase that month with $1,000. If she had purchased $12,000 worth of shares in January at a cost of $10 per share, she would own 1200 shares at the end of the year worth $19,200. By dollar cost averaging with $1,000 per month, she would have been able to purchase a higher number of shares overall. At the end of the year, she will have invested the same amount, $12,000, but will own 1643 shares worth $26,228 – a significantly higher return on her investment.



ARMED WITH THE FUNDAMENTALS

You now have a handle on these basic fundamentals of investing:

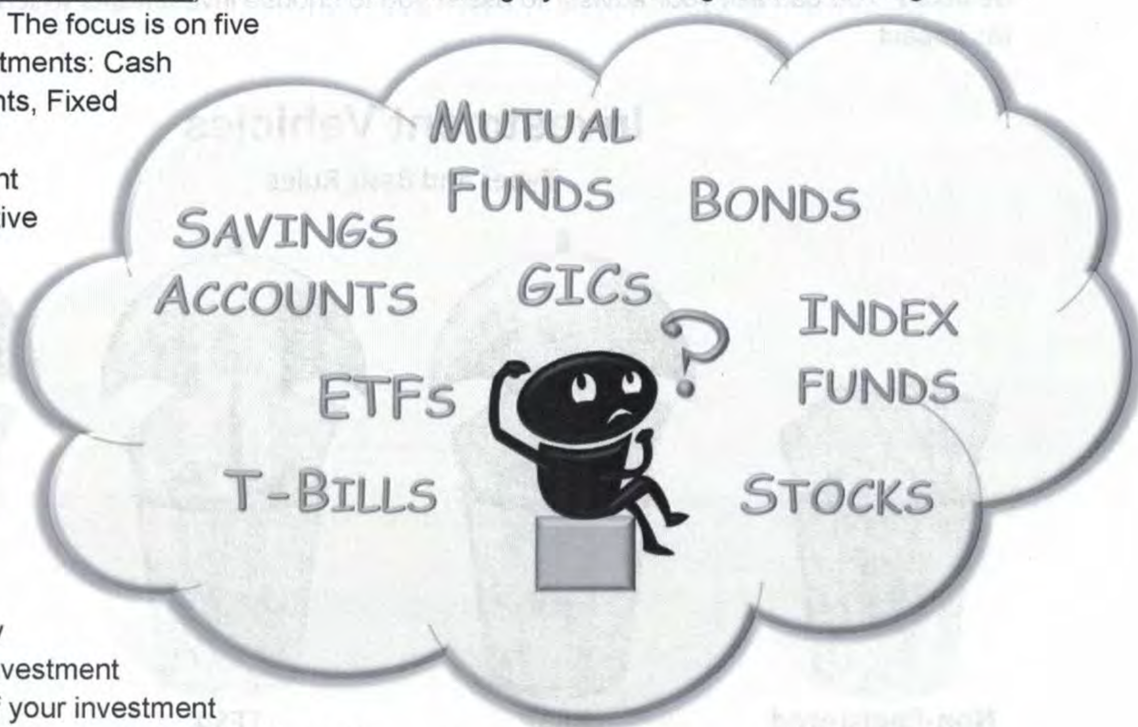
1. **Pay Yourself First** – Setting aside a percentage of your income for saving/investing before you do anything else.
2. **Saving versus Investing** - Parking cash in a safe and accessible account or product for short-term needs and capital preservation versus investing capital to build your wealth over the long-term.
3. **Knowing your numbers** - Making sure you know where you're starting in terms of income, expenses, assets and debts.
4. **Rule of 72** - Importance of getting a reasonable rate of return and using the Rule of 72 to estimate how long it will take for your money to double.
5. **Now versus later** – Investing as early as you can makes it easier to accumulate your nest egg. More time means you can save less, take on less risk, and still succeed with a larger portfolio in the end.
6. **Risk Tolerance and Risk Capacity** – Understanding the amount of risk you can stomach compared to the risk you must take as an investor to reach your goal.
7. **Diversification** - An investment strategy to reduce investment risk and increase yield by spreading your money across a range of investments in your portfolio.
8. **Choosing Your Portfolio** - You and/or your advisor designing a portfolio where the mix of assets (stocks & bonds) makes sense for your investment objective, timeframe, risk tolerance and risk capacity.
9. **Rebalancing Your Portfolio** - Reviewing your progress and readjusting your asset allocation as needed.
10. **Dollar Cost Averaging** – Principle of investing at regular intervals to reduce the chance you will "buy high and sell low", rather than "buy low and sell high".

Now, the next steps are what to buy and where to put it....

WHAT CAN YOU BUY?

There isn't a much more daunting question than what to buy and hold in your investment portfolio. The types of investments available are vast. Having a professional advisor can be a big advantage when navigating the investment marketplace.

To educate yourself on your options, comprehensive information can be found on the Canadian Securities Administrators website in a publication called ***Investments at a Glance*** (www.securities-administrators.ca). Each investment category from savings bonds to hedge funds is described. The focus is on five categories of investments: Cash and cash equivalents, Fixed income securities, Equities, Investment funds, and Alternative investments. Investments vary in terms of returns, risks, and costs and need to be evaluated based on your individual situation.



You can hold many different types of investment products in each of your investment vehicles (some of which are outlined in the next section). Advisors, dealers and institutions are each licensed to sell certain types of investments, so the investment options available to you is governed by those licenses. For example, an advisor who is a member of the Mutual Fund Dealers Association of Canada (MFDA) is licensed to sell mutual funds. An investment firm under the Investment Industry Regulatory Organization of Canada (IIROC) can sell stocks to investors. Ask any potential advisors what types of investment products they are licensed to offer.

WHERE DO YOU PUT IT?

The simplest way to explain the options of where you can stash your investments is to visualize a serious of buckets. Each of these buckets is a place to hold investments; they are not investments themselves. You <u>buy</u> an investment, but you <u>hold</u> it in one of several investment vehicles. For example, you don't <u>buy</u> an RRSP, per se; you <u>hold</u> an investment <u>in</u> an RRSP. Examples of investment vehicles include: Registered Retirement Savings Plans (RRSPs), Tax-Free Savings Accounts (TFSAs), Registered Education Savings Plans (RESPs), and Non-registered Investments (also referred to as Open Investments).

Three of the four buckets illustrated have umbrellas over them. The umbrella symbolizes a tax shelter. The investments held in these buckets grow tax-sheltered. Canada Revenue Agency can peek in the bucket, so it knows what is there, but the structure means income tax is not eating away at the value of the investments. This allows them to grow more quickly. Try the TFSA versus Taxable Calculator to see the difference (http://www.lifestylecalculators.com/tax-free-savings-account-tfsa/) a tax-sheltered vehicle makes to the value of your investment.

The non-registered bucket does not have the benefit of a tax shelter, so investment growth will be taxed. You can ask your advisor to assist you to choose investments which will minimize the tax impact.

RRSPs are an investment vehicle with three jobs: Retirement, Home Buyers' Plan, and Lifelong Learning Plan.

- Retirement - The main purpose of an RRSP is to hold investments for retirement. Contributions to an RRSP are tax-deductible at your current tax rate, but the funds are taxed on withdrawal when your tax rate could be lower. The investment growth is tax-sheltered. - http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/rrsp-reer/rrsps-eng.html
- Home Buyers' Plan (HBP) – This federal program allows you to "borrow" funds, up to certain limits, from your RRSP to use for the purchase of your first home. - http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/rrsp-reer/hbp-rap/

- Lifelong Learning Plan (LLP) – This federal program allows you to "borrow" funds, up to certain limits, from your RRSP to use to go back to school. - http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/rrsp-reer/llp-reep/

TFSAs are tax-sheltered, flexible vehicles which can be used for a variety of purposes, such as emergency savings, short-term savings, supplementing retirement, etc. Contributions to a TFSA are not tax-deductible, but withdrawals are completely tax-free. - http://www.cra-arc.gc.ca/tfsa/

RESPs are tax-sheltered, investment vehicles to save for your children's education. Contributions are not tax-deductible, but government grants on contributions are available up to prescribed limits. Growth, not contributions, is taxed in the hands of the student at the time of withdrawal. Individual, Family, and Group plans are available. - http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/resp-reee/

For even more information on RRSPs, TFSAs, and RESPs check out the links below.

HELPFUL RESOURCES

Get Smarter About Money – www.getsmarteraboutmoney.ca

Get Smarter About Money is a project of the Investor Education Fund which is a non-profit established by the Ontario Securities Commission.

> *"Develops and promotes unbiased, independent financial information, programs and tools to help consumers make better financial and investing decisions."*
>
> *~ Investor Education Fund*

Canadian Securities Administrators – www.securities-administrators.ca

Investment tools to assist consumers to understand investment basics, investment options, work with financial advisors, and fraud protection.

> *"The CSA Investor Education Committee is comprised of representatives from the provincial and territorial securities regulators who provide information and education to help investors make appropriate investment decisions and recognize, avoid and report fraudulent investments. The Investor Education Committee also conducts investor research and provides free downloadable brochures for investors.*
>
> *~ Canadian Securities Administrators*

Alberta Securities Commission - http://www.albertasecurities.com

Educational tools and resources to assist investors including: budget & planning tools, money-saving tips, investment types, risk tolerance, and finding a financial adviser. Search tools check if your financial advisor or firm is registered.

> *"The ASC is the regulatory agency responsible for administering the province's securities laws. It is entrusted to foster a fair and efficient capital market in Alberta and to protect investors."*
>
> *~ Alberta Securities Commission*

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