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## Family file revisited: Case 2 - April/08

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### Case 1-November 2007

#### Will the Blitts ever be able to help their daughter buy a home?

**Then:** Back in the spring, Ottawa residents Kevin and Linda Blitt's biggest financial concern was the upcoming nuptials of their 27-year-old daughter, Jennifer, and her fiancé, Bill. It wasn't the fact that weddings are expensive that was troubling the Blitts. What they really wanted to do was help Jennifer and Bill by giving or lending them \$20,000 for a down payment to buy their first home. Making matters more urgent was Rover, Jennifer and Bill's aging, incontinent beagle. It was just getting too difficult to keep the poor dog in their high-rise apartment, with his increasingly frequent needs to dash outside to relieve himself.

Given that Kevin and Linda - age 52 to and 48 - were only two years away from paying off the mortgage on their home, and that they had an income of more than \$150,000, they figured they would be able to afford to help the kids. The question was, how? For starters, they were concerned about potential tax implications of transferring so much money. More generally, they were concerned about the strife that making large loans within families can cause, and whether Jennifer and Bill would be able to pay it back within eight years, when Kevin hits 60, his target for retirement.

Despite their concerns, the Blitts developed three options for helping Jennifer and Bill buy a home: (1) Lend them \$20,000 and co-sign the mortgage; (2) buy a home and rent it to Jennifer and Bill with a view to selling it later and giving after-tax equity growth to the young couple as a gift; (3) be lavish and give Jennifer and Bill a \$20,000 gift and a \$20,000 loan, so that they'd have a smaller mortgage and an easier time paying back the loan. The Blitts' question: Which option was best?

**Now:** After reviewing the Blitts' situation back in April, financial planners Margaret Cameron and Marc Lamontagne were both struck by what they considered a major oversight. Kevin and Linda had come up with a handful of scenarios for how they might help their daughter and her fiancé, but they hadn't factored in how such a gift or loan

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would impact their ability to save for a retirement that was only eight years away. Both said the Blitts should be focused on building up their savings, not giving their money away. "They're at a crucial time in their lives," Lamontagne said, adding that the euphoria of paying off a mortgage can lead to a false sense of financial security.

Given the historic dive markets have taken in recent months, and the damage it could have done to the Blitts' \$500,000 portfolio, Cameron's and Lamontagne's concerns are that much more compelling. "Since they don't have pensions, I hope the Blitts have a good portion of their RRSPs in low-risk guaranteed investments," Cameron says. "The low-risk investments are the base on which their other investments rest."

Kevin and Linda did not provide details of their asset mix for our article, but if their portfolio is weighted toward equities, it could be off 30% or more this year and will take considerable time to rebuild. But even if they've been more conservative and have sustained few investment losses, they still have a lot of saving to do. Both Lamontagne and Cameron made this point in April, and their opinions have not wavered. The problem is that, even with a net worth at the time of roughly \$850,000 when you include their home, the Blitts assets aren't likely to have enough savings to carry them through retirement with their lifestyle intact. Cameron estimates they'll need more than \$1 million in savings if they are to stop working in eight years, with an income of \$50,000 annually into their 90s. In other words, the Blitts have to basically double the value of their portfolio - and that's assuming they've already invested conservatively and have been spared the market pain. "If they're all in high-risk investments, they're going to have to keep working for a long, long time," Cameron says.

But what if the Blitts had been conservative all along? Would they be able to give Jennifer and Bill an assist with their home? It's doubtful, at least as far as Cameron is concerned. She had little enthusiasm for the plan back in April, saying that the best scenario she could develop involved having the Blitts buy a house and then rent to the kids at low-end market rate. That way, Jennifer and Bill would have an easier time saving their own money for a down payment, and the Blitts would be able to deduct any losses due to lower rent from their income taxes. Today, she's every bit as concerned. Giving or lending \$20,000 to Jennifer and Bill means they'll be saving less, and that could damage their retirement savings, "especially since interest rates are dropping and the market is down so much."

Lamontagne, meanwhile, was more optimistic in his original analysis. He suggested that the Blitts look at the possibility of giving their daughter and her fiancé a \$20,000 gift and a \$20,000 loan. Jennifer and Bill could then deposit all the money in RRSP accounts. Ninety days later, they'd be free to withdraw the funds for a down payment under the federal Home Buyers Plan. That way, they'd have a substantial down payment, lowering mortgage costs, and a substantial tax return that they could use to knock down a major portion of the debt to the Blitts.

Lamontagne says this option is still worth investigating, although he now advises the Blitts to wait for markets to recover before deciding to follow through. "The money would have to come out of their investment account," he says. I would not recommend selling anything while the markets are down."

Additionally, Lamontagne says that since the Blitts' priority should be saving for retirement, they should consider leverage, that is, borrowing to invest. With the markets battered and interest rates falling, this is likely the best opportunity they'll have before retirement to buy low," he says. "So as long as they are comfortable with volatility, this is something they should consider." Better yet, when markets recover - and Lamontagne says they have never not recovered - the Blitts will then have the funds to make a gift or loan to their daughter from the profit on their investments.

Borrowing to invest can be risky, especially if markets continue to fall. But even Cameron - who calls herself a conservative adviser - says the strategy is worth investigating in the Blitts' situation. "Leverage is always an option," she says. "But it depends on the people - the sleep factor. If they're not sleeping because of the state of their RRSPs, then it might not be for them. But 10 years out, it can be worth it." Another advantage of leverage, she adds, is that the loan repayments are like a forced savings account for people who are tempted to spend money.

Whatever the Blitts choose to do now, however, both Lamontagne and Cameron say their original advice is every bit as relevant today as it was back in April: Giving gifts to your children is a wonderful thing, but for Kevin and Linda the first priority should be ensuring they've saved enough money to fund their retirement.

### **Case 3-December 2007**

#### **The Comries have been great savers. Are they still on track?**

**Then:** Matthew and Beatrice Comrie were sitting in the proverbial catbird seat when they volunteered to be Family File subjects in our December issue. The Calgary couple, both MBA-educated, had already accumulated savings and investments worth more than \$1.3 million - and they were still in their mid-40s. But for all their success as savers and investors, the Comries still felt that they had several financial loose ends that needed to be tied up.

The Comries, for example, were sitting on a cash savings account that had ballooned to \$175,000, representing about 15% of their entire portfolio. Matthew, an energy executive who looked after the couple's investments, knew that this sum was far too large to hold as a passive investment. But what to do with it? Both he and Beatrice were not interested in putting it into the stock market. Equities already accounted for 62% of their portfolio, and that was the maximum amount of risk they were willing to take. The Comries toyed with the idea of using the money to buy a rental property, but they had serious reservations. "You hear about people that make all this money in real estate, but what a hassle," Beatrice remarked at the time, imagining days filled with the headaches of collecting rent, fixing broken appliances and resolving disputes with tenants. In addition to the amount of their cash savings, the Comries were concerned about the RESPs they had set up for the education of their three children. Those accounts were already worth \$116,000, and Matt had begun to wonder if that was sufficient. Both he and Beatrice certainly had ideas about other uses for the money. After all, they had been disciplined savers for many years, and they were ready to splash out a little - mainly on travel as a preview of the retirement lifestyle they hoped to achieve in 10 years' time. Could they afford to give themselves such a break?

**Now:** It comes as no surprise that John Amonson, the Calgary financial planner who led the review of the Comries' scenario, was very pleased with the skill and discipline they had already brought to their financial planning when he first looked at their case. Sure, they faced issues that they needed to resolve. But on the whole, they were well on track to meet most of their goals. That assessment still holds, and Amonson says there's little in his advice that he'd change if the Comries approached him today.

To begin, he still believes that the Comries have nothing in particular to gain from investing their cash savings in a rental property, even though real prices have softened in the city and the market may have become more favourable for buyers. Back in December, he suggested they look at mortgage investment corporations as an alternative. Mortgages may be getting bad publicity these days but, as Amonson notes, investment corporations can be simple and profitable diversification tools when they are well run and responsible with their lending.

But really, Amonson continues, the Comries should be focused on choosing between individual investments right now. In light of the economic and market turmoil, he says their main focus should be on their overall asset mix. This recommendation comes from the very core of Amonson's financial planning philosophy. His overarching advice to clients is to set benchmarks for the various asset classes in their portfolios. Those benchmarks will vary between individuals, but once they're established they should be monitored to ensure they are being met. If one benchmark increases above its threshold - say a person decides they want 50% of their assets in equities - then some assets in the class should be sold once the benchmark is met. When a class falls under the benchmark, then you buy to bring it back to the correct level. Over time, this becomes a simple method of ensuring that you're always selling assets when prices are strong and buying when they are weak. "I've seen the concept work over and over again," Amonson says. "There's no hocus pocus and my clients get it."

Given this approach, the Comries should probably start by looking at the value of their equities. If they have a goal of holding 62% of their portfolio in stocks, it's almost certain that they've fallen far below this benchmark. This might be a time for them to refocus their efforts on buying equities - something that will be easy to do if they still have their substantial cash savings. After that, they should look at their other asset classes, review where they stand relative to benchmarks and adjust accordingly.

Next up for the Comries is the issue of their RESP accounts. Originally, Amonson advised them to keep saving - whether in RESPs or other instruments, such as informal in-trust accounts - since education costs are always increasing. That advice holds. And if the Comries' education savings were heavily weighted in equities, they might do well to save even more, Amonson says, as such investments may not have time to recover in value before the kids start their post-secondary educations. "I see people continually make the mistake of taking on too much risk in their RESPs," Amonson says. "They just don't realize that they haven't got the time horizon."

Last, Amonson recommends that the Comries continue to monitor their finances as they pursue their goal of travel in advance of Matt's retirement. There's no particular reason why they shouldn't travel - just so long as the spending doesn't start cutting into other elements of their financial plan. If it does, they'll have to make choices, such as whether it's more important for Matt to retire in 10 years or whether they want to enjoy certain luxuries now. After that, Amonson says, the rest is up to them.

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