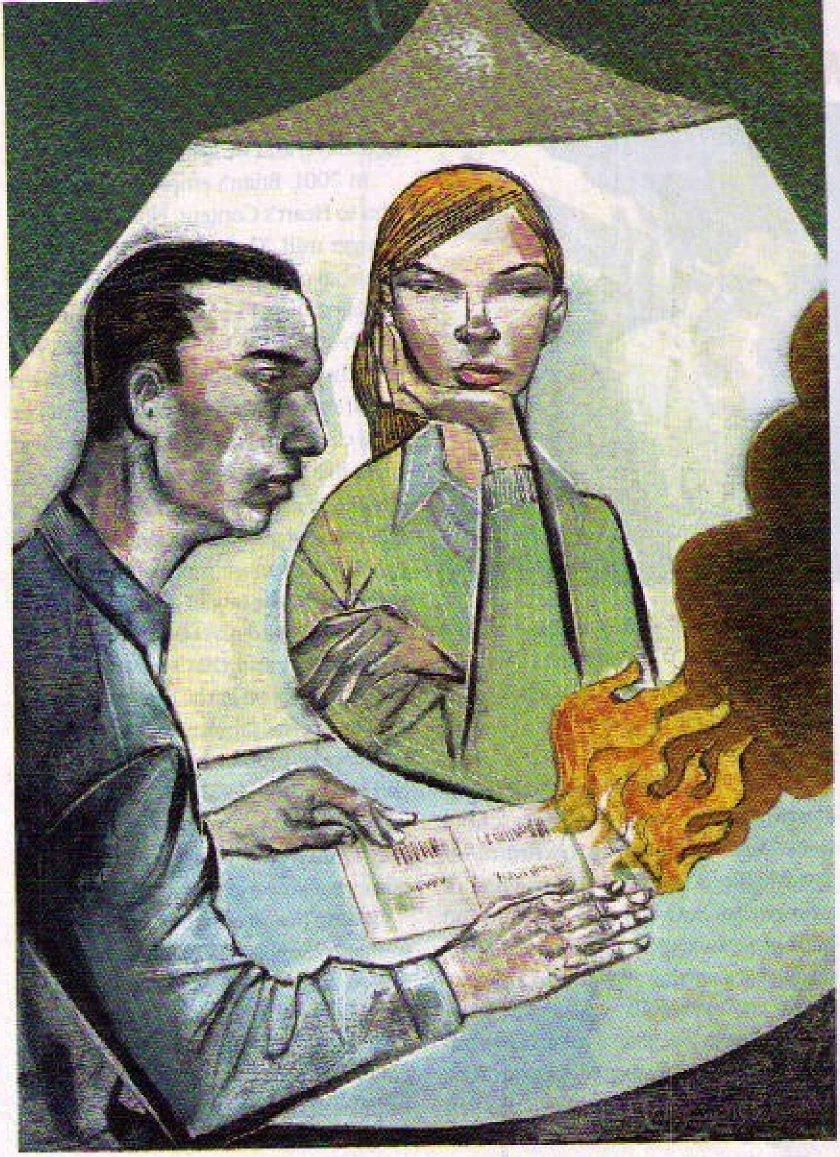
Planned to death

The Greens have lots of professional advice—and tons of debt to show for it

by Julie Cazzin



BRIAN AND PENELOPE Green are smart people. In fact, they have six university degrees between them. But as they sit at the kitchen table of their comfortable home in Heart's Content, Nfld., the young couple are at a loss to explain where their money is going. They earn a combined income of $185,000 a year, but can't make ends meet. "To show you how bad things are, we bounced a day care cheque this past month," says Brian. "Then to cover other expenses, we had to borrow $450 from our line of credit and take another $400 from our meagre savings."

The Greens (whose names we've changed) aren't spendthrifts. Both hold down responsible jobs—Brian, 36, is an engineer, while Penelope, 35, is a physiotherapist. They keep monthly statements that track every penny they spend on themselves and their two daughters, Lina, 5, and Rosemary, 3. But despite all their best efforts, their assets are declining while debt is creeping higher and higher. "We are clearly spending more than we are making," says Brian. "Meanwhile, none of our investments seem to be making us any money. We don't know what's wrong."

Brian is a natural comic, but even he finds it tough to chuckle when he recalls all of his failed efforts to take charge of his financial destiny. He started an investment club, but it dissolved after a few meetings, never having bought a thing. Then he read a contrarian's guide to buying stocks, but was never able to bring himself to actually invest in something. He talked to his brother about buying and flipping rental properties in Toronto, but they never got around to doing that either. "I'm not sure if I have analysis paralysis, confidence issues or, as we say in Newfoundland, I'm just stunned, but none of my plans has gone anywhere," says Brian. "We've wound up relying on others to manage our money and that, too, has been a disaster."

The Greens have worked with four financial planners in recent years, and they feel that they've been taken to the cleaners by all them. Thanks to their advisers, the Greens own a slew of underperforming mutual funds and lacklustre segregated funds (a type of investment fund sold by insurance companies). All those funds come with high fees and most of them are financed with investment loans that the Greens don't fully understand.

The Greens' last visit with a planner took place more than two years ago. Among other things, the adviser sold them $100,000 worth of segregated funds and arranged for them to take out a $100,000 loan to pay for the purchase. The Greens are still writing a cheque every month on that investment loan, but the funds themselves don't seem to be gaining much in value. "My Spidey sense tells me there is something inherently wrong with this," says Brian. "But we've succumbed to fast talk and, in all honesty, sometimes we feel that we are too far in to get out now."

The couple desperately wants to eliminate their $361,500 debt—$205,000 on the home they built six years ago, and $156,500 in personal debt. They also want to increase their savings. But every passing month leaves the Greens more worried. "We want a plan we can understand," says Brian. "We would like to say with confidence that our children's education will ➤

Illustration by JOE MORSE

be taken care of, that our house will be ours, and that our retirement will be something we can look forward to. Can our financial life be saved?"

BRIAN AND PENELOPE GREW UP IN Newfoundland and were high school sweethearts. Brian was the son of an RCMP officer; Penelope the daughter of a fisherman. Both did well at school and both of them loved university. Penelope completed a nursing degree, then a biology degree and a physiotherapy degree. Brian did a chemistry degree, then an environmental engineering degree, topped off by a master's degree. They finished school in 1997 with $48,000 in student debt.

They began paying off the debt as soon as they started working. Brian landed an excellent job in Thunder Bay, Ont., as a supervisor in a pulp and paper mill while Penelope found a position as a physiotherapist at the local hospital. Their combined income topped $100,000. "We rented a small apartment together and I put any extra money after our expenses toward the student loans," says Penelope. "We paid off everything in just a few years."

By 2000, the Greens were feeling downright affluent. Meanwhile, the stock market was booming and Brian decided it was time to get himself a piece of the action. That's when he met with his first financial planner. At the planner's suggestion, Brian took out a loan for $15,000, bought a clutch of mutual funds and deducted the interest on his tax return. "We had six to eight months of phenomenal returns and then we ate our hat when the technology sector crashed," says Brian. "Our adviser had us in 15 different funds, all of them very aggressive, and we lost half our money."

In 2001, Brian's employer transferred him to Heart's Content, Nfld., to manage a larger mill. The couple found another financial planner. This new planner consolidated their 15 mutual funds into five, which struck the Greens as sensible. But then they discovered she was only allowed to sell mutual funds associated with her fund company. Furthermore, she seemed more like a salesperson than a financial adviser. When the Greens asked her for a full financial plan, she responded by trying to sell them more mutual funds. "She wasn't up to the task of giving us a plan," says Brian. "She didn't talk to us about cash flow or debt and that's what we really needed advice on at the time."

The Greens' problems hit a peak when they decided to build their own home. They had scoured the local real estate market, but couldn't find anything they liked. So they figured they would build their own home, but keep a close eye on costs.

It didn't work out quite that way. "We went way over budget," says Penelope. "We rented while building and we got fussy about what the house should include. I know it sounds silly, but we became beguiled with picking out the tiles and the shingles. It was very bad for our finances." When all was said and done, the Greens owed $170,000 on their mortgage, $40,000 on their line of credit and $15,000 to their RRSP Home Buyers' Plan.

Money became even tighter in 2003 when their daughter Lina was born. Rosemary followed two years later. In 2005, they met their worst financial adviser yet. Their new planner, who was affiliated with a local bank, advised the Greens to consolidate all of their lines of credit and remortgage their home for $220,000. This would have been fine except that the planner also advised the Greens to borrow $100,000 from the bank and buy a basket of segregated—or "seg"—funds that the Greens later realized carried huge management fees, as much as 4% annually. The planner also convinced them to take out a $40,000 bank loan to buy aggressive, high-growth mutual funds. "It really screwed up our cash flow," says Brian. "We're paying $900 a month towards our loan payments but we don't have the money to contribute to RRSPs anymore. We've actually had to take money out of our retirement funds to make our monthly loan payment. So now we're getting older and our RRSPs are shrinking. It's scary."

The Greens worry constantly about their $100,000 seg fund loan. Brian admits he was infatuated with the idea of getting a tax break by borrowing money to invest, but is beginning to realize how hard it is to carry debt while the market is going down. "Penelope can't sleep at night," says Brian. "I'm worried, too. I would do just about anything to get out of our loans and seg fund contracts. We need to move on."

The good news is that Brian continues to shine at work and won a promotion that increased his salary to $126,000 a year. To ensure the extra money doesn't get frittered away, he and Penelope have set up automatic withdrawals from their paycheques. But the amounts they're saving aren't huge—$300 a month from Brian and $150 from Penelope—and even that is a struggle. Sometimes the Greens must dip into savings to make ends meet.

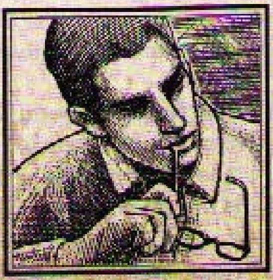
The Greens don't see how they're going to accomplish their goals of paying off their mortgage in 13 years and saving enough for their daughters' university education in 15 years. Their mutual funds and ➤

WHERE THEY STAND

Assets	
Home	$260,000
Brian's RRSP	23,980
Penelope's RRSP	40,372
RESPs	4,500
Segregated funds	108,000
Mutual funds	37,000
Chequing account	6,000
Savings account	2,100
1999 Acura	3,000
Trailer	14,000
TOTAL ASSETS	**$498,952**
Liabilities	
Mortgage (at 3.9%)	$205,000
Mutual fund investment loan (at 5.25%)	38,000
Credit card debt (at 19.97%)	500
Segregated funds loan (at 6%)	100,000
Trailer loan (at 5.75%)	18,000
TOTAL LIABILITIES	**$361,500**
Net worth (total assets minus total liabilities)	**$137,452**

Illustration by JOE MORSE

A revenue-boosting measure worth pondering



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HOW THE MONEY IS SPENT

Yearly Disposable Income	
Brian's income	$126,000
Penelope's income	59,000
Total income from salaries	**185,000**
Plus: Interest from mutual funds	+5,172
RRSP withdrawal	+1,500
Total gross income	**191,672**
Minus: taxes and deductions	-75,986
NET DISPOSABLE INCOME	**$115,686**
Debt Repayment	
Segregated fund loan	$7,680
Credit card	2,000
Mutual fund investment loan	3,600
Trailer loan	1,920
TOTAL DEBT REPAYMENT	**$15,200**
Shelter	
Mortgage (incl. property taxes)	$18,907
Home insurance	1,367
Electricity	4,434
Phone/cable/Internet	2,818
House cleaning services	1,750
TOTAL SHELTER	**$29,276**
Transportation	
Lease payments on van	$7,464
Car insurance	1,601
Gas	4,800
Maintenance	1,326
Trailer loan and insurance	1,932
TOTAL TRANSPORTATION	**$17,123**
Personal	
Groceries	$14,100
Day care	12,060
Professional dues	500
Vacation	3,200
Kids' activities	375
Haircuts	500
Gym memberships	725
Restaurants/entertainment	1,600
Gifts	5,000
Charity	600
Clothing/furniture	4,500
Life insurance	516
Miscellaneous	5,550
TOTAL PERSONAL	**$49,226**
TOTAL EXPENSES	**$110,825**
Total income minus total expenses	**$4,861**
Minus: automated savings plan deposits	-4,800
Annual income available for investment	**$61**

segregated funds are sinking in value by the week. "I just don't know where we stand anymore," says Brian. "My last promotion keeps me too busy to do a budget anymore. We save what little we can and that's it."

What the experts say

Alfred Feth, a fee-for-service financial planner in Waterloo, Ont., is outraged at the treatment the Greens have received. "The number of planners they've had is astounding," says Feth. "What's worse is that not one of the planners spent any time determining their financial goals and values. In every case, the planners were only interested in selling them products."

But the Greens must bear some responsibility for their predicament, says Marc Lamontagne, a fee-only planner with Ryan Lamontagne in Ottawa. They didn't take the time to understand what a toxic mix they were buying when they loaded up on debt and high-priced investment funds. "The people who fall prey to these kinds of investments are usually people who want to get ahead quickly," says Lamontagne. "They often get into trouble when the markets go down. Then they panic."

Here's what our experts think the Greens should do:

Sell the seg funds. The Greens listened to the advisers who told them to borrow to invest, but they didn't take the time to understand the practical implications of the strategy.

Borrowing to invest, or "leveraging," is a way to make your money grow faster. It takes advantage of the fact that stocks usually produce higher after-tax returns than the after-tax cost of the money you borrow to buy them. If your stocks produce 9% returns, but it costs you only 5% to borrow the money required to buy them, you pocket the 4% difference.

But borrowing comes with risk—when the market falls, your portfolio may be worth less than you've borrowed. This makes it a bad choice for the Greens, who have a low tolerance for risk. Both Feth and Lamontagne say the Greens should extricate themselves from their current portfolio. Based on their loan documents, it appears the Greens can sell their seg funds, pay a 4.5% penalty—$4,500—and clear their $100,000 loan. They can then claim the $4,500 as a capital loss on their tax return. As painful as paying the penalty will be, it will free up $7,680 a year that was going to service the seg fund loan.

Sell the mutual funds. The Greens also took out a loan to buy five balanced mutual funds. Our experts say these funds should be sold and the $38,000 loan paid off. "This is a collection of funds with no real reason for existing," says Lamontagne. "There is no evidence of professional asset allocation that I can see." Selling the funds and clearing the loan will save the Greens $3,600 a year in debt payments.

Save. With their investment loans paid off, the Greens will have $11,280 a year to invest. Feth advises them to set up automatic monthly payment plans that will put $2,500 a year in each of the girls' RESPs and the remainder in Penelope's RRSP, because she doesn't have as generous a pension plan as Brian. Any other money should go toward paying down debt, starting with their high-interest credit card bill. When the Greens' child-care expenses begin to decline, they should apply the extra money to their mortgage. "They should have no problem paying off their mortgage in 13 years," says Feth.

Find a good planner. The Greens need a planner who will put their interests first. As the Greens have discovered, many planners employed by financial institutions are actually salespeople who make their money from the commissions they earn for selling products. Because of how they're paid, many planners push high-fee products that earn big commissions for them, but do little for the client.

The Greens may have more luck with a fee-only or fee-for-service planner. These planners don't earn commissions, but bill the client directly, often based upon an hourly rate, so they don't have the same motivation to push dicey products. (For a list of such advisers, visit www.moneysense.ca.) Feth and Lamontagne suggest the Greens pick three planners and interview them about their qualifications. They should make sure they know how the planner is being compensated to avoid a repeat of their sad experience to date. M

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