get out of debt now

Easy money has allowed us to become addicted to debt, but we're about to pay the consequences

By Rosalind Stefanac

To say Canadians have been on a major spending bender would be an understatement. Our consumer debt-to-income ratio continues to hit record rates quarter after quarter, and we're now outspending all the other G7 countries. If the latest predictions from the parliamentary budget watchdog hold true, we'll hit our highest household debt level since 1990 later this year. Consumer spending was up 6.7% across Canada in the third quarter of 2015, which was the fourth consecutive quarter in which spending increased, according to Moneris, one of North America's largest processors of debit and credit payments. High-end apparel retailers Saks Fifth Avenue and Nordstrom, which are opening their first stores in Canada this year, are certainly banking on our inability to curb our appetite for spending anytime soon.

Of course, one positive outcome of all this largesse is that it's keeping the Canadian economy afloat at a time when the resource sector is being beaten up and manufacturing has yet to rebound despite the weak loonie. Yet there are fears that it can't last much longer. Half of Canadians are within only $200 of not being able to pay their bills and debt payments, according to an Ipsos-Reid poll conducted in early 2016 for MNP Ltd., a consumer insolvency firm. And just over 30% said any increase in interest rates would move them towards bankruptcy, a troubling statistic given that rates are near zero.

The latest analysis of Canadian credit trends by TransUnion shows delinquency rates on auto loans rose almost 10% last year, the highest they've been in four years. The credit reporting agency's 2015 report focusing on oil prices and consumer delinquencies showed a clear connection between lower oil-sector investment and higher unemployment leading to an inability to service debt. It warned that if lenders didn't take proactive measures, the oil crisis could increase delinquencies by up to 60% across all products.

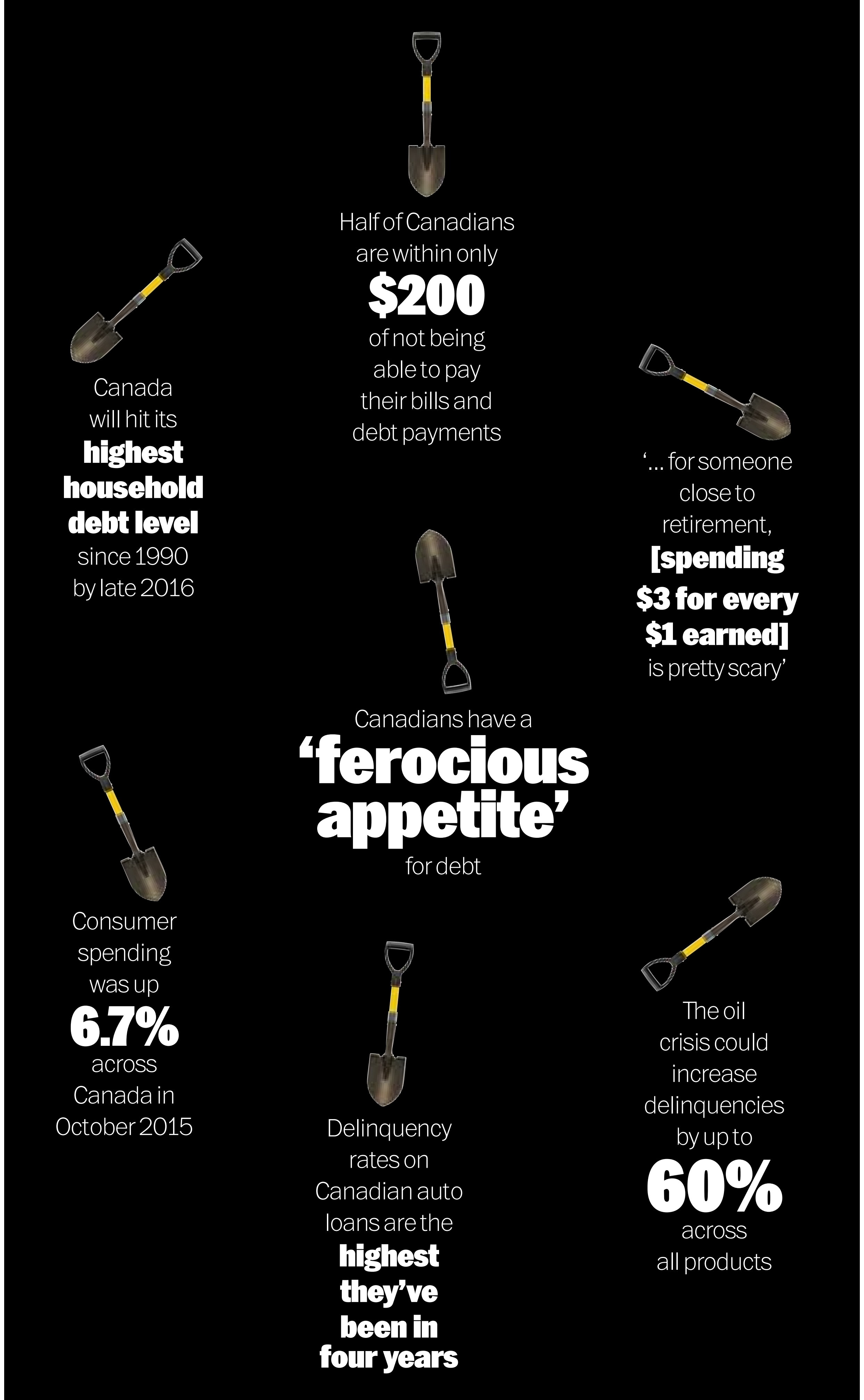
Oil issues aside, analysts point to low interest rates and a subsequently inflated housing market in some of Canada's major cities as key contributors to our overloaded debt. Jason Wang, TransUnion's Canadian director of research and industry analysis, says people need to feel "real pain" to recognize that their spending has gone off the rails, and, outside of the oil patch, a lot of consumers just aren't there yet. "If they still have a job today and they look at their bank statement and see the low interest rate, they assume this will continue forever," he says. "A lot of consumers just aren't prepared for what happens if it doesn't."

Wang points to Alberta as a prime example of what can happen. Prior to the oil crisis, the province's unemployment rate was lower than the national average and people were spending because they were earning a good income. When oil prices started plummeting in mid-2015, a pretty good lifestyle quickly went sour. Wang says many were so unprepared when they lost their jobs that they just couldn't keep up with their loans once their severance packages ran out. "The other problem is that most credit-savvy consumers know they can get a line of credit to pay off their credit card eventually, so it makes it easy to spend," he says. "A few years of doing that and it becomes a habit."

Laurie Campbell, CEO of Toronto-based Credit Canada Debt Solutions, paints an even bleaker picture. She believes we have a "ferocious appetite" for debt in this country. As head of a credit counselling service that's been in business for 50 years and helps clients ranging from doctors to those on social assistance, she says over-spenders share a common vice: holding onto a lifestyle they simply can't afford until it devastates them. "I've seen people walk away from houses and lose their marriages," she says. "Living on the edge is stressful and people fail to realize the emotional toll that can take, or the impact on their health."

Paul Shelestowsky, a senior wealth advisor at Meridian Credit Union in Niagara-on-the-Lake, Ont., says a psychological shift in our spending habits over the past few generations is a factor in our rising debt. "In my parents' time, you didn't go on vacation until you had enough money to do it; now, delayed gratification has gone out the window," he says. "The idea is, I have room on my credit card so let's go."

A 25-year veteran of the banking industry, Shelestowsky spends a lot of time helping clients distinguish between "wants" and "needs." A place to live, for example, is a need, but he says he's seeing more and more people retire with mortgages — some purposefully, but others because they couldn't control their cash flow. "I had one 72-year-old client who passed away with a big mortgage and his wife was forced to sell," he says. "You don't want to see anyone have to leave their family home."



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Debt consolidation can be a good way to get back on track, but Shelestowsky says too many consumers are using it as a Band-Aid to fix their overspending. "I'm always amazed by how many people come back after two years with another $30,000 racked on their credit cards," he says. "You can only reconsolidate so many times before the banks will say no."

Part of the problem is that money has never been cheaper to acquire. But people who look at borrowing as cheap money inevitably get trapped, says Robert Stammers, director of Investor Education at the CFA Institute. "We see this with student loans that are so cheap students end up living with them for years and it gets in the way of other things, like their ability to buy a house," he says. "In the U.S., people overbought, loans were easy to get and it was all fine until there were problems with unemployment and everybody lost their homes — then you see that house of cards falling apart."

Stammers believes there is a lot of financial risk developing in the market as people take on more and more. "It's not a problem today, but if the economy changes, you'll see people defaulting." Others are a bit more optimistic that Canada won't fall into a U.S.-style debt-infused meltdown. RBC's chief economist Craig Wright says there are more differences than similarities between the U.S. and Canadian housing and banking markets — and way more speed bumps this side of the border when it comes to debt accumulation.

"We are nowhere near their peak before the crash and I think we're on the verge of stimulation so that things will eventually get better," Wright says. He's even cautiously optimistic that Canadians can get back in the black when it comes to personal debt. "The biggest concern with elevated debt levels is a sharp deterioration in the job market," he adds. "As long as people have income, they can service that debt and Canadians are pretty good at that."

Other than pockets of weakness across the country, Wright says Canada's labour force growth showed positive acceleration in 2015. He's not too concerned with a sudden hike in interest rates, either. Even if they do rise, he says the lion's share of mortgages are locked in for five years so that means there will be a gradual cooling in the housing market. "It also looks like fiscal policy will be more pro-growth than it has in the past and that's what we need," he says.

But as Canadians wait for the economy to revive, they can't keep ignoring the red flags about our spending habits, says Stephanie Holmes-Winton, CEO of The Moneyfinder, a financial services training company based in Bedford, N.S. "It's time to get clear about the kinds of debt we have and if it's reasonable for our age and stage," she says. When measuring one's debt-to-service ratio, for example, it's not unusual for someone just starting out to be spending $3 for every $1 earned. "But for someone close to retirement, that service ratio is pretty scary," she says.

Holmes-Winton looks for patterns in client debt that indicate a high risk for potential problems in retirement. Do they have more credit-card debt than 10 years ago? How many times have they refinanced? How much progress are they making on their mortgage? Is their line of credit too large in relation to salary? "People say they'll make more money next year, but that makes a small difference overall," she says. "Even if you downsize, you have to ask how much it will cost you to move and pay condo fees."

Of course, not having any debt is likely unrealistic, but managing it in a way that doesn't cost you the most money is very doable. Holmes-Winton says the key is to figure out the structure of your debt and then get it to the most efficient place in order to pay it down. "The majority of us who are working with a decent salary can do more than we think we can," she says.

The experts say so much of successful debt management comes down to spending discipline and a decent understanding of personal finances. "People don't have the skills and knowledge and are embarrassed to ask for help so they make mistakes," CFA's Stammers says. "If we had these skills in the front end, we wouldn't have gotten into problems in the first place." No matter how big your salary is, be in tune with where the money goes. "I know people who are frivolous with money and if you show them where it's spent, they will self-correct," he says, pointing to all kinds of "leakages" that deplete potential savings, such as banking fees and service contracts that aren't renegotiated annually, leaving potential savings on the table. "I've caught my bank making mistakes, which they are happy to refund if I point them out," he says.

Rather than use the word budget, Stammers likes to refer to a spending plan, one that involves figuring out what you need to pay your bills and save for the future before spending what's left over. For Meridian's Shelestowsky, it's a simple formula that his parents taught him and he continues to pass onto his son. "If I wanted something, I had to work for it and I had to save," he says, recalling that his mom kept one envelope with money to save and another he could use for spending. "To this day, I still know I can't spend all the money I make." **FP**

READY TO TACKLE THAT DEBT?

Here are five strategies on how to do it right

Whether you're losing sleep over exploding bills or simply looking to stop depleting your savings account, here are some strategies to consider:

GO TO SOMEONE IN THE KNOW Seek advice from financial professionals who specialize in debt management. If they're simply recommending another way to consolidate debt rather than a process to repay it, that won't help you in the long run. Push back for other solutions or go elsewhere.

UNIFY YOUR DEBT It sounds simple, but putting your debt in as few accounts as possible will give you a better handle on where your money goes. Don't get too distracted by low initial interest rates without looking at total interest costs. The better organized your debt and the faster you repay principal, the less total interest you'll pay.

KEEP TRACK OF WHERE THE MONEY GOES Take the time to track your expenses every week or month (there are several free online programs that can help) to figure out exactly where your money is going and where you could be cutting back. Meridian Credit Union's Paul Shelestowsky tells all his clients to do this regardless of age. "It's a lot harder to get in over your head when you're tracking your money day in and day out," he says. "Then you can develop a realistic budget to meet your goals."

CHANGE YOUR SPENDING PATTERNS You can organize your debt load perfectly, but if you're not changing the way you spend, you'll just end up with a different colour of debt, says MoneyFinder CEO Stephanie Holmes-Winton. She suggests creating a cash-flow plan that puts a dollar limit on high-risk expenses, such as credit-card purchases for non-essentials. The advisors she trains help clients find an average of $3,300 a month in spending that they didn't know they could control. You can also set up your bank account to automatically pay everything from property taxes and utility bills to credit-card balances, which will prevent you from falling behind on payments and facing ballooning balances due to interest charges.

DON'T STOP SAVING A good financial plan should include contributing to debt repayment and savings simultaneously. Cutting back on long-term investments for a while to tackle debt makes sense, but putting money aside for unforeseen emergencies is essential too. "People who put all their efforts into paying debt tend to bail on themselves when they hit an emergency," Holmes-Winton says. "They think they have no control and give up altogether." Having an emergency fund also prevents you from having to dip into your retirement savings during a crisis.