

The new face of debt

For James Kennedy, a federal civil servant before he retired, and his wife, Jane, who retired from the Calgary civil service, the golden years have become a series of tough compromises. Both 59, they live in Qualicum Beach, B.C., a five-minute walk from the Strait of Georgia on Vancouver Island. They enjoy the mild weather, long walks on the beach and their beautiful home.

Trouble is, a lack of employment income combined with debt stalk the good times they thought they would have after they left their careers.

Their jobs paid them a total of about \$100,000 per year. Today, as a result of too much house and the repairs it entails — repainting, new floors, new electrical circuits, new kitchen counters, custom French doors and other elegances — they carry a debt of almost \$70,000, nearly twice their retirement income of \$37,000 a year.

If they pay off the debt, James and Jane would face a cash shortage. They could do it, but it would wipe out all of their RRSPs and other retirement assets built up over their working lives. A tough choice.

“We used to think that our house would go up enough in price to cover our debts,” Mr. Kennedy explains. “But I don’t think you can rely on that.”

Their situation could be resolved by selling the house, yet they fear that having paid too much in renovations, even downsizing might leave them house broke — with a nice abode and nothing else.

“As I approach the age of 60, I don’t want to carry so much debt. There has to be an end to the debt. I want my mind to be clear that when we get our Canada Pension Plan and Old Age Security, we will be able to keep those benefits. We don’t want to go into our sunset years paying off our debts.”

See The Kennedys are not alone. A flurry of recent studies show a significant increase of retirees in debt. First was Investors Group, which said 62% plan to carry debt such as a mortgage into

their golden years. Then Royal Bank of Canada came out with its Ipsos Reid poll, which found four in 10 Canadians retired with some form of debt, and one in four began retirement with a mortgage on their primary residence.

“More and more, Canadians are carrying debt into retirement,” said Lee Anne Davies, head of retirement strategies at RBC.

Just this week, BMO Financial Group noted less than half of Canadians 55 and over have a post-retirement income strategy in place and only a third have considered that they might outlive their savings.

It’s a new and dangerous trend.

Unlike their parents and grandparents, who remembered the Great Depression and regarded debt as a first step toward ruin, today’s retirees, especially Baby Boomers born between 1947 and 1966, grew up comfortable with owing others. Indeed, for many who grew up in the expansionary years of the 1960s, it was a normal and expected to have a credit card, fund a university education with loans, graduate to readily available mortgages and then to handy lines of credit from accommodative banks.

“Retirees, especially Boomers, are less averse to debt than their parents were,” says Peter Drake, vice president for retirement and economic research with Fidelity in Toronto. The contrast with earlier generations is stark, Mr. Drake adds. “They lived through a sustained period of strong economic growth and have adopted the idea that they will be well-off.”

Boomers have always had a major influence on consumer trends, and now they are changing the face of retirement as well.

“Boomers don’t have the same sense of saving for bad days that their parents had,” explains Charles Mossman, a finance professor at the Asper School of Business at the University of Manitoba. “When they retire, former workers, especially those who don’t have defined-benefit pensions that provide a guaranteed and sometimes even an indexed cash flow, wind up with more debt service charges than they can afford.”

According to a special report by The Office of the Superintendent of Bankruptcy that was released in 2008, 15.3% of all individual bankruptcies in Canada in 2003 were of individuals 55 and over, up from 6.9% in 1993. “Those over 65 are less likely to be able to recover economically and socially from the bankruptcy,” noted the OSB.

The risk of senior bankruptcy grows with age. A study for the Canadian Institute of Actuaries released June 2007, shows that longevity risk — the chance of living to a very ripe old age — poses the problem of running out of personal savings.

Given Canadians' extending life expectancy — currently 78 for males, 83 for females — a person retiring at age 55 has a 40% chance of running out of personal savings by age 85 and a 90% chance of being flat broke by age 95. It should be noted the data shows that women, who outlive men on average and tend to have lower lifetime incomes, have even greater reason to fear poverty caused by longevity.

Compounding the longevity problem is the trend, promoted by some financial services companies, to early retirement. Remember Freedom 55? But retiring at that age means giving up what may be one's most financially productive years. Indeed, if the average retiree has paid down most of his or her debts, and delays retirement to age 62, he or she can live in reasonable financial security, says demographer David Foot, an economist on the faculty of the University of Toronto and author of the 1996 bestseller *Boom, Bust & Echo*.

It would be wrong to label all debt foolish and all debtors in peril of financial catastrophe, argues Tina DiVito, head of retirement solutions at BMO Financial Group. "There is bad debt and good debt. Bad debt may be what one borrowed for a transitory pleasure, such as a vacation, after which the borrower has to pay high interest rates and gets no tax breaks.

"Good debt bears moderate rates of interest and is payable in a reasonable time period, perhaps as a part of an investment that makes interest tax-deductible," Ms. DiVito says.

For good debt, consider the case of 61-year-old Montreal retiree Ioanna Jakus, who has maintained a mid-six figure investment portfolio while living on an after-tax income of less than \$2,000 per month.

A former bank employee, she has a \$10,000 line of credit with her stock broker. "I use the line to buy stocks and bonds," she says. "I can deduct the interest I pay from my taxable income. My investments have been successful and have more than paid the cost of credit. What's more, rates of interest are so low that borrowing to invest just makes sense for me."

Not only has Ms. Jakus made intelligent use of credit, she has done so expertly, selecting low-risk GICs, bonds and blue-chip stocks with strong dividends. "I have always been motivated by the knowledge that only I can control my destiny," she explains. "My husband and I paid off the mortgage — that was when interest rates were near 20% — and we never borrowed again for spending.

“Of course, I can clear my investment debt in a moment by using cash in one of my accounts. My philosophy has always been not to take risks that I cannot afford, especially when it comes to borrowing money.

“Nobody can look after me as well as I can,” she adds.

That’s a lesson a lot of retirees have yet to learn.