FAMILY FINANCE.

Turning the page

BY DANA LACEY

Samantha Holmes is rebuilding her life after a divorce. Her biggest question: Can she afford the family home?

A YEAR AGO, Samantha Holmes separated from her husband. She moved with her three-year-old son from the Markham, Ont., townhouse she shared with her ex into her parents' home, where she had few expenses. There was no messy drama or fierce feelings in the split; the pair simply agreed they could not be together anymore. This has made the long, expensive divorce process a little easier. Today, Holmes, 36, is just a few fine details away from officially ending her marriage.

But even the most amicable of divorces can flip lives upside down, and this family is no exception. In the coming months, Holmes will need to rebuild her financial plan, which includes figuring out how much she should save for her son's post-secondary education and her own retirement. Most immediately, she wants to know if she can afford to buy her ex-husband's share of the family home and move back in.

Thanks to a healthy income, she's off to a great start. Holmes (not her real name) is a full-time teacher. She earns a salary of $72,000 a year, and she tutors during the school year, earning an additional $3,000 annually. She also receives a $1,200 Canada Child Tax Benefit and $1,248 Universal Tax Credit, bringing her total yearly income to $77,448.

Holmes also enjoys a comfortable support network. Her ex-husband contributes half the cost of their son's $6,900 yearly daycare expenses, and she expects to receive about $250 a month in child support, although that detail has yet to be agreed upon.

With those kinds of resources, Holmes believes she's ready to move forward with her life. Trouble is, she's not sure what her next move should be. "I'm at that point where I can start planning," she says, "but I have no idea where to start." She owns no major assets other than her car and the family home, whose ownership is still in negotiation.

When the couple decided to divorce last spring, her ex stayed in the house — worth around $380,000 — and continued to make the $1,460 monthly payments on their $308,000 mortgage. Freed from that cost, and with benefit of living with her parents, Holmes has managed to pay off debt and save $25,000 since separating from her husband. She's even put $3,000 into a GIC for her son and set up a registered education savings plan

LAST SPRING, SAMANTHA AND HER THREE-YEAR-OLD MOVED INTO HER PARENTS' HOUSE. "I AM VERY SERIOUS ABOUT PLANNING A FUTURE FOR ME AND MY LITTLE GUY. WHERE DO I BEGIN?"

ILLUSTRATION BY JACKIE BESTEMAN

(RESP) for him. "On my banker's advice, I put $300 into a mutual fund RESP and arranged to put $100 a month into it. I plan on maximizing it every year."

But cash will get tighter in the near future. Holmes realizes that she'll eventually have to leave her parents' home — "You can't live with your parents forever, or they'll shoot you" — and she's been considering her options, with her house as the top priority. She wonders if it makes sense to buy her ex-husband's share. "It's not a battle," says Holmes. "It's just a matter of who's going to buy it." Several factors suggest Holmes should. She and her ex will share custody of their son, but he will live with his mother most of the time. For that reason, Holmes says it's probably best for her to live in the house with her son. "It's in a nice area, close to good schools. It's a desirable place to raise kids."

Holmes could, of course, buy a less expensive house of her own. But there are advantages to keeping the old one. Because the deed has both their names, Holmes would be spared many of the usual costs associated with closing a mortgage, including the land transfer tax and the customary 5% commission paid to a real estate agent.

Once her divorce is final and her financial picture is more clear, Holmes wants to start thinking about retirement. Although she has contributed nearly $25,000 to her teachers' pension, she has no RRSPs, and this worries her. "I wish to retire as soon as I can receive maximum pension benefits," she says. She's having trouble, however, figuring out when she can retire. "I can never find financial information that really pertains to me."

In the big picture, what Holmes really needs is a little guidance. This is a pivotal moment in her life, and she just wants to make sure she's choosing the right path. "Essentially, I'd like to know if it's possible for me to live in the house and still be able to live a modest but comfortable lifestyle, and be able to contribute to both RESP and RRSPs," she says. "I am very serious about beginning to set up a wisely planned future for me and my little guy. Where do I begin?"

WHAT THE EXPERTS SAY

Buying the family house may be within reach for Holmes, but it won't come without sacrifice. Jonathan Flawn, a certified financial planner (CFP) for Page and Associates in Richmond Hill, Ont., warns that taking on the mortgage will limit cash flow and leave little room for savings. "Her current income, minus expenses, plus child support is $15,762. Even with a 35-year amortization, a 4.6% mortgage would require yearly payments of $17,392." That would leave Holmes short $136 a month.

There are ways to make ends meet, though. "A few expenses (like clothing) can be reduced, and she'll have access to tax breaks on child-care expenses," says Flawn. He also hopes she'll negotiate for more child support: "$250 a month is peanuts."

The key to making the home purchase affordable is how it's valued, so Flawn advises Holmes to be careful on that point. "It will be in her husband's interest to have the value maxed out, and in hers to have it minimized." He recommends she hire an accredited mortgage professional to help conduct a proper appraisal. The good news, though, is that Holmes will likely avoid mortgage insurance, since the home will already be more than 20% paid off.

Jason Heath, a CFP for EES Financial Services in Markham, Ont., offers a longer-term perspective. He says that, while Holmes could afford to live in the house, her finances might be too tight. He suggests she eventually — but not just yet — consider buying a cheaper house. "It's probably best for her and her son to settle into the family house for the next year, and wait for life to calm down a bit," he says.

Whether Holmes decides to buy a new house or the old one, Flawn says she should apply as much of her savings as possible to reducing the mortgage, which would help with cash-flow management. She should also arrange an unsecured line of credit to cover emergency cash needs. Two to three months' worth is ideal.

Tip of the Month

Valuation of the home is key in a divorce

When it comes to divvying up the assets after a divorce, the house is usually the biggest piece of the pie. So it's important to get an appraisal on which both parties can agree. The first step should be to hire an accredited mortgage professional to steer the process. One strategy, for instance, might be to get three independent appraisals, then use the highest and lowest values to find an average.

Financial Snapshot

Income	
Salary, tutoring	75,000
Child tax benefits/credits	2,450
TOTAL INCOME	$77,450
Expenses	
Income taxes	15,850
CPP, EI, professional dues	6,450
Benefits, group insurance	4,600
Mortgage (post-divorce)	17,400
Property taxes, utilities	7,400
Insurance (auto, home)	2,500
Vehicle payments	6,300
Gas, auto expenses	2,300
Cable, phone, Internet	2,800
Groceries, cleaning Supplies	4,000
Daycare	3,400
RESP	1,200
Cleaning service	1,500
Hair dresser, toiletries	500
Clothing	2,500
Music lessons, sports	1,000
TOTAL EXPENSES	$79,700
Savings	
TOTAL SAVINGS	($2,250)
Assets	
House (post-divorce)	380,000
Vehicle	35,000
Non-registered investments	48,400
TFSA	5,000
TOTAL ASSETS	$493,300
Liabilities	
Mortgage (post-divorce)	303,000
Car Loan	34,500
TOTAL LIABILITIES	$337,500
NET WORTH	$155,800

Heath, meanwhile, worries that Holmes may be underestimating her expenses. "Among other things, there's nothing planned for vacations. I like to plan for a client to be able to live a little."

Flawn and Heath agree that Holmes shouldn't rush to start an RRSP. As a teacher, she can retire at age 58 with a full pension. She should aim to pay off the mortgage by then, which will allow her to live on 70% of her income. "Because she has a lucrative pension as a teacher, she is saving for retirement with each passing day of service in the plan," says Heath.

In fact, according to Flawn, Holmes should be directing any available savings into a Tax-Free Savings Account (TFSA), not an RRSP. Because she has such a strong pension, "by the time she retires, it's likely that her tax rate will be over 50%. Anything she pulls out of an RRSP will be taxed at this top rate." So investing in a TFSA should be more tax-efficient. Any savings over the TFSA limit should go into equity investments, says Flawn, which offer tax savings and deferral on capital gains.

The experts also point out that Holmes is lucky that she and her husband are taking the more civil divorce-planning route. "There is a huge potential for loss of family wealth when there is fighting and rancour in the negotiations," says Flawn. "You have lawyers consuming tens of thousands of dollars in literally the blink of an eye."

To expedite the process, they should hire a financial divorce specialist, who can mediate with both parties' interests in mind. "A financial divorce specialist can look at all the pieces of the puzzle and figure out what the best solution is for everybody," says Heath, "whereas a lawyer is looking for a legal solution and working for one party."

"A divorce highlights the importance of both spouses being involved in financial planning," Heath adds. Holmes was smart to ensure her name was also on the deed. She's in a good place financially, and is on track to sending her son to university or college. With a bit of prudence, she's also ready to tackle her life's next phase. **FP**

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Money Talk

Too good to be true?

Your adviser tells you about a tempting tax loophole. A buddy lets you in on an investment opportunity. Sounds great, but before you jump, figuring out the risk involved is key. Here, one reader asks about the risks of preferred shares, while another says a tax strategy described in our May issue could cause problems.

THE DIRT ON PREFERRED SHARES

Q: My investment manager is recommending I consider investing in the preferred shares of a large mutual-fund provider, which provide guaranteed return via dividends of 5.6%. I have never invested in preferreds and want to understand if these are a good investment. What are the risks and rewards of these shares?

Greg, Mississauga, Ont.

A: Preferred shares are frequently purchased in non-RSP accounts where the investor is seeking a regular cash flow and wants to minimize income taxes. A key advantage is that the dividends are taxed at lower rates than interest income. But compared with a bond, the security of the capital is lower and the price volatility is greater. General market conditions, interest rates and concerns about the issuer's credit rating will all impact on the market price.

As a purchaser of a preferred share you want to understand the fine print, as there can be many important features that will impact on the value of the share. Is it retractable? Redeemable? Is there a fixed dividend rate? In what circumstances can a dividend be suspended? Does the dividend rate get reset at a certain date? When? What is the new level?

It is also important to review the rest of your portfolio to ensure that you do not create concentration in a particular company or sector. Remember, when you are being paid more return, it is because you are taking on more risk.

Nancy Graham, Investment adviser, PWL Capital, Ottawa

SHARING CAPITAL GAINS MAY NOT BE A SUREFIRE STRATEGY

I read your May "FF Feedback" article, which outlined a tax strategy whereby a spouse owning shares with an accrued gain can sell half of the shares to their spouse and gift the remaining half to them. The result upon the sale of the shares on the market is that 25% of the overall gain would be taxed in the recipient spouse's hands, who is presumably in a lower bracket. The way it was presented made it sound like this was common acceptable tax planning.

It is very possible that such planning may be challenged by the Canada Revenue Agency. For example, a recent Canada Revenue Agency technical letter said it would apply the General Anti-Avoidance Rule (GAAR) to a plan where the objective is to utilize the recipient spouse's capital gains exemption. It may also consider assessing the recipient spouse's lower tax bracket, personal exemptions, etc., as equally offensive. As well, the Lipson Supreme Court decision in January may also call this type of tax-strategy planning into question.

Lorne Richter, CA, CPA, Montreal

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