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Master planners?

The Jensens want a bigger house and a bigger family. With slow-growing incomes, they hope they can afford it

Andrew Allentuck | Tuesday, February 2, 2010

ILLUSTRATION BY JACKIE BESTEMAN

Raising children and planning for life decades in the future is never an easy job. But rather than do it by chance and just taking what comes along, Catherine and Oliver Jensen (not their real names) want to do it in careful steps. With one child a year old—and more planned—they recognize that they must develop a financial strategy or risk losing what has until now been a comfortable cushion of income.

Catherine is a health-care professional, Oliver a manager in a small business. Both 31, they've been married for three years. Their gross family income, $118,000 per year, is a good base for a young couple, but life in Toronto is costly. For the Jensens, the financial issue comes down to knowing what they can afford for their growing family. "We want to know if we are where we should be right now in terms of managing our obligations and our futures," Catherine says.

Home ownership is a key issue. The Jensens want to move from their 1,050-square-foot condo, valued at $300,000, to a house with three bedrooms, a basement recreation room and more storage space. They want to stay in their mid-town neighbourhood, Catherine says, but achieving that goal will come at a high price, due to Toronto's costly real estate market. Buying a house could easily run to $500,000, maybe even more. Given that the Jensens will realize about $200,000 on the sale of their condo, they'll be left with a $300,000 mortgage—a significant increase over their current $95,000 mortgage. A jump that large will require them to readjust their entire household budget and financial plan.

Compounding the issues the Jensens face is the fact that Catherine's $78,000 salary, which makes up two-thirds of their gross earned income, is not expected to rise much in coming years. Oliver's income is static, too. "So our rate of savings will decrease as our household grows," Oliver says. The good news is that Catherine and Oliver have already built up a tidy nest egg. Their financial assets total $166,533, including Catherine's defined-benefit pension plan with a present cash value of $38,000. Oliver manages the family's investments, about 55% of which are held in equities, including 18 individual stocks, with the remaining 45% in fixed income and cash. Overall, their portfolio is rock solid and, if anything, perhaps too conservative for a couple still decades from retirement. So the big issues boil down to how Catherine and Oliver will manage the cost of providing for a growing family. It's a big question for them as they have never lived on a budget before. Do they have the means to be able to provide for a growing family and continue to save for their own financial future?

What the Experts Say

Catherine and Oliver can breathe easy. They are in good financial shape, with sufficient assets and income to raise a growing family and meet their larger financial goals, our advisers say. What's more, according to Derek Moran, head of Smarter Financial Planning in Kelowna, B.C., they're heading into the future with a particular advantage: Catherine's job in the health-care industry is essentially recession-proof, so both she and Oliver have a strong and steady base from which to build their plan.

In respect of their near-term concerns, though, Moran says the couple need to rethink a couple of points. His first suggestion: Even though the Jensens plan to move in to a house, they should try to accelerate the paydown of their $95,000 condo mortgage. He suggests they look at their savings with fresh eyes. Between them, Catherine and Oliver have almost $22,000 in cash and short-term GICs. Using that for mortgage reduction would cut their current balance to $73,290. That's a safe move, Moran says. "Interest rates will rise, so the Jensens should cut their debt. It will pay when they have more childhood costs and less financial flexibility."

Reducing their mortgage now will also help them when they decide to buy a new house. If they were to upgrade their present $300,000 condo to a $500,000 house soon, their mortgage would climb to about $273,000, assuming they first apply their cash savings to their condo mortgage. If they financed their home purchase on a 4% fixed-term mortgage with a monthly payment of $2,290 - the $1,090 cost of the payment on their condo combined with the $1,200 they now put aside for savings each month - they could pay off their mortgage in just 13 years. After that, they could refocus on saving and investing.

To enhance the children's financial security, Catherine and Oliver also need to buy more life insurance, Moran says. Their current group policies, which each pay two years salary in the event of a death, aren't enough. Assuming that Catherine and Oliver are healthy, Moran recommends they get $500,000 each of term insurance with premiums revised each decade.

In terms of longer-range financial outlook, the Jensens have invested well, says **Nigel Roberts, a chartered financial analyst who heads Bluenose Investment Management Inc.** in Oyama, B.C. He does say, however, that their direction could use a tweak. Roberts suggests that Oliver take a core-and-satellite approach to the equity part of their portfolio. The core portion, with 60% to 80% of all the family's equity assets, should have at least one broad market exchange-traded fund. With their low management fees, ETFs are about the cheapest way to invest in baskets of Canada's top companies. Individual securities would make up the satellite portion of the portfolio. Fixed income assets, meanwhile, could still be held in GICs or other low-risk, interest-generating devices like government or top-quality corporate bonds.

"This approach provides the couple with a diversified, low-maintenance portfolio while also giving them the flexibility to include some individual equities," Roberts says. "But the portfolio should have no more than 10 individual stocks so that monitoring them isn't so overwhelming that it does not happen."

So, when you boil it down, the key theme for the Jensens' financial plan is debt management combined with a straightforward investment program. Put these two components together, and they should meet their goals of owning a family home, providing for their children and preparing for retirement. And for new parents, that's about as good as it gets.