Module 4

BORROWING MONEY IN SENIORS YEARS

MONEY AND YOU SENIORS EDITION

Module 4

BORROWING MONEY IN SENIORS YEARS

Let's Discuss…

- $ Why Seniors Get Into Debt
- $ Taking Stock of The Need
- $ Your Borrowing Capacity
- $ Your Borrowing Psyche
- $ How You Will Finance Debt
- $ Knowing The Score – Your Credit Score
- $ Making Your Decision About Debt
- $ How Secure Is Your Debt Repayment Plan?
- $ How An Outstanding Debt Impacts Your Estate

If you are like most Canadians, chances are that you have borrowed money at various times in your life.

Even the soundest of financial plans can be upended by an unexpected household expense, family emergency or other financial event. Seniors are certainly not immune to life's sudden twists and turns; the recent pandemic is a good example.

While it can be tempting in a financial emergency to take a quick route to solving the problem, or worse, to ignore the problem and fall increasingly into more debt, knowing more about your different borrowing options – before you do so – can help you plan for a financial emergency, avoid borrowing pitfalls and make good borrowing decisions.

Older adults who are considering taking on additional debt need to carefully consider their options before they do. Others, who must take on debt to make ends meet, need to think about how to pay the money back in an orderly way. That can be a more difficult challenge.

In this module, we'll discuss options for responsible borrowing – that is, how to take on debt with an orderly repayment plan.

Think About It

- **It is true that the percentage of older adults in our population is on the rise – doubling from 8% in 1971 to 17% in 2017 and expected to rise to 24% by 2036[1].**
- **At the same time, between 1999 and 2016, the proportion of seniors with debt increased quite significantly: from 27% to 42%.**

1 Statistics Canada – Insights on Canadian Society: Debt and Assets Among Senior Canadian Families (April 2019) https://www150.statcan.gc.ca/n1/pub/75-006-x/2019001/article/00005-eng.htm

Why Seniors Get Into Debt

Responsible borrowing – that is, borrowing for the right reasons and within your means to repay, may have helped you to buy a home, enhance your career prospects through higher education, finance a business, maximize registered savings opportunities, pay for emergency expenses, or take a once-in-a-lifetime family trip.

However, as you enter your pre- and post-retirement years, it may be wise to rethink your approach to borrowing. Life on a fixed income may require lifestyle and spending adjustments.

As difficult as it is to contemplate, the possibility of serious health issues, disability and even the death of yourself or partner can turn assumptions about your ability to repay debt upside down.

There are some interesting statistics available about why seniors go into debt. In fact, many older adults enter their pre-retirement years carrying debt.

Recall that research carried out by Statistics Canada in 2016 found that the proportion of senior-led families with debt was 42%, up from 27% in 1999. In addition:

- Senior families in younger age groups were more likely to be in debt: about 6 in 10 (58%) had debt, while among older seniors aged eighty and over, only 1 in 5 (20%) had debt.
- Working seniors were also more likely to have debt than non-working seniors.
- The proportion with mortgage debt almost doubled from 8% to 14%
- The share of those with consumer debt increased from 24% to 37%.[2]
- A key measure of financial security for older adults is their debt to asset ratio[3]. Statistics Canada found

2 https://www150.statcan.gc.ca/n1/pub/75-006-x/2019001/article/00005-eng.htm

3 Debt-to-Asset Ratio or Debt Ratio: A calculation used by lenders to assess the risk of lending to you – calculated by dividing your total debt by your total assets.

that between 1999 and 2016, the median debt-to-income ratio for senior families with debt *more than doubled*.

One of the chief reasons for retirement age borrowing is simply ***insufficient income***. Low interest rates on savings combined with increases in the cost of living have their biggest impact on older Canadians who turn to lines of credit, credit cards, or payday loans to shore up their monthly budget.

Chief reasons seniors borrow:

Action Item

- **Ask Yourself: Could inadequate source deductions on pension income leave you scrambling to come up with funds at tax time?**

But, there are also more happy reasons to borrow. Financially secure seniors may take on debt in the form of a mortgage to finance a vacation home. That may be perfectly reasonable – and affordable – provided proper plans for repayment are possible.

Low interest rates on savings → High Cost of Living → Family Pressures → Insufficient income

Family pressures have been identified as another contributor to increases in seniors' borrowing as financially strapped adult children pressure parents to help them with home purchases or grandchildren's education.

Think About It

- **For the median family in 2016, debt amounted to 52% of after-tax family income, up from 24% in 1999.**

Taking Stock of the Need

There is nothing fundamentally right or wrong about borrowing, but financial experts often distinguish between "good debt" and "bad debt."[4]

If you are thinking about borrowing, first have a hard look at whether the expenditure is essential. The answers to a few basic questions are a good place to begin.

4 https://www.canada.ca/en/financial-consumer-agency/services/financial-toolkit/credit/credit-1.html

- Will this result in “good debt” or “bad debt”?
- Is it for a “need to have” or a "nice to have”?
- Can you delay the expenditure and save to cover it?
- Can you ask for more time to pay your bills?
- Will your seller/supplier/ tradesperson let you pay in instalments over time?
- Is the need to borrow a result of ongoing overspending?
- Do you need to cut your monthly budget?

Good debt - an investment in something that creates value or produces more wealth in the long run. Good debt may also be debt where the interest is tax deductible. A reason to get into “good debt” is to buy an asset that will increase in value at an after-tax rate higher than the cost of borrowing.

Bad debt - debt taken on to buy something that immediately goes down in value or to buy something that you can't repay on time and in full. Interest on bad debt is also unlikely to be tax deductible.

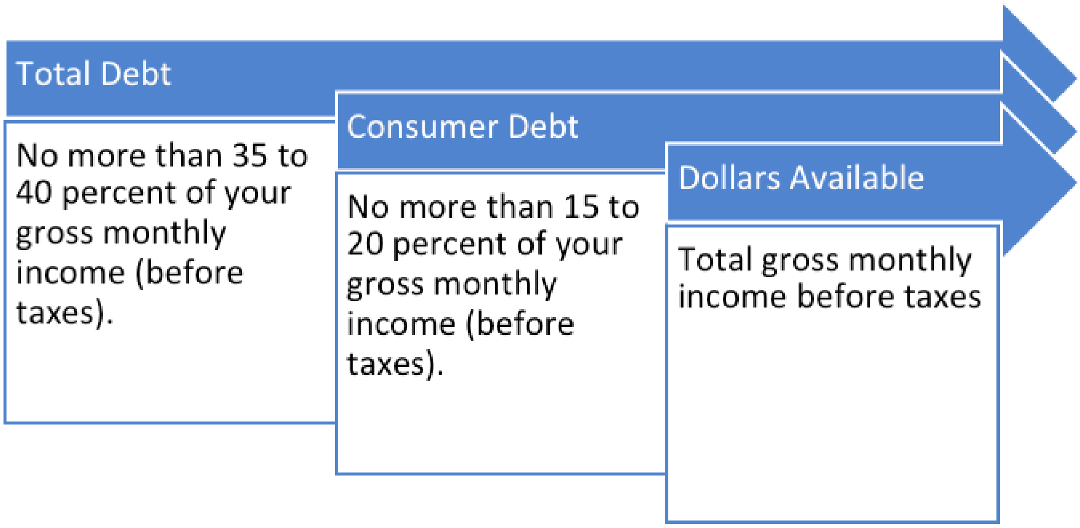
Your Borrowing Capacity

Your borrowing capacity is the maximum amount you can borrow without jeopardising your financial solvency. Borrowing capacity is a measure banks and other lenders use when deciding whether to approve a loan or line of credit. It provides the lender with some comfort that you will have the financial resources to repay the loan.

Think About It

How much debt can you safely take on? It depends on:

- **your income**
- **your personal and household expenses, and**
- **how well you are able to repay the debt.**



Experts often distinguish between

- consumer debt (money owed on items other than a mortgage, such as unpaid credit card balances, auto loans, store loans, etc.) and
- total debt (which includes mortgage debt in addition to consumer debt).

Money Tip

Debt use is largely dependant on your comfort levels and financial capacity, and should not exceed these limits. As a general guideline:

- **Your consumer debt payments should not exceed 15 to 20 percent of your gross monthly income (before taxes).**
- **Your total debt payments should not exceed 35 to 40 percent of your gross monthly income (before taxes).**

Older adults approaching retirement or living on a fixed income may want to aim for a lower ratio to ensure that they can meet their debt obligations and day-to-day living expenses.

Money Tip

If your debt repayments are already higher than these percentages, taking on further debt could put you at risk of insolvency.

Your Borrowing Psyche

Shakespeare famously admonished "Neither a borrower nor a lender be . . ."

How you feel about credit and debt is influenced by your attitudes toward money, the way you define your needs and wants, and your emotions, habits, and values.

Research conducted in Sweden[5] confirmed that intergenerational influences and cultural factors often come into play as well.

Just as your attitude toward credit and debt may have been passed on to you by your parents, you may see your attitude reflected in your own children.

How Seniors Finance Debt

- credit cards
- lines of credit
- personal loans
- payday loans
- home equity-based loans

Take The Quiz

How do you feel about being in debt?

Here are some sample statements. Check the one that is closest to your attitude.

- ☐ "I never use credit if I can avoid it."
- ☐ "I'll borrow money, but I'm not comfortable until I've paid it back."
- ☐ "I use credit if it helps me get what I want."
- ☐ "Credit is a convenience and I have no problem using it."
- ☐ "I don't worry about how much debt I'm carrying because I figure I'll make the payments."
- ☐ "I'm not out of money until I'm out of credit."
- ☐ "I can't control my use of credit."

Source: Financial Consumer Agency of Canada https://www.canada.ca/en/financial-consumer-agency/services/financial-toolkit/credit/credit-1/2.html

CREDIT CARDS – Instant availability may tempt you to use your existing credit card as a borrowing vehicle but using it to finance more than you can repay in a month will trigger hefty interest charges – averaging around 20% and often higher if you miss your payments. If you are determined to use a credit card, shop around for one with a lower interest rate. Several firms offer cards with rates in the 9%

5 https://gflec.org/wp-content/uploads/2020/04/Working-Paper-Attitudes-Toward-Debt-and-Debt-Behavior- 3_26_2020.pdf?x21285

range for purchases and 13% for cash advances to those who qualify.

LINES OF CREDIT – Lines of credit come in various forms and are available from your financial institution. They account for 55 per cent of non-mortgage debt held by seniors. Their advantages are lower rates of interest and the flexibility to borrow and repay as much or as little as you choose up to a set limit. Disadvantages include the temptation to overuse the line and cost of servicing the debt should interest rates increase.

SECURED LINE OF CREDIT – As the name implies, you use an asset – e.g., your car or home, as collateral. The lender is then able to offer a lower rate of interest than with an unsecured line of credit.

> **Unsecured lines of credit -** With an unsecured line of credit, such as a personal line of credit, the loan isn't secured by any of your assets. They generally have a lower maximum limit and are suitable for unexpected expenses or consolidating higher interest rate loans. Interest rates are usually lower than for credit cards and personal loans.

Personal loans – When you take out a personal loan, you borrow a fixed amount of money and agree to pay it back the full amount plus interest and fees in installments over a set period of time. You do this by making regular payments, called instalments. Personal loans are usually taken to finance a specific purpose They are available from a wide range of lenders, including banks and credit unions, as well as alternative lenders such as payday lenders, title loan companies, private lenders, and pawn shops.

Borrowing against insurance – If you are like many seniors, you may have built considerable cash value in a permanent life insurance policy (whole life, universal life). You may be able to withdraw some or all of the cash value but be aware that the withdrawn funds cannot be repaid into the policy, which means reducing the ultimate payout to your beneficiaries. You may also be able to take out a policy advance or loan from the insurance company. Repayments of the loan will be in addition to any remaining premium obligations.

Money Tip

Look Before You Leap: Insurance cash value withdrawals and policy loans can potentially trigger taxation.

PAYDAY LOANS - Seniors are a growing target market for payday loan companies that specifically advertise that they will loan against CPP, ODSP, retirement benefits, pensions. When you take out a payday loan, you agree to repay the funds out of your next pay (employment, pension, etc.), usually giving the loan company permission to withdraw the full amount directly from your bank account. Loans are for less than $1,500 but carry extremely high interest rates – typically 500-600%. If you are unable to pay, penalties are added to the debt.

Consumer agencies such as the Financial Consumers Agency of Canada[6] advise extreme caution about using payday loans at any age.

6 https://www.canada.ca/en/financial-consumer-agency/services/loans/payday-loans.html

"Before taking out a payday loan, be very sure that you can pay it back on time. If not, your financial situation may get worse. Your debt can keep growing and you can end up paying a lot of money over time."

Source: Financial Consumer Agency of Canada

Think About It

Always be careful not to borrow more than you can pay back even if your lender is offering more.

Home Equity-based Loans

Many older Canadians retire on limited retirement and emergency savings.

In a 2018 survey[7], baby boomers (aged 55+) estimated they would need half a million dollars in savings to retire comfortably. That same survey also revealed that 32% of pre-retirement respondents (ages 45 to 64) had saved nothing and 49 per cent had saved less than $250,000.

Thanks to Canada's hot real estate market, many seniors who may be 'cash poor' are 'house rich.' In response, Canada's financial institutions have developed several ways for older adults to tap into the value of their home without having to sell.

And because the funds are a loan, they are tax-free. Consider these options:

Reverse Mortgage

A reverse mortgage is a loan available to seniors over the age of fifty-five that enables you to access funds using the equity you have built in your home. You can borrow up to 55% of its current assessed value – the maximum is linked to your age and home's appraised value. The funds can be taken as a lump sum or can be flowed as fixed monthly payments over time.

A key feature of a reverse mortgage is that it does not require monthly repayments, making it an attractive option for low-income seniors. Instead, the loan and associated interest are repaid when you sell or move out of the home, or on the death of the last remaining borrower.

Money Tip

Interest rates tend to be higher than for a conventional mortgage and can deplete the equity in your home.

Home Equity Loans - Refinancing

Home equity loans are another loan product with particular appeal for older adults. As with reverse mortgage lenders, home equity lenders tend to base your loan on the appraised value of your home, not your credit score, job history or income.

Unlike a reverse mortgage, the funds are loaned only as a lump sum, and you will be required to make monthly payments of interest and principal until the loan is repaid.

7 https://cibc.mediaroom.com/2018-02-08-Am-I-saving-enough-to-retire-Vast-majority-of- Canadians-just-dont-know-CIBC-poll

Money Tip

Interest rates may be slightly higher than prime lending rates but have the advantage of leveraging a higher percentage of the home's value – as much as 80%. They may be a good option if you require a larger amount of money and can afford the monthly payments.

Home equity line of credit (HELOC)

A home equity line of credit is a secured line of credit where your house acts as collateral. They come in two forms –

- mortgage plus HELOC typically taken by younger home buyers and
- stand-alone

Although not specifically designed for older adults, the stand-alone has gained popularity among seniors looking to access the equity in their homes without selling.

In most cases, you can access a higher credit limit and lower interest rate with a HELOC than you can through other loans and lines of credit.

As with other lines of credit, you withdraw what you need as you need it – up to 65% of your home's value as long as your HELOC and outstanding mortgage do not total more than 80% or your home's value. You can rollover the principal owed indefinitely but will

Equity Based Loan	Age Qualified?	Maximum $ available	Interest	Lump sum Income?	Fixed Monthly income?	Optional drawdown?	Monthly re-payments?
HELOC	No	65% of assessed value*	Variable Prime + 0.5-1%	Yes	Yes	Yes	Interest only
Reverse Mortgage	55+	55% of assessed value	Fixed	Yes	Yes	No	No
Mortgage Refinancing	No	80% of appraised value	Fixed	Yes	No	No	Yes, principal plus interest

*Maximums are based on the appraised value minus any outstanding mortgages, HELOCs and other loans secured by your home.

have to make monthly payments equal to the interest due.

Money Tip

Keep in mind that the Interest on a HELOC is calculated daily at a variable rate attached to the Prime rate – roughly Prime plus 0.5 to 1% – and a hike in interest rates could cause a sudden increase in your minimum monthly payment.

Think About It

- **Home equity-based loans, including reverse mortgages, and lines of credit may incur other fees: real estate appraisal, title search and insurance, set up, and legal fees that can run as high as $3000.**

Do You Know the Score?

Credit worthiness can impact the interest rate you will be charged on a loan. With compounding, even a slightly lower interest rate can mean substantial savings over time. Make sure your credit score is accurate and up to date. Some banks have a link to your credit score on their website or you can contact Canada's two consumer credit reporting agencies directly.

https://www.consumer.equifax.ca/personal/products/credit-score-report/

Credit Report, Credit Score & Credit Rating | TransUnion

Making Your Decision About Debt – Weigh the pros and cons

Assess all your options before you decide to borrow – should you liquidate assets or borrow to meet an unplanned expense?

- Do you have any untapped potential sources of income, e.g., a government benefit, uncollected monies owed to you? Keep in mind that you may need to put aside a portion for taxes.
- Do you have savings you can tap into or an asset you can sell? Be cautious about tapping into registered retirement savings. They cannot be replaced over age 71, and withdrawals will be subject to withholding tax. Similarly, proceeds from the sale of an asset may be taxable.
- Is there a family member or friend you can turn to? You may be reluctant to admit that you need help, but family or friends can be

an option if you are confident that it won't harm your relationship.

- Is downsizing an option? Rising house prices have gifted many homeowners with significant additional equity. Proceeds from the sale may be enough to finance a new lower cost residence with funds left over to pay for unforeseen expenses, pay down debt, or boost retirement savings. You may also qualify to claim the principal residence exemption on your home[8]. This would mean your gain on the value of the home is tax free. However, be aware that flipping homes to make a tax exempt gain on the principal residence will be scrutinized by CRA and may be reversed to make the sale a taxable one. In addition, whether the sale is tax exempt or not, it must be reported when you file your tax return. There are many complex rules to follow when you change the use of your principal residence to a rental property or have more than one personal residence at the same time. Consult a qualified tax professional for help before you sell or change the use of your home.

8 https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax- return/completing-a-tax-return/personal-income/line-12700-capital-gains/principal-residence-other-real- estate/sale-your-principal-residence.html

Action Item

Take an honest look at your need for taking on debt before you do so. Key questions to help you decide which option makes sense:

- **How much do you really need?**
- **Is it a relatively small amount for an immediate need or a larger amount to pay for ongoing expenses?**
- **How soon can you repay?**
- **Will owing this money make you lose sleep?**
- **Can you afford monthly payments and still be able to cover your monthly expenses?**
- **Do the fees involved in arranging for this loan make sense given the amount you need to borrow?**
- **How good is your health?**
- **How secure is your income?**
- **Do you have security you can offer?**
- **How much would insuring the debt add to the costs?**
- **Will your estate have enough assets to repay the debt if need be?**

Complete the following worksheet to record your answers and then take stock of

a. ***your wants and needs***
b. ***your capacity to borrow money***
c. ***your other options.***

Next think about your **Plan A:** What you will acquire and how you will fund this.

Finally, have a contingency plan; your **Plan B:** How you will fund your purchase if things change.

BORROWING WORKSHEET FOR SENIORS: Is it (a) or (b)?

Thinking About Wants and Needs		
(a) "Nice-to-have" or	(b) "Need-to-have"?	
(a) Good Debt or	(b) Bad Debt?	
(a) Urgent or	(b) Can This Be Delayed?	
(a) Small One-Time Expense or	(b) Larger Regular Cash Infusions	
(a) Cash Problem or	(b) A Spending Problem?	
Thinking About Capacity To Borrow Money		
(a) I can afford monthly payments	(b) I cannot afford the payments	
(a) I can pay back the principal on time	(b) I cannot repay	
(a) I can afford an interest rate increase	(b) I can't afford it	
(a) I have security to offer	(b) I have no security	
(a) My income is likely to change	(b) my income won't change	
(a) How much do I owe already?	(b) I don't owe money now	
(a) My health is good	(b) I am not healthy	
(a) My estate can repay the debt	(b) my estate cannot repay it	
Are There Other Options?		
(a) I can tap sources of income	(b) I have no other income	
(a) I can collect monies owed to me	(b) I have not lent money	
(a) I can tap family /friends for a loan	(b) This is not an option	
(a) Non-registered savings available	(b) No non-registered funds	
(a) Saleable assets	(b) no saleable assets	
What Are The Best Options?		
What is your debt repayment plan?	Plan A Plan B	

The Indebted Estate

As you consider whether to borrow and your repayment options, take time to consider the impact on your estate. Assuming that your estate assets exceed your debts, your executor will be required to settle all of your debts before any funds are passed on to your beneficiaries.

There are some exceptions, for example, in certain cases your named beneficiary of a pension or RRSP/RIF will inherit the funds in your account on a tax free rollover basis. But if there is no named beneficiary, the funds go through the estate.

If you have an outstanding reverse mortgage, your agreement will probably require repayment within a set period following your death.

If your executor needs time to liquidate assets to pay your debts, your estate may accumulate interest and penalties, further eroding its value.

Think About It

- **Responsible borrowers often receive regular increases in their credit limits.**
- **Reduce the temptation to use easy credit by asking that your limits be reduced.**

Action Item

What steps can you take to protect your assets?

1. **Prioritize repayments in your lifetime according to their cost:**
   a. **Taxes first -their interest rates may appear low, but high penalties added to the principal can quickly increase the cost.**
   b. **Credit cards – with interest rates of 20% and more, make every effort to pay the balance in full each month and consider a lower cost loan to pay it off if you get in over your head.**
   c. **Other high interest or high balance accounts.**
2. **Insure your debts:**
   a. **Shore up your life insurance to help pay off debt. Life insurance is usually paid out quickly and can be used by your estate to pay off your most pressing outstanding debts.**
   b. **Credit card balance insurance generally pays a percentage of your balance in the case of illness or loss of income to a pre-set maximum and the balance in full in the event of critical illness or death.**
   c. **Line of credit insurance – may help cover your loan payments if you can't make them due to illness, accident, death, or loss of income. Typically this is billed monthly to your line of credit account based on your age and daily balance during the billing period.**

SUMMARY

- As you approach your retirement years, it is a good idea to revisit your attitudes and comfort level with debt.
- Debt and borrowing – taken on responsibly and knowledgeably, can help you live securely in retirement.
- Understanding the details of your various borrowing options can help you avoid financial pitfalls such as high interest rates.
- Analyzing your financial need and thoughtfully weighing the pros and cons will help you choose the borrowing option that is best suited you.
- Including debt repayment plans in your estate planning will ensure that your loved ones will receive the inheritance you intend for them.

Glossary of Terms

Amortization: A schedule for paying off the principal and interest on a debt over time.

Asset: Something you own that can be assigned a specific monetary value, e.g., real estate, investments, cars, collectibles, business interests.

Bad Debt: Debt taken on to buy something that immediately goes down in value or to buy something that you can't repay on time and in full and unlikely to be tax deductible.

Borrowing Capacity: A measure used by lenders to determine the maximum amount you can borrow.

Consumer debt: Money owed on items other than mortgage debt, including unpaid credit balances, auto loans, etc., normally not including regular expenses that are paid monthly, such as phone bills, utility bills, etc.

Conventional mortgage - payments to the bank or lender such that at the end of the term you usually owe less than you borrowed.

Creditor: A person or institution that has lent money – a lender.

Debt-to-Asset Ratio or Debt Ratio: A calculation used by lenders to assess the risk of lending to you – calculated by dividing your total debt by your total assets.

Debt-to-Income Ratio or Debt Ratio: A calculation used by lenders to assess the risk of lending to you – calculated by dividing your total debt by your total income.

Debt load: The total amount of money you owe

Debtor: A person who owes money to an individual or institution.

Home equity: The difference between the value of your home and how much you owe on your mortgage.

Home equity loan – A mortgage type lump sum loan secured by the equity you have in your home.

Home equity line of credit - A line of credit loan that is secured by the equity you have in your home.

Liability – A financial obligation either in the short or long term.

Line of Credit – A type of loan that enables you to borrow as you need it up to a set limit.

Net worth – The value of your total assets minus your total liabilities.

Opportunity cost – The cost of what you have to give up when choosing between two options.

Payday loan – A short term loan at exceedingly high interest rates repayable through your next paycheque.

Penalties – Amounts of money charged by a lender over and above interest for failing to meet a financial obligation.

Principal – The original sum of money lent (i.e., does not include interest)

Reverse mortgage - no ongoing payments with the principal and interest payable at the end of the reverse mortgage.

Total debt: Consumer debt plus any mortgage loans

Resource Links

Canadian Bankers Association
https://cba.ca/managing-debt

CPA Canada
https://www.cpacanada.ca/en/the-cpa-profession/financial-literacy/financial-literacy-resources/just-the-facts/just-the-facts-seniors

Credit Canada – Debt Solutions
www.creditcanada.com

Financial Consumer Authority of Canada
https://www.canada.ca/en/financial-consumer-agency/services/loans.html

Fiscal Agents
www.fiscalagents.com

Getsmarteraboutmoney.com
https://www.getsmarteraboutmoney.ca/

Government of Canada – Debt and Borrowing
https://www.canada.ca/en/services/finance/debt.html