

The Conrads: Making \$120,000 work like a quarter million

By Nancy Ackert, RHU, CAFA.

The following is based on one of Nancy Ackert's clients, Lisa Conrad. All of the names and telling details have been changed to preserve client privacy.

Lisa Conrad, a 38-year-old high-school teacher, and her husband, Tom, a 42-year-old engineer, felt the same burdens most couples face—struggling to balance schedules, the household and their two kids' extracurricular activities—but life was good as far as Lisa was concerned.

Lucky for Lisa, however, a friend of hers was able to sense a danger she wasn't. Lisa's friend and a client of mine, Carol, knew that something lurked beneath the surface of their happy lives—something that could threaten to ruin the life Lisa had worked so hard to maintain. Carol had experienced a crisis a few years back, which is why she insisted Lisa and her husband take an hour out of their busy schedules to meet with me.

Lisa was reluctant at first. She knew what Carol's worry was—the Conrads' finances. They leased two cars, had balances on a few credit cards and a credit line, and were looking to refinance their house for a renovation. While Lisa admitted things were a little messy, she trusted they would be okay. Plus, for various reasons, she had a distrust of financial advisors. But she didn't want to disappoint her friend, so she agreed to see me.

When I met with Lisa and Tom, both were kind and warm to me, but one of the first things Lisa said was, "I know you've helped Carol with her financial troubles, but we're in a different situation."

After I asked Lisa what she meant, she said, "Carol and her husband Rob had serious money problems. The house they bought was a money pit. They lost all their savings in the recession. Rob's business slowed down. I know they couldn't have survived without your help, but we're a lot more secure. I don't worry about losing my job and Tom's one of the most valued employees where he's at. I know there are no guarantees, but we have two healthy incomes and we'll get by."

Lisa was indeed lucky and two reliable incomes is enviable these days, but Lisa's response hinted at a dangerous misperception. I knew that helping Lisa achieve the true happiness she sought was going to require a breakdown of this and probably other

misperceptions. So I began by asking Lisa if she knew what the annual family income was.

"Yes," she said. "\$120,000."

I asked her if she was sure and she insisted she was. "So, each month," I said, "together you two deposit \$10,000 into your bank accounts?"

"I see what you're getting at—you want the after-tax dollars."

"That's partly what I'm getting at."

"After tax it's probably \$6,500 a month."

"Now," I asked, "let's say you went to a dollar store and wanted to buy a pen that was priced at a dollar. How much would that pen cost you?"

"Now you're getting at sales tax," Lisa said. "Okay, it would cost me \$1.13."

"Before we get to the true answer on what spending a dollar costs you, I know you two are going away to Barbados next week."

Tom nodded and said they always go away for a week once a year and this year they were lucky to get a great deal. \$1,100 for each of them, all inclusive.

"So together how much is that costing you?"

Tom gave me a curious look. "\$2,200."

"Did you pay cash?" I asked.

"We put it on a credit card," Tom said.

"And do you always pay off your entire credit card each month?"

Tom shook his head.

"Would you have booked the trip if the price was, say, \$6,600?"

Tom gaped. "Absolutely not."

"Unfortunately," I said, "I think that might be what this trip is costing you. A lot of couples in your situation pay \$3 for every dollar they spend."

"How can that be?" Lisa said. "I know we pay interest on our credit cards, but nothing like that."

"One of the most important things about money is how much each dollar you spend actually costs you. And the price of each dollar is affected by all the things we have to give up each time we spend one, like all the various taxes and fees and interest payments. When you're sixteen and working your summer job, a dollar

might cost you only a little bit more than a dollar. But as soon as you start moving into higher income tax brackets, using credit cards, leasing a car, buying a home, getting a credit line and so on, the price of a dollar rises. And that goes for every dollar you spend, no matter if you go to that dollar store and pay cash, because each dollar you spend is affected by the value of all the other dollars in your life.

“Most people,” I continued, “don’t realize the accumulative effect, especially when you’re carrying debt over a long period of time. You may have a family income of \$120,000, but I have a client who only makes \$60,000 who effectively earns more than you two because each dollar costs her around \$1.50. The problem is, without some new way of dealing with your money, the cost of each dollar is only going to go up for you. Eventually you could be paying \$4, \$5, or \$6 for each dollar. It’ll be like you’re only making \$20,000. And at some point, you won’t be able to keep up. That’s when people start selling things off, losing their homes, going bankrupt.”

Lisa and Tom looked at each other with concern.

“I don’t want to alarm you,” I said, “but those scenarios can happen even if you keep your two incomes. Imagine if, God forbid, something happened to one of you and you were down to one income.”

Lisa said they both had great benefit plans through work.

“I’m glad to hear that, but one of the problems these days is that medicine is advancing at an incredible rate.”

“Isn’t that a good thing?” Lisa said.

“Not financially, no. Diagnoses that led to death decades ago now often only cause illness. Life and disability insurance don’t pay out on an illness, so if a spouse gets sick, it’s often a financial disaster. And people get sick more often than they die or become disabled. So financial stability isn’t just about making sure you don’t lose your job, it’s about protecting your income no matter what happens.”

Tom spoke up. “Someone already spoke to us about critical illness and we can’t afford it now.”

“I agree,” I said. “You can’t afford it when you’re paying \$3 for every dollar, but you could if you were only paying \$1.50 or less for every dollar.”

Lisa spoke up, “Okay, but what do we have to give up? Because we like our lifestyle. We like this house, our vacations, all the things we do.”

“You have to give up your debt,” I said. “The banks want to keep you in debt. They want you to pay three and four times as much for your money as you should be.”

“Okay,” Tom said, “but how can we get rid of our debt? We’re paying off what we can each month.”

“I’m not going to say that it won’t require some discipline,” I said, “but in my experience, the reason people don’t apply discipline is because they think the required changes are drastic and that they won’t actually make much difference. Let’s take a look at where and how I think you should be spending your money.”

With the aid of a software program I reworked the Conrads’ finances. One of the main things I did was rejig their priorities. By changing the outflow of money so they were paying off debts in the right order, I showed them how they could maintain their monthly mortgage payment of \$1,500 but instead of taking 30 years to pay off the house, they could do so in 12. That meant the difference between paying only 1.5 times for their house instead of 3 times. This change saved them nearly \$200,000. And the discipline required? They only had to find an extra \$300 a month, which was easy to do, mostly by trimming some superfluous spending and by being a little bit smarter about where and when they shopped for groceries and household items. We were also able to free up the money they needed to fully protect their incomes. The Conrads were on their way to making their \$120,000 income work as well as what most couples who earn a quarter million get for their money. Furthermore, both Lisa and Tom felt a genuine sense of happiness and security. They knew they were doing all the right things with their money and that they were doing all they could to ensure the family enjoyed a bright, prosperous future.

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