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Family profile: A lesson in austerity

Henry and Carlena Sullivan used to live large on almost $190,000 a year. Then Henry lost his job and was forced to take on a new one that paid only half as much. Can the Sullivans adjust to their new frugal reality?

By Julie Cazzin | From MoneySense Magazine, September/October 2011

What the experts say

Henry and Carlena Sullivan have always bought whatever they wanted. Now, with less income, they will have to learn to live on less. "It might not be as bad as they think," says Barb Garbens, a fee-only financial planner in Toronto. "We often waste a lot of money, and the truth is that living on more doesn't necessarily mean living better."

Rona Birenbaum, a fee-only financial planner at Caring for Clients in Toronto, agrees. "The key is to be committed to your values and priorities. Having a plan will lower Carlena's anxiety because she will be able to see clearly that, even with less money, they can achieve their goals over time. Patience is the key." Here's what the Sullivans need to do.

Slash their spending. The Sullivans' annual household expenses currently exceed their net income by $8,711. When you factor in their savings goals, the shortfall is closer to $20,000 a year. Both experts say they should start by cutting $3,250 from the grocery bill. "A family of four should be able to eat at home for $1,000 per month with careful shopping," says Birenbaum. They should also cut $700 from the clothing budget, $500 from the vacation budget, $1,740 from landscaping, $500 from furniture and electronics, $500 from life insurance (see below), and possibly drop their disability insurance if it can be replaced by group coverage from Henry's employer.

Pay down their debt. The $14,000 they'll net from the U.S. savings account and the $12,000 in emergency savings should be used to pay down the line of credit, leaving only $6,000 outstanding. "There is no point in paying over 3% interest on the line of credit and earning 1% after tax on savings," says Birenbaum. "The Sullivans are paying 2% per year to see money in a bank account. That's false security. In an emergency, they can access the line of credit." By cutting the interest cost, they will save about $700 a year.

Restructure their car costs. When Henry's car lease comes due later this year, he should use a service such as LeaseBusters to pick another short-term lease. He should be able to get something decent for $400 a month—resulting in $1,472 in annual savings.

Then, when Carlena's old car dies in a year or so, they can lease one for her as well. "It doesn't make sense to pay $3,750 a year in repair costs," says Garbens. "Take that money and lease a car for $250 a month. That's cheap." Garbens says that the cost of leasing Carlena's car can be covered by the money they're now spending on car maintenance, plus the $1,472 in savings from Henry's lease.

Be choosy about savings. Carlena should keep contributing to her defined contribution pension plan (the employer matches her contributions), but stop all payments to the emergency fund and extra mortgage payments for now. "They're creating stress for themselves," says Garbens. "They'll be able to catch up with their savings when Carlena returns to work full-time."

Review their insurance needs. Henry has $1.6 million in term life insurance and Carlena has $1 million. "Henry is over-insured by $400,000 and Carlena is over-insured by $300,000," says Birenbaum, who reviewed the couple's situation. "Cutting their coverage will save them $500 annually. Life insurance after 2025, when these policies come due would be nice," but because the kids will be grown up by then, "it isn't essential."

Use Henry's commissions for savings and debt payments. Henry doesn't know how much he will earn in commissions from his new sales job, but he should put the first $5,000 into RESPs and whatever remains should go toward the line of credit and the mortgage.

Catch up on their RRSPs later. In five years, maybe earlier, the $5,300 annual child care expense will end, and that money can be redirected to their RRSPs. When Carlena returns to work full-time, an additional $20,000 from her increased salary can be allocated to RRSPs. “It’s not a big deal to stop contributing to RRSPs for the next five years,” says Garbens. “They can make larger contributions from 44 to 60. Any tax refund should go towards paying down the mortgage.”

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