Ditching debt:

5 ways to better manage your money

Congratulations!

You've already taken the first step toward conquering your debt and adopting good financial habits—and that's no small feat. People often feel so overwhelmed that they're too paralyzed to take any action. (Screening bank calls? Ghosting your account statements? You're not alone.)

We won't sugar-coat it: The road to zero debt involves taking an uncomfortable look at your finances and probably making a few sacrifices when it comes to your spending habits. But the relief you'll feel when your debt starts shrinking (and your savings start growing through investments) will be worth it. We consulted Pamela George, a Canadian financial literacy and credit counsellor, for practical tips to help you take control of your cash and credit.

Here's her first takeaway: Financial wellness means being self-sufficient—living within your means and not relying on anyone else's financial support.

Millennial debt by the numbers

$11,716

The average amount of millennial credit card debt in 2018.[3]

216%

The average millennial debt to after-tax income ratio.[1] That's over 1.7 times more than young Gen-Xers and 2.7 times more than young boomers.

$14,311

The average amount of student loan debt carried by millennials in 2018.[3] That's more than any previous generation (nay).

70%

The percentage of millennial Canadians who hold a post-secondary certificate, diploma or degree.[2] That's more than any previous generation (yay!).

[1] https://www150.statcan.gc.ca/n1/en/pub/11-627-m/11-627-m2019029-eng.pdf?st=RMcsTCoU
[2] https://www150.statcan.gc.ca/n1/pub/11-626-x/11-626-x2019006-eng.htm
[3] https://www.bnnbloomberg.ca/millennials-buried-in-student-debt-as-insolvencies-surge-study-1.1229899

Good debt and bad debt

Not all debt is created equal, and it pays to pay attention to interest rates.

Credit cards aren't inherently bad, but carrying credit card debt is not a good thing, because most of them have sky-high interest rates (generally around 20%, while your student loan or personal line of credit might have a significantly lower one). Mortgage rates are usually much lower and generally considered a "healthy" form of debt since you're increasing your net worth as you pay off your property—but it's only healthy if you can afford to pay your mortgage payments and regular expenses, plus make savings contributions, without relying on credit cards.

Not in your best interest

It's common for credit cards to lure people in with points or cashback programs, but that can backfire and end up costing far more than the value of the reward. Below is a chart that shows the true cost of a rewards card with a 20% interest rate if you only make the minimum payment each month.

Spoiler alert: It might be worth skipping the potential points and paying for your own flight.

Costly rewards	
Credit card balance	$5,000
Interest rate	20%
Minimum payment (3%)	$150/month
Time to pay off	251 months (minimum payment only)
Value of points earned	$200 (4x points per $1 spent)
Total interest paid	$5,990.60

Verdict: You'd end up paying close to $6,000 (especially once you factor in annual credit card fees) for $200 in rewards.

Check out the Canadian government's credit card payment calculator to see how much interest you'd pay on your balance.

EXPERT TIP

Want it? Then save for it.

"Many millennials grew up seeing their parents using credit cards to pay for things, and it took away the value of saving and the delayed gratification of buying something with your own hard-earned money," says Pamela. "It sounds simple, but it's so effective: Don't spend more than what you're earning. Make a savings plan for the bigger-ticket items you want." For those extra big items, like a home, starting to invest now can really give you a boost.

How to get out of debt

There are two popular strategies for getting out of debt: the snowball and the avalanche methods.

The snowball method

- You'll focus on paying off the **smallest balance first** (while still making minimum payments on all your debts).
- Having one credit card balance completely gone can motivate you to move on to the next, and the next (rolling up like a snowball).
- This method is generally easier but can be more expensive than the avalanche method if you have high-interest debt.
- **Works best if:** you need to see progress to feel motivated. If you feel like your largest balance is too big to even make a dent in, start small.

The avalanche method

- You'll still make the minimum payments on all debt, but you'll focus on paying off the debt with the **highest interest rate**.
- This method is a bit more challenging and requires strong willpower (it's tough to follow through with big payments when you're not seeing much progress).
- On the plus side, it can be the most efficient path to zero debt, with less overall interest paid.
- **Works best if:** you've got a large, high-interest balance that's costing you an arm and a leg in monthly interest payments.

EXPERT TIP

Balance transfer, beware

Credit cards will often advertise low introductory interest rates, but Pamela George warns against using this method to reduce your interest costs unless you are seeking the guidance of a financial professional. If you've calculated how long it's going to take to repay your debt and it's around six months or less (since most intro rates last for about six months), it may be favourable to transfer your balance—"as long as you immediately cancel the first (higher-interest) card and continue making your payments to the new card," says Pamela.

Roadmap to repayment

There's one obvious but oft-forgotten golden rule:
Your income needs to be greater than your expenses.

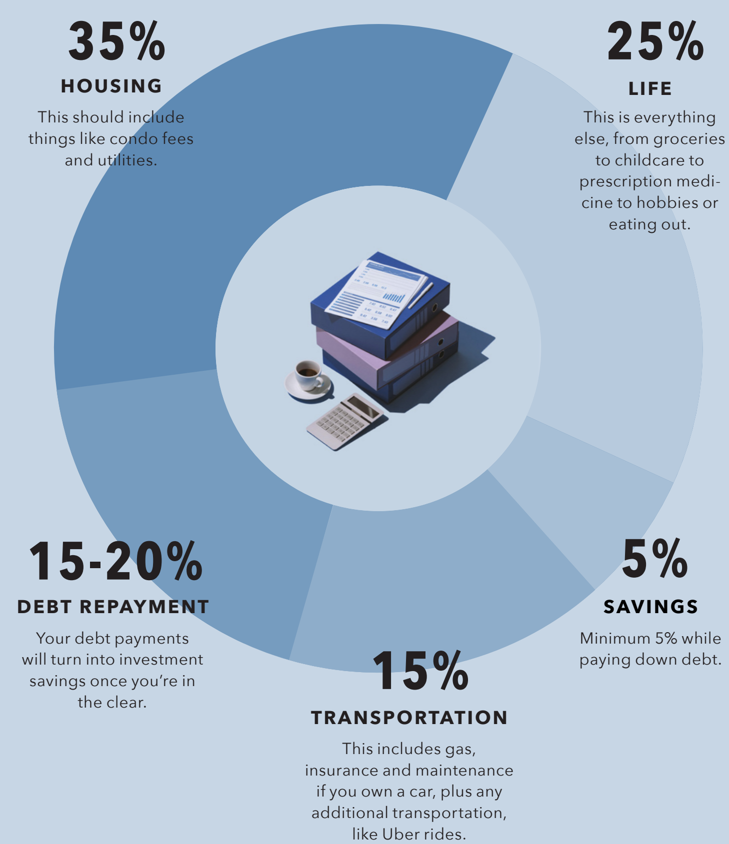
Establishing this balance is the very first step toward financial health. Take the time to add up a list of all your expenses (even using your past few bank statements) and get real about whether or not you're living within your means. If you're not, you'll need to cut down spending where you can—or take on a side hustle for extra income to balance your budget.

Divide and conquer

Most people are still working with just one chequing and savings account, but that kind of banking is old-school. Setting up different accounts can give you a much clearer picture of your finances: If the related bank fees are reasonable, consider having one account for fixed expenses, one for debt reduction, one for emergency fund savings and one for discretionary spending. It's smart to take advantage of automatic bank transfers to have your income immediately divided into these categories (so you don't accidentally spend your rent money on an online shopping spree). Just be careful to look over all your accounts at least once a month to check in on your balances and statements.

Budget basics

To the right is Pamela's general recommendation as to how much of your net income (after taxes) could be allotted to different expense categories, but the ideal breakdown can vary from person to person. Live downtown and spend less on transit? That 10% difference will likely go toward housing. Just don't skimp on debt repayment and savings because it feels like the easiest place to trim.



EXPERT TIP

Making the cuts

Are you spending more money than you're earning? You may want to consider the following:

- Would your grocery bill be cheaper at another store?
- Can you skip the weekly takeout?
- Can you renegotiate your phone, TV or Internet bill?
- Can you find a less expensive apartment or vehicle?
- Can you make extra money by marketing your skills online?
- Can you sell any valuables that are collecting dust?

Stick with the program

With every dent you make in your debt, you're one step closer to the amazing feeling of financial freedom. That means not owing anyone, not wasting money on interest and having extra funds to pay the person that matters most: you.

Even with that in mind, it helps to have a specific goal when paying down debt, or else you can get discouraged by making hefty payments without getting anything in return. Let yourself start dreaming. What will you do once you have your first $5,000 saved up, plus a healthy emergency fund? Maybe you'll be able to treat yourself to an Instagram-worthy vacation. What about $20,000? Maybe you'll be able to make a down payment on a condo. You'll also want to start thinking about your retirement and visualizing how you're going to spend it (you'll adjust your long-term savings plan depending on whether you see yourself gardening in the countryside or yachting around the Caribbean). Your best strategy is to eliminate high-interest debt and then focus on reducing low-interest debt while beginning to invest for the long term. The sooner you can take advantage of the power of compounding, the more your money can grow.

Investing while paying off debt

It's generally best to be debt-free before investing if you are carrying significant credit card debt. But investing even a small amount (whatever you can afford while still making your debt payments) can help set up healthy financial habits for the long term. There's no need to opt out of investing if you've got a low-interest debt like a student loan. And if your employer offers plans such as RRSP or pension contribution matching, try to take advantage by fitting this into your budget wherever possible. Free money is too good to pass up!

EXPERT TIP

Top it off

Received a bonus from work or an extra-generous cash gift? As painful as this sounds, the best option is to close your eyes and throw 80% of it toward your debt. You can spend the remaining 20% on something fun and meaningful to you. This will actually stretch those dollars further, since you're cancelling out some future interest payments. But it will also allow you to enjoy a bit of your windfall, too.

EXPERT TIP

Freelance or self-employed?

The major perk of working for yourself is making your own schedule. The downside is the irregular paycheque. It's tricky to budget when your income fluctuates from one month to another, but a simple strategy can help. Add up the past few months of income (or look at your last annual tax statement). What is your average monthly income? Try using this to set your budget. Remember: As a self-employed person, you may need to put money aside for taxes.

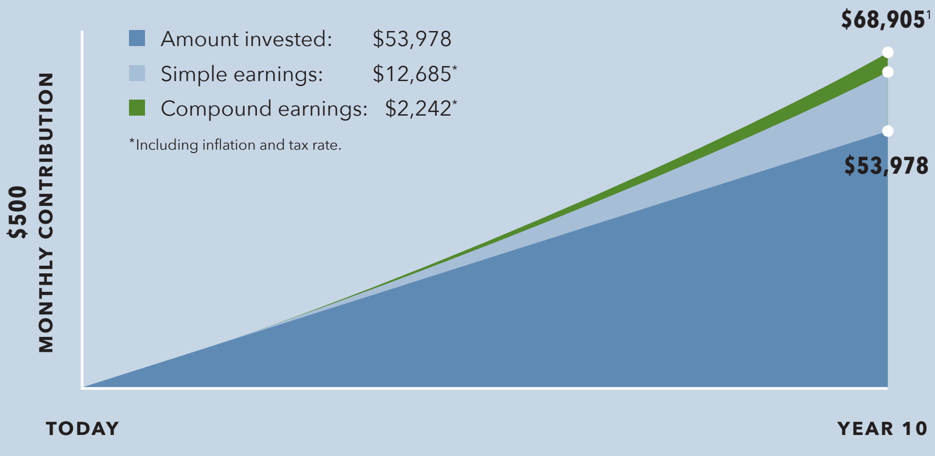
Get ahead of debt and stay ahead

Once you're debt-free (woohoo!), you'll have more funds freed up, since you won't be making monthly debt payments.

You can treat yourself a little after working hard to wipe out those balances, but don't go spending-happy to the point where you're living above your means again. Stick with your healthy money habits, review your budget every month and start multiplying your wealth through investments. And remember—you can start small, even as you pay off your debt, to get a head start. If the rate of return on an investment is higher than the interest rate of your debt, it's worth looking into (as long as you're still able to make your debt repayments according to plan).

Once you're in the clear, whether you turn to an investment advisor or opt to do it yourself with ETFs (exchange-traded funds), you'll likely want to be saving around 15-20% of your after-tax income in order to make your long-term dreams a reality. It's easier to cut back on smaller luxuries now than it is to take a drastic lifestyle cut if you retire without enough saved. How much will you need to save for your long-term goals? The good news is that compounding interest on investments can get you there quicker than you might think. See the graph below to get an idea of just how quickly your money can grow once those pesky debt payments are being put to use in an investment fund with an average rate of return of 5%.

Growing your money



When you're debt-free, you're already on the path to financial freedom—and through smart investments, you'll be in the fast track.

EXPERT TIP

Savings grace

"Once you're debt-free, start putting monthly payments toward building an emergency fund in a TFSA that's equivalent to at least six months of your salary," recommends Pamela. A regular savings account is also an option, but your TFSA is tax-sheltered. Once you've achieved that goal, you can put the additional funds into higher-return portfolios (depending on your risk tolerance).

[1] The rate of return shown is used to illustrate the effects of the compound growth rate and is not intended to reflect future values of the fund or returns on investment in any fund.

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INVESTMENTS

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