

## **Should you pay off your old loans or borrow for present needs?**

After you graduate, it's often difficult to pay off your loans and build up your savings while enjoying what life has to offer. The cost of your education may be holding you back, your income is probably still low and, let's face it, the realities of retirement just don't seem relevant right now.

Nevertheless, it IS possible to reconcile debt payments, leisure activities and saving for the future. We recommend a few basic solutions to get you headed in the right direction. The first step is to make a detailed list of your income and expenses – that's right you need a "budget" – so that you can take full advantage of the proposed solutions. If you need help preparing a budget, simply refer to our related article "The art of budgeting".

### **Solution 1: Pay down existing debt**

Your repayment strategy should be adapted to each type of debt you have.

For example, it is recommended that you use your liquid assets (including non-RRSP investments) to pay back loans whose interest is not tax deductible:

- Credit cards
- Personal loans
- Car loans

It is also preferable to use fixed income sources to pay off loans whose interest is tax deductible:

- Loans used to earn business income or income from property (shares, bonds, funds)

Important: Although reducing your debt load quickly is a smart option, don't compromise your quality of life. If you need help determining your repayment terms, talk to a financial advisor.

### **Solution 2: Decide whether to borrow**

Before you even consider taking out a loan, regardless of the reason, be sure to calculate your borrowing capacity by measuring the impact a loan would have on your current budget (see the related article "The art of budgeting").

If you decide to go ahead with a loan, your choice will depend on certain key factors:

- Term and interest rate

Interest rates are usually lower for short terms (between 30 days and one year) than for longer terms. On the other hand, a short term entails greater risk because interest rates may rise. For that reason, a term between three and five years can give you peace of mind, especially if your budget is tight.

Important: Choosing your loan term according to the interest rate available can be a risky strategy. Be sure to take into account the impact of a possible rate increase when reviewing your budget.

- Payment frequency

Weekly or bi-weekly payments enable you to pay off the loan sooner because the annual amount you pay will be higher.

Important: If your salary is paid on a monthly basis rather than every two weeks, don't choose weekly or bi-weekly payments. Your payments should always coincide with your incoming funds (e.g. employment income).

### **Solution 3: Spend wisely**

- When you take out a car loan, the term should not be longer than the normal ownership period for a car – four years – since vehicles depreciate rapidly.
- If necessary, take out a loan to pay off your credit card debt. The rate on the loan will be lower than the rate charged on the outstanding credit card balance.
- Be careful about “don't pay for a year – interest free” offers made by furniture stores. They can often end up costing you more.

### **Questions?**

Financial institutions are a great source of information about debt and borrowing. Don't hesitate to ask questions or request advice from an expert.