70

Percentage of Canadians' $1.874 trillion debt load that is due to mortgages

20

Percentage of Canadians' debt load that is due to lines of credit

5

Percentage of Canadians' debt load that is due to credit cards

PERSONAL FINANCE

CHLOE CUSHMAN / NATIONAL POST

WHEN 'GOOD' DEBT GOES 'BAD'

Why it can be dangerous to categorize what you owe

By Danielle Kubes

Here's what I've always wondered: You have a Toronto couple, standing beside the semi-detached house that they just paid $1 million for — $800,000 of which they owe to the bank — and they're beaming. They take selfies and post them on Instagram.

Then you have a girl, let's say 25, who is crying, feeling like an idiot. She went on an all-inclusive vacation, then the zipper on her winter coat broke so she bought another. She wanted a warm one, it's cold in Saskatchewan where our fictional lady lives, and so she bought one with real goose feathers. It was a splurge, she knows. Somehow, the little things, they all added up, and she now owes $8,000 to Visa.

So, my question is: Is our dualistic attitude, where we moralize debt as "good" or "bad," causing us to become so complacent about the former that it's piling up to the point that it's turning into the latter?

"Bad" debt, defined as borrowing to purchase depreciating assets like, cars and couches, seems to always impose shame even if it's a modest amount and even if it's obtained cheaply.

Traditionally, bad debt was expensive, which may have lent colour to its already nasty reputation, spurred by its frequent ties to "frivolous" consumer items.

Credit cards, payday loans and financing plans like the Brick's "Don't Pay a Cent Event" lend money at rates often starting near 20 per cent and have inflexible, even predatory terms. But only a minuscule number of Canadians carry credit card debt — as of August 2015, it made up just five per cent of our overall household debt, according to the Canadian Bankers Association.

In a time of historically low interest rates, it's far more likely that Canadians are buying depreciating assets by using lines of credit, which have interest rates as low as 3.5 per cent. According to the CBA, lines of credit make up 20 per cent of Canadians' total indebtedness, and we owe a total of $266 billion on them, up from $35 billion in 2000.

"Good" debt — spent on anything that can help you make money — on the other hand, seems to introduce nervous cheer, even if the dollar figure is an overwhelming amount.

Canadians have embraced this sort of debt like no other. Of the nearly $1.9 trillion Statistics Canada says we owe, more than 70 per cent of it is because of mortgages. University graduates — education being the other common example of "good" debt — are in the hole for an average of about $27,000 each, according to the Canadian Federation of Students.

The popularity of "good" debt could partly be because it's the cheapest form of debt. Five-year fixed mortgages, for example, are available for as little as 2.42 per cent. Still, eat a handful of almonds or bite into a chocolate bar and your body will gain weight at the same rate. A calorie is a calorie, whether it comes from a "good" fat or a "bad."

So what makes debt different?

"Ideally, no one wants to have any debt," says Laurie Campbell, CEO of Credit Canada, a non-profit organization that provides financial counselling. "Debt is debt. Sometimes debt is for a good cause, like securing a house or getting an education, so it's a necessary evil."

Sean Cooper is a prime example of how a house, though a temporary burden, can truly be a "good" debt.

When this 30-year-old pension analyst purchased a property in an up-and-coming borough just east of Toronto, he ensured that the monthly mortgage payments were an appropriate percentage of his income and he planned an aggressive budget, including suspending contributions to his TFSA, to pay it off.

"My debt weighed on me," he says. "I didn't feel comfortable having six figures of debt hanging over my head, so I vowed to pay it down as soon as possible.

"You're using leverage to grow your net worth," Cooper says. "And long as housing prices continue to go up, you're in good shape."

Cooper's sacrifices paid off, and in just three years he had paid the $225,000 mortgage in full.

But, he cautions, that doesn't mean all mortgage debt is good debt.

"Even with good debt you can have too much good debt," Cooper says. "A lot of people, when they go to a bank, they don't know how much they want to spend on a house and when the bank gives them $800,000 they buy themselves the most expensive house possible and give themselves no breathing room at all if rates go up."

Campbell offers a similar caution.

Particularly dangerous, she says, is the exploding trend of HELOCs, where homeowners get a line of credit by using their property as collateral. It's an especially tempting way to borrow because it is easily accessible, available at a low interest rate and you can get huge sums — up to 65 per cent of your property's value.

That's probably why more than 22 per cent of homeowners had a HELOC in 2014, owing an average of $57,000, according to the Canadian Association of Accredited Mortgage Professionals (CAAMP). Next to mortgages, HELOCs are now banks' biggest consumer lending product.

Canadians surveyed by CAAMP in 2014 say they are most commonly taking out HELOCs to consolidate or pay off debt. That makes sense, since the interest rates on HELOCs can be six times less than credit cards.

But it's curious that Canadian homeowners even have high-interest debt in the first place. One reason may be that they simply can't meet their monthly expenses because so much of their cash flow is tied up in their mortgage payments.

"They say a house is a good debt. 'It's OK to have a mortgage and I can even dip into any equity in my home and have a second mortgage and it's still good debt,'" Campbell says. "(But) they're failing to recognize in some cases they're so house poor, they don't have money for their regular expenses and they start using not good credit, like credit cards, to cover the debt."

That's what happened to Hyla Korn but with another type of "good" debt: student loans. This Toronto lawyer, 33, graduated in 2009 with $115,700 in student debt. She soon secured a job and was able to make her payments while budgeting carefully and living at home. But then Korn was laid off. Without an income, her savings soon dwindled.

"The bank isn't forgiving at all if you lose your job," she says. Without any alternatives, she had to use her credit card to fill the gap.

Is it even fair to consider credit card debt "bad," if Canadians are often using it to chase the good?

"I don't think it's good or bad," Korn says. "I think everyone now who goes to school, anyone that does any type of degree beyond undergrad, would incur some debt."

Unfortunately, Korn is right when she says that debt is "inevitable." Like the housing market, the education business has outpaced wages so fast that the majority of Canadians have no option but to finance their schooling: Either parents give them the money or a bank loans it. "That's the reality of the world we're living in," Campbell says. "Nothing comes easy."

To minimize the impact, Campbell says we must consider both a leveraged home and a leveraged education as if they're purchases like any other. A strategy focusing on the return is a must.

In the same way that "you're not going to buy the most beautiful home in the crappiest neighbourhood," she says, "you don't go to school and get into a field that is not going to materialize in a career over time."

Ultimately, the distinction between good and bad debt isn't that important, since good debt can too easily slide into the opposite category. It's far more important, says Campbell, that you can "manage your debt and see it dissipate over time."

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> THE BANK ISN'T FORGIVING AT ALL IF YOU LOSE YOUR JOB

SHADES OF RED

The best debt is none at all. But if you must borrow, Laurie Campbell, CEO of Credit Canada, a non-profit organization that provides financial counselling, has laid out the best to the worst on a sliding scale. An A is reserved to those in the black, and then it goes down (and gets more expensive) from there. It's doubtful too many readers will find themselves below a C since the majority of Canadians' household debt stems from mortgages.

In fact, over 70 per cent of our collective $1.874-trillion debt load is due to mortgages, with 20 per cent due to lines of credit (which many have taken out against a house to get larger cash flow) and only five per cent from credit card debt. But remember: It's not OK to have any sort of debt unless you can afford the monthly payments and are dedicated to getting rid of it.

Mortgage or student loan debt: B+

"The interest rate on mortgages are quite good right now, so that's the good news, but if you keep dipping into that equity on your home you're not really getting anywhere," Campbell said.

"Student loans can be good," she says, "But you have to work your butt off to pay them off as quickly as you're done school or else you're delaying your ability to move on with your future because you're still in a situation where you've got a huge fixed payment."

Consolidated debt and lines of credit: B

"It's a great idea to consolidate debt into a lower rate as long as you don't rack up those credit cards again," Campbell says. But, since consolidated debt often takes the form of a line of credit, it can be hard to get out of it. "It's not a fixed payment. You get a $100,000 line of credit, you rack it up to $5,000, you pay it off, but then guess what? You've got room to rack it up to $5,000 again and you never get out of debt because there's no sunset clause, so people perpetually find themselves in hot water with their line of credit."

Credit Cards: C

"An extremely expensive form of purchasing items if you're not going to pay it on time," she says.

Overdraft Debt: C-

"You're charged immediately and the interest is around 21 per cent," Campbell says. "It's a very expensive form of debt"

Finance debt, like the "Don't Pay a Cent Event": D

"Suddenly that couch you bought for $1,000 has a retroactive interest for 30 per cent."

Payday loans: F

"It tends to be a never-ending loan," Campbell says.

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